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Abbreviations:

AJPES	Agency of the Republic of Slovenia for Public Legal Records and Related Services
AMC	Association of Management Companies
BoS	Bank of Slovenia
CCBM	Correspondent Central Banking Model
CEIOPS	Committee of European Insurance and Occupational Pensions Supervisors
CSCC	Central Securities Clearing Corporation
ECB	European Central Bank
ECBC	European Covered Bond Council
EFAMA	The European Funds and Asset Management Association
EFTA	European Free Trade Association
EMF	European Mortgage Federation
EMU	Economic and Monetary Union
EONIA	Euro OverNight Index Average (weighted average interest rate for overnight credit)
ESCB	European System of Central Banks
ERM II	Exchange Rate Mechanism II
EU10/12	EU member-states joining in enlargement of 1 May 2004 and 1 January 2007
EU12	Euro area member-states, excluding Slovenia, Malta and Cyprus
EU15	EU member-states prior to the enlargement of 1 May 2004
EU25	EU member-states prior to the inclusion of Bulgaria Romania
EU27	EU member-states
EU3	EU member-states prior to enlargement of 1 May 2004 not in the euro area
EURIBOR	Interbank interest rate at which representative banks in the euro area offer deposits to one another
Eurostat	Statistical Office of the European Communities
FED	Board of Governors of the Federal Reserve System
HFRS	Housing Fund of the Republic of Slovenia
IC	Investment company
IF	Investment fund
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IMF	International Monetary Fund
ISA	Insurance Supervision Agency
Leaseurope	The European Federation of Leasing Company Associations
LJSE	Ljubljana Stock Exchange
LTI	Loan-to-income ratio
LTV	Loan-to-value ratio
MCs	Management companies
MF	Mutual fund
MTS Slovenija	Portion of the Euro MTS electronic trading platform for state and para-state reference bonds denominated in euros
NACE	Statisitical Classification of Econimic Activities in the European Community
NHSS	National Housing Saving Scheme
OECD	Organisation for Economic Co-operation and Development
OFIs	Other financial institutions
PDII	Pension and Disability Insurance Institute
P/E	P/E reflects the ratio of share prices to the previous year's net earnings per share
PID	Authorised Investment company
PIX	Investment funds index
SAS	Slovenian Accountign Standards
SBI 20	Leading Slovenian stock market index
SI O/N	Interest rate for unsecured interbank overnight deposits in euros between Slovenian credit institutions and euro area credit institutions
SLA	Slovenian Leasing Association
SLONEP	Slovenian real estate portal (www.slonep.net)
SMA	Securities Market Agency

SORS	Statistical Office of the Republic of Slovenia
S&P	Standard and Poor's
RTGS	Real-Time Gross Settlement
TARS	Tax Administration of the Republic of Slovenia
TR	Turnover ratio
TUVL	Segment of Ljubljana Stock Exchange Trading for a Selection of Government Securities through Designated Market Makers
UP	Mutual fund unit price
Vzajemci.com	Portal of Slovenian mutual funds (www.vzajemci.com)

CONCLUSIONS

For the first time in five years, the Financial Stability Review places greater attention on the realisation of financial risks as a warning of potential systemic risks in the Slovenian financial system, as the international financial turmoil seriously affected the normal operations of a number of banks around the world in the final quarter of last year. In 2008 a period of relatively high stability of the Slovenian financial system ended, and a period of uncertainty accompanied by the increased realisation of risks was ushered in.

The high lending growth required by continued excessive economic activity at the beginning of 2008 was only possible by acquiring bank funding in the rest of the world, which until recently seemed unlimited. The escalation of the financial turmoil in autumn of last year and the undermined confidence on the financial markets resulted in a complete reversal in the supply of lending by Slovenian banks. This was no longer determined by demand for loans alone, but became entirely dependent on the availability of bank funding. Alongside the pass-through of the financial turmoil to the real sector, the reversal in the credit cycle in Slovenia was also affected by the decline in economic growth on key export markets. Credit demand will continue to slow this year in the context of the continuing economic crisis. The pro-cyclical behaviour of banks during a period of contracting economic growth hinders corporate operations, as such behaviour does not provide for an adequate supply of long-term loans.

Normalising the supply of lending by level and maturity requires the unimpeded refinancing of Slovenian banks in the rest of the world or the replacement of foreign funding with long-term domestic savings. Short-term financial assets acquired via bank borrowing from the Eurosystem and an increase in short-term government deposits at banks do not resolve the problem of obtaining stable long-term funding for the Slovenian banking system. Such short-term funding merely provides banks with the liquidity to make regular repayments of liabilities due to foreign lenders. Bank borrowing in the rest of the world without a government guarantee is inadequate, as the functioning of the international financial markets remains highly unstable. The immediate implementation of the measure regarding the government guarantee for the borrowing of credit institutions in the rest of the world, adopted at the end of last year, is urgent. Delaying the implementation of the measure in practice further damages the economy in the form of deteriorating corporate liquidity and a rising lack of payment discipline.

The reversal of the credit cycle and the depth and duration of the economic crisis increase credit risk at banks. This risk is becoming a decisive factor in banks' performance in the coming years. Banks that respond to increased credit risk by providing for an adequate level of capital and by implementing other risk management measures will have relatively more success surviving the economic crisis. The rising number of corporates settling loans in arrears, an increasing proportion of classified claims paid in arrears and the need to form additional impairments and provisions will result in sharply lower profits or losses at banks. Although Slovenian banks still disclosed a historically low percentage of bad loans (1.8% of classified claims) at the end of last year, this proportion is expected to rise in the context of the recession and the expected slow pace of economic recovery.

The current practice confirms the correctness of the Bank of Slovenia's decision in 2006 to introduce, together with the international accounting standards, a deduction item from banks' original own funds for inadequate impairments (the so-called prudential filter), thus forcing banks to create a greater level of impairments and provisions in the form of surplus capital. The temporary abolition of the original own funds deduction item in the context of the last year's escalation of the financial turmoil was one of the first measures adopted, the purpose of which was to provide a counter-cyclical effect by the Bank of Slovenia as supervisor of the banking system.

Increased credit risk and low interest rates, which drive down the net interest margin, will increase income risk at banks. Falling profits and even possible losses will limit banks' ability to increase their capital. From 2004 to 2007 profit reserves and retained and revised earnings represented 60% of the increase in original own funds. This autonomous source for increasing banks' original own funds will at least temporarily be exhausted. In the context of banks' falling return on equity and increased credit risk, conditions on the financial markets will not be favourable for issuing subordinated instruments as a means of increasing additional own funds. In the context of increased write-offs of bad loans, bank owners will be forced to respond to the new circumstances via capital injections. The government also represents an important owner of Slovenian banks, and will be forced to provide additional capital in this role, independent of the anti-crisis measures adopted.

The capital adequacy of banks, which at the end of 2008 showed a surplus of capital over capital requirements of more than 30%, indicates that the banking system's capacity to absorb a further increase in the realisation of risks is sufficient. Nevertheless, the ability of bank owners to provide capital injections will be important due to uncertainty regarding the duration of recessionary pressures and the expected increase in credit risks in 2009.

The underlying condition for the normalisation of banks' lending activity in 2009 remains the need to normalise bank refinancing on the international financial markets. Since this is unlikely in the short term, the measure regarding the issue of a government guarantee for credit institutions' borrowing in the rest of the world must be implemented as soon as possible. At the same time, banks must change the structure of their funding by intensifying the collection of funds via the issue of own securities on the financial markets and to domestic institutional investors. If the volume of bank refinancing in the rest of the world and the additional collection of domestic funds prove insufficient, banks will suffer a painful contraction in financial intermediation in 2009 owing to the urgent restructuring of available funding.

Marko Kranjec, Ph.D.
Governor

EXECUTIVE SUMMARY

The depth of the Slovenian financial system stood at 174% of GDP at the end of the third quarter of 2008, or 40.7% of the depth of the euro area financial system. In Slovenia total assets from intermediation have risen by 14 percentage points since the third quarter of 2007 to 117% of GDP, while the figure for the euro area remained almost unchanged until the middle of 2008, at 276% of GDP. The traditional prevalence of monetary financial institutions in the financial sector strengthened further last year, their proportion rising to more than 76% primarily owing to a decline in the proportion of investment funds. The proportion of non-monetary financial institutions was down nearly 5 percentage points as a result of negative developments on the capital and financial markets.

The financial turmoil has not had a direct effect on Slovenian banks. In contrast to more developed banking systems, the Slovenian banking system had almost no bad investments in high-risk financial instruments. It was exposed on the funding side, as borrowing in the rest of the world was up sharply due to high domestic demand for loans in the period of high economic growth prior to the financial turmoil. With the malfunctioning of the financial markets, the financial turmoil has prevented opportunities for the continuation and renewal of such borrowing. Following the increase of the Slovenian economy's net financial liabilities to the rest of the world to 30% of GDP in the first three quarters of 2008, in which banks contributed most by raising loans, banks began repaying liabilities to the rest of the world in the final quarter. The second means by which the turmoil passed through to Slovenia was the rapid drop in foreign demand, on which the export-oriented Slovenian economy is highly dependent. The slowdown in economic activity was unrestrained, economic growth falling from 5.7% in the first quarter of 2008 to -0.8% in the final quarter. Despite deteriorating macroeconomic indicators and conditions in the international environment, Slovenia has maintained its country risk rating of AA.

Banks, with total assets of EUR 47.5 billion or 128% of GDP, remain the most important financial intermediary. In autumn 2008 banks were affected by the shock of the malfunctioning of the international financial markets. The Eurosystem responded appropriately by immediately providing the necessary level of short-term funding. In Slovenia the banks under majority domestic ownership were most exposed to the shock, as a larger portion of their liabilities to the rest of the world fell due for payment in a short period of time. The banking sector has neutralised the shock in three ways: First, banks increased their net borrowing at the Eurosystem from around EUR 0.2 billion to EUR 1 billion by the end of January 2009. Second, from November 2008 to the end of March 2009, Slovenian banks made net debt repayments to foreign banks of EUR 1.7 billion. Third, banks attempted to increase deposits via their interest-rate policies. This, however, had no significant effect. The net increase in deposits by non-banking sectors stood at EUR 1.2 billion last year, the net increase in household deposits accounting for EUR 1.1 billion of this amount, comparable to 2007. The banks under majority domestic ownership, in particular, funded themselves via deposits by non-banking sectors, while the banks under majority foreign ownership relied on the more accessible and cheaper funding provided by their owners. On the investment side, banks responded most rapidly by decreasing investments in foreign marketable securities, in October 2008 by EUR 552 million, and by an additional EUR 408 million by March 2009. At the same time, they decreased the supply of lending by tightening credit standards for all categories of potential borrowers. Corporate lending came to a standstill in November 2008, while households made net repayments to banks. Government interventions delayed the contraction of the banking system's total assets until March 2009. The government issued treasury bills in the amount of EUR 876 million, and two government bonds with a total value of EUR 2.5 billion. A large portion of the proceeds from the sale of securities was deposited at banks. Total government deposits at banks exceeded EUR 3.4 billion at the beginning of April 2009.

The banking system's liquidity prior to the financial turmoil and after its escalation was adequate, when assessed according to the value of the liquidity ratio and the stagnation in secondary liquidity. The banking system's structural liquidity indicators are deteriorating. Noteworthy is the ratio of non-banking sector deposits to loans, which fell from full coverage at the end of 2005 to 62% at the end of 2008. At the same time, this was 14.8 percentage points lower than the average of medium-sized EU banks at the end of 2007. The banks under majority foreign ownership stand out among bank groups in Slovenia with regard to a low level of coverage. It is this extremely low coverage of loans to non-banking sectors by deposits that resulted in Slovenian banks' high dependence on the malfunctioning of the international wholesale financial markets.

Risk on the funding side is triggering structural changes in banks' balance sheets. The servicing of banks' past-due liabilities and their liquidity are provided by available Eurosystem funding. Maintaining the proportion of short-term liabilities of up to 1-year at around 28% of total liabilities to foreign banks has resulted in a rapid increase in the proportion of funding with a maturity of less than 6 months. Last year the proportion of banks' short-term loans raised at foreign banks rose from one-third to one-half. A shortage of long-term funding is preventing the normalisation of credit activity. The characteristically pro-cyclical behaviour of banks during a period of contracting economic growth is putting further strain on corporate operations, as such behaviour does not provide for an adequate supply of long-terms loans and impedes their activities. Furthermore, this results in decreased demand for loans and the further contraction of economic activity.

These changing circumstances are bringing new systemic risks to the banking system. In the context of a shortage of foreign funding, banks initially increased competition for domestic deposits by non-banking sectors by raising interest rates. Such competition is unacceptable in the context of falling reference interest rates and the general government guarantee for the bank deposits of small depositors. This merely resulted in the shifting of savers between banks and changing deposit maturities, and not in a significant increase in savings at banks. To a certain extent, the increased dispersion of deposits was also the result of investors' wishes to spread risk by placing deposits at several banks.

The costs of newly raised funds on the foreign wholesale markets rose for Slovenian banks as risk premiums over reference interest rates rose. At the end of the year risk premiums exceeded 1 percentage point. The cutting of interest rates as a result of ECB measures since autumn 2008 has not translated entirely to a reduction in the burden of servicing corporate loans. In the structure of interest rates, premiums over the EURIBOR have risen as the EURIBOR, which is incorporated into the majority of loan agreements at Slovenian banks, has declined. This is particularly true for high-risk loans, the proportion of which is rising during the turmoil. Higher premiums will increase the debt servicing burden when the variable portion of interest rates rises again from current low levels. The increase in the proportion of newly approved loans with a fixed interest rate is negligible. Therefore the risk linked to the servicing of debt has risen for corporates in the context of rising premiums. The probability of this risk being realised is deferred until that time when interest rates begin to rise.

The risks in the banking system rose at the end of 2008 and in early 2009 with the spread of the economic crisis. Alongside the aforementioned refinancing risk faced by banks, this is particularly true with regard to rising credit and income risks. At the same time, the possibility of autonomously increasing the capital of banks based on profits generated is diminishing. The conditions on the capital markets are unfavourable for issuing subordinated instruments as a means of increasing the additional own funds of banks.

Credit risk at banks has risen in line with the downturn in the economic cycle. Banks have responded to the changing economic conditions by tightening credit standards and reducing the supply of loans. Growth in loans to non-financial corporations fell from 38% at the end of 2007 to 14% in March 2009. Four factors have contributed to the drop in lending growth: the tightening of bank refinancing conditions in the rest of the world, the tightening of credit standards due to deteriorating economic conditions, lower demand due to rising real interest rates and a base effect. Banks have shortened the maturity of newly approved loans to corporates, the proportion of long-term loans to corporates falling from 66% in 2007 to 44% in the final quarter of 2008. Corporates have adapted to the limited supply of loans by reducing and changing the structure of current financing. Total current corporate financing was down 0.5% in year-on-year terms over the first three quarters of 2008. Corporates responded to the tightening of credit standards and financing conditions at banks by borrowing in the rest of the world, by increasing business-to-business lending and by borrowing from non-monetary financial intermediaries.

The shortening of maturities had a more significant impact on small and medium-sized enterprises (SMEs), where liquidity risk is more concentrated. Rising corporate liquidity risk is being reflected in an increase in past-due unpaid liabilities. In the final quarter of 2008 the proportion of corporates that settle their liabilities to banks more than 90 days in arrears rose from 5% to 7.6%. The proportion of total classified claims accounted for by such debtors rose from 2.4% to 3.4% in the same period. This is a clear indication of the rapidly rising credit risk in the final months of last year. Thus deteriorating corporate liquidity is being transferred to banks as the realisation of credit risk. It would be possible to mitigate this process by increasing medium-term corporate lending, the necessary preconditions being an increase in longer-term bank funding and the earliest possible implementation of the guarantee scheme for corporate loans.

Further increasing banks' credit risk is the higher corporate debt-to-equity ratio, which has risen owing to the sharp falls in the value of equity in the context of slower growth in total corporate financial liabilities. The ratio has risen further, after deteriorating from 102% at the end of 2007 to 131% by September 2008. This significant increase in corporate indebtedness is resulting in a deterioration in corporates' credit ratings, and is reducing the possibility of raising new bank loans. Certain corporates require additional own funds to improve their structure of financing and thus their credit rating, as confirmed by a comparison with the average structure of euro area corporate financing.

Changing the structure of financial investments is one way in which corporates are adapting to the recession. Following a wave of M&A activity, corporates reduced their financial investments in equity in 2008. With limited financial assets, corporates have attempted to promote sales and limit the adverse effects of falling domestic demand by increasing business-to-business lending. To the same end, they are increasing the stock of trade credits to subsidiaries on foreign markets outside the EU.

Alongside growth in loans to non-financial corporations, growth in household lending is also declining, from 27% in 2007 to 10% in March 2009. Although year-on-year growth in housing loans remains high at 24%, household lending stalled in March 2009. The household sector maintained a relatively low level of indebtedness in 2008: at 30% of GDP its financial liabilities were more than one-half lower than the euro area average. The average proportion of household employment earnings earmarked for the repayment of loans did not rise significantly last year, remaining at 21%. However, household exposure to risks is not limited to their level of debt, but also derives from other factors. First, households' debt servicing burden at banks will rise primarily as a result of slowing growth in private sector wages and rising unemployment. Second, in the context of falling interest rates at the end of 2008, banks raised premiums over the reference interest rate, these premiums representing the fixed portion of the cost of a loan. Premiums will remain at a high level, even when reference interest rates begin to rise and when the burden of debt repayment increases. This warning holds true given the fact that the average maturity on new housing loans lengthened last year, as the proportion of new housing loans with a maturity of more than 20 years is rising. Third, borrowing in Swiss francs almost stalled towards the end of 2008. However, Swiss franc loans account for 35% of the stock of housing loans and 8% of consumer loans. Therefore, households remain exposed to the risk of changes in the Swiss franc/euro exchange rate, while potential credit risk remains for banks.

Increased credit risk to households is also linked to developments on the capital and real estate markets. The sharp 67.5% drop in the SBI 20 in 2008 resulted in a decline in the value of household investments in equity and investment fund units, which were down EUR 1.8 billion by the end of September 2008, and by a further EUR 2 billion in the final quarter of last year, according to estimates, owing to accelerating adverse developments on stock markets. Thus the value of household financial assets fell below the level recorded at the end of 2007.

The negative wealth effect for households deriving from developments on the capital markets has resulted in a decline in purchasing power and lower demand for housing loans. In the context of the falling value of financial assets this has slowed growth in the value of real assets in the form of real estate. The figures from SORS, the Surveying and Mapping Authority of the Republic of Slovenia (SMARS) and the Bank of Slovenia vary due to differences in the methodologies for calculating real estate prices, but all the figures indicate a sharp drop in the growth of real estate prices in 2008. According to the Bank of Slovenia's calculation, growth in housing prices stood at 4.3% in 2008, compared with 23.4% a year earlier. Prices have eased throughout the country, the gap between the Ljubljana urban region and the rest of Slovenia narrowing. Housing affordability actually rose in the context of an increase in average net wages and falling interest rates towards the end of the year. However, alongside the negative wealth effect, the demand for real estate has been further curtailed by the tightening of lending terms on housing loans. Compared with other countries, Slovenian households are less exposed to the risk of eviction from housing due to the inability to repay housing loans or pay rent, owing to the high proportion of owner occupiers.

The factors of falling demand for real estate are accompanied by growing concern over the duration and depth of the recession and expectations of falling real estate prices. The real estate market initially responded by extending the sales period, which translated into a sharp fall in the number of transactions. The extent to which selling prices of real estate are rigid due to the possible oligopolistic structure of the new build market remains untested. An additional supply of completed new builds can be expected in the short term, given the number of building permits issued. Although this will increase the downward pressure on selling prices of real estate, the duration and depth of the recession will have a more profound impact.

The increase in the level of coverage of classified claims by impairments from 2.8% to 3.0% at the end of the year confirms that banks recorded increased credit risk, particularly from the end of the final quarter of 2008 on. Bad loans as a proportion of classified claims also rose by 0.2 percentage points, to 1.8%. However, banks have not responded to increased credit risk by merely increasing impairments and provisioning; they have also implemented other risk management measures. Banks have reduced the average loan-to-value (LTV) ratio on loans with real estate collateral, and have obtained additional collateral for 60% of loans with securities collateral, the LTV ratio of which had risen above the internally defined limit, and have reduced the overall proportion of collateral in the form of securities and mutual fund units. At the same time, banks have increased the proportion of loans with real estate collateral. The proportion of newly approved unsecured loans to non-banking sectors has risen, but as a result of the shortening of loan maturities. The proportion of unsecured short-term loans is higher than the proportion of unsecured long-term loans. All of the aforementioned points to the beginning of increased credit risk in 2008, which will rise further in 2009 in the context of the continuing recession.

The total exposure of Slovenian banks to the rest of the world was down nearly 3.1% on 2007 at EUR 11.8 billion. However, exposure increased to the countries of eastern and central Europe, and to the former Yugoslav republics, which are faced with the devaluation of domestic currencies against the euro, resulting in an adverse effect on the solvency of borrowers. Credit risk is partly mitigated by the fact that the number and sum of large exposures were down in 2008.

Income risk has increased on account of several factors. First, at EUR 304 million, the banking system's pre-tax profit in 2008 was down 62% on the previous year. Second, the structure of profit has deteriorated. Net non-interest income was down one-third, primarily on account of the valuation of securities, and partly due to falling growth in net fees and commissions. Net non-interest income as a proportion of gross income fell by 12.6 percentage points to 30.6%. Third, impairments of financial assets and provisioning for off-balance sheet liabilities were up sharply on the previous year owing to deterioration in the quality of the investment portfolio. In 2008 banks created impairments and provisions in the amount of EUR 277 million, more than two-thirds of this amount in the final quarter of the year. The ratio of impairment and provisioning costs to gross income nearly doubled last year. Last year the large domestic banks were most effective in controlling operating costs. The operating costs of Slovenian banks as a proportion of average total assets are higher than those of medium-sized EU banks. However, the gap is closing. Nevertheless, banks will be increasingly forced to streamline operations due to the additional needs to create impairments. The Slovenian banking system's ROE halved last year, to 8.1%. Fourth, the probability of continued stagnation in the value of investments on the capital markets and low growth in fees and commissions will, together with the expected increase in impairment and provisioning costs, further reduce the profit of banks. This increases the risk that individual banks will begin generating losses. Falling profit temporarily limits opportunities to increase the capital of banks. All that remains to banks during the recession and the downturn in the lending cycle is the reduction of operating costs, and capital injections carried out by owners or other investors. Fewer adjustments will be necessary by the banks whose owners, during the positive economic climate, were conscious of the fact the banking is a cyclical economic activity, and guided the business policies of their banks and managed the level of capital accordingly.

In the final quarter of 2008 the capital adequacy of the banking system reached its highest level of the last four years, at 11.7%, owing to capital injections and the temporary abolition of the original own funds deduction item (the so-called prudential filter). Tier 1 capital adequacy rose to 10.0%. The capital adequacy of the Slovenian banking system overall was slightly above the EU average at the end of 2008. The capital adequacy of the small Slovenian banks (10.7%) and that of the banks under majority foreign ownership (10.6%) lag behind the EU average.

The Bank of Slovenia's temporary abolition of the deduction item from original own funds in October 2008 had the counter-cyclical effect of slowing the contraction in lending activities. Declining capital adequacy prior to this measure was a result of an increase in the deduction item from original own funds (the prudential filter), the introduction of the new capital requirement for operational risk, and increasing capital requirements for credit risk in the third quarter of 2008. The latter accounts for the highest proportion (92.5%) of total capital requirements. Growth in capital requirements for credit risk outstrips growth in banks' total assets, indicating the high level of willingness on the part of banks to assume credit risk. The banks under majority foreign ownership achieve the highest proportion of capital requirements for credit risk.

In 2008 original own funds increased by 38.1%, primarily on account of share capital and capital surplus (the share premium account). More than half of banks carried out capital injections in 2008, in the total amount of EUR 666 million. Lower bank profits in 2008 were reflected in a 50% drop in growth in original own funds, arising from profit reserves and retained and revised earnings. This important source for increasing banks' original own funds in the past will decrease in the future, providing an additional challenge to the owners of those banks whose management boards identify the need for capital injections. Additional own funds were down 5.2% owing to a smaller surplus from innovative instruments, a lower revaluation surplus adjustment and a decrease in subordinated debt. Capital injections, particularly into the large domestic banks prior to the escalation of the financial turmoil, significantly improved the quality of regulatory capital.

Interest-rate risk measured as the difference between the average repricing periods for asset and liability interest rates diminished last year. Interest-rate gaps in the categories of up to 3 months and up to 6 months narrowed towards the end of last year, and remained relatively low in the first months of 2009. The interest-rate gap in the category of up to 1 year has remained low relative to the level of 2007. Interest-rate risk has increased in three segments. First, banks' sensitivity to changes in interest rates on the funding side has increased. Second, the portion of interest-rate risk arising from the mismatch in the structure of interest-sensitive assets and liabilities relative to the reference interest rate has increased. Third, banks' exposure to interest-rate risk arising from the prepayment of loans or the call (redemption) of debt securities by an issuer has risen.

Currency risk for banks has decreased sharply with the introduction of the euro. In 2008 the net open foreign exchange position as a proportion of regulatory capital remained low, at -0.2%. Last year banks' position in Swiss francs opened further, while the position in US dollars closed significantly. In February 2009 foreign currency assets and liabilities accounted for 6% and 4.6% of total assets/liabilities respectively.

The insurance sector stagnated last year, its proportion of the financial sector remaining above 8%. The total written premium of insurers stood at 5.2% of GDP in 2008, or EUR 931 per capita, which is just over one-third of the average written premium per capita in euro area countries. In 2008 insurers recorded weaker results than the previous year. In 2008 growth in written insurance premium was the lowest in recent years, while the claims ratio deteriorated and ROE fell to 10.9%. A positive development in terms of risk management was the increase in the coverage of net technical provisions by assets covering technical provisions, as was the increase in the proportion of the most conservative or safest forms of investment. The investments of Slovenian insurers are more conservative compared with those of their euro area counterparts. Therefore, capital losses arising from the falling values of equities and investment fund units were relatively low in 2008. The 2.5% year-on-year decline in written gross life insurance premium reflects falling demand linked to the economic crisis. Life insurance accounted for 27.9% of total gross premium, while total life insurance assets accounted for 50.4% of insurers' total assets at the end of 2008. Despite the profoundly negative developments on the capital markets, investments in unit-linked life insurance were up 5.9% in 2008. Contrary to expectations, the proportion of total written life insurance premium accounted for by life insurance in which policyholders assume the investment risk rose to 47.1%. Thus the household sector is further exposed to the risk of falling values on the capital markets, indirectly via the life insurance products of insurers.

At the end of 2008 investment funds, with a value of EUR 1.9 billion (5% of GDP), accounted for 5.1% of the total financial assets of households, down 4.1 percentage points on 2007. The decrease is the result of capital losses, on account of which the weighted average unit price fell by 43%. Despite this, the proportion of equity funds did not decline, and thus capital losses have already added significantly to the burden on households, which remain exposed to the risk of changes in value on the capital markets. However, this type of exposure is low compared with the euro area. The total assets of domestic investment funds per capita have fallen to EUR 931, compared with the euro area average of EUR

6,537. Banks' exposure to management companies is extremely low, while the likelihood of mutual ties or mergers is rising.

The proportion of total investment fund assets accounted for by mutual funds rose to 79% owing to the conversion of investment companies. In 2008 the assets of mutual funds were down 48.2% on December 2007, and were down an additional 6.2% by the end of March 2009, to EUR 1,420 million or 3.8% of GDP. The decrease in assets is a result of the fall in securities prices on the domestic and foreign capital markets, movements in exchange rates and the net outflows from mutual funds. Net outflows in 2008 in the amount of EUR 303.7 million were relatively low, merely accounting for slightly more than one-fifth of the decrease in mutual fund assets. Domestic mutual funds significantly reduced investments in the former Yugoslav republics in the context of declining investment in domestic shares and an increase in investments in domestic bonds. The increased redemption of fund units forced operators to secure liquid assets. Despite the pressures on operations as a result of developments on the capital markets, at the end of 2008 mutual funds' liquid assets were up on the previous year.

The financial infrastructure has functioned smoothly during the financial turmoil. Owing to the high value of transactions, its key element is the TARGET2-Slovenija payment system. The payment system's exposure to risk diminished in 2008 on account of a decrease in the concentration of the number of transactions.

The purpose of the Financial Stability Review is to present how elements of the financial system responded to the pass-through of the turmoil from the international environment to Slovenia, the risks to which they are exposed and how they are mutually linked to these risks. The Financial Stability Review has been expanded in the sections relating to the household and corporate sectors and the rest of the world due to the interaction of risks between them and the financial system. The introduction is dedicated to inter-sector financial flows. It presents which sectors in surplus met the demands for financial assets of those sectors in deficit, in what forms financial assets were transferred, and how financial relations with the rest of the world have changed. This is followed by a presentation of the financial position and transactions of the household sector, which has been faced with the declining value of financial assets during the turmoil, and has responded by changing its behaviour. The real estate market is analysed separately owing to its size and importance for households and the financial system. With a description of developments on the capital market, the Financial Stability Review shifts to the core of the report, where changes in the Slovenian banking system, the risks to which it is exposed in conditions of tightened access to funding and the reversal of the economic cycle are discussed. The operations of non-banking financial intermediaries, namely insurers, investment funds and leasing companies, are analysed in a similar manner. The conclusion of the Financial Stability Review focuses on the financial infrastructure.

1 INTER-SECTOR FINANCIAL CLAIMS AND LIABILITIES [1]

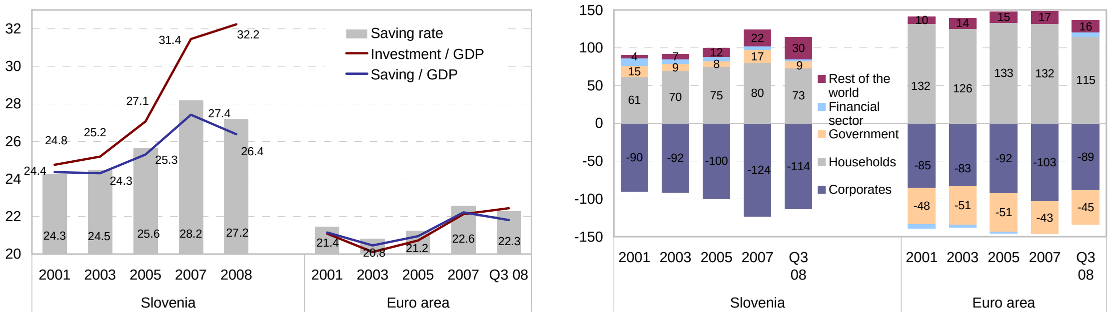
Economic growth fell from 5.6% in the first half of 2008 to -0.8% in the final quarter.

Economic growth reached 5.6% in real terms in the first half of 2008. The subsequent spread of the financial turmoil to other sectors of the economy was reflected in a rapid decline, with growth standing at -0.8% in the final quarter. The major factors in this decline were falling foreign demand and negative real growth in gross investment. The financial flows of the domestic economy and its financial flows with the rest of the world were generated in line with the deterioration in key macroeconomic aggregates.

Dependence on foreign funding increased in 2008 owing to a widening savings-investment gap.

The gap between investment and savings as a proportion of GDP widened further in 2008, requiring continued borrowing in the form of foreign loans and an increase in net financial liabilities to the rest of the world to 30% of GDP. The response on the investment side to the financial turmoil was weak. Thus the lag on the savings side had a more significant impact on the widening savings-investment gap. During the period of rapidly tightening conditions on the international financial market, dependence on foreign funding increased, and with it the risk of a rapid decrease in available foreign funding, which was realised in autumn 2008. A decline in investment as a proportion of GDP, in particular, is expected to forcibly close the savings-investment gap in the future. Higher aggregate growth rates in Slovenia than in the euro area are evidence of the process of convergence. However, they reflect the overheating of the domestic economy in the years prior to 2008 which, in the context of high demand for foreign funding, led to borrowing in the rest of the world before the outbreak of the financial turmoil.

Figure 1.1: Saving rate[2], ratios of investment and saving to GDP (left, in percentages), and net financial positions of individual economic sectors (as a percentage of GDP)



Note: Figures include the household sector (S.14) and non-profit institutions serving households (S.15).

Sources: Bank of Slovenia, SORS, ECB, Eurostat

The tightening of financial and economic conditions in 2008 was seen in Slovenia and the euro area as a decline in the net financial positions of individual sectors relative to 2007, which reflects slowing economic activity and increased prudence in the behaviour of those performing transactions. Among domestic institutional sectors, non-financial corporations recorded a lower net negative financial position in the amount of -114% of GDP, which was financed to a lesser extent than in 2007 by the household sector and to a greater extent by the rest of the world. Bank intermediation in the transfer of foreign funding to the domestic economy prevented a slowdown in growth of the banking system's balance sheet prior to the escalation of the financial turmoil in autumn 2008.

Households

The household sector[3] remains the most important domestic sector, with its surplus of financial assets facilitating the financing of non-financial corporations, primarily via the financial sector. Households accounted for nearly half of non-financial corporations'

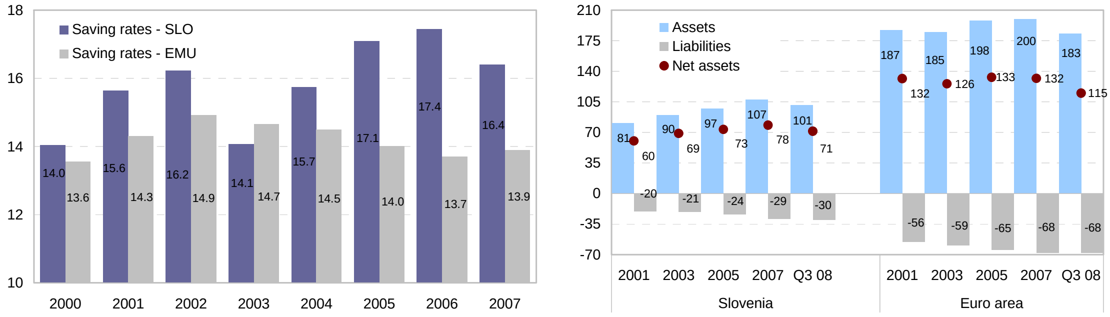
[1] Owing to a methodological revision to GDP, SORS released revised non-financial sector accounts for the period 2000 to 2006. Therefore some values in this section differ from those published in Financial Stability Reviews in previous years.

[2] The saving rate is an indicator calculated from the institutional sector accounts, and represents the ratio of gross saving to gross disposable income. In addition to employee compensation and social security benefits, it also includes gross operating surplus from manufacturing, other current transfers such as compensation from non-life insurance, and ownership-related income such as interest and profit distributions. It does not include value changes or capital gains.

[3] Sector S.14 in accordance with the financial accounts methodology.

domestic resources in 2008. In 2007 the household saving rate fell to a still high 16.4%, partly as a result of the positive wealth effect and the higher value of financial investments. The difference in the household saving rate relative to the euro area began to narrow again in 2007, when the rate in Slovenia fell from 17.4% to 16.4% , while the euro area recorded a slight increase to 13.9%.

Figure 1.2: Saving rate, financial assets and liabilities, and net financial position (net assets) of households as a percentage of GDP

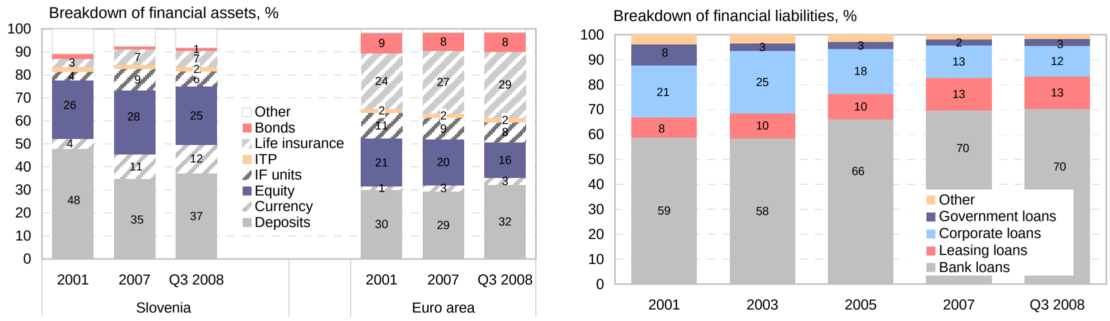


Sources: Bank of Slovenia, SORS, ECB

Euro area households are more than twice as indebted as Slovenian households.

The increase in the financial liabilities of euro area households slowed in 2007, and stagnated in 2008. The response of Slovenian households to changing conditions was similar, but less pronounced. Given the large difference in the levels and the same well-known reasons for the lower stock of financial assets of Slovenian households (lower household purchasing power, the high burden of contributions on income, the high proportion of real estate ownership and a lag in the development of non-banking financial institutions and investment forms), convergence in this area will be a more protracted process compared with other integration processes in the euro area. Slovenian household indebtedness of 30% of GDP remains one-half of euro area household indebtedness. However, the net financial assets of the latter in the amount of 115% of GDP remain sharply higher than the net financial assets of Slovenian households. In comparing household assets, real assets, which are significant in Slovenia due to the high proportion of housing ownership, must also be taken into account in addition to financial assets.

Figure 1.3: Breakdown of financial assets of households in Slovenia and the euro area (left), and breakdown of financial liabilities of households in Slovenia (right) in percentages



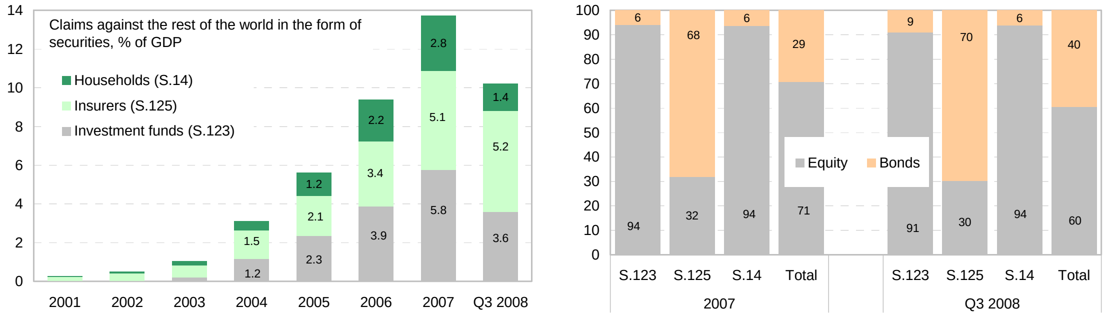
Note: ITP: insurance technical provisions; IF: investment funds. Includes the household sector (S.14) only. Does not include non-profit institutions serving households (S.15).
Sources: Bank of Slovenia, ECB

The proportion of bank deposits and cash in the breakdown of Slovenian households' financial assets has fallen slightly in recent years, but remains 14 percentage points higher than the euro area. The effects of negative developments on the capital markets are reflected in an increase in deposits at the expense of a declining proportion of equity and investment fund units. The difference in the proportion of life insurance and pension insurance provisions remains pronounced. The difference between Slovenian and euro area households is most significant in this form of financial assets, indicating in particular relatively less developed pension insurance. Changes to the pension system are therefore necessary, not only due to demographic trends and the need to ensure a long-term, financially sustainable pension system, but also for reason of the normalisation of the structure of Slovenian households' financial assets. The second significant difference is the proportion of debt instruments, which on the one hand indicates the relative underdevelopment of the Slovenian capital market and the practice of corporate financing via loans, and on the other hand Slovenian households' propensity for higher-risk financial investments in equity. With regard to transactions with banks, Slovenian households became more restrained in 2008 in raising loans, which can also be seen in the stabilisation of the overall structure of their financial liabilities.

The value of Slovenian households' claims against the rest of the world fell to 10% of GDP.

The value of household claims against the rest of the world rose relatively rapidly until 2007, reaching a peak of nearly 14% of GDP. A reversal followed in 2008 due to negative developments on the capital markets, accompanied by capital losses and difficulty in migrating to other investment forms. Thus the direct claims of households halved and claims in the form of investment funds fell sharply, while the increase in claims against insurance companies was merely symbolic.

Figure 1.4: Breakdown of household claims against the rest of the world by intermediary as a percentage of GDP (left), and by foreign equity/debt securities (right) in percentages



Note: S.123: Other financial intermediaries, except insurance corporations and pension funds (also includes investment funds); S.125: Insurance corporations and pension funds; S.14: Households. The figures have been simplified, with all investments by sectors S.123 and S.125 in foreign securities being treated as household assets, although a specific portion are their own investments or corporate investments.

Sources: Bank of Slovenia, SORS

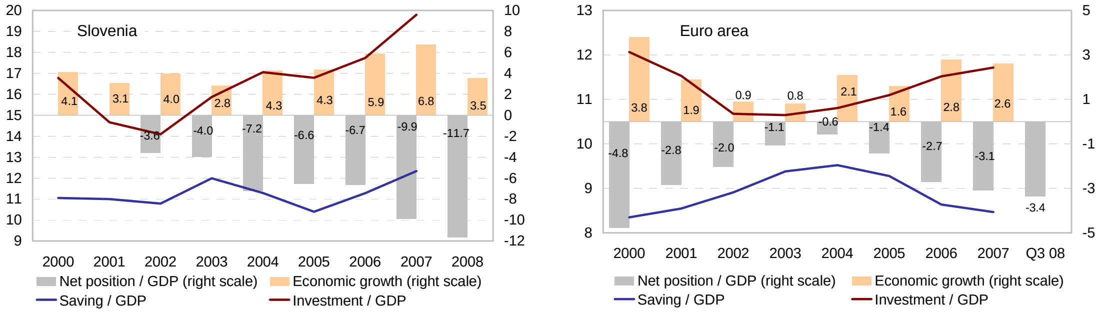
The value of household investments in foreign securities fell to 10% of GDP. Of this amount, 60% was in the form of equity. The changing ratio relative to 2007 in favour of debt capital reflects a decrease in the value of equity due to capital losses and the migration to other forms of investment. It can be concluded that the aforementioned household investments in the rest of the world may have also declined on account of investments in domestic forms of savings, although the negative developments on the domestic capital market did not encourage this type of behaviour, while the diversity of non-banking financial investments did not increase. A change to the pension system in particular would result in a welcome, deep-rooted change. Implemented properly, such a change could help retain a larger portion of household savings in Slovenia than in the past, thus slowing the widening of the savings-investment gap and growing dependence on unstable flows of foreign funding.

Non-financial corporations

The rising net negative financial position of non-financial corporations prior to the financial turmoil resulted in increased dependence on foreign funding.

The increase in investment in Slovenia prior to the outbreak of the financial turmoil increased the net negative financial position of Slovenian non-financial corporations as a proportion of GDP. This in turn resulted in increased demand for loans, which, in the context of insufficient domestic funding, led to borrowing by banks in the rest of the world. Funding received from the rest of the world facilitated lending to domestic sectors during a period when the economy was overheating. This was followed by a downturn in which the rate of economic growth was halved, aggregate demand fell and investment plans were adjusted. This decreased the needs of non-financial corporations for continued growth in borrowing from banks. The high value of investments and savings of non-financial corporations in Slovenia in 2007, and a comparison of the aforementioned categories as a proportion of GDP with euro area non-financial corporations, indicate that a slowdown was to have been expected, even in the absence of the financial turmoil.

Figure 1.5: Investment, saving, net position in transactions of non-financial corporations as a percentage of GDP, and real economic growth in Slovenia and the euro area in percentages

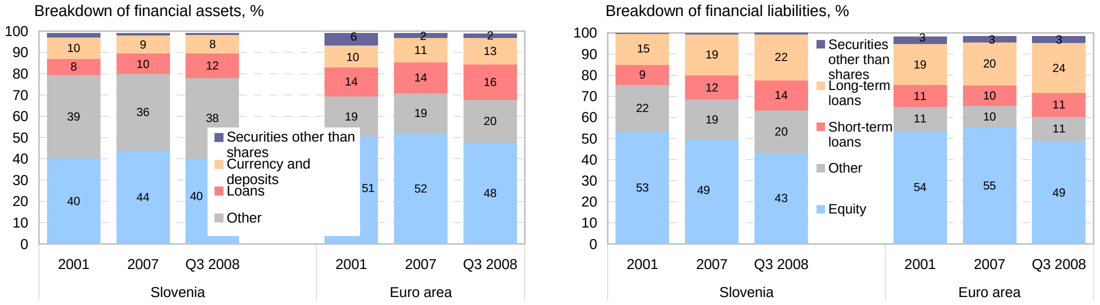


Note: The third quarter figures for real euro area economic growth include the four preceding quarters. The net financial position represents the difference between financial transactions from assets and liabilities in the period in question. In the figures for Slovenia, the net financial position for 2008 relates to the end of the third quarter.

Sources: Bank of Slovenia, SORS, ECB, Eurostat

Since the outbreak of the financial turmoil, non-financial corporations in Slovenia and the euro area have attempted to adapt to the simultaneous decline in economic activity by increasing business-to-business lending. At the same time, developments on the capital markets have decreased the value of their equity. Owing to the lower proportion of equity of Slovenian corporates relative to euro area corporates, those in Slovenia are more dependent on other sources of financing, and are therefore more exposed to refinancing risk during the period of unstable conditions on the financial markets.

Figure 1.6: Breakdown of financial claims and liabilities of non-financial corporations in percentages



Sources: Bank of Slovenia, ECB

Given that Slovenian corporates, even prior to the financial turmoil when it was easier to inject capital or issue debt securities owing to high values, rarely operated in this manner, it is not surprising that they have continued this business practice. Therefore, the opportunity to invest the savings of the household sector domestically instead of in the rest of the world remains in part unexploited. For this reason the capital market also remains shallow.

Financial sector

The financial sector reduced its domestic liabilities, and increased liabilities to the rest of the world.

Restricted domestic resources in the first three quarters of 2008 were reflected in a decrease in the domestic financial liabilities of the financial sector of 4.8 GDP percentage points and in an increase in liabilities to the rest of the world of 3.9 GDP percentage points.[4] Claims against the domestic sectors were unchanged, and were down slightly against the rest of the world, primarily due to a decrease in cash and equity. The commercial banks account for around 75% of the Slovenian financial system’s assets (based on financial accounts figures, excluding the central bank). The euro area banks have increased their proportion of the financial sector's assets slightly, to 60%, primarily on account of a significant decrease in the assets of other financial intermediaries.

[4] Includes the entire financial sector (S.12) in accordance with the classification of the financial accounts system.

General government sector

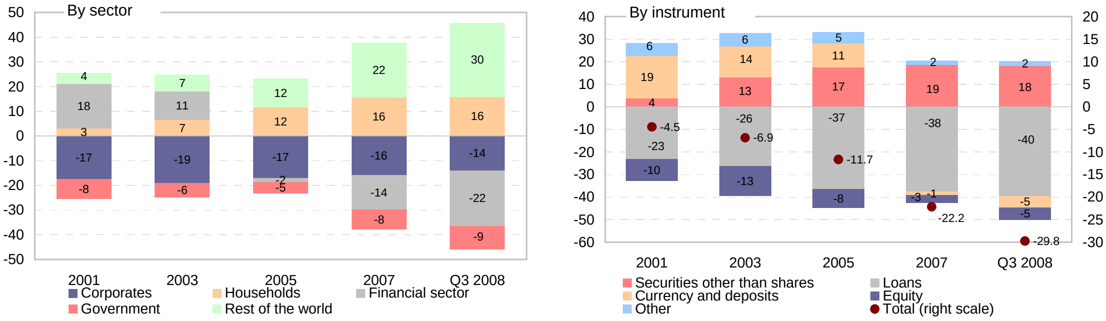
From the end of 2007 until the end of the third quarter of 2008, the general government sector's net financial position fell by 7.5 percentage points to 9.4% of GDP. The majority of the decrease on the claim side was due to decreases in the value of equity of non-financial corporations and the general government sector itself. The general government sector temporarily decreased its liabilities, primarily in the form of securities, which will increase again in 2009.

Rest of the world

The proportion of financing from the rest of the world continued to rise over the first three quarters of 2008 due to the delayed decline in investment activity.

The increase in the financial liabilities of Slovenian households to the rest of the world from 2005 to 2007 is a reflection of high economic growth rates prior to the financial turmoil, while their continued rise until the third quarter of 2008 delayed the decline in investment, relative to the deteriorating financial and economic conditions.

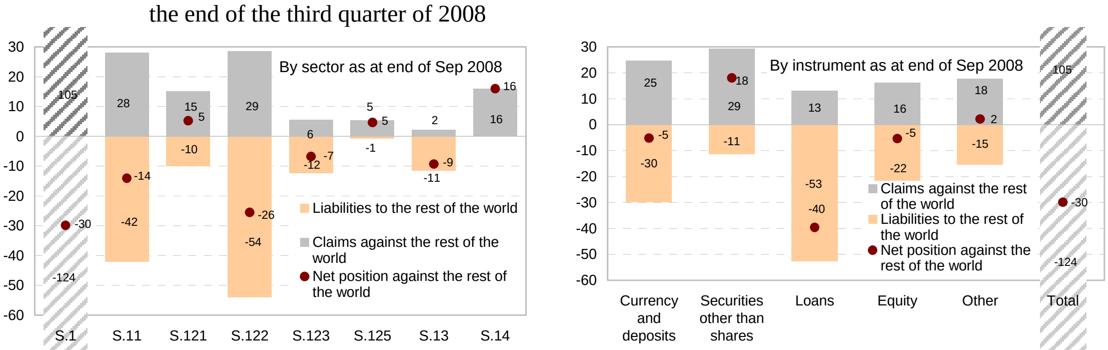
Figure 1.7: Net financial position against the rest of the world as a percentage of GDP, by institutional sector and financial instrument



Source: Bank of Slovenia

The household sector's net surplus against the rest of the world stalled in 2008. The general government sector's net deficit to the rest of the world was almost unchanged, despite the issue of bonds at the beginning of 2008. The transactions of the financial sector best reflect the relationship with the rest of the world. Net financial liabilities to the rest of the world in the form of loans rose again in 2008, while net claims in the form of debt securities stagnated. Taking into account a minimal increase in the proportion of equity, sensitivity to the turmoil has increased.

Figure 1.8: Financial claims, liabilities and net position against the rest of the world as a percentage of GDP, by institutional sector and financial instrument at the end of the third quarter of 2008



Note: S.1: Slovenian economy; S.11: Non-financial corporations; S.121: Central bank; S.122: Other monetary financial institutions (includes commercial banks and savings banks); S.123: Other financial intermediaries, except insurance corporations and pension funds (includes investment funds and leasing companies); S.125: Insurance corporations and pension funds; S.13: General government; S.14: Households.

Source: Bank of Slovenia

Playing a key role was the banking sector: its net negative position against the rest of the world was up 6 percentage points to 26% of GDP. At the same time, the net negative financial position of other financial intermediaries, including leasing companies and investment funds, deteriorated by a further 4 percentage points of GDP. The stagnation in the net negative financial position of non-financial corporations against the rest of the world is evidence that they are able to secure financing under more favourable conditions via the intermediation of the financial sector than via direct borrowing, and that rising liabilities to the rest of the world are accompanied by an increase in claims against the same. The expected drop in investment due to the recession will slow the increase in the financial leverage of non-financial corporations, which have become increasingly sensitive to the drop in demand in 2009 owing to the previous increase.

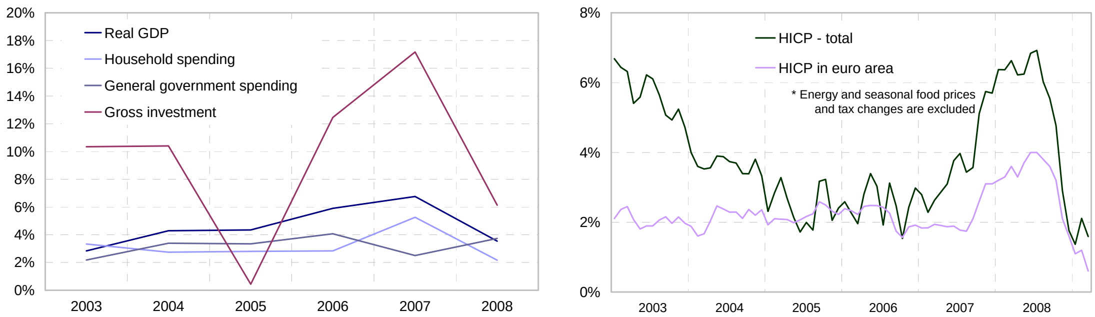
2 ECONOMIC TRENDS IN SLOVENIA

2.1 Economic activity and inflation

Declining economic growth in 2008.

Economic growth in Slovenia fell to 3.5% in 2008. Economic growth was driven by still relatively high growth in gross investment in the first half of the year, and partly by continued solid year-on-year growth in exports of goods and services over the first three quarters. Last year's GDP growth was a reflection of two different periods: a deteriorating economic climate in the first half of the year, and a sharp decline in economic results in the second half of the year due to the escalating financial turmoil. Economic growth was actually negative in the final quarter of last year owing to a rapid drop in domestic demand and a sharp decline in merchandise exports, which were down 9.4% in real terms. The value of merchandise imports was also down sharply, by 7.3%. Capital expenditure was also down 5.3% in real terms in the final quarter. In 2008 year-on-year growth in gross investment of 6.1% was the major factor in economic growth, contributing 1.9 percentage points. Household spending and general government spending followed, contributing 1.1 percentage points and 0.7 percentage points respectively. Last year net trade made a negative contribution (of 0.2 percentage points) to economic growth.

Figure 2.1: GDP growth and components of GDP growth in percentages (left), and movement of inflation indices in Slovenia and the euro area



Source: Bank of Slovenia

Rising average inflation in 2008 relative to 2007, and a rapid fall in inflation in the second half of the year.

In 2008 average inflation in Slovenia as measured by the harmonised index of consumer prices (HICP) stood at 5.5%, up 1.7 percentage points on 2007. Inflation fell rapidly in the second half of 2008, to stand at 1.8% at the end of the year. The relatively high inflation in the first half of 2008 was a result of high economic activity in the preceding period, growth in labour costs and the rise in commodity prices on global markets. In the context of still relatively high growth in labour costs, falling prices of oil and other commodities contributed most to declining inflation in the second half of the year.

Last year Slovenia didn't succeed in maintaining a relatively low current account deficit, compared with the years prior to the introduction of the euro. The current account deficit widened by 1.3 percentage points in 2008, to 5.5% of GDP. The current account deficit was financed by net financial inflows from the rest of the world of EUR 1.4 billion into the private sector and EUR 1.1 billion into the general government sector. Banks contributed most to the former, despite the net repayment of debt to the rest of the world in the final quarter.

2.2 Country risk

Country risk assessment

Slovenia's country risk assessments indicate the relatively sound positioning of Slovenia in the group of AA rated countries.

Slovenia's country risk assessments indicate the relatively sound positioning of Slovenia in the group of AA rated countries. However, viewed long term, international rating agencies have warned of the problem of an aging population and the slow pace of structural reforms. Slovenia also has a relatively low wealth level compared with the "median for AA countries". In this year's risk assessment for Slovenia, S&P cited a stable outlook with an expectation of continued fiscal consolidation and solid medium- and long-term economic growth. The agency stated improvement in competitiveness and further economic restructuring to support the process of income convergence with the median for AA countries as key factors in Slovenia's long-term rating improvement.

S&P published a rating for Slovenia in March 2009, holding it at AA/A-1+. Likewise, the ratings of comparable countries in terms of GDP per capita do not indicate any significant changes compared with last year. Rating agencies have cited the following country risk assessments for the aforementioned countries: Portugal A+/A-1+, Italy A+/A-1+, Greece A-/A-1, Belgium AA+/A-1+, Cyprus A+/A-1, Malta A+/A-1 and Slovakia A+/A-1.

Moody's held Slovenia's rating this year at Aa2. In March 2008 the agency cited similar upgrade factors and major challenges to those in the previous report. Among the former it cited several decades of corporate experience with European markets, political consensus regarding economic decisions, sustainable public finances and debt management. According to the agency, the challenges faced by Slovenia include a large public sector, particularly social transfers, and the rigidity of the labour market, including labour costs and the aging of the population, which will require additional pension reforms in the future. As factors that could lead to an upgrade in the future, Moody's cited measures to balance the structural fiscal deficit, which would ensure continued fiscal sustainability. The agency also cited wage policy as an important factor that would balance competitiveness towards full income convergence with the EU15. On the other hand, factors that could result in a future downgrade include a protracted deterioration in the fiscal position, such as ineffective pension reforms and ineffective management of public transfers.

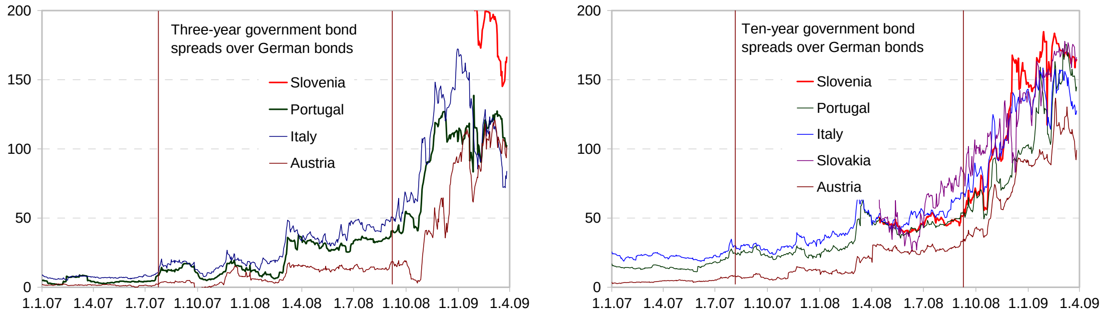
Minor corrections to Slovenia's country risk assessment in March 2009.

At the end of March 2009 Moody's changed the rating of Slovenian government bonds from Aa2 with a positive outlook to Aa2 with a stable outlook, primarily due to the deteriorating results of the public and export sectors in the context of the financial turmoil, which has an adverse effect on export markets.

Risk premium on Slovenian government securities

The financial turmoil and economic crisis have been strongly reflected in a comparison of movements in the yields on specific types of Slovenian and German 3-year and 10-year government bonds. The first significant rise in premiums on 3-year and 10-year Slovenian government bonds over German government bonds was seen in March 2008. The first clear upward trend was recorded following the escalation of the financial turmoil in autumn 2008. In March 2009 the premiums on 3-year and 10-year Slovenian government bonds stood at 170 basis points and 167 basis points respectively. In March 2009 the premiums on 3-year government bonds over the yield on comparable German bonds were lower than the premiums on comparable Greek bonds and similar to those on Irish bonds. In March 2009 the premiums on 10-year Slovenian government bonds over the yield on comparable German bonds were lower than the premiums on Irish and Greek bonds with comparable maturities, but higher than those on Portuguese and Italian bonds. The level of premiums on Slovenian government bonds also reflects the relatively low volume of bond issues, and their resulting lower liquidity.

Figure 2.2: Movement of premiums on 3-year (left) and 10-year Slovenian government bonds (right) over comparable German bonds and those of selected countries in basis points



Note: The vertical lines in the above figures indicate increasing uncertainty on the financial markets in August 2007 (left) and the escalation of the financial turmoil in September 2008 (right)

Source: Bank of Slovenia

3 HOUSEHOLD SECTOR

3.1 Household borrowing

Slower growth in household indebtedness in 2008.

Household borrowing was down in 2008 relative to 2007. The stock of household financial liabilities was up 19.5% in year-on-year terms over the first nine months of 2008, while growth is expected to fall below 15% by the end of 2008. Although there has been no further pressure on the financial stability of households, mainly due to the rapid pace of borrowing, the debt burden on households will rise on account of other factors. The economic crisis will affect the debt servicing of households via slowing private sector wage growth and rising unemployment.

Households primarily borrow from banks and other financial intermediaries.

Households borrow most by raising bank loans, and to a lesser degree via other financial intermediaries. In the last three years the proportion of household financing accounted for by banks has risen by 7 percentage points to nearly 70%, while the proportion accounted for other financial intermediaries has risen by 2 percentage points to 12%. The financing of consumption via trade credits directly at sellers of goods and services was down 2 percentage points over the same period. During the economic downturn, corporates can be expected to promote sales through more favourable trade credits, which have been supplanted by favourable loans by financial intermediaries in recent years.

Table 3.1: Stock of household financial liabilities by instrument in EUR million

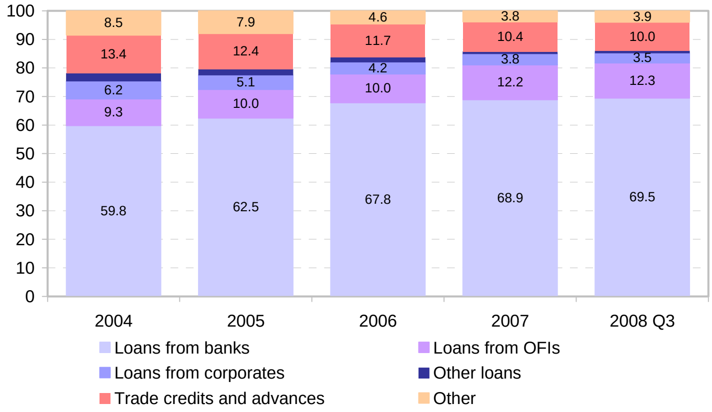
	2004	2005	2006	2007	2008[1]
	(EUR million)				
Total	5,748	6,882	8,093	10,054	11,203
Growth rate (%)	8.3	19.7	17.6	24.2	19.5
As % of GDP	21.2	24.0	26.1	29.2	30.3
Loans	4,491	5,482	6,777	8,620	9,637
Corporates	357	348	336	386	392
Banks	3,439	4,298	5,491	6,926	7,783
Other financial intermediaries	537	690	813	1,227	1,373
Government	86	87	82	77	84
Rest of the world	73	58	55	3	5
Trade credits and advances	770	855	945	1,049	1,123
Other	486	545	371	386	442

Note: [1] Figures for September 2008.
Source: Bank of Slovenia

Current household borrowing via loans was down in 2008 at banks, at corporates and at other financial intermediaries. Several factors affected household borrowing to a lesser degree. Rising interest rates on loans for the majority of the year stands out on the supply side. Towards the end of the year interest rates fell in nominal terms, but were up in real terms owing to falling inflation.

Household demand for loans also fell due to slower private sector wage growth compared with 2007, rising unemployment and an increasing lack of confidence. Movements in prices on the real estate market and the devaluation of financial assets on the capital market further drove down demand for housing loans.

Figure 3.1: Percentage breakdown of household financial liabilities by instrument



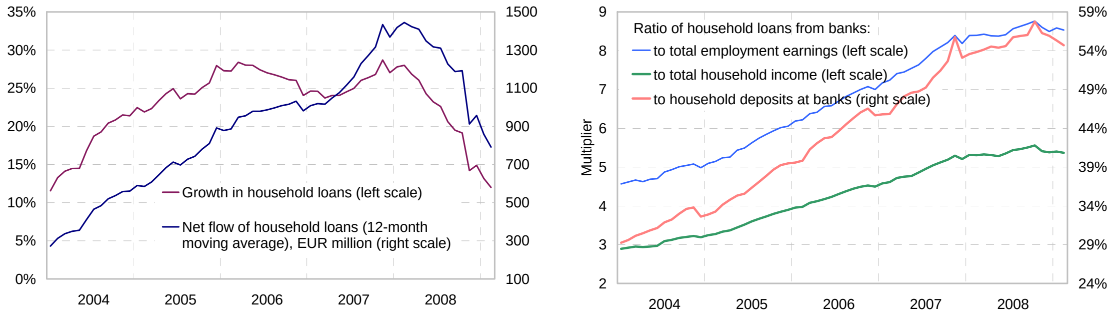
Sources: Bank of Slovenia

Household borrowing at banks

Slowing growth in household borrowing at banks.

Growth in household borrowing at banks fell from around 25% in 2006 and 2007 to less than 15% in 2008, housing loans and consumer loans recording different growth rates. Despite a slowdown, housing loans maintained a high rate of growth, which stood at 27.4% in December 2008. At the same time, growth in consumer loans slowed to 5%, their increase significantly lower compared with 2007. Slowing growth in housing and consumer loans continued at the beginning of 2009.

Figure 3.2: Growth in household loans in percentages and in EUR million, and indicators of household indebtedness at banks

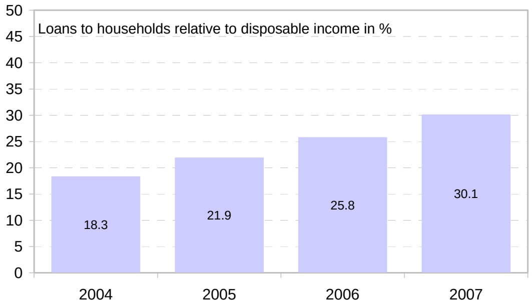


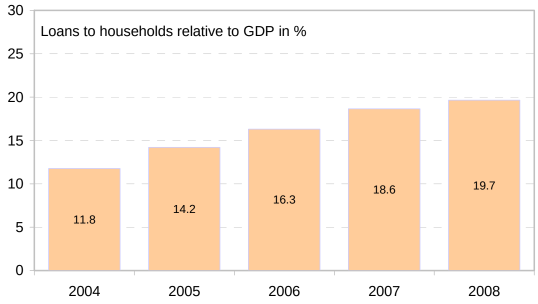
Source: Bank of Slovenia

Indicators of household indebtedness have fallen since November 2008, but at varying rates.

In the context of a slowdown in borrowing relative to 2007 and growth in average nominal and real wages and in total household income, the deterioration in household debt ratios was slower than in the two preceding years. Their levels have also fallen in absolute terms since November 2008. At the end of 2008 the ratio of household loans to monthly employment earnings reached 8.5, up just 0.3 on the end of 2007. The macroeconomic indicator of household indebtedness at banks rose less than in previous years, from 18.6% of GDP to 19.7% of GDP. Here the heterogeneity of households should be noted. Households from lower wage brackets, which typically demonstrate a higher level of indebtedness, are mostly covered by groups of households that have been or will be most affected by unemployment. Lower risk of debt default primarily applies to public sector employees, who are less exposed to the risk of unemployment.

Figure 3.3: Comparison of the stock of bank loans to households with annual disposable income (left) and GDP (right)





Source: Bank of Slovenia

Increase in the proportion of household employment earnings earmarked for the payment of interest on bank loans.

The average burden on households in repaying bank debt was estimated on the basis of bank surveys and available statistics. Due to slowing growth in borrowing, there was no notable rise in the debt repayment burden on households relative to 2007. In 2008 the average proportion of household earnings earmarked for loan repayment was similar to 2007, at 21%. The proportion of employment earnings accounted for by paid interest was up slightly less than 1 percentage point, at 4.3%, as a result of rapidly rising interest rates over the majority of the year and the prevalence of variable-rate loans.

Increasing maturities on housing loans and shortening maturities on new consumer loans in 2008, particularly towards the end of the year.

In 2008 new loans to households were down on 2007, their maturities also changing. Maturities on housing loans are lengthening, with a significant increase in the proportion of loans with a maturity of more than 20 years in 2008, to more than 40%. The trend of decreasing maturities on consumer loans continued, particularly towards the end of the year. In 2008 short-term loans accounted for 22% of all new consumer loans to households, and for 28% in the final quarter. According to bank surveys, new loans to households, mostly short-term, for the purchase of securities declined from 4% in 2007 to less than 1% of all new loans to households in 2008.

Table 3.2: Maturity breakdown of new housing loans in percentages

(%)	up to 5 years	5 to 10 years	10 to 15 years	15 to 20 years	over 20 years
2004	3.2	18.6	46.7	20.8	10.6
2005	2.2	13.0	35.0	24.2	25.6
2006	2.3	14.9	25.0	23.8	34.0
2007	3.3	15.4	22.9	21.5	36.9
2008	4.0	14.8	19.9	20.1	41.2

Note: The figures up to 2005 relate to loans by the eight largest banks, while the figures from 2006 cover all banks.
Source: Bank of Slovenia

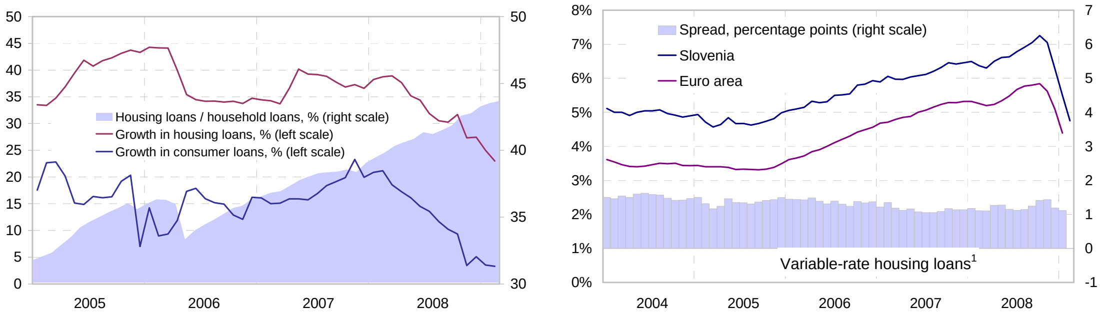
Falling interest rates since October 2008 and rising premiums over reference interest rates.

Interest rates on household loans have been falling since October 2008. By February 2009 the variable interest rate on housing loans had fallen by 2.5 percentage points, and slightly less on consumer loans (by 1.8 percentage points). Here it should be noted that nominal interest rates fell less than expected, given the drop in the interbank interest rate during this period, as banks raised their premiums over the reference interest rate, these premiums representing the fixed portion of the cost of a loan. The former will remain high even when reference interest rates begin to rise in the future.

The positive spread in interest rates on housing loans compared with euro area banks has been maintained.

The dynamics of interest rates on loans at Slovenian banks are similar to those at euro area banks overall. The spread between Slovenian and euro area interest rates did not change significantly in 2008. Slovenian borrowers still face interest rates on housing loans 1.2 percentage points higher on average than those on loans from euro area banks.

Figure 3.4: Growth in housing loans (left), and comparison of interest rates on new housing loans with interest rates in the euro area (right) in percentages



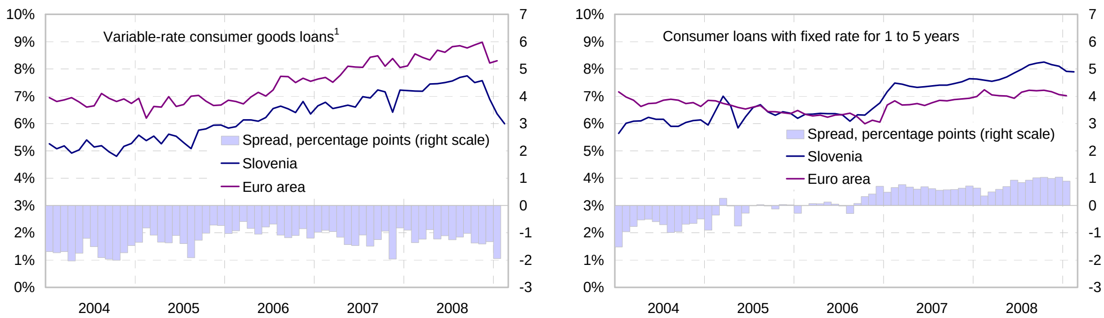
Note: [1] Includes loans in which the agreed interest rate is variable or fixed for up to one year. Since May 2005 the figures for Slovenia have been in line with ECB methodology, having previously been estimated on the basis of reports by eight major banks.
Source: Bank of Slovenia

Consumer loans with a variable interest rate are cheaper, while those with a fixed interest rate are more expensive than in the euro area.

The spread of 1.2 percentage points on consumer loans with a variable interest rate was also maintained in 2008, albeit in the opposite direction. The lowering of interest rates for this category of loans did not begin until December, later than interest rates on both housing loans and corporate loans. The drop in interest rates at the beginning of 2009 was greater than at the euro area banks.

The positive spread on consumer loans with a fixed interest rate for a period of 1 to 5 years increased from zero on average in 2006 to 0.6 percentage points and 0.8 percentage points over the next two years respectively. The decline in the fixed interest rate in the final quarter of 2008 was significantly less than the decline in variable interest rates on consumer loans, reflecting banks' expectations of renewed growth in the future.

Figure 3.5: Comparison of interest rates on consumer loans in Slovenia with those in the euro area, by type of remuneration, in percentages



Note: [1] Includes loans in which the agreed interest rate is variable or fixed for up to one year.
Source: Bank of Slovenia

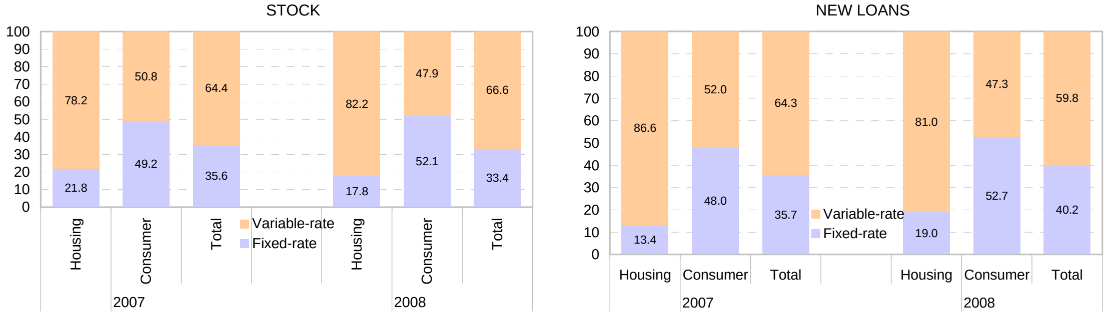
Interest-rate risk to households is increasing owing to the prevailing proportion of housing loans with a variable rate.

In 2008 the proportion of new housing loans and new consumer loans with a fixed interest rate was up. Loans with a fixed interest rate accounted for 19% of new housing loans, and within that loans with maturity of more than 10 years prevailed. Loans with a variable interest rate still account for a prevailing proportion. Households that raise such loans are exposed to interest-rate risk. The debt repayment burden of such loans increases during a trend of rising interest rates, while the premiums applied by banks to prevent a significant fall will remain at the currently defined high level.

The proportion of consumer loans with a fixed interest rate exceeded 50%.

The proportion of consumer loans with a fixed interest rate exceeded 50%, both in terms of stock and new loans. Despite higher interest rates when a loan is raised, in terms of interest-rate risk to households, these loans are more favourable in a period of rising interest rates. When raising a loan in 2008, loans with a fixed interest rate were 0.5 percentage points more expensive on average than loans with a variable interest rate and 0.8 percentage points more expensive in the final quarter of the year. This spread continued to widen in the first months of 2009.

Figure 3.6: Breakdown of household loans by type of remuneration in percentages



Source: Bank of Slovenia

Currency breakdown of household loans

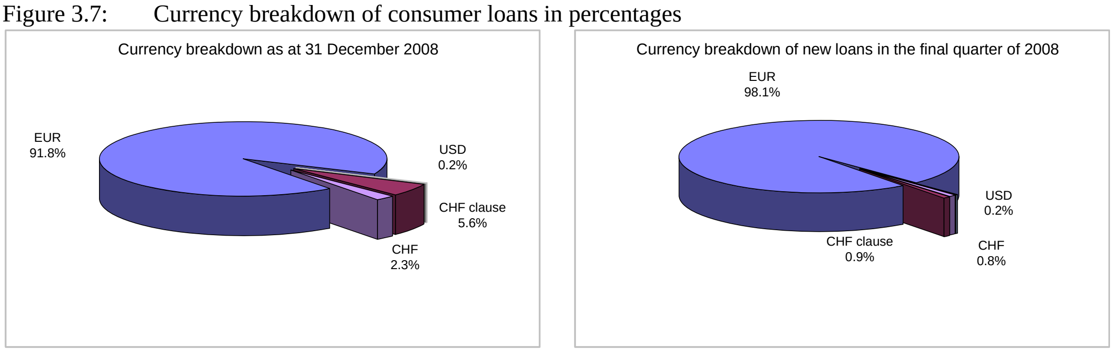
Borrowing in Swiss francs declined in 2008, coming to a near standstill towards the end of the year.

In 2008 the trend of rising household borrowing in Swiss francs ceased. Following two years of depreciation of the Swiss franc against the euro, which alongside the favourable reference interest rates for this type of borrowing had a favourable effect on loan instalments, the Swiss franc began to appreciate in 2008. Swiss franc loans began to decline as a proportion of new loans, particularly in the final three months of 2008 when this currency appreciated most against the euro. Nevertheless, Swiss franc loans increased slightly as a proportion of existing household loans owing to the conversion of the stock of these loans to euros at a higher exchange rate.

Swiss franc loans account for a relatively small proportion of consumer loans.

Non-euro currencies are rarely seen among consumer loans, Swiss francs accounting for nearly the entire stock of non-euro loans. They accounted for 4.4% of new loans in 2008, down 2.3 percentage points on 2007, and for less than 1% from November on. Euro-denominated loans account for 99.5% of short-term consumer loans, while Swiss francs are generally seen in long-term loans.

Figure 3.7: Currency breakdown of consumer loans in percentages



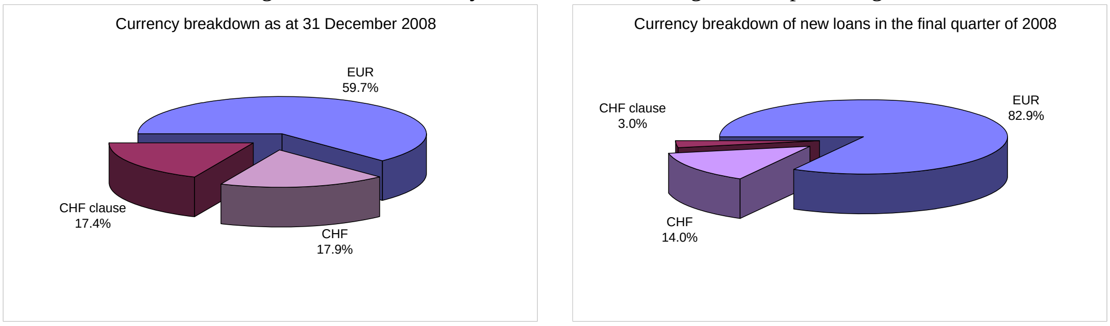
Source: Bank of Slovenia

Despite a decline, the proportion of Swiss franc housing loans remains high, and represents a source of currency risk and interest-rate risk.

The raising of housing loans in Swiss francs declined gradually in 2008. The proportion of all new loans accounted for by this currency stood at 33.5% on average in 2008, down more than 6 percentage points on 2007. Like consumer loans, housing loans in Swiss francs came to a near standstill at the end of the year. Nevertheless, borrowing in this currency will represent a source of currency risk and interest-rate risk to households for several years on account of the longer maturities of housing loans. Swiss franc loans account for 35% of total household debt from housing loans, this proportion rising by 4 percentage points over the last year, despite the decline in new borrowing in this currency, owing to the aforementioned conversion to euros at a higher exchange rate.

According to a bank survey, households have subsequently converted a portion of loans originally raised in Swiss francs into euros. However, these loans as proportion of total Swiss franc debt are negligible: 0.6% in 2007 and 1.3% in 2008.

Figure 3.8: Currency breakdown of housing loans in percentages



Source: Bank of Slovenia

The banks under majority foreign ownership account for the highest proportion of Swiss franc lending.

Two-thirds of new housing loans in Swiss francs in 2008 were approved by the banks under majority foreign ownership. While this group of banks has the highest proportion of Swiss franc loans, it has also recorded the fastest decline in this proportion, from 56% in 2007 to 42% in 2008. The banks under majority foreign ownership have the highest market share of Swiss franc loans to households, accounting for 66% of housing loans and 69% of total household loans.

Table 3.3: Proportion of new household loans in Swiss francs in percentages

	Proportion of new loans in CHF (%)					
	Housing loans			Household loans		
	Proportion of loans in CHF		Bank group's proportion of total loans	Proportion of loans in CHF		Bank group's proportion of total loans
	2007	2008	2008	2007	2008	2008
Large banks	24.1	23.8	32.8	8.1	7.4	29.6
Small banks	14.2	10.2	1.3	4.3	2.5	1.6
Banks under majority foreign ownership	55.7	42.1	65.9	32.9	23.5	68.8
Banking sector	38.7	32.5	100.0	16.4	12.7	100.0

Source: Bank of Slovenia

3.2 Forms of household financial assets

Decline in household assets in 2008 due to the effect of financial turmoil.

Household financial assets increased by 3.8% in 2008. This small increase compared with previous years is partly a reflection of lower current household investments, and primarily the result of a negative value changes. Household financial assets increased by EUR 0.5 billion in value over the first nine months of 2008. Current household investments stood at EUR 1.8 billion, down slightly on the same period last year, while losses due to value changes reached EUR 1.3 billion.

Money invested in equity and investment fund units had a decisive effect on the low growth in household financial assets. Both current investments and the value of the existing portfolio had an impact on the decline in this portion of assets. Households made a net withdrawal from these investments due to huge losses on the stock markets, while remaining assets lost value. The result of these two negative flows was a decrease in the value of investments in equity and investment fund units of EUR 1.8 billion over the first nine months of the year. It is estimated that the accelerated adverse developments on the stock exchanges in the final quarter of 2008 contributed to a further drop in the value of this portion of investments of EUR 2 billion, which would take the total stock of household financial investments at the end of 2008 below the level recorded at the end of 2007.

Table 3.4: Stock of household financial investments by instrument in EUR million

	2004	2005	2006	2007	2008[1]
			(EUR million)		
Total	25,982	28,307	32,016	37,416	37,952
Growth rate (%)	13.8	8.9	13.1	16.9	3.8
As % of GDP	96.0	98.6	103.3	108.5	102.7
Monetary gold					
Cash and deposis	12,995	14,248	15,495	17,089	18,919
Bank deposits	10,041	10,651	11,448	12,540	13,492
Securities other than shares	744	512	491	449	477
Loans	626	885	838	859	876
Shares and other equity	6,759	6,906	8,147	10,384	9,611
Investment fund shares/units	1,549	1,828	2,461	3,440	2,391
Life insurance	920	1,137	1,448	1,695	1,743
Pension insurance	386	510	643	815	888
Other technical reserves	565	633	655	652	769
Other claims	1,437	1,648	1,837	2,034	2,277

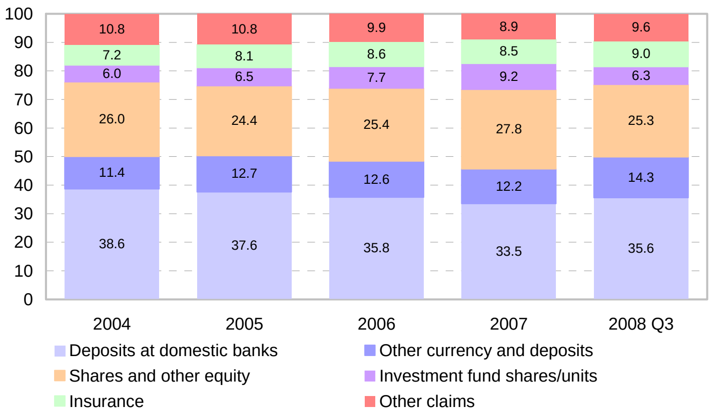
Note: [1] Figures for September 2008.
Source: Bank of Slovenia

All other forms of investment were up as a proportion of total household assets owing to the aforementioned large falls in investments in shares and investment units. There were no notable shifts in the sample of household behaviour. Deposits at the domestic banks grew at the same pace as 2007, when inflows into mutual funds were at their peak. The flight from higher-risk forms of investment has not yet brought about a shift to safer investments.

The flight from higher-risk investments has not yet been reflected in an increase in safer forms of investment.

In 2008 life and pension insurance rose at a slower pace than in previous years. These types of insurance do not account for a significant proportion of household financial investments.

Figure 3.9: Breakdown of household financial investments by instrument in percentages



Source: Bank of Slovenia

The effects of the turmoil to date in the financial and real sectors have had a greater impact on household financial assets than on access to financing or borrowing. As a consequence, net household financial assets decreased by EUR 600 million over the first nine months of 2008 to EUR 26.7 billion, or 72.4% of GDP, down 7 percentage points on the end of 2007.

Net household assets declined to 72.4% of GDP.

Table 3.5: Stock of net household investments at banks (financial accounts) in EUR million

	2004	2005	2006	2007	2008[1]
			(EUR million)		
Liabilities	3,619	4,480	5,558	6,965	7,820
Growth (%)	18.9	23.8	24.1	25.3	18.4
Investments	10,189	10,798	11,611	12,929	13,792
Growth (%)	7.6	6.0	7.5	11.4	11.2
Net investmets	6,570	6,318	6,053	5,965	5,972
As % of GDP	24.3	22.0	19.5	17.3	16.2

Note: [1] Figures for September 2008.
Source: Bank of Slovenia

In September 2008 net household assets at banks were at a level similar to 2007. Though somewhat higher than in the preceding period, growth in bank deposits in the last two years was still outpaced by growth in loans. However, the growth rates had converged by February 2009 due to the rapid decline in lending. Net savings at banks were equivalent to 16.2% of GDP, down 1 percentage point on 2007.

Interest rates on household deposits at banks

Banks implemented a more active interest-rate policy in the long-term household deposit segment.

After difficulties in securing funding emerged, banks began implementing a more active interest-rate policy to attract household assets. Interest rates on deposits of more than 1 year have significantly exceeded the comparable interest rates in the euro area since the middle of 2007. In summer of 2008 interest rates on household deposits had yet to reach the level of the EURIBOR, but have substantially exceeded that level in recent months. There was a notable increase in the spread between individual banks' interest rates, particularly in the long-term deposit segment.

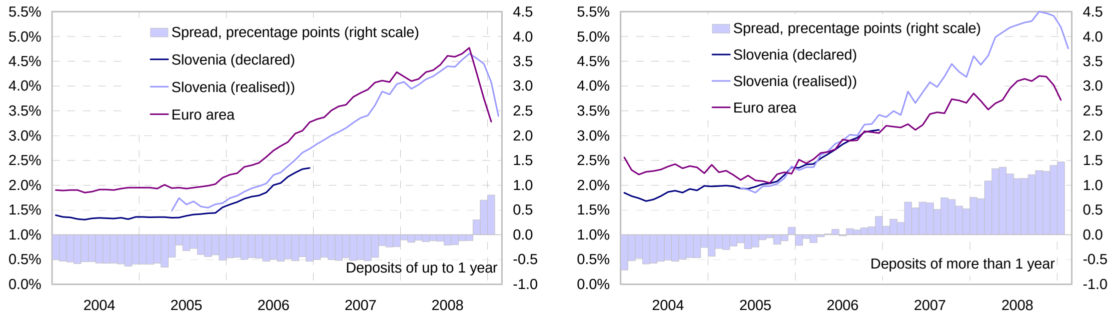
The spread between domestic and euro area interest rates also began to widen on short-term deposits.

The Bank of Slovenia's interest rates on short-term deposits did not vary significantly from the euro area average throughout most of 2008. The spread did not begin to widen until the final months of 2008. In this period there was a more notable widening in the spread in interest rates between individual banks.

The maturity breakdown of household bank deposits is lengthening.

Household deposits overall did not grow faster than in 2007 in the context of such incentives. There was, however, a change in the maturity breakdown of these deposits. The proportion of sight deposits declined by 5 percentage points, to 38.3%, as a result of more favourable nominal, and in particular, real interest rates on time deposits, and the decision of households to maintain a portion of their assets at banks rather than assume the greater risks associated with investments on the stock markets.

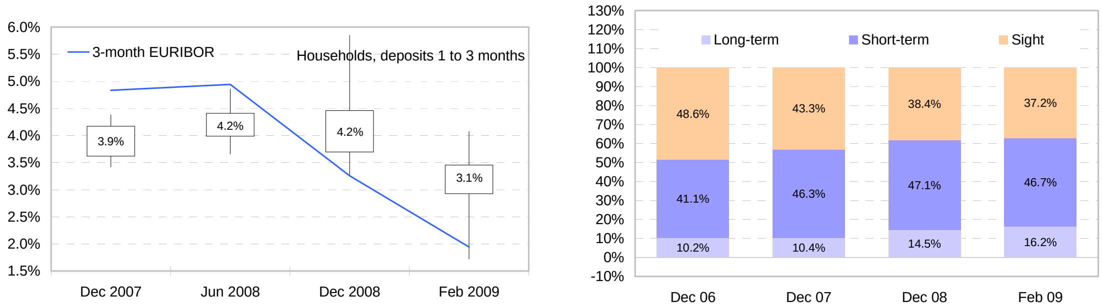
Figure 3.10: Comparison of Slovenian interest rates on deposits of up to 1 year (left) and more than 1 year (right) with euro area interest rates in percentages



Note: The figures for realised deposit rates in Slovenia are available from May 2005. The spread before this date has been calculated from declared interest rates.
Source: Bank of Slovenia

Longer-term deposits are increasing as a proportion of time deposits. Time deposits of more than 1 year were up more than 50% in 2008, accounting for 23.6% of all time deposits at the end of 2008 compared with 18.3% at the end of 2007.

Figure 3.11: Distribution of interest rates on household deposits (left) and maturity breakdown of household deposits (right)



Source: Bank of Slovenia

In the bank deposit segment, favourable changes are taking place primarily with regard to lengthening maturities, while there has been no notable acceleration in bank deposit growth. This is to be expected given that there was reversal in the assumption of risks by households in 2008, which was reflected in an almost complete flight from high-risk financial investments.

3.3 Real estate market

Decline in advertised housing prices at the end of 2008.

Growth in the transaction prices of housing slowed in the first half of 2008. This was to be expected given the above-average growth recorded in recent years. Last year growth in the transaction prices of housing in the Ljubljana urban region slowed sharply. Growth in prices in the rest of Slovenia, which follows the Ljubljana urban region with a delay, was considerably lower than in recent years. Growth in average advertised prices of housing stalled in 2008, the prices of smaller flats having recorded a decline. Increased segmentation of prices between new builds and existing housing units can be expected in the future, with regard to year of construction, quality, and distance from city centres and motorways. There is also little likelihood of a more significant fall in the prices of new housing, this being prevented by rising construction costs and the fact that investors have placed newly constructed housing on the rental market. Given the volume of real estate transactions in 2008, which was down more than 50% on 2007, and slowing growth in prices, it can be concluded that supply reached demand. A reversal of the business cycle on the real estate market remains highly likely, meaning the end of a period of several years of growth.

A significant fall in prices on the supply side could result in the recovery of the real estate market. To date there has been no need on the part of sellers to respond to the sharp fall in the number of transactions with a more pronounced cut in prices. It is therefore possible to conclude that there are reserves in the construction sector owing to labour market flexibility and in the ability to delay the start of projects is greater than the financial figures from this sector suggest. Although the price responsiveness on the supply side of the real estate market is low, in part due to an expected time delay, it gives rise to the question of the level of competition on the real estate market. The need to decrease selling prices will rise in the context of the continuing economic crisis and the low number of transactions on the real estate market. Construction companies' primarily have to ensure the necessary cash flows to regularly repay bank loans and settle liabilities to subcontractors with an adequate level of sales, supported by appropriate price flexibility, albeit at the cost of falling profits.

Published growth rates of Slovenian real estate prices

Publication of real estate price indices by SORS and SMARS.

In October 2008 SORS announced that the prices of existing flats and family houses were down 2.6% on average in the first half of 2008, relative to average 2007 prices. Flats were still 4.7% more expensive on average. However, according to a SORS study, the prices of family houses were down 17.1% on average over the first six months of the year. The index was calculated according to the so-called hedonic method. The hedonic method of time-dummy variables was used in 2007, while the hedonic method of characteristics price indices was used in the first half of 2008. In its analysis for the first three quarters of 2008, the SORS announced in December 2008 that the prices of used housing were up by an average of 4.1% on average 2007 prices. Annual indices, calculated from the average of quarterly indices, were published in April 2009. According to the SORS figures, annual growth in used housing prices was between 15.6% and 22.6% in the period from 2005 to 2007, and just 3.1% in 2008.

Table 3.6: Year-on-year growth in transaction prices of housing in percentages

(%)	Slovenia BS	Slovenia SORS	Slovenia flats SORS	Slovenia flats GORS	Slovenia houses GORS
2005	10.3	12.3	15.6		
2006	14.0	15.5	17.6		
2007	23.4	22.9	22.6		
2008	4.3	-1.6	3.1	5.3	-7.1

Sources: Bank of Slovenia, TARS, SMA, SORS

In its 2008 interim report, the Surveying and Mapping Authority of the Republic of Slovenia (SMARS) announced that housing prices were up 10% in the first half of 2008 compared with the final quarter of 2007, while its report for the fourth quarter of 2008 reported annual growth of 5.3%. SMARS calculates the average quarterly prices of flats, and one- and two-family dwellings, according to price and analytical regions, as the arithmetic mean of unit transaction prices of real estate in a given quarter.

Transaction prices of housing and growth rates calculated from the Fischer index

Annual growth in transaction prices of housing has fallen.

According to the Bank of Slovenia's calculations, growth in transaction prices of housing in Slovenia stood at 4.3% in 2008. Year-on-year price growth was down notably last year, both in the Ljubljana urban region[5] and in the rest of Slovenia. Transaction prices of housing were down 3.1% in the first quarter of 2009.

Table 3.7: Year-on-year growth in transaction prices of housing in percentages

(v %)	Slovenia	Ljubljana urban region	Ljubljana city	Ljubljane surroundings	Rest of Slovenia	Euro area[1]
2005	10.3	8.8	10.6	4.5	11.1	7.6
2006	14.0	13.5	14.0	12.2	14.3	6.5
2007	23.4	15.6	17.4	12.5	26.5	4.4
2008	4.3	4.1	3.0	6.5	4.3	2.7
Q1 2009	-3.1	-6.6	-7.7	-4.8	-1.9	-

Note: [1] Estimate based on available figures. Figures for 2008 relate to the first half of the year.
Sources: TARS, SMA, Bank of Slovenia, ECB

Narrowing gap in housing prices between Ljubljana and the surroundings.

In regional terms, the gap between prices in the Ljubljana urban region and the rest of Slovenia is narrowing, primarily owing to relatively high growth in real estate prices in the rest of the country in the last two years.

Table 3.8: Regional differences in housing prices[6]

	Slovenia	Ljubljana urban region	Ljubljana city	Ljubljane surroundings	Rest of Slovenia
2004	100	141	154	107	78
2005	100	145	158	112	77
2006	100	143	155	111	78
2007	100	141	160	114	82
2008	100	139	154	117	83
Q1 2009	100	140	153	120	85

Sources: TARS, SMA, Bank of Slovenia

Advertised prices of housing

Advertised prices of larger dwellings in Ljubljana stagnated, while those of smaller housing units were down in 2008. Annual growth in advertised prices of three-room flats in Ljubljana was almost unchanged at the end of 2008, while the prices of one-room and two-room flats were down 2% and 3.1% respectively. Advertised prices of studio flats were down 4.4%. In 2008 the gap between advertised prices of larger dwellings between Ljubljana and the surroundings was lower than the average gap of the last four years.

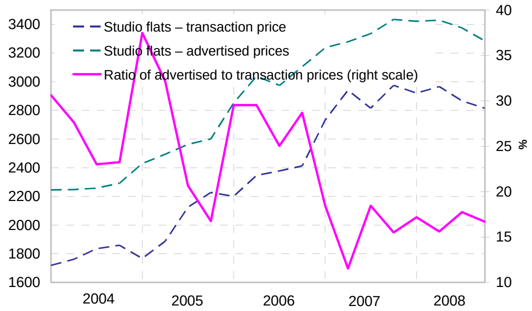
[5] The geographical breakdown of transaction prices of housing was made in line with level 2 statistical regions (NUTS 2), where the Ljubljana urban region is the same as the Central Slovenia level 3 region, and the rest of Slovenia comprises the 11 other level 3 regions. The Ljubljana urban region is then further divided into the city of Ljubljana and the surroundings.

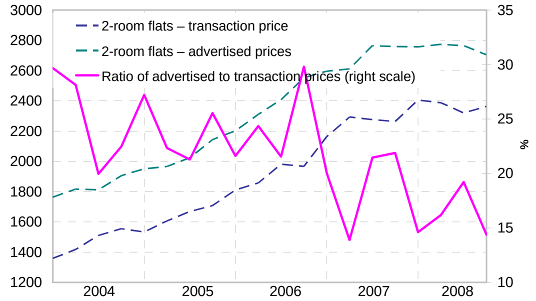
[6] The regional differences in price levels are calculated from the weighted average of transaction prices in each year.

The narrowing gap by which advertised prices exceed transaction prices points to an easing of housing prices.

The gap by which advertised prices exceed transaction prices in Ljubljana in relative terms is narrowing. In 2006 advertised prices were 27.3% higher on average than transaction prices, the gap falling to 15.9% in 2008. The narrowing gap is at least partly a reflection of the diminished expectations of economic entities regarding rising prices, compared with recent years.

Figure 3.12: Ratio of advertised prices to transaction prices per m^2 in Ljubljana for studio flats (left) and two-room flats (right)

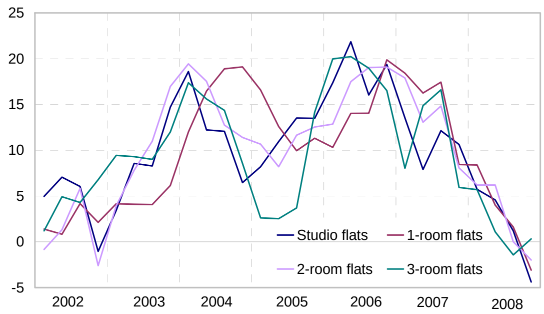


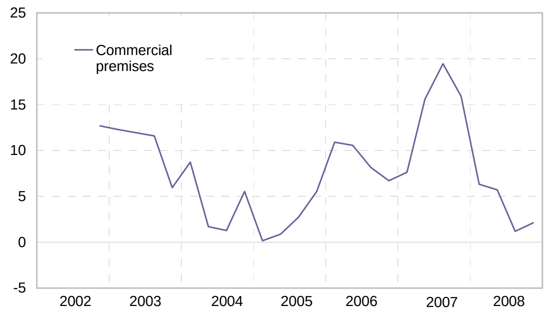


Sources: TARS, SMA, SLONEP

Following an increase in the prices of commercial premises of 15.9% in 2007, these prices were up more than 2.1% in 2008. Rents for commercial premises were unchanged. Owing to the increased supply of rented commercial premises in Ljubljana and the drop in average advertised prices, it can be concluded that companies that do not require narrowly specialised equipment are increasingly opting to rent commercial premises. This is more favourable in terms of taxes, and a rational decision in the context of higher interest rates on bank loans. The renting of commercial premises during time of turmoil can be advantageous, as it permits increased flexibility of operations.

Figure 3.13: Year-on-year growth in advertised prices of housing (left) and commercial premises[7] (right) in Ljubljana in percentages





Sources: SLONEP, own calculations

Price sustainability

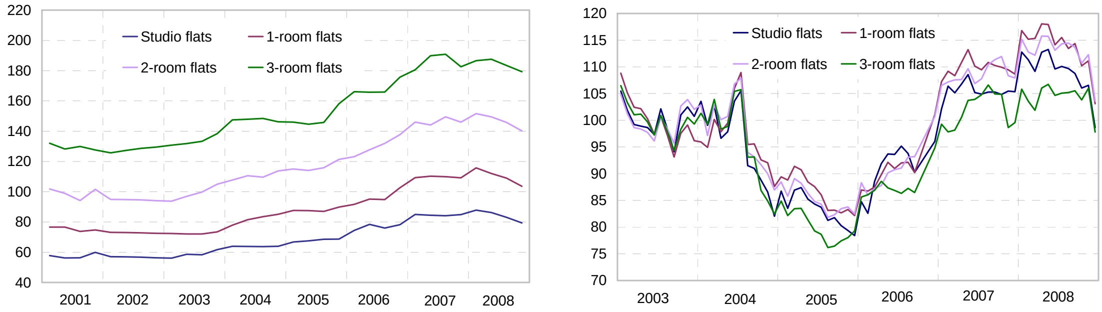
The sustainability of housing prices is a reflection of the ratio of actual prices to fundamental prices, i.e. the prices justified on economic and institutional grounds. Three indicators of price sustainability on the real estate market in Ljubljana are given, namely the ratio of housing price to average net monthly wages, the housing affordability index, and the ratio of housing prices to rents, based on which the fundamental price of housing is calculated.

Increased housing affordability owing to higher net wages and lower transaction prices.

Housing affordability, as expressed by the ratio of housing prices in Ljubljana to the annual moving average of monthly net wages, increased in 2008. The calculation takes into account advertised prices, which fell in the second half of the year. The rise in average net wages by 8.2% also facilitated affordability. At the end of 2008 the purchase of studio flats, one-room flats and two-room flats required between 5.5 and 6 average net monthly wages less than in the final quarter of 2007, while purchasing a three-room flat required 3.3 average net monthly wages less.

[7] Prices for office space in Ljubljana were used to calculate the growth rate.

Figure 3.14: Ratio of housing prices to annual moving average of net monthly wages in Ljubljana[8] (left) and housing affordability index (2003 = 100) (right)



Sources: Bank of Slovenia, SLONEP, SORS, own calculations

Actual housing affordability, which in addition to movements of housing prices takes into consideration conditions in the housing loan market, increased slightly. The housing affordability index,[9] which is expressed as the ratio of monthly loan repayments to net wages, decreased due to falling housing prices and rising net wages. The largest increase in affordability was recorded for studio flats (up 6.4%) and for one-room and two-room flats, up 5.1% and 4% respectively. Affordability for three-room flats was up 1.8%.

Banks tightened lending terms and credit standards for housing loans.

Lending terms for new housing loans tightened in 2008. Banks require greater participation on the part of buyers for the purchase of real estate, and a detailed project plan with a projected timetable for realisation from investors. The tightening of credit standards in the context of high construction activity in the past, which was triggered by several years of high growth in prices, could translate into falling transaction prices.

Rising interest rates on variable rate housing loans were 82 basis points higher in October 2008 than at the end of 2007, but were down 15 basis points annually to 6.3% in December on account of the lower EURIBOR.

The rate at which average growth in rents in Ljubljana outpaced growth in housing prices in 2008 was higher relative to 2007, as reflected in a decline in P/E ratios on all housing other than studio flats. In the current market conditions, buyers who purchase real estate as an investment receive between 4.7% and 5.7% of money invested via rents in a one-year period.

The overpricing of larger dwellings in Ljubljana diminished.

Following a long period of growth, the ratio of actual prices to fundamental prices declined in 2007, signalling a diminishing in the overvaluation of housing. This process continued in 2008 with a brief pause in the first half of the year. Housing prices in Ljubljana are still not justified by fundamentals, which explains the current low liquidity on the real estate market. This is particularly true for smaller dwellings.

According to the Real Estate Institute[10] the price per square metre of a flat in Ljubljana based on a purchase price calculation amounts to around EUR 1,890. In addition to construction, fitting and installation costs, the calculation includes landscaping costs, municipal fees and land costs,[11] as well as 8.5% VAT and a 10% gain for the investor. As there is no official record of new housing prices in Slovenia, an average price is given of EUR 2,680 per square metre for older housing in Ljubljana, according to the SMARS figures at the end of 2008.

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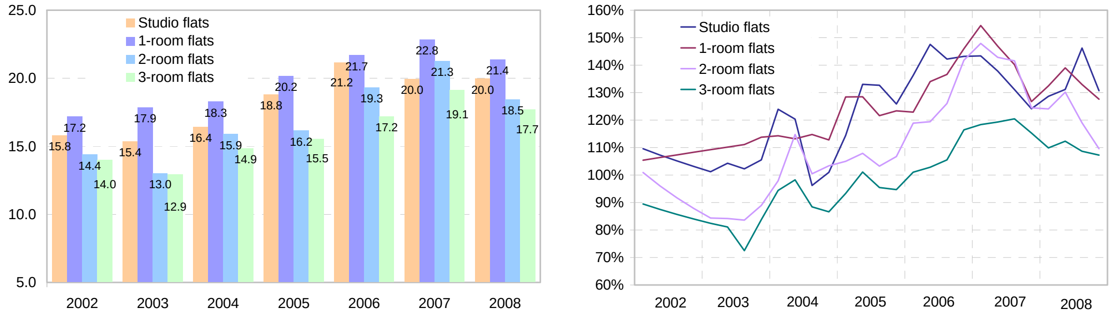
[8] In calculating the ratio of housing prices to average monthly wages, advertised housing prices were reduced differently by individual year: by 20% prior to 2007, by 15% in 2007 and by 10% in 2008. Average transaction prices were lower than advertised prices by the aforementioned percentages in a given period. The gap varies from quarter to quarter, for which reason the calculated affordability can also differ from the actual affordability.

[9] It is assumed in the calculation that the full value of the real estate is financed via a housing loan from a bank. In the calculation of the index, the monthly annuity for a loan in the amount of housing value is first computed on the basis of the interest rates and the weighted average maturity of new housing loans in a particular month. The next step is to calculate the ratio of the monthly annuity to the 12-month moving average of net monthly wages in Ljubljana, from which the basic index is then calculated. A rise in the index reflects a decline in housing affordability.

[10] Source: Real Estate Institute: Housing market in Slovenia, February 2009.

[11] The calculation takes into account the average value of an empty lot in Ljubljana of EUR 300 per m^2.

Figure 3.15: Ratio of housing prices to rents (P/E) (left), and ratio of actual prices to fundamental prices of housing in Ljubljana on this basis[12] (right)

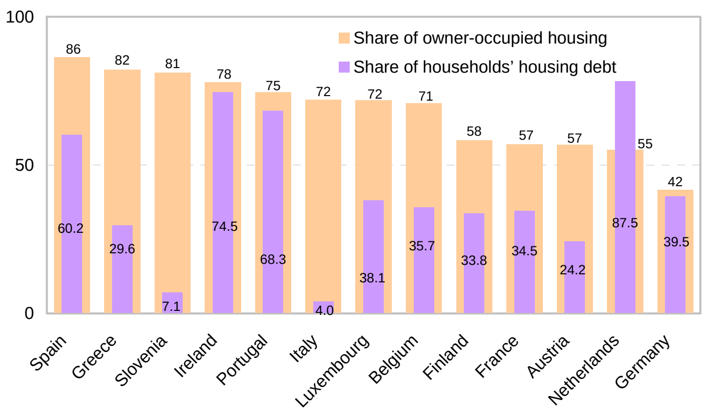


Sources: SLONEP, own calculations

The real estate market in EU Member States varies in terms of housing ownership. Mediterranean countries are characterised by a high percentage of privately owned housing, with Slovenia at the top of the list. On the domestic market there is an insufficient number of non-profit rented housing, which is important for the long-term sustainability of housing prices. Countries with a lower level of ownership can limit possible unjustified growth in prices by increasing the supply of rented housing during a period of above-average growth in housing prices. Thus a sufficient supply of rented housing could be an important factor in preventing a real estate bubble.

Slovenia has a high percentage of privately owned housing. Rented housing is an important factor in preventing real estate bubbles.

Figure 3.16: Proportion of privately owned housing and housing debt as a proportion of total household debt in 2007 in percentages



Source: ECB

The lower housing debt as a proportion of total household debt in Slovenia compared with other countries is the result of the method by which social housing was privatised in the 1990s. Also affecting the low level of debt in recent years were holdings in financial assets, an integral component of which were the relatively high capital gains achieved in 2006 and 2007.

Factors in real estate prices

In contrast to the escalation of the financial turmoil on developed financial markets, problems in Slovenia first began on the capital market, as a result of developments in the rest of the world. The adverse effects then passed through to other segments, including the real estate market. In the last year the value of household assets has declined by one-third owing solely to the drop in the value of investments in shares and investment funds. Following several years of growth, capital losses slowed real estate purchases in 2008. At the same time, interest rates on bank loans have risen in the context of tightened lending

The effects of the turmoil on the capital market have had an adverse impact on the Slovenian real estate market.

[12] The calculation of fundamental housing prices on the basis of the ratio of housing prices to housing rents (P/E) takes into consideration the average P/E value between 1995 and 2003. A more accurate calculation of the fundamental price would require the calculation of the average P/E ratio over a longer, more stable period of at least 10 to 15 years. The short time in which the Slovenian housing market has functioned normally makes this impossible. These limitations must be borne in mind when interpreting the results, although over a longer timeframe a lower average P/E ratio would be anticipated, and housing would appear to be even more overpriced according to this indicator.

terms. The majority of purchases in the last year were aimed at resolving housing problems, while there were fewer purchases of housing as investments, and fewer speculative purchases. This has led to a further decline in transactions on the real estate market.

According to some indicators, supply has outstripped demand for real estate, thus extending the time required for sales. An additional supply of completed new builds can be expected in the short term given the number of building permits issued in recent years. On the other side, household financial liabilities have increased.

Supply-side factors

Construction activity is declining.

Owing to the large number of dwellings under construction, the supply of housing could respond to lower demand and negative economic expectations through the extension of deadlines for the completion of started projects, the lowering of selling prices and a decline in construction activity. The response of investors was seen back in the first half of 2008 when the number of building permits issued was down 21.4% on the same period in 2007, and down 17.3% overall for the year. Construction activity is also declining in several European countries. In 2008 there were 27.9% fewer building permits issued in Portugal than in 2007, 26.8% fewer in Denmark, 17.7% fewer in France and 5.1% fewer in Germany. According to the first available figures, only the Czech Republic recorded an increase (of 5.8%) in the number of building permits issued.[13]

Table 3.9: Completed dwellings, building permits issued and gross investment in housebuilding

	2002	2003	2004	2005	2006	2007	2008
	Estimate of housing stock						
Number of dwellings[1]	730,064	736,420	743,133	750,355	757,522	765,552	
Number of dwellings per 1,000 inhabitants	366	369	372	375	374	378	
	Completions including extensions and change od purpose						
Number of new dwellings	7,265	6,567	7,004	7,516	7,538	8,357	
Number of new dwellings per 1,000 inhabitants	3.6	3.3	3.5	3.8	3.8	4.1	
Floor area (m^2)	824,608	746,517	761,430	807,607	860,537	928,941	
	Building permits issued						
Number of dwellings	5,080	6,122	7,002	7,235	8,463	10,204	8,442
Floor area (m^2)	597,366	711,385	793,200	880,751	1,028,024	1,127,420	975,251
	Supply of the Housing Fund of the Republic of Slovenia (HFRS)						
Number of dwellings deliveres	76	59	160	353	453	685	35
Proportion of new dwelling (%)	1.0	0.9	2.3	4.7	6.0	8.2	
	Gross investment in residential buildings						
Growth rate (%)	5.9	-0.1	20.8	21.7	18.6	18.8	9.8
As % of GDP	3.1	2.9	3.2	3.7	4.0	4.3	4.3
	Growth rate (%)						
Construction costs - new housing[2]	4.5	6.6	11.7	3.0	4.6	4.2	4.4
Material costs			14.7	1.0	5.5	2.8	3.8
Labour costs			4.4	8.4	2.5	8.0	5.8

Notes: [1] Housing stock includes occupied and temporarily unoccupied dwellings for permanent use.
[2] Costs of construction, finishing and installation work on new housing, excluding land costs.
Sources: SORS, HFRS, own calculations

Financial leverage increased in the construction sector in 2007. Financial and operating liabilities were four times higher than the value of equity. Corporate liquidity has deteriorated on account of a freeze in housing sales and a lack of payment discipline, which could trigger a fall in prices.

Growth in the costs of constructing new residential buildings other than land costs stood at 4.4% in 2008. Material costs contributed most to the relatively high growth in construction costs on account of rising commodity prices. Rising construction costs are preventing a more significant fall in real estate prices, despite a declining number of transactions.

The real estate market can be expected to segment further in the future. There is little likelihood of a sharp fall in new housing prices, as their growth is being driven by

[13] Source: Provisional Eurostat figures.

construction costs alone. At the same time, investors have entered the rental market as providers of newly built housing. The gap between new and older housing prices has risen with regard to the functional distribution of living space, urban development and quality.

Demand-side factors

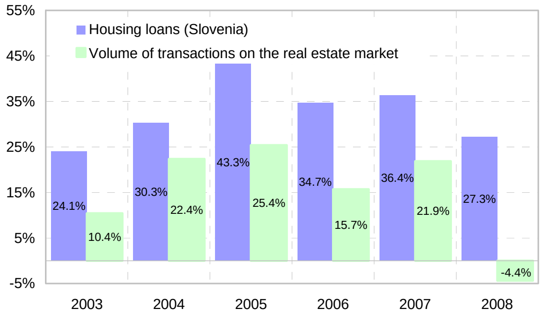
Despite a real increase in wages, the decline in the value of newly approved housing loans in the second half of the year had an adverse effect on demand for housing in 2008.

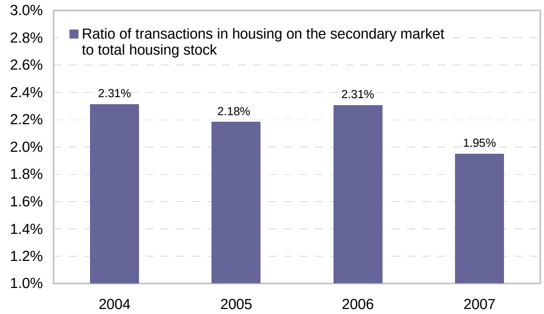
Growth in new housing loans is declining.

Year-on-year growth in housing loans was down 9.1 percentage points, compared with 5.4 percentage points in the euro area overall.[14] Household financial liabilities are continuously rising, albeit at a slower pace, growth reaching 19.5% in year-on-year terms.[15] Rising household debt is reducing their creditworthiness.

There was a notable decrease in the amounts of new housing loans towards the end of 2008.[16] The annual total of new loans in the amount of EUR 1,004 million, down 2% on 2007, was achieved primarily on account of the exceptionally high lending in March and April 2008. New housing loans accounted for 55.2% of the estimated volume of transactions on the secondary real estate market by households.

Figure 3.17: Year-on-year growth in the stock of housing loans and growth in the volume of real estate transactions by households[17] (left) and ratio of transactions in residential real estate to housing stock (right)





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

The spread between interest rates in Slovenia and the euro area on housing loans widened at the end of 2008. In November the spread reached 140 basis points, and then narrowed to 120 basis points in December, up 10 basis points on the end of 2007.

Loans tied to the Swiss franc are more expensive due to the appreciation of this currency.

Alongside interest rate risks, households also assume currency risks on their loans tied to the Swiss franc. This, in the context of the Swiss franc's annual appreciation of 11% against the euro, was reflected in a heavier loan repayment burden on household income and an increase in debt measured in euros. The heavier debt repayment burden due to the Swiss franc's appreciation was partly offset by a lower interest rate at the end of 2008.

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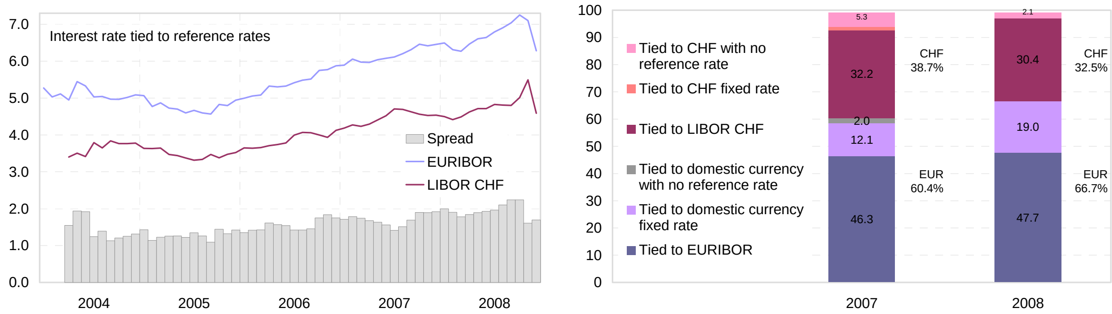
14 Source: ECB
15 Figures for the third quarter of 2008.
16 In the euro area overall, the repayment of housing debt outstripped the amount of new housing loans by EUR 38.4 billion in the final quarter of 2008. Source: ECB.
17 The volume of transactions on the real estate market is estimated on the basis of the figures for payments of 2% real estate sales tax made by private individuals. It is the seller of the real estate that customarily pays the tax. Sales of new real estate are not included. Henceforth the volume of transactions on the real estate market refers to the volume generated by households.

Figure 3.18: Interest rates on housing loans (left) and prevailing types of interest rate on new housing loans (right)



Source: Bank of Slovenia

An increase in premiums over reference interest rates.

The premiums over the reference interest rates for housing loans have increased this year. In December 2008 the premiums over the EURIBOR were up 54 basis points on the end of 2007, while those over the LIBOR were up 130 basis points. The average LTV ratio on new housing loans decreased from 60.5% at the end of 2007 to 52.0% at the end of 2008.[18]

Fewer purchases by non-residents on the real estate market.

Demand from non-residents for housing was down more than one-third in 2008 from the previous year. Despite significantly fewer purchases, the proportion of total purchases accounted for by non-residents was up owing to inactivity on the real estate market.

Table 3.10: Breakdown of non-residents' purchases of real estate by tax office[19]

	Structure (%)								Number of purchases by non-resid.	Proportion in all purchaese (%)
	Celje	Koper	Kranj	Ljubljana	Maribor	Murska Sobota	Nova Gorica	Other		
Jul-Dec 2004	6.5	26.0	11.1	5.9	7.7	21.4	10.8	10.6	443	-
2005	4.0	16.4	18.5	6.1	6.7	18.4	14.3	15.6	642	3.9
2006	5.5	20.7	12.8	4.7	4.2	16.9	20.3	14.9	740	4.2
2007	7.0	22.5	11.5	4.2	4.9	19.5	16.6	13.8	730	4.9
2008	7.0	25.8	7.2	8.5	4.7	19.7	15.7	11.4	472	6.6

Sources: TARS, SMARS, own calculations

Institutional factors in real estate prices

A reduced VAT rate of 8.5% on new housing purchases is valid in Slovenia until 2010. Owing to social and economic conditions, discussions are taking place at the EU level to maintain the lower tax rate on the construction, renovation and maintenance of structures that are not subject to social policy. Instead of increasing tax rates, a decrease in rates is more likely in several EU Member States.

Stiff standards regarding the energy efficiency of buildings will result in the differentiation of market prices of real estate.

In September 2008 two new regulations entered in force, completing the transposition of the European directive on the energy efficiency of buildings into the Slovenian legal system. The regulation on the promotion of efficient energy use and use of renewable energy sources and the regulation on efficient use of energy in buildings lay down standards and the potential availability of funding for achieving energy efficiency in buildings during construction. One standard entails ensuring that a minimum of 25% of energy used in buildings comes from renewable sources. There was a considerable tightening of standards for the construction of new buildings and for major renovations of existing buildings with regard to the insulation, heating, ventilation, cooling, air-conditioning, and hot water and lighting fixtures in buildings. The new guidelines are expected to result in a 10% increase in new build costs.

Purchase of housing as an alternative to financial investments

Negative annual return on the purchase of a flat in Ljubljana via a loan.

In 2008 returns on investments in housing in Ljubljana declined in the context of investing own funds. The purchase of housing via a loan no longer results in gains. However, in 2008 it still proved to be relatively stable investment compared with investments in securities on the capital markets. Uncertainty regarding the future

[18] Estimate of LTV ratio from a sample of survey figures of 19 banks, compared with 18 banks in 2007.
[19] The numerator includes all purchases by non-residents, irrespective of the type of real estate, while the denominator includes all purchases of housing in the specific period at the tax office in question.

development of real estate prices, and increased volatility and price corrections on the capital markets following the outbreak of the financial turmoil increased the appeal of saving in the form of long-term bank deposits in 2008.

Table 3.11: Return[20] on investments in housing in Ljubljana allowing for loan repayment and comparison of return on investments in housing with other forms of financial investments[21] in percentages

(%)	Purchase of housing with loan	Investing own funds: Housing	Capital market indices: SBI 20	Capital market indices: VEP MF	Deposit rate[1]
2003	19.0	30.3	17.7	17.1	7.8
2004	11.7	19.8	24.7	17.8	4.5
2005	13.9	19.1	-5.6	7.2	3.3
2006	19.1	25.0	37.9	18.8	3.4
2007	6.0	13.1	78.1	28.0	3.9
2008	-3.4	3.5	-67.5	-42.8	5.2
	Average annual return				
2003 – 2008	11.4	18.5	14.2	7.7	4.7

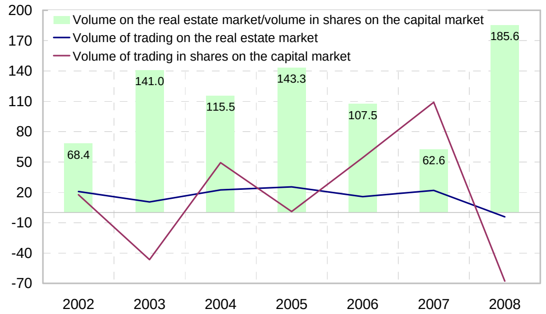
Note: [1]Average annual interest rate for deposits of more than 1 year. Prior to the end of 2005 the figures for interest rates on tolar deposits are tied to the tolar indexation clause, but from 2006 the figures are for euro deposits.
Sources: SLONEP, Bank of Slovenia, SORS, LJSE, Vzajemci.com, own calculations

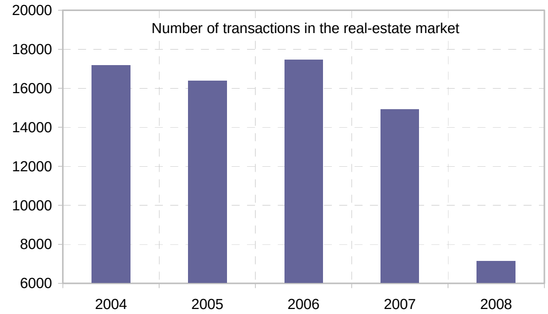
Poor liquidity on the real estate market

The number of transactions on the real estate market was down sharply in 2008.

The volume of household transactions on the real estate and capital markets were down owing to the uncertainty on the capital markets. The ratio of household transactions on the real estate market to the volume of trading in shares on the Ljubljana Stock Exchange increased as a result of the relatively large fall in the volume of trading in equities, which was down more than two-thirds in year-on-year terms.

Figure 3.19: Year-on-year growth in volume of trading on the capital market and volume of transactions on the real estate market, and ratio of volumes in percentages (left), and estimated number of transactions on the real estate market (right)





Sources: TARS, SMARS, LJSE, own calculations

Following above-average returns on the capital markets in 2007 when capital gains passed through to the real estate market, last year's negative returns had a notable affect on the volume of real estate transactions. Growth in loans for the purchase of real estate is not expected to increase significantly, at least for some time, due to unfavourable lending terms, currency risk tied to loans in foreign currencies, and the high level of own funds in the value of a real estate purchase. Uncertainty regarding the continuation of the financial turmoil is also contributing to the passivity of households.

[20] All returns are before tax.
[21] Calculations are for a 60m^2 flat in Ljubljana. The calculation of return uses the price of the flat at the beginning of the year in question. For the purchase of the apartment via a loan the LTV ratio is assumed to be 100%, while the return is calculated under the assumption that the loan is repaid early when the flat is sold at the end of the year in question. Rents have been included alongside capital gains as income. The return on the investment of the buyer's own funds in a flat includes the increase in the value of the flat and rental income.

Table 3.12: Changes in households' time deposits and alternative financial investments, volume of transactions on the real estate market, and changes in the stock of housing loans

	2003	2004	2005	2006	2007	2008
			(EUR million)			
Change in stock of household time deposits excluding sight deposits	257	538	-424	163	1,177	1,301
Change in stock of household financial assets[1]	2,569	3,257	1,982	3,779	5,373	1,333
Turnover in shares on the capital market	623	931	941	1,451	3,035	980
Turnover on the real estate market	879	1,075	1,348	1,559	1,900	1,818
Change in the stock of housing loans	151	235	439	464	781	727
			Growth rate (%)			
Household time deposits excluding sight deposits	5.0	9.9	-7.1	2.9	20.6	18.9
Household financial assets[2]	12.9	14.5	7.7	13.6	17.0	3.7
Turnover in shares on the capital market	-46.4	49.4	1.0	54.3	109.1	-67.7
Turnover on the real estate market	10.4	22.4	25.4	15.7	21.9	-4.4

Notes: [1] The change for 2008 has been calculated from the values at the end of the third quarters in 2008 and 2007.
[2] Year-on-year growth for 2008 relates to the end of the third quarter.

Sources: Bank of Slovenia, TARS, LJSE, own calculations

4 CORPORATE SECTOR

4.1 Corporate financing and net debt

The turmoil spread from the financial sector to the real sector in 2008.

The financial turmoil, which initially affected financial institutions and significantly hindered the supply of funding, spread to the real sector at the end of the year. The Slovenian economy recorded negative growth in the final quarter of 2008. Forecasts of a continuing decline in economic activity in 2009, primarily due to a further drop in investment and export demand, and historically low business and consumer confidence indicate that lower demand for corporate financing will have a greater impact on the amount of corporate financing in the future than the supply of financing by financial intermediaries.

Current corporate financing was down in 2008, driven by the escalation of the financial turmoil and the crisis in the real sector. The sharpest drop was recorded by corporate financing at banks, which was replaced by increased business-to-business financing and financing from the rest of the world. Maturities on banks loans are shortening, particularly on those to SMEs, in the context of rising needs for financing on account of the urgent increase in the promotion of sales via the financing of customers. The structure of corporate financing has deteriorated sharply due to developments on the financial markets. The debt-to-equity ratio deteriorated from the previous year, and is higher than in the majority of euro area countries. The commercial risk faced by corporates is rising, as they are forced to adapt their business policies to maintain operating activities at the expense of medium-term development.

Corporate financing flows

Corporates offset the decline in bank lending by raising loans in other sectors.

After nearly doubling in 2007, current corporate financing was down 0.5% over the first three quarters of 2008. At 72.6% (up 1.2 percentage points on the same period in 2007), loans still account for a prevailing and growing proportion of corporate financing. The recent escalation of the financial turmoil has resulted in significant changes to the breakdown of loans by sector.

Table 4.1: Flow of corporate financial liabilities by institutional sector in EUR million

	2004	2005	2006	2007	2008[1]
			(EUR million)		
Total	1,314	4,583	4,797	9,237	6,547
Growth in financial flows (%)	-57.4	248.8	4.7	92.6	-0.5
Slovenia	583	3,764	3,755	7,731	5,432
Growth in financial flows (%)	-76.8	545.8	-0.2	105.9	-2.3
Corporates	-1,094	1,092	1,061	3,455	1,782
Banks	1,423	1,891	2,347	4,037	2,973
Non-monetary financial institutions	164	196	265	397	527
Governmenr	65	-88	58	-169	-39
Households	26	673	23	11	189
Rest of the world	731	819	1,042	1,506	1,114
Growth in financial flows (%)	27.5	12.0	27.2	44.6	9.3
			Structure (%)		
Slovenia	44.4	82.1	78.3	83.7	83.0
Corporates	-83.3	23.8	22.1	37.4	27.2
Banks	108.3	41.3	48.9	43.7	45.4
Non-monetary financial institutions	12.5	4.3	5.5	4.3	8.1
Governmenr	4.9	-1.9	1.2	-1.8	-0.6
Households	1.9	14.7	0.5	0.1	2.9
Rest of the world	55.6	17.9	21.7	16.3	17.0

Note: [1] First nine months.
Source: Bank of Slovenia

Loans remained the prevailing form of corporate financing in 2008.

Current corporate financing via bank loans was down 16.5% in year-on-year terms over the first three quarters of 2008. In the context of a sharp decline in their most important source of financing, corporates succeeded in maintaining relatively favourable economic growth by offsetting insufficient resources by borrowing in other sectors. In particular, business-to-business lending and the raising of loans in the rest of the world were up 63% and 71% in year-on-year terms respectively. Corporates also increased their borrowing from non-monetary financial institutions by just under one-third.

Business-to-business lending as a proportion of total current corporate financing via loans rose to 16.7% over the first three quarters of 2008, nearly double the amount in 2007. The proportions of loans from non-monetary financial institutions and the rest of the world rose to 11.2% and 11.7% respectively, at the expense of a decline of 13.5 percentage points in the banking sector's proportion to 59.7%.

Table 4.2: Corporate financing flows via loans and trade credits in EUR million

			Period Q1 - Q3	
	2006	2007	2007	2008
		(EUR million)		
Loans	3,032	6,162	4,696	4,753
- business-to-business	50	538	487	793
- bank	2,276	4,514	3,400	2,839
- non-monetary financial institution	510	596	410	532
- rest of the world	209	469	327	557
Trade credits	1,343	1,931	1,129	1,001
- business-to-business	846	1,179	643	347
- rest of the world	461	614	368	507

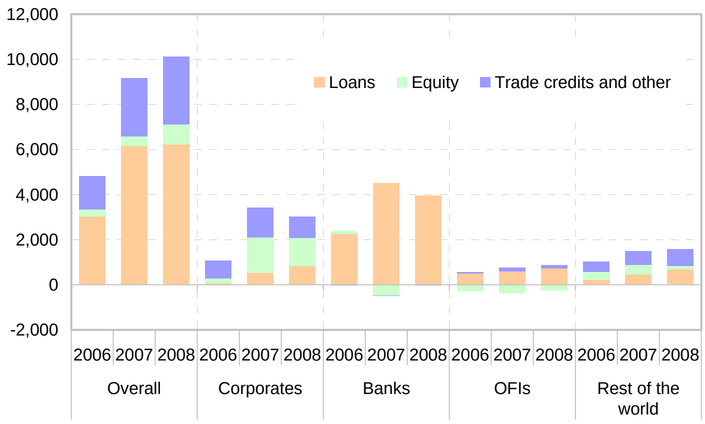
Source: Bank of Slovenia

The sustainability of the change in the breakdown of corporate financing indicated by the September 2008 figures in the coming period is uncertain. Corporates and non-monetary financial institutions were faced with a further deterioration in liquidity in the final months of 2008, which will reduce their ability to provide financing. In the third quarter the stock of corporate loans by non-monetary financial institutions was already lower than in the first two quarters. Corporates will likely be forced to secure new sources of financing by increasing trade credits from suppliers, and by seeking other sources of financing, such as commercial paper.

The costs of corporate financing via banks are rising due to the rapid fall in inflation.

Rising interest rates on bank loans in real terms also contributed to the search for alternative sources of financing and lower corporate demand for bank loans. The price of these loans was down in nominal terms in the final months of the year owing to measures taken by the ECB, but fell at a significantly slower pace than inflation, which contributed to a notable rise in real interest rates in the second half of 2008.

Figure 4.1: Flows of corporate financing by creditor sector and prevailing instrument in EUR million



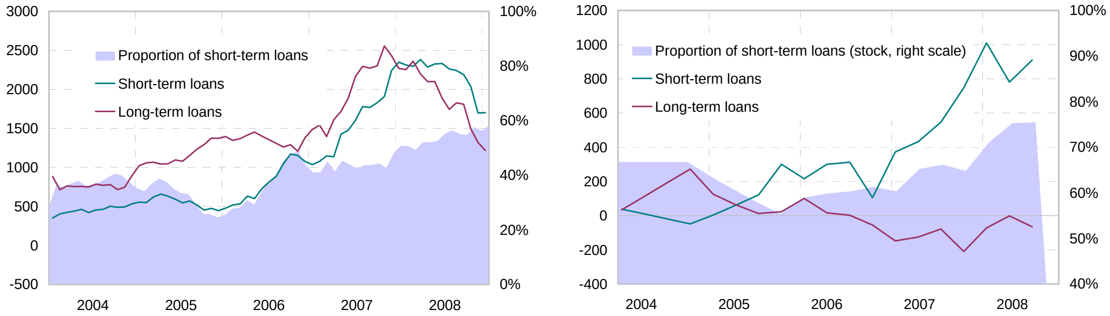
Note: Figures for 2008 are for the last four quarters (Q4 2007 to Q3 2008).
Source: Bank of Slovenia

The financial turmoil has also been seen as a decrease in corporate financing via purchases of corporate equity.

Despite the sharp increase in business-to-business financing via loans in 2008, total financing within the corporate sector lost several structural points compared with 2007. The major factor in this change was the lower volume of transactions in corporate equity, which in 2007 was largely the result of extensive M&A activities. The drop in activity on the stock exchange in 2008 resulted in a drop in the volume of transactions in equity, both between Slovenian corporates and from the rest of the world. Thus the proportion of total corporate financing accounted for by non-residents' equity purchases fell from 4.6% to

0.7%, while the proportion of equity transactions between corporates was down from 17% to 9.3%.

Figure 4.2: Corporate borrowing at domestic banks (12-month moving sums; left) and at other corporates (3-quarter moving sums; right) in EUR million



Source: Bank of Slovenia

Shortening of financing maturities at banks and between corporates.

The increased restrictiveness of banks with regard to corporate financing is evidenced by a limited supply of loans and the shortening of their maturities. The proportion of short-term loans has been rising since the final months of 2007, partly as a result of the financing of corporate M&A activities via short-term loans. The trend of shortening of maturities continued in 2008: in the final quarter only 44% of current corporate financing was accounted for by long-term loans, a drop of 12 percentage points compared with 2007. In contrast to 2007, the shortening of loan maturities was a consequence of banks' refinancing difficulties in the rest of the world via long-term sources. With the escalation of the crisis in the real sector, an additional factor in the shortening of maturities was uncertainty in assessing the long-term creditworthiness of corporates. Nearly all of business-to-business financing via loans, as a replacement for the loss of financing at banks, is short-term. Shorter financing maturities combined with extended payment terms for customers and at suppliers contribute to the deepening of corporate liquidity problems, and profoundly limit the normalisation of their operating activities.

The decline in banks' lending activities hit smaller sectors the hardest.

More difficult access to bank loans has affected individual sectors to varying degrees. In smaller sectors, such as information and communication and miscellaneous business services, growth in loans fell below 10%, a drop of more than 40 percentage points relative to 2007. A sharp drop in growth in loans was also seen in the electricity, gas and water supply sector and the financial intermediation sector. In 2008 growth in loans in the construction sector was still among the highest recorded, but recorded a sharp drop in the final quarter. Construction is one of the sectors that will be hit hardest by the economic downturn, as seen in early 2008 when figures began to indicate a considerable drop in the number of building permits issued.

Table 4.3: Corporate financing via bank loans by sector

	Outstanding amount of loans at year-end			New short-term loans				
	Annual growth rate; %			Share of short-term loans			Change	
	2006	2007	2008	2007	2008	Q4 2008	2008	Q4 2008
Agriculture, mining	15.2	21.8	22.2	82.5	64.7	77.8	-17.7	13.1
Manufacturing	20.1	18.1	20.2	71.1	82.2	82.0	11.2	-0.3
Electricity, gas and water	13.9	62.4	10.1	67.7	61.8	74.3	-5.9	12.5
Construction	48.6	61.9	28.1	69.8	79.6	81.5	9.8	1.9
Trade	8.4	24.8	20.2	70.9	83.8	82.1	12.8	-1.6
Transportation and storage	24.6	29.1	19.4	49.1	58.1	59.7	9.1	1.6
Hotels and restaurants	22.8	25.7	27.3	44.4	69.2	64.6	24.8	-4.6
Information and communication	31.0	49.9	5.2	74.3	90.0	91.0	15.8	1.0
Financial and insurance activity	30.9	68.9	14.1	73.8	90.2	93.6	16.4	3.4
Real estate activities	103.1	54.3	24.5	57.0	66.1	60.6	9.1	-5.5
Professional scientific and technical activities	33.2	51.9	7.9	61.8	76.3	77.4	14.5	1.1
Public services	42.5	40.9	38.5	30.4	62.3	58.1	31.9	-4.1
Total	23.8	34.9	19.1	67.9	80.5	81.3	12.6	0.8

Source: Bank of Slovenia

A sharp drop in growth in corporate lending at banks is also present in the real estate sector, where year-on-year growth in loans was halved in 2008 relative to a year earlier. According to the figures for the end of 2008, the decline in banks' lending activity has not yet had a significant impact on the sectors of manufacturing, trade, hotels and restaurants or public services.

The shortening of loan maturities was most evident in the hotels and restaurants and public services sectors in 2008.

The shortening of loan maturities, as a consequence of the tightening of financing conditions at banks, has affected all but two smaller sectors. Short-term loans as a proportion of all new loans exceeded 80% in 2008 compared with 68% in 2007. The maturities on new loans were shortened most on loans to corporates from the sectors of hotels and restaurants and public services. Short-term loans as a proportion of all new loans exceeded 90% in the information and communication, financial and insurance sectors, an increase of 16 percentage points on the previous year. A sharp increase in short-term financing was also seen in the trade sector, where there is also a high "turnover" in loans owing to the nature of this sector. More notably than in other sectors, the decline in the proportion of long-term loans to corporates in the trade sector is reflected in an increase in the proportion of loans with a maturity of up to 3 months. Similar shifts in the maturity breakdown of bank loans can also be seen in the manufacturing sector, while the shift to shorter maturities was less evident in other sectors.

Table 4.4: Financing of small and medium-sized enterprises (SMEs) via bank loans by sector in EUR million

	Share of short-term loans in SME; %			Increase in share; percentage points		Difference relative to increase in share in total companies	
	2007	2008	Q4 2008	2008	Q4 2008	2008	Q4 2008
Agriculture, forestry, fising and mining	72.8	68.2	65.9	-4.6	-2.3	-	-
Manufacturing	64.0	77.1	77.9	13.1	0.8	1.9	1.1
Electricity, gas and water, envir. remediation	53.0	78.3	86.6	25.3	8.3	31.2	-4.2
Construction	60.4	73.0	76.9	12.6	3.9	2.8	2.0
Trade	65.0	82.2	78.9	17.2	-3.3	4.4	-
Transportation and storage	49.1	71.2	89.0	22.1	17.8	13.0	16.2
Hotels and restaurants	27.7	59.6	71.8	31.8	12.3	7.0	16.8
Information and communication	42.3	80.5	84.4	38.1	3.9	22.3	2.9
Financial and insurance activity	90.8	96.6	99.2	5.8	2.6	-10.6	-0.8
Real estate activities	56.5	75.6	70.9	19.1	-4.7	10.0	-
Professional scientific and technical activities	69.2	75.2	74.2	6.0	-1.1	-8.4	-
Public services	19.7	51.7	53.2	32.0	1.5	0.1	5.6
Total	64.3	79.2	79.6	14.9	0.4	2.3	-0.4

Source: Bank of Slovenia

SMEs were more affected by the shortening of loan maturities in 2008 than large enterprises.

Deteriorating financing conditions affected all corporates, regardless of size. Short-term loans account for a high proportion (80%) of all new loans to SMEs, and the increase is more notable than for corporates overall, by 15 percentage points. The shortening of maturities on new loans to SMEs was seen in almost all sectors in 2008. The proportion of short-term loans to this group of corporates was up sharply in the sectors of transport, hotels and restaurants, real estate, and information and telecommunications. In the majority of sectors, particularly in the aforementioned, the shortening of maturities was more intense for SMEs than for corporates overall. Since this is an economically weak group of corporates with limited negotiating power, the contraction of banks' lending activities affected them more than the large corporations.

Corporate financial liabilities

Corporate financial liabilities as a proportion of GDP were down due to changes in the value of equity.

The stock of corporate financial liabilities was up 4.4% in year-on-year terms over the first nine months of 2008, the smallest increase in the last five years. Alongside the smaller stock of current financing relative to the previous year, a major factor in the small increase were changes in equities, as a result of falling share prices. In the context of current corporate financing in the amount of EUR 6.5 billion over the first three quarters, the stock of corporate financial liabilities was up just EUR 1.8 billion at the end of September 2008. Negative values changes represent the difference. Corporate equity and debt were down 12 percentage points on 2007 at 243% of GDP, primarily owing to negative value changes.

Changes in the breakdown of corporate financial resources as a result of growth in the value of equity.

Equity remains prevalent in the breakdown of corporate financial resources, accounting for 43%, down sharply by 6.2 percentage points on 2007. Over the first nine month of 2008, equity was down EUR 4.6 billion, or slightly less than 11%.[22] The SBI stock market

[22] Financial assets and liabilities are disclosed in the financial accounts at market value. Listed corporate shares are disclosed at current market price as at the cut-off date, while unlisted shares

index lost an additional 40% of its value in the final quarter of 2008, which will further increase the overall drop in the value of equity for the year. Thus the stock of financial liabilities is expected to fall below the level recorded at the end of 2007.

Table 4.5: Stock of corporate financial liabilities by sector in EUR million

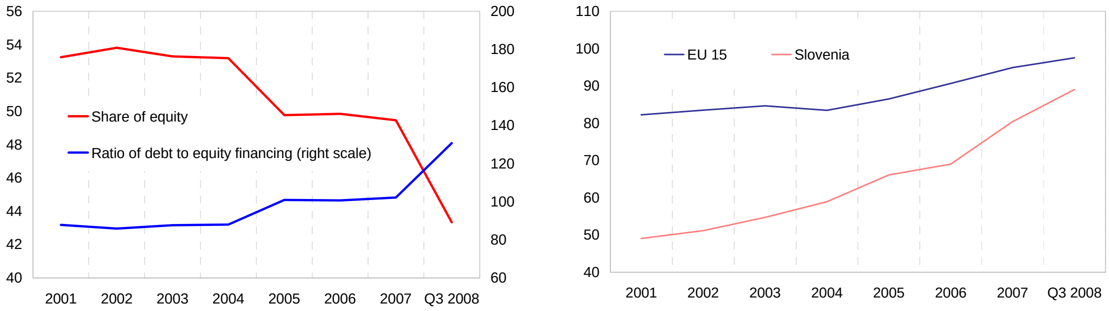
	2003	2004	2005	2006	2007	2008[1]
			(EUR million)			
Total	52,387	56,551	62,984	71,305	88,014	89,847
Growth rate (%)	10.4	7.9	11.4	13.2	23.4	4.4
As % of GDP	208.6	208.9	219.4	230.0	255.3	243.2
			Structure (%)			
Slovenia	82.3	82.5	81.2	82.3	83.6	82.7
Corporates	34.0	31.3	31.1	29.9	30.0	29.9
Banks	15.0	16.6	18.0	19.4	20.9	23.7
Bank loans	13.9	15.3	16.7	18.0	19.9	22.7
Non-monetary financial institutions	6.9	7.3	6.6	6.8	7.4	6.5
Government	12.5	13.3	11.9	12.5	12.3	10.0
Households	13.9	14.0	13.6	13.5	13.0	12.6
Rest of the world	17.7	17.5	18.8	17.7	16.4	17.3
Loans at foreign banks	3.0	2.6	2.3	1.7	1.5	1.6

Note: [1] September 2008.
Source: Bank of Slovenia

Sharp deterioration in the corporate debt-to-equity ratio.

The sharp falls in the value of equity in the context of slower growth in total corporate financial liabilities were reflected in a higher corporate debt-to-equity ratio.[23] This ratio rose from 102% at the end of 2007 to 131% over the first nine months of 2008, and will likely reach a significantly higher value by the end of the year. Such a sharp increase in corporate indebtedness will result in the deterioration of the credit ratings of individual corporates at banks, which will further limit possibilities for financing and increase the costs of already limited resources.

Figure 4.3: Increasing corporate debt-to-equity ratio (left) and rising corporate debt in Slovenia and the euro area as a proportion of GDP (right)



Source: Bank of Slovenia

Increase in the debt-to-equity ratio more pronounced in Slovenia than in the euro area.

The increase in the debt-to-equity ratio in 2008 was somewhat higher at Slovenian corporates (by 29 percentage points) than at euro area corporates (by 24 percentage points). In the context of a similar increase, there are differences in the magnitude of factors that impact this ratio. The fall in the value of equity had a greater impact on the increase in this ratio in the euro area than in Slovenia. The proportion of Slovenian corporates listed on the stock exchange is lower than in the euro area. Therefore, falls in the stock indices in Slovenia have less of an impact on the value of corporate equity: the value of corporate equity in the euro area fell by 19%, compared with a fall of just under 11% at Slovenian corporates. In contrast, increased borrowing had a more significant impact on the rising debt-to-equity ratio in Slovenia than in the euro area. In 2008 both factors contributed to a similar increase in this ratio, its level for euro area corporates being more favourable than in Slovenia, at 104.8%, owing to a higher proportion of equity in the breakdown of financing.

and other equity are disclosed at book value. In the context of a higher proportion of corporates listed on the stock exchange, the fall in value of equity valued as such would have been significantly higher, on average.

[23] The corporate debt-to-equity ratio calculated on the basis of national financial accounts statistics (source: Financial Accounts, Bank of Slovenia) differs from the value of corporate financial leverage by sector calculated on the basis of annual accounts (corporate asset balances) due to differences in the methodologies of valuation and corporate reporting.

Table 4.6: Stock of corporate financial liabilities by instrument in EUR million

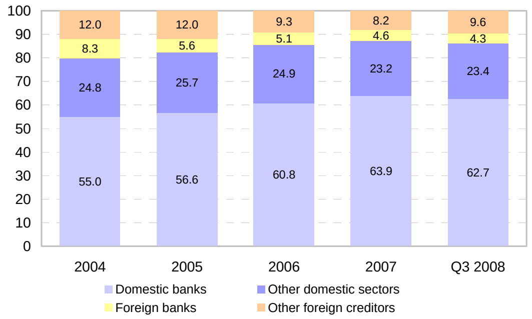
	2003	2004	2005	2006	2007	2008[1]
	(EUR million)					
Total	52,387	56,551	62,984	71,305	88,014	89,847
Growth rate (%)	10	7.9	11.4	13.2	23.4	4.4
Debt[2]	13,744	15,949	18,972	21,403	27,714	32,894
Growth rate (%)	16	16.0	19.0	12.8	29.5	25.4
As % of GDP	54.7	58.9	66.1	69.0	80.4	89.0
	Structure of financial liabilities (%)					
Structure of liabilities	100.0	100.0	100.0	100.0	100.0	100.0
Securities other than shares	0.4	0.6	0.8	0.7	0.7	0.7
Loans	25.8	27.6	29.3	29.3	30.9	36.0
Short-term	8.9	8.7	9.4	9.8	11.5	14.4
Long-term	16.9	18.9	19.9	19.5	19.4	21.6
Shares and other equity	53.3	53.2	49.8	49.8	49.5	43.3
Other accounts payable	20.4	18.6	20.1	20.1	19.0	19.9
Trade credits and advances	14.8	13.7	14.9	15.1	14.4	15.4
Other	5.6	4.9	5.2	5.0	4.5	4.5

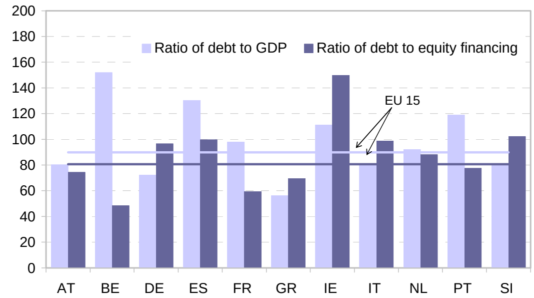
Notes: [1] September 2008.
[2] Debt includes loans, debt securities (excluding derivatives) and technical provisions, and in the Slovenian corporate sector practically consists solely of loans raised.
Source: Bank of Slovenia

The ratio of corporate debt to GDP in Slovenia is slightly below the euro area average.

Corporate debt, which is a narrower aggregate than total financial liabilities, reached 89% of GDP in 2008. As in previous years, euro area corporate debt is higher at 98% of GDP. However, with corporate borrowing rising faster in Slovenia, the gap is narrowing from year to year, having fallen from 22 percentage points in 2006 to 8.5 percentage points in the third quarter of 2008. Corporate indebtedness is higher in the majority of euro area countries than in Slovenia,[24] from 92% of GDP in the Netherlands to 152% of GDP in Belgium. Only in Greece is the debt ratio notably lower, at 56% of GDP. Comparisons of corporate indebtedness at the micro level with euro area countries are less favourable. The debt-to-equity ratio for Slovenian corporates is higher compared with the euro area average, and also compared with the majority of Member States, which indicates a capital shortage at Slovenian corporates compared with other Member States.

Figure 4.4: Breakdown of Slovenian corporate debt in percentages (left) and comparison of corporate indebtedness with the euro area in 2007 in percentages (right)





Source: Bank of Slovenia

Trade credits and non-residents' equity are growing in importance in the breakdown of debt to the rest of the world.

The proportion of total corporate financial liabilities accounted for by the rest of the world was up slightly less than 1 percentage point in 2008, to 17.3%. In 2008 corporates compensated for a portion of the shortage in financing at the domestic banks by increasing their long-term and short-term borrowing in the rest of the world. In contrast to previous years, when corporate borrowing in the rest of the world declined owing to favourable and competitive financing conditions in Slovenia, accessibility to loans became an important factor following the escalation of the financial turmoil, with corporates once again turning to the rest of the world in search of sources.

[24] Figures by country and comparisons with Slovenia are for 2007.

Corporate financial assets and net financial position

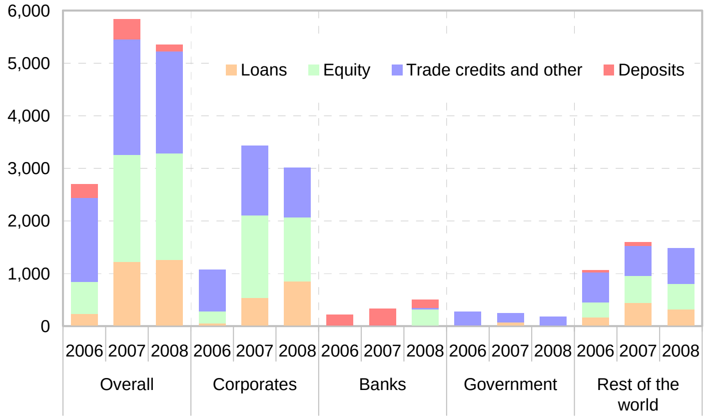
Corporate financial investments were down 12.9% in year-on-year terms over the first three quarters of 2008. The most significant drop was recorded by investments between corporates, which are also prevalent in the breakdown of corporate investments. Investments in other corporates, which reached their highest value in 2007 at EUR 3.5 billion and 59% of total corporate financial assets (primarily on account of corporate M&A activities), were halved in 2008, to EUR 1.8 billion. In particular, investments in corporate equity and trade credits granted were down, while the volume of loans to other corporates was up.

Corporate financial investments are declining due to fewer transactions between corporates in 2008.

By increasing investments in loans, corporates financed their own customers and thus promoted sales, which had begun to feel the effects of the decline in economic activity. In 2008 trade credits, which were nearly halved in year-on-year terms, were partly replaced by loans, at least at domestic partners. The stock of corporate loans, including loans to other sectors, accounted for nearly 26% of the stock of financial investments in 2008, compared with 21% in 2007.

Corporate investments in loans exceeded one-quarter of total financial investments in 2008.

Figure 4.5: Flows of corporate investment by creditor sector and prevailing instrument (transactions in EUR million)



Note: Figures for 2008 are for the last four quarters (Q4 2007 to Q3 2008).
Source: Bank of Slovenia

Corporate investments in the rest of world show a different trend to investments in the domestic sectors. There has been a notable decrease in short-term and long-term loans to the rest of the world, while the financing of customers via trade credits, particularly in countries outside the EU, is rising. An increase in the financing of customers in the rest of the world via trade credits can also be expected in the future, as a way to stimulate falling demand.

Table 4.7: Corporate financial assets, stock at year end in EUR million

	2003	2004	2005	2006	2007	2008[1]
			(EUR million)			
Total	29,334	29,766	34,314	37,715	45,416	47,860
Growth rate (%)	12.3	1.5	15.3	9.9	20.4	7.8
As % of GDP	116.8	110.0	119.5	121.6	131.8	129.5
			Structure (%)			
Slovenia	84.8	83.2	79.9	79.8	80.3	78.3
Corporates	60.8	59.4	57.1	56.6	58.1	56.2
Banks	11.5	11.8	11.4	11.2	10.1	10.3
Non-monetary financial instit.	3.4	3.7	3.4	4.1	4.8	4.1
Government	4.3	4.6	4.1	4.6	4.2	4.7
Households	4.5	3.7	3.7	3.2	2.9	2.9
Rest of the world	15.2	16.8	20.1	20.2	19.7	21.7

Note: [1] September 2008
Source: Bank of Slovenia

Corporate investments in non-monetary financial institutions have declined due to major losses on the financial markets. The shortage in corporate liquidity has also led to the withdrawal of corporate deposits from the domestic banks.

Corporates are decreasing their investments in non-monetary financial institutions and bank deposits due to liquidity problems.

Decline in the net corporate debt position by 10 percentage points, to 113.6% of GDP.

However, the stock of financial investments rose by 7.8% over the first nine months of 2008, which is lower than the growth recorded in 2007, but higher than the growth in financial liabilities. Thus the net corporate debt position declined in 2008, to stand at 113.6% of GDP at the end of the third quarter of 2008, down 10 percentage points on 2007.

The net debt position of euro area corporates stood at 89% of GDP in the same period. Euro area corporate indebtedness as a proportion of GDP was practically the same as in Slovenia, at 246%, while corporate financial investments in the euro area were significantly higher, at 157% of GDP, compared with Slovenia, at 129.5% of GDP. The net debt position of euro area corporates declined faster in 2008, primarily on the liability or financing side, down 30 percentage points of GDP, compared with just a 12 percentage point decline in Slovenia over the same period. This illustrates that euro area corporates were hit harder by the effects of the financial turmoil over the first three quarters of 2008, with regard to financial support for corporate economic activity.

Table 4.8: Net corporate financial liabilities, stock at year end in EUR million

	2003	2004	2005	2006	2007	2008[1]
			(EUR million)			
Total	23,052	26,785	28,670	33,590	42,598	41,987
Growth rate (%)	8.2	16.2	7.0	17.2	26.8	0.8
As % of GDP	91.8	98.9	99.9	108.3	123.6	113.6
			Structure (%)			
Slovenia	79.3	81.6	82.9	85.0	87.2	87.6
Banks	19.5	21.9	26.0	28.6	32.4	38.9
Non-monetary financial instit.	11.4	11.4	10.4	10.0	10.1	9.3
Government	22.9	22.9	21.3	21.4	20.9	16.0
Households	25.8	25.5	25.4	25.2	23.9	23.6
Rest of the world	20.7	18.4	17.1	15.0	12.8	12.4

Note: [1] September 2008.
Source: Bank of Slovenia

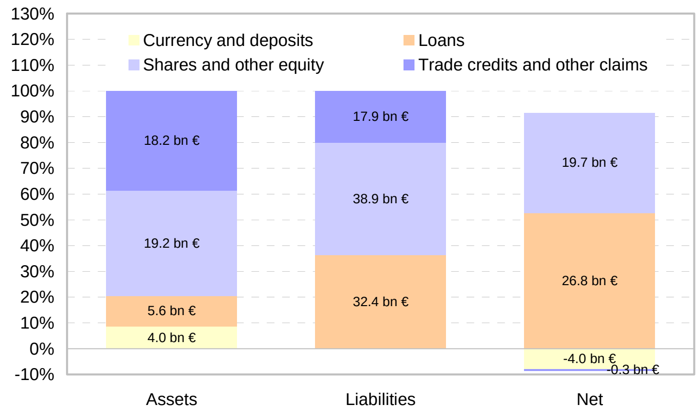
Lower net debt position against the general government sector and non-monetary financial institutions.

Compared with other sectors, the most notable decline was recorded in the net debt position against the general government sector, owing to the devaluation of its corporate equity holdings. The net debt position against non-monetary financial institutions is also more favourable, and to a lesser degree against all other sectors except the domestic banks.

Higher net debt position against the banking sector.

Despite the drop in financing via bank loans in 2008, net corporate indebtedness at banks, as a proportion of total net corporate indebtedness, was up 6.5 percentage points, to just under 39%. The lower growth in corporate financing via bank loans is still inappropriately higher than growth in financial investments at banks. Thus the stock of corporate deposits was up a meagre 0.6% in 2008, while debt at banks from loans was up 17.7%.

Figure 4.6: Breakdown of corporate assets and liabilities by instrument in percentages and amounts in EUR billion



Source: Bank of Slovenia

Table 4.9: Corporate loans and deposits at banks, stock at year end in EUR million

	Corporate borrowing at banks		Corporate	Net corporate borrowing at banks		
	Corporate loans		deposits			
	(EUR million)	(as % GDP)	(EUR million)	(EUR million)	Ratio	(as % GDP)
	(1)	(2) = (1)/GDP	(3)	(4) = (1-3)	(5) = (1/3)	(6) = (4)GDP
2002	5,353.2	23.1	2,524.4	2,828.8	2.1	12.2
2003	6,663.6	26.5	2,585.5	4,078.1	2.6	16.2
2004	8,087.0	29.9	2,654.6	5,432.4	3.0	20.1
2005	9,907.0	34.5	3,128.1	6,778.9	3.2	23.6
2006	12,364.1	39.9	3,341.1	9,022.9	3.7	29.1
2007	17,039.1	49.4	3,674.2	13,364.8	4.6	38.8
2008	20,055.1	53.4	3,696.8	16,358.3	5.4	43.5

Source: Bank of Slovenia

4.2 Interest rates and interest-rate risk for corporates

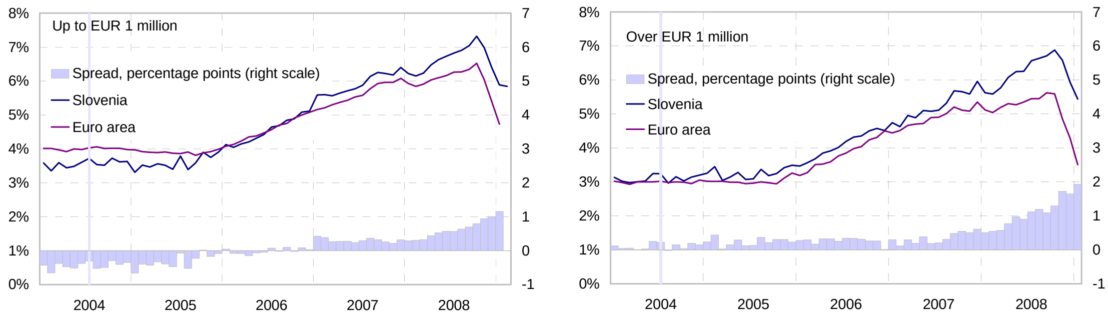
Interest rates on loans to corporates fell sharply in the final months of 2008. The fall in nominal interest rates was accompanied by an increase in premiums over the EURIBOR on new loans, which will increase the loan repayment burden on corporates in the future, given the prevailing proportion of loans with a variable interest rate. The increase in premiums over the EURIBOR is more pronounced for high-risk loans. Given that the proportion of high-risk loans will rise during the turmoil, growing difficulties in servicing corporate debt can be expected.

Lending rates for corporates

Several consecutive cuts in the central bank interest rate since October 2008 had the initial effect of a sharp nominal fall in lending rates. Interest rates at Slovenian banks fell less than in the euro area overall. In early 2009 the nominal interest rate on bank loans to euro area corporates returned to the level from the middle of 2006, and to the level from the middle of 2007 for Slovenian corporates.

Bank interest rates have fallen from October on, under the influence of ECB measures.

Figure 4.7: Interest rates on loans in Slovenia and in the euro area, and spread between them in percentage points



Source: Bank of Slovenia, ECB

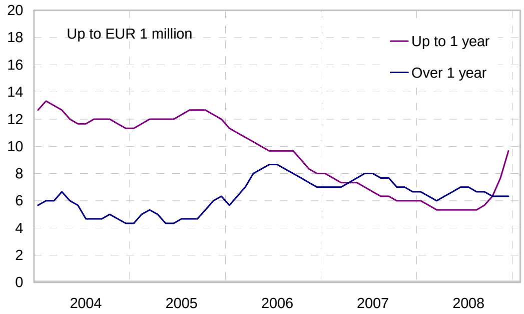
The spread between the corporate interest rates of Slovenian and euro area banks has widened gradually since the second quarter of 2008, and reached 1.2 percentage points at the beginning of January 2009. For large loans, divergence from the euro area began with the first signs of the financial turmoil in autumn 2007, and reached a higher level.

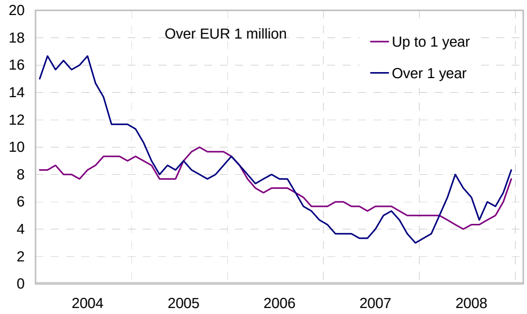
The spread between Slovenian and euro area interest rates widened in 2008.

The increasing spread in corporate interest rates between banks in Slovenia and the euro area is not particular to Slovenia alone. A sharp increase in the spread in interest rates began in the second half of 2008 across the euro area. Interest rates in Member States, which for a longer period demonstrated a trend of convergence, are once again diverging. The coefficient of variation increased sharply primarily for short-term loans to corporates and for large long-term loans.

The variability in interest rates between euro area countries is increasing.

Figure 4.8: Dispersion of corporate lending rates in Member States with regard to the euro area average, coefficient of variation expressed in percentages



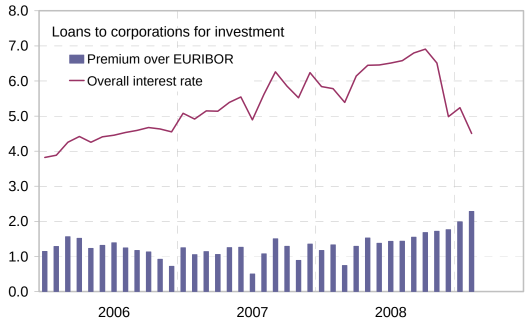


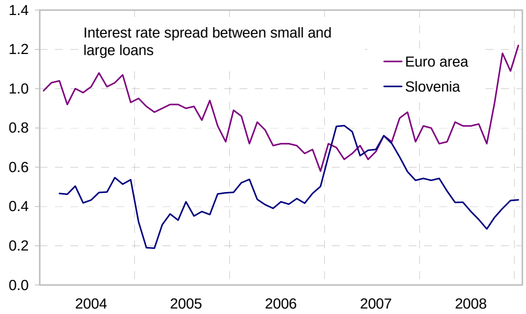
Source: ECB

In the final months of the year, interest rates on large loans fell faster, significantly faster in the euro area than in Slovenia.

The lowering of interest rates in the euro area varied in intensity, depending on the size of the loan. Interest rates on large loans fell faster than rates on small loans. The spread between interest rates on small and large loans rose from an average of 0.8 percentage points in October 2008 to 1.22 percentage points in January 2009. The differentiation in interest rates with regard to the size of a loan was less pronounced at Slovenian banks in this period.

Figure 4.9: Spreads in interest rates on corporate loans with regard to size of loan in percentage points





Sources: Bank of Slovenia, ECB

The sharp fall in nominal interest rates coincided with a significant drop in inflation in 2008. Real ex post interest rates on corporate loans rose in early 2009. Thus the fall in interest rates has no significant impact on easing the cost burden of corporate financing.

Rising premiums over the EURIBOR in the cost of a loan will increase the debt repayment burden in the future.

In the structure of interest rates, premiums over the EURIBOR have risen as this reference interest rate, which is a part of the majority of loan agreements at Slovenian banks, has been cut. The premium over the EURIBOR on corporate loans for investment rose by 0.6 percentage points to an average of 2 percentage points between summer 2008 and January 2009. The premium on short-term loans for current assets rose by 0.9 percentage points to 2.4 percentage points. Premiums generally represent the fixed portion of the cost of a loan, meaning an increase in the debt servicing burden for corporates in the future when the variable portion of the interest rate rises again from its current low level.

Interest-rate risk for corporates (proportions of fixed and variable remuneration)

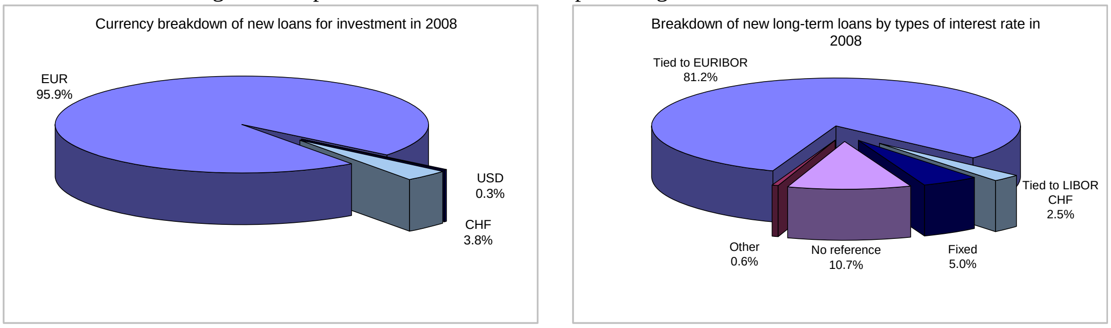
Decline in loans raised in Swiss francs, which resulted in diminishing currency risk for corporates.

Long-term corporate loans are most frequently raised in euros with the EURIBOR as the reference interest rate. Similarly to 2007, these types of loans accounted for 81.1% of all new long-term loans for investment in 2008. More significant changes have been seen in the type of interest rate on loans tied to the Swiss franc. The proportion of these loans fell from nearly 7% in 2007 to 3.8% in 2008, and they are mostly tied to the Swiss franc LIBOR (2.5% of all loans), and are also displaying a declining trend. In 2008 currency risk tied to these loans was realised, and their declining proportion is a reflection of a delayed awareness of this type of risk.

The shortening of loan maturities has resulted in an increase in the proportion of loans with a fixed interest rate.

Following a sharp decline in 2007, the proportion of new long-term corporate loans with a fixed interest rate doubled, to 5%. These loans also have a higher interest rate when raised compared with current variable interest rates.

Figure 4.10: Currency breakdown (left) and breakdown by type of remuneration (right) on long-term corporate loans from banks in percentages



Source: Bank of Slovenia

The breakdown of remuneration on short-term corporate loans did not change significantly from 2007. Only at the end of the year was there a notable increase in the proportion of new short-term loans with a fixed interest rate, from 33% on average for the year to 44% in the final quarter. The increase in these loans can be explained by the shortening of maturities on corporate loans, as loans with the shortest maturities mostly carry a fixed interest rate.

Table 4.10: Proportion of new corporate loans with a variable interest rate[1]

	2006	2007	2008	Q4 2008
		(%)		
Euro area	87.1	87.6	90.2	90.8
Under EUR 1 million	85.9	85.5	86.0	86.7
Over EUR 1 million	87.6	88.4	91.5	92.0
At domestic banks	97.2	99.2	99.2	98.7
Under EUR 1 million	97.3	98.1	98.4	97.9
Over EUR 1 million	97.1	99.6	99.4	98.9

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

Sources: ECB, Bank of Slovenia

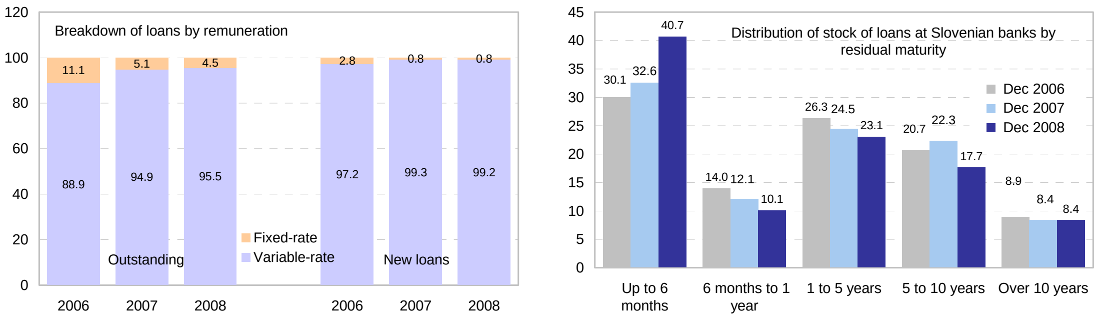
The proportion of loans with a fixed interest rate is higher in the euro area than at Slovenian banks.

In the euro area corporate loans with a fixed interest rate (regardless of loan maturity) represent 10% of all new loans. Their proportion decreased in 2008, particularly on large loans. By comparable methodology, loans from Slovenian banks with a fixed interest rate represent less than 1% of all new corporate loans, but are displaying a rising trend, in contrast to the euro area.

Loans are falling due for payment faster than a year earlier, aggravating corporate liquidity problems.

The liquidity problems faced by corporates are increasing owing to the shortening of corporate loan maturities. At the end of 2008, 40.7% of corporate debt to banks had a residual maturity of less than six months, a significant increase on the previous year when that proportion stood at 32.6%. The largest drop was recorded by loans with a maturity of between 5 and 10 years, the proportion of which fell from 22.3% to 17.7%.

Figure 4.11: Breakdown of corporate loans from banks by remuneration (left) and maturity (right) in percentages



Source: Bank of Slovenia

Premiums over the EURIBOR on loans with regard to debtor's credit rating

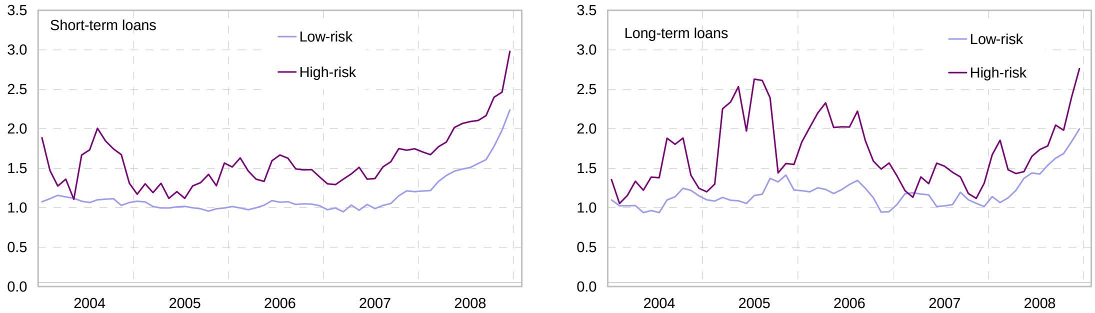
The financial turmoil is accompanied by rising premiums over the EURIBOR.

At the first signs of financial unrest in autumn 2007, banks responded by raising the risk premium on new loans. Risk premiums also rose in 2008 with the escalation of the financial turmoil. Rising premiums over the EURIBOR in the cost of loans is the result of banks' increasingly difficult access to funding, as well as the higher costs of the latter, and awareness of the higher risk associated with lending activity after the turmoil engulfed the real sector. The increase in premiums over the EURIBOR has affected not just high-risk loans, but also those that banks define as low-risk.

The accelerated raising of premiums is more pronounced for high-risk loans in the context of the escalating financial turmoil.

At the first indications of the turmoil in the final months of 2007, banks raised the premiums on short-term corporate loans by around 0.3 percentage points, and made a similar increase in the first half of 2008. There were no notable changes for long-term loans over the same period. Following the escalation of the financial turmoil in autumn 2008, the raising of risk premiums accelerated sharply on long-term loans, to a similar extent as those on short-term loans. Between summer of 2008 and January 2009, the premium over the EURIBOR rose by 0.6 percentage points on low-risk loans, and by 1 percentage point on high-risk loans.

Figure 4.12: Premiums over the EURIBOR for short-term (left) and long-term (right) euro-denominated corporate loans, by client credit rating (3-month moving average in percentage points)



Note: High-risk loans are those classified in credit rating categories C to E. Risk-free loans are those classified in credit rating categories A and B.
Source: Bank of Slovenia

Corporate loan repayment burden

Prior to 2008 the high level of indebtedness and rising interest rates did not result in a heavier corporate loan repayment burden. High economic growth and favourable operating results supported the rising level of indebtedness and facilitated the smooth servicing of debt. The first signs of the rising burden from rapid borrowing were seen in 2007 when corporate debt rose by 11 percentage points to 80.4% of GDP. Following several years of improvement or at least stagnation, indicators of the interest repayment burden deteriorated during the aforementioned year.

The interest burden increased most in the real estate sector, while a lesser increase was also seen in the majority of other sectors. According to bank surveys, the ratio of paid interest to total income rose by a further 0.1 percentage points in 2008, to 0.9% of total income.

Table 4.11: Indicators of corporate interest repayment burden

	2003	2004	2005	2006	2007
Ratio of interest paid to income	1.1	0.9	0.8	0.7	0.8
Ratio of net interest paid to net income	0.6	0.5	0.5	0.5	0.6
Agriculture, forestry, fising and mining	0.6	0.9	1.0	0.7	0.9
Manufacturing	0.6	0.5	0.4	0.5	0.5
Electricity, gas and water, environmental remediation	0.3	0.3	0.2	0.3	0.1
Construction	0.8	0.7	0.7	0.6	0.7
Trade	0.4	0.3	0.3	0.3	0.4
Transportation and storage	1.2	0.8	0.5	0.6	0.6
Hotels and restaurants	1.3	1.1	1.1	0.8	0.9
Information and communication	1.2	0.9	0.8	0.2	0.1
Financial and insurance activity	2.4	0.8	4.2	4.7	4.3
Real estate activities	2.5	2.1	1.9	2.5	3.0
Professional scientific and technical activities	0.9	0.8	0.7	0.7	0.8
Public services	0.5	0.5	0.5	0.5	0.6
Ratio of net interest paid to net profit	24.2	18.5	16.6	13.2	13.8

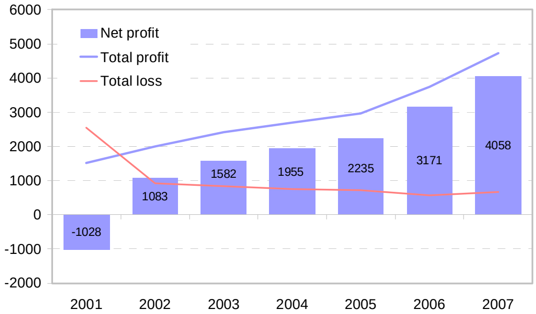
Sources: AJPES, own calculations

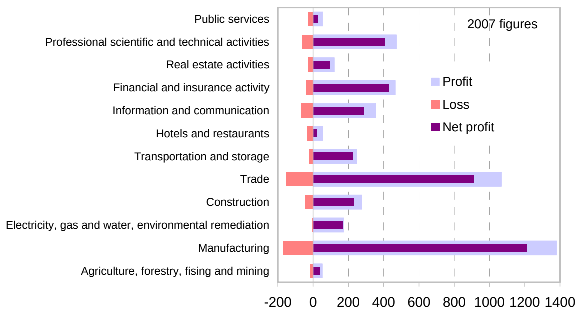
4.3 Corporate performance and risk by sector

Poor corporate performance in 2008 will be seen in a deterioration in operating results.

The latest corporate operating results from 2007 were still under the influence of the favourable economic climate. According to expectations, the consequences of the escalating turmoil in the real sector will be seen in the business reports for 2008. The sharpest drop in economic activity was felt by the manufacturing and construction sectors, where growth fell by around 10 percentage points between the third and fourth quarters.

Figure 4.13: Total profit/loss by year (left) and by sector (right) in EUR million





Sources: AJPES, own calculations

Net profit reached EUR 4 billion in 2007, up 28% on the previous year. Growth in profit at corporates with positive operating results reached 27%, similar to 2007, while losses increased by 21% at those with negative operating results. Growth in profit in 2008 is expected to be lower than that achieved in previous years. However, the drop will not likely be significant owing to the still-favourable economic activity in the first half of the year.

Poor corporate performance in 2008 will be seen in a deterioration in operating results.

The favourable economic growth in the years prior to the turmoil in the financial and real sectors was supported by growing corporate borrowing. The sectors that recorded the highest growth in net profit in 2006 and 2007 also recorded above-average growth in borrowing over the same period. This is particularly true for the construction sector and for the real estate sector, which is closely tied to the former. The financial intermediation sector stands out with regard to growth in borrowing and operating results in 2007.

Table 4.12: Corporate financial and operating liabilities by sector in percentages

	2004	2005	2006	2007	Growth rate (%) 2004	2005	2006	2007
Corporate financial and operating liabilities (EUR million)	31,965.8	36,375.1	40,858.3	51,139.1	14.0	13.8	12.3	25.2
	Structure (%)							
Agriculture, forestry, fising and mining	1.1	1.1	0.9	0.9	21.9	8.0	-5.5	17.6
Manufacturing	23.6	23.6	23.8	22.2	8.7	13.9	13.1	16.5
Electricity, gas and water, environmental remediation	6.3	6.0	5.9	5.6	3.5	8.3	11.7	18.8
Construction	7.3	7.6	8.6	9.7	18.0	17.5	27.3	41.9
Trade	23.1	22.5	21.1	20.3	16.7	11.0	5.3	20.5
Transportation and storage	16.9	16.1	15.7	14.9	12.9	8.2	9.9	18.5
Hotels and restaurants	2.1	1.9	2.0	2.0	28.3	3.6	21.9	25.3
Information and communication	4.3	3.7	3.4	3.7	11.1	0.1	3.2	33.6
Financial and insurance activity	3.7	5.8	5.4	6.7	36.6	76.9	4.9	56.6
Real estate activities	3.0	3.2	3.8	4.5	24.1	21.1	35.9	46.4
Professional scientific and technical activities	7.5	7.4	8.0	8.2	17.1	13.2	21.1	27.8
Public services	1.2	1.2	1.3	1.3	8.8	11.5	19.3	33.5
Total	100.0	100.0	100.0	100.0	14.0	13.8	12.3	25.2

Sources: AJPES, own calculations

High borrowing during a period of growth represents a dual burden for corporates during a period of economic crisis: first, owing to a rising debt servicing burden, which corporates repay from reduced income in a poorer economic climate; and second, due to the increased prudence of banks when financing highly indebted corporates, which hinders further operations and exacerbates liquidity problems.

Further deterioration in corporate liquidity is expected.

Short-term corporate liabilities have risen faster than short-term claims since 2004. The liquidity ratio fell from 82% in 2004 to 76.3% in 2007. The deterioration of the liquidity indicator is expected to accelerate further in 2008 due to the sharp shortening of maturities on corporate financing. One of the indicators of deteriorating corporate liquidity is the stock of past-due unpaid liabilities, which was already 70% higher than a year earlier at the end of 2008 and at the beginning of 2009. Corporates are also faced with increasingly longer payment terms for their customers, which is particularly true in relations between large corporates on one side and SMEs on the other. This has resulted in the deterioration of the quality of short-term claims required to cover the increasing stock of short-term liabilities due to shorter financing maturities.

Table 4.13: Maturity breakdown of financial and operating claims and liabilities in percentages

	2003	2004	2005	2006	2007
	Structure (%)				
Financial and operating claims					
Long-term	42.1	40.6	42.5	39.4	39.2
Short-term	57.9	59.4	57.5	60.6	60.8
Financial and operating liabilities					
Long-term	39.9	41.4	41.2	41.2	40.0
Short-term	60.1	58.6	58.8	58.8	60.0
	Ratio of claims to liabilities (%)				
Total	85.3	80.9	81.4	75.1	75.2
Long-term	90.0	79.3	83.9	71.7	73.7
Short-term	82.1	82.0	79.8	77.5	76.3

Sources: AJPES, own calculations

Risk indicators by sector

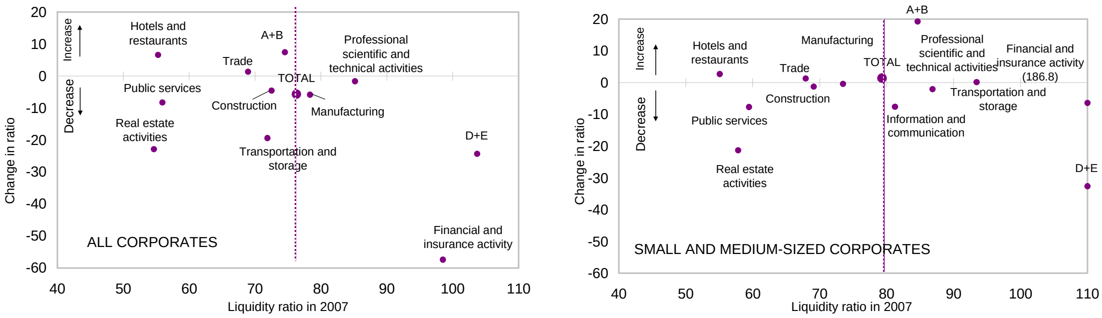
Liquidity ratio: current liquidity is lower than three years ago in the majority of sectors.

An examination of liquidity by sector for 2007 points to a continuing trend of deteriorating liquidity indicators in the majority of sectors. The major cause of this prior to 2008 was the increase in corporate financing via short-term resources. The most significant deterioration in liquidity in 2007 was recorded by corporates in the sector of electricity, gas and water supply. At the same time, this is the only sector that discloses full coverage of short-term liabilities by short-term claims.

A significant deterioration in liquidity over the last three years is seen at corporates in the real estate sector (by 27 percentage points) and in the transport and storage sector (by 19 percentage points). Corporates from the financial intermediation sector recorded the most notable deterioration in liquidity over the last three years, but solely due to the fall recorded in 2005, as there was no further deterioration in the two subsequent years.

The level of and changes in the liquidity of SMEs do not differ significantly in the majority of sectors from those of corporates overall. Major differences painting a more favourable picture for small enterprises are present in the transport and storage sector and in the financial intermediation sector. It is deterioration at larger corporates that primarily causes the overall deterioration in these sectors.

Figure 4.14: Liquidity ratios by sector and change in percentage points in the last three years



Note: A+B: agriculture, forestry, fishing and mining; D+E: electricity, gas and water supply, environmental remediation.
Sources: AJPES, own calculations

Financial leverage: financial and operating liabilities exceeded corporate equity by one-half.

Corporate financial and operating liabilities recorded high growth of 25% in 2007. Corporate financial leverage[25] increased further, reaching 151%. The highest level and largest increase in financial leverage in recent years were recorded by corporates in the construction sector, where financial and operating liabilities are 4 times in excess of equity. Financial leverage also increased sharply in the real estate sector. A high level of indebtedness is also displayed by corporates in the transport and storage sector. Indebtedness in the trade sector is slightly above average, but relatively stable. All other sectors are slightly below average in terms of the level of and increase in financial leverage, while none of these sectors recorded a decline in indebtedness in this period.

Table 4.14: Financial leverage by sector in percentages

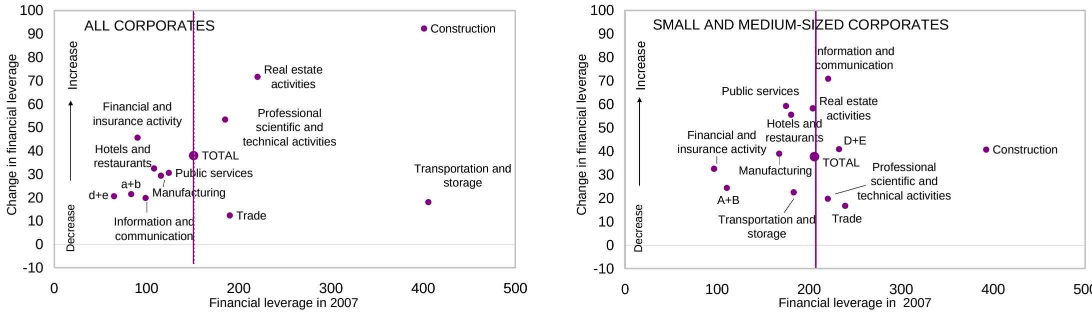
	All corporates				Small and medium-sized corporates			
	2004	2005	2006	2007	2004	2005	2006	2007
Financial leverage								
Agriculture, forestry, fising and mining	62.0	69.8	74.5	83.5	86.4	97.6	112.4	110.8
Manufacturing	86.3	91.6	104.2	115.7	128.7	136.4	154.7	167.6
Electricity, gas and water, environmental remediation	44.3	47.1	55.4	64.9	191.7	206.9	223.8	232.6
Construction	308.8	302.3	339.2	401.1	351.8	314.4	319.2	392.5
Trade	178.1	179.0	180.6	190.4	222.6	221.9	226.3	239.3
Transportation and storage	387.7	370.5	371.0	405.8	160.9	176.5	146.0	183.4
Hotels and restaurants	75.8	78.1	93.4	108.3	125.0	129.0	158.1	180.5
Information and communication	79.3	75.0	74.8	99.1	149.9	164.3	195.8	220.8
Financial and insurance activity	44.8	69.7	75.6	90.4	64.3	88.8	100.7	96.8
Real estate activities	148.8	145.5	186.6	220.4	145.9	143.2	174.6	204.2
Professional scientific and technical activities	131.9	139.8	170.6	185.3	200.6	196.2	217.1	220.4
Public services	93.8	94.0	105.0	124.3	115.7	133.1	145.8	175.0
Total	113.2	119.3	133.2	151.2	168.2	175.0	191.0	205.9

Sources: AJPES, own calculations

SMEs display a higher level of financial leverage, and a more significant increase in almost all sectors. Financial and operating liabilities at SMEs are two times higher than equity. Somewhat less indebted compared with the average are small enterprises in the construction and real estate sectors; however, at such a high level that there is no substantial difference.

[25] Financial leverage is calculated as the ratio of operating and financial liabilities to equity on the basis of corporate annual reports; source: AJPES.

Figure 4.15: Financial leverage by sector and change in the last three years



Note: A+B: agriculture, forestry, fishing and mining; D+E: electricity, gas and water supply, environmental remediation.
Sources: AJPES, own calculations

There was a notable increase in payment arrears by corporates at banks in the final months of 2008.

The exacerbation of corporate liquidity problems came to the fore with the development of the economic crisis towards the end of 2008. Arrears in the payment of liabilities to banks began to increase. Corporate arrears nearly doubled in the final quarter of 2008, as did arrears as a proportion of total classified claims against corporates, from 6.6% to 12.8% in three months.

Defaults increased most in the category of arrears of up to 30 days, which confirms that problems with arrears in the payment of liabilities began to escalate in the aforementioned period. Arrears of the shortest maturities as a proportion of classified claims nearly tripled in three months, from 2.8% to 8.1%. Contributing most to this increase were corporates from the transport and storage sector, where arrears account for more than one-third of banks' classified claims against this sector. Nearly all arrears of corporates from the transport sector were realised in the final quarter, as the proportion was still only 3.5% in September. A significant increase at the end of the year was also recorded by corporates from the real estate sector, with the proportion of past-due unpaid liabilities reaching 9.6%, compared with 2.1% in September 2008.

At the end of the year arrears as a proportion of classified claims also exceeded 10% at corporates from the manufacturing, construction and financial intermediation sectors, miscellaneous professional services (at just over 11%), and in the agriculture, forestry, fishing and mining sector, at 13.7%.

Arrears exceeding 90 days accounted for 3.4% banks' classified claims.

Longer arrears exceeding 90 days accounted for 3.4% of banks' classified claims at the end of the year. Above-average proportions of arrears are also seen at corporates from the sectors of trade and miscellaneous business services, at 4.7% and 4.8% respectively, up around 2 percentage points.

Table 4.15: Number of days past due for payments at banks as at the end of 2008

	Number of corporates in arrears	Proportion of corporates in arrears in total number of corporates at banks			Average number of days in arrears	Proportion of classified claims of corporates in arrears in bank's portfolio		
		Total	Of these: a delay of			Total	Of these: a delay of	
			30-90 days	over 90 days			30-90 days	over 90 days
Agriculture, forestry, fising and mining	37	17.7	1.4	12.0	414	13.7	0.4	6.4
Manufacturing	577	15.4	2.2	8.7	232	11.6	1.7	3.8
Electricity, gas and water, envir. remediation	19	8.6	0.9	3.2	291	5.6	0.4	1.6
Construction	413	16.2	2.6	9.0	170	11.6	1.4	2.9
Trade	779	13.0	1.9	8.0	372	9.7	1.2	4.7
Transportation and storage	193	17.1	2.2	10.0	25	36.5	0.3	2.6
Hotels and restaurants	173	20.0	3.5	13.1	213	9.5	1.9	3.3
Information and communication	77	7.3	1.7	4.2	178	4.4	0.8	1.4
Financial and insurance activity	20	13.5	4.1	4.7	31	11.3	0.1	1.4
Real estate activities	72	12.9	3.1	6.3	167	9.6	4.8	2.0
Professional scientific and technical activities	393	9.5	1.3	5.3	315	12.0	1.2	4.8
Public services	74	7.1	0.7	3.8	193	2.6	0.2	1.1
Total	2,829	13.1	2.0	7.6	184	12.8	1.3	3.4

Source: Bank of Slovenia

The concentration of corporates in arrears is highest in the hotels and restaurants sector at 20%, and in the transport and construction sectors and in the manufacturing sector overall, ranging between 15% and 17%. The concentration of corporates in arrears is higher than their proportion of classified claims in the majority of sectors, indicating that payment delays are most frequently seen at small enterprises. Given their higher exposure to risk due to lower economic and negotiating power in relation to larger corporates, financial institutions and the government, a higher concentration of liquidity problems can also be expected in this group in the future.

The average number of days past due at corporates in arrears was actually down slightly relative to September, because new corporates, which initially display shorter arrears, are prominent among those in arrears.

Risk premiums at banks by sector

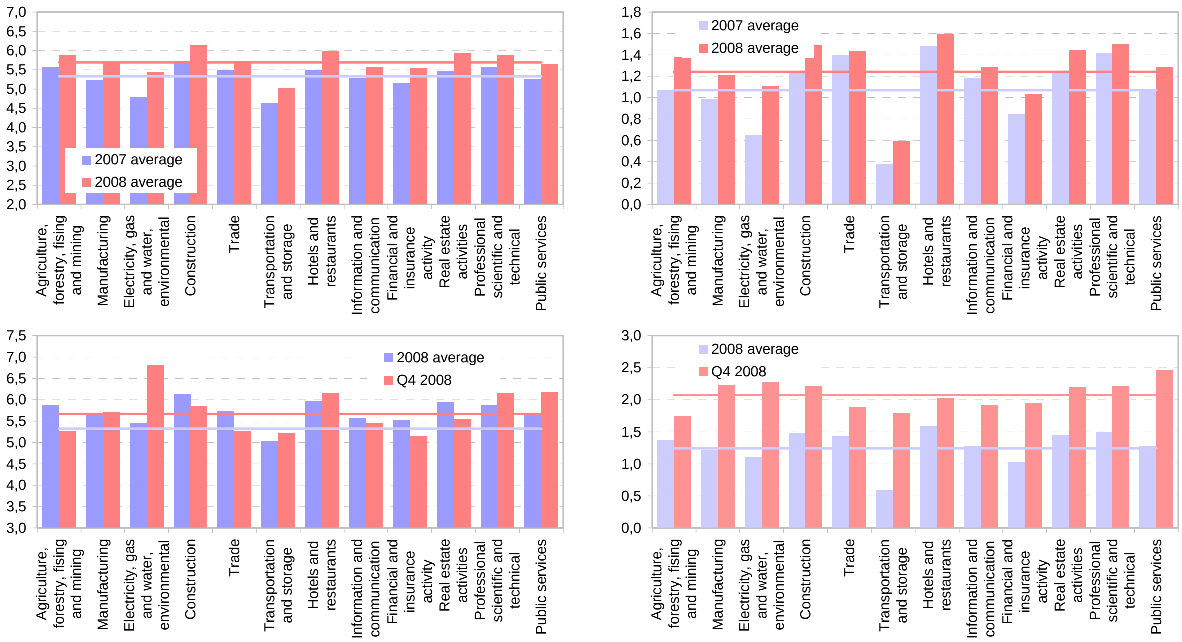
Increase in premiums over the EURIBOR throughout the financial turmoil, particularly at the end of 2008.

Interest rates on long-term corporate loans were 0.4 percentage points higher on average in 2008 than a year earlier, despite the sharp drop in the final quarter of the year. Premiums over the EURIBOR began rising at the first indications of the financial turmoil in autumn 2007, and received an additional boost in the final quarter of 2008, when they exceeded the average for the year by 0.8 percentage points.

Risk premiums are highest in the sectors of hotels and restaurants, construction, trade and real estate.

Interest rates on new corporate loans at the domestic banks vary from sector to sector. In 2008 premiums over the EURIBOR deviated upwards in the sectors of hotels and restaurants, construction, trade, real estate and miscellaneous business services. In the final quarter premiums on long-term corporate loans rose in all sectors, particularly in the electricity, gas and water supply sector.

Figure 4.16: Overall interest rate in percentages (left) and premiums over the EURIBOR in percentage points (right) on long-term bank loans by sector



Note: Interest rates on long-term bank loans; only loans tied to the EURIBOR are included in the premium figures.
Source: Bank of Slovenia

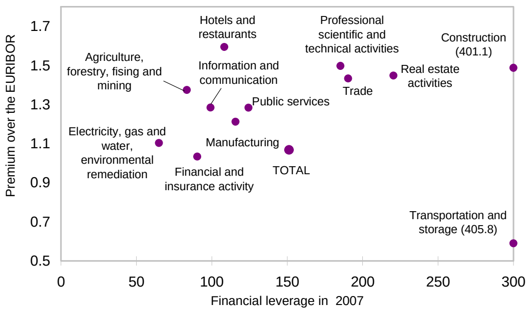
Several factors affect the differentiation in interest rates between individual corporates and sectors. Available figures for 2007 do not provide a sufficient basis to assess the interdependence between the financial position of an individual corporate and the cost of a loan in 2008. In light of the economic conditions in the second half of the year and forecasts of further deterioration in 2009, the decisive factor in the level of risk premiums at banks is probably the ability of corporates to pay due liabilities on time.

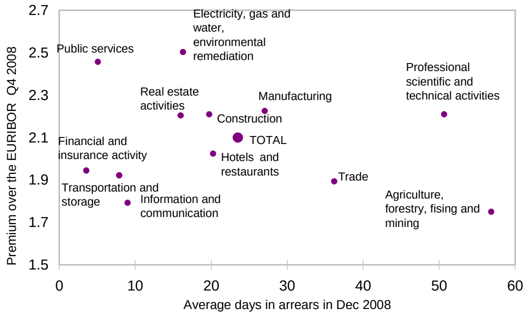
Corporate indebtedness and liquidity have an impact on the risk premium.

Corporates in the sectors in which the indicators of indebtedness and/or current liquidity deviate from the average in the direction of higher risk face higher premiums over the EURIBOR at banks compared with sectors classed as low-risk according to these indicators.

Of all sectors, corporates from the hotels and restaurants sector paid the highest premiums over the EURIBOR in 2008. This sector stood out with its low liquidity indicator and high proportion of arrears exceeding 90 days. Premiums fell below the average in the final quarter. However, corporates from this sector have been paying a higher risk premium since 2006. Over the same period, risk premiums have also been higher for corporates from the construction and trade sectors which, alongside a high level of indebtedness, also stand out in terms of longer arrears. Premiums are also above-average in the sectors of information and communication and miscellaneous business services. The agriculture, forestry, fishing and mining sector is among the less-indebted sectors, but stands out in terms of arrears in 2008, and thus pays higher premiums. Premiums in the manufacturing sector also recorded an above-average increase in the final quarter of 2008.

Figure 4.17: Average premium over the EURIBOR on new bank loans to corporates in 2008 in relation to corporate financial indicators by sector





Source: Bank of Slovenia

Table 4.16: Financial performance indicators by sector, and premiums over the EURIBOR on new loans at domestic banks

	Debt ratio	Financial leverage	Liquidity ratio	Average number of days in arrears	Overall rank	Premium over EURIBOR	Rank
	2007	2007	2007	Dec 08		2008	
Agriculture, forestry, fising and mining	42.2	83.5	74.5	56.8	4.0	1.4	7.0
Manufacturing	51.1	115.7	78.3	27.0	5.0	1.2	4.0
Electricity, gas and water, envir. remediation	37.6	64.9	103.7	16.3	1.0	1.1	3.0
Construction	76.5	401.1	72.5	19.7	9.0	1.5	10.0
Trade	64.3	190.4	68.9	36.2	11.0	1.4	8.0
Transportation and storage	78.7	405.8	71.9	9.0	9.0	0.6	1.0
Hotels and restaurants	50.2	108.3	55.3	20.2	7.0	1.6	12.0
Information and communication	48.0	99.1	76.4	7.9	3.0	1.3	6.0
Financial and insurance activity	47.0	90.4	98.5	3.5	1.0	1.0	2.0
Real estate activities	67.0	220.4	54.7	16.0	11.0	1.4	9.0
Professional scientific and technical activities	63.0	185.3	85.2	50.7	8.0	1.5	11.0
Public services	53.4	124.3	55.9	5.1	6.0	1.3	5.0
Total	58.2	151.2	76.3	23.5		1.1	

Note: For the liquidity ratio, a higher value represents better liquidity, while for all the other indicators a higher value is less favourable. The overall ranking is calculated from the individual rankings for each indicator, where a higher ranking indicates higher risk. The premiums refer to those on long-term loans tied to the EURIBOR.

Sources: AJPES, Bank of Slovenia, own calculations

4.4 Corporate position against the rest of the world

A net corporate debt position against the rest of the world of 14.1% of GDP, with a declining trend.

The net corporate debt position against the rest of the world reached EUR 5.2 billion or 14.1% of GDP at the end of September 2008. Both financial liabilities and financial investments in the rest of the world are rising, the latter somewhat faster. Slovenian corporates disclose a net debt position against EU Member States and a net credit position against other countries, both displaying a rising trend.

Increased financing from the rest of the world via loans and trade credits.

In 2008 corporates increased their stock of current financing from the rest of the world via loans and trade credits. Investments by non-residents in corporate equity, which represented a stable flow in the average amount of EUR 400 million each year over the last four years, have nearly stalled.

Table 4.17: Corporate financing from the rest of the world, transactions and stock in EUR million and in percentages

	Financial flows from the rest of the world					Stock at the end of the period				
	2004	2005	2006	2007	2008[1]	2004	2005	2006	2007	2008[1]
Total (EUR million)	731	819	1,042	1,506	1,114	9,921	11,811	12,633	14,426	15,575
Growth rate (%)	27.6	12.0	27.2	44.6	9.3	7.3	19.0	7.0	14.2	10.8
	Structure (%)									
Securities other than shares	-2.4	0.7	1.0	0.2	0.2	0.1	0.1	0.2	0.2	0.4
Loans	24.2	7.7	20.1	31.2	50.0	32.4	28.3	24.2	24.7	29.4
Equity	55.0	51.9	36.3	28.1	4.3	43.8	42.9	44.3	44.6	38.1
Trade credits and other	23.3	39.7	42.6	40.5	45.6	23.7	28.7	31.3	30.5	32.1

Note: [1] Figures to September 2008.
Source: Bank of Slovenia

Corporate financial investments in the rest of the world recorded negative year-on-year growth in 2008. Nevertheless, they outstripped flows of financing from the rest of the world, as in the previous three years. The stock of investments in the rest of the world more than doubled in four years, while growth in liabilities was half of that rate. Corporates finance the rest of the world primarily via trade credits.

Trade credits are prevalent in investments in the rest of world, representing the majority of the latter in 2008. Loans to the rest of the world were down slightly, as were investments in equity, the latter still representing a high 26% of current investments in the rest of the world.

Table 4.18: Corporate financial investments in the rest of the world, transactions and stock in EUR million and in percentages

	Assets flows in the rest of the world					Stock at the end of the period				
	2004	2005	2006	2007	2008[1]	2004	2005	2006	2007	2008[1]
Total (EUR million)	502	954	1,068	1,611	1,364	4,996	6,901	7,607	8,954	10,383
Growth rate (%)	-26.1	89.9	12.0	50.9	-11.1	11.7	38.1	10.2	17.7	15.8
	Structure (%)									
Securities other than shares	4.3	0.2	0.3	1.0	0.2	0.7	0.6	0.5	0.6	0.6
Loans	-13.5	33.4	15.6	27.6	13.4	8.0	8.1	7.6	11.7	13.7
Equity	38.3	38.2	27.0	31.7	25.8	26.2	31.3	28.6	31.8	27.7
Trade credits and other	65.2	31.8	53.2	35.5	61.8	63.1	59.1	62.0	53.9	56.1

Note: [1] Figures to September 2008.
Sources: Bank of Slovenia

The majority of loans with which Slovenian corporates finance the rest of the world go to foreign subsidiaries. To a lesser degree, corporates also make loans to their parent companies in the rest of the world. However, this group of debtors primarily made net repayments of loans in 2008.

Corporate financing at parent companies in the rest of the world was up in 2008.

Corporates finance themselves in the rest of the world mainly at non-affiliated corporates, and partly at their parent companies in the rest of the world. In 2008 foreign investors tripled their stock of current financing of their corporates located in Slovenia relative to 2007. These are primarily corporates from EU Member States.

Table 4.19: Percentage breakdown[1] of loans to and from the rest of the world with regard to ownership ties

	Loans from the rest of the world				Loans to the rest of the world			
	From parent companies	From subsuduarues	From non-affiliates	Total	To parent companies	To subsuduarues	To non-affiliates	Total
2005	-1.5	9.4	-107.9	-100.0	59.6	11.2	29.2	100.0
2006	50.6	-5.5	54.9	100.0	-57.6	37.7	119.8	100.0
2007	23.6	11.8	64.7	100.0	25.5	60.6	13.9	100.0
2008	38.4	1.5	60.1	100.0	-116.0	171.8	44.1	100.0
	From EU countries	From ex-YU countries	From other countries	Total	To EU countries	To ex-YU countries	To other countries	Total
2005	102.6	-0.3	-2.4	100.0	59.1	9.0	31.9	100.0
2006	4.9	-0.3	95.4	100.0	17.9	90.8	-8.7	100.0
2007	10.7	3.8	85.5	100.0	56.6	38.6	4.8	100.0
2008	40.5	5.0	54.5	100.0	-103.0	78.9	124.1	100.0

Note: [1] A negative sign signifies net repayment of loans.
Source: Bank of Slovenia

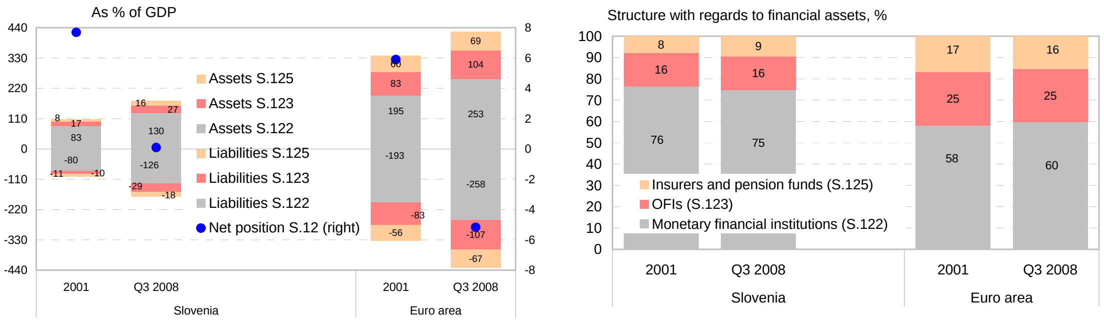
5 THE SLOVENIAN FINANCIAL SYSTEM

5.1 Structure of the Slovenian financial system

The depth of the Slovenian financial system increased slightly to reach 40.7% of the depth of the euro area financial system.

The depth of the Slovenian financial system (excluding the central bank) was up just under 3 percentage points over the course of one year to stand at 173.5% of GDP at the end of the third quarter of 2008.[26] The depth of the euro area financial system declined by nearly 20 GDP percentage points over the same period. However, the difference in their levels, driven by historical development, remains significant. The Slovenian financial system achieves 40.7% of the depth of the euro area financial system.

Figure 5.1: Ratio of financial assets, liabilities and net position to GDP by financial sub-sector (left) and structure of the financial sector in terms of financial assets (right) in percentages



Note: Excludes the central bank. S.122: Other monetary financial institutions (includes commercial banks and savings banks); S.123: Other financial intermediaries, except insurance corporations and pension funds (includes investment funds and leasing companies); S.125: Insurance corporations and pension funds.
Sources: Bank of Slovenia, ECB, Eurostat, SORS

There were small changes in the breakdown of financial assets in Slovenia. The traditional prevalence of monetary financial institutions is more pronounced than in the euro area, accounting for three-quarters of the financial sector.

Table 5.1: Overview of the Slovenian financial sector in terms of total assets

	Assets (EUR million)		Structure (%)		% of GDP		No. of inst.		
	2007	2008	2007	2008	2007	2008	2006	2007	2008
Monetary financial institutions[1]	42,598	47,820	72.2	76.9	123.6	128.8	25	27	21
Non-monetary financial inst.	16,388	14,354	27.8	23.1	47.5	38.7			
Insurers[2]	5,035	5,189	8.5	8.3	14.6	14.0	15	16	17
Pension companies/funds[3]	1,001	1,039	1.7	1.7	2.9	2.8	11	10	10
Investment funds	4,138	1,912	7.0	3.1	12.0	5.1	106	116	131
Leasing companies[4, 5]	5,348	5,348	9.1	8.6	15.5	14.4	20	20	22
BHs, MCs, others[5]	867	867	1.5	1.4	2.5	2.3	-	-	-
Total	58,986	62,174	100.0	100.0	171.1	167.5			

Notes: Figures for financial institutions that are not banks, insurers, pension companies or pension and investment funds are obtained from the AJPES database of annual accounts based on the SKD 2008 classification.
[1]Monetary financial institutions do not include the central bank. [2] Figures for total assets of reinsurance companies are for the end of the third quarter of 2008. [3] Includes the First Pension Fund. [4] The figures for the number of leasing companies comprise the number of active members of the SLA in 2007, and the number of leasing companies being monitored by the BAS's leasing committee in 2008. [5] Total assets according to figures for the end of 2007.
Sources: Bank of Slovenia, ISA, SMA, SLA, AJPES, BAS

Although an assessment of the role of various groups of financial institutions and their comparison solely in terms of total assets cannot be comprehensive and entirely relevant in terms of substance, certain characteristics of the Slovenian financial system's development are worthy of note: the slowly growing importance of insurers and pension

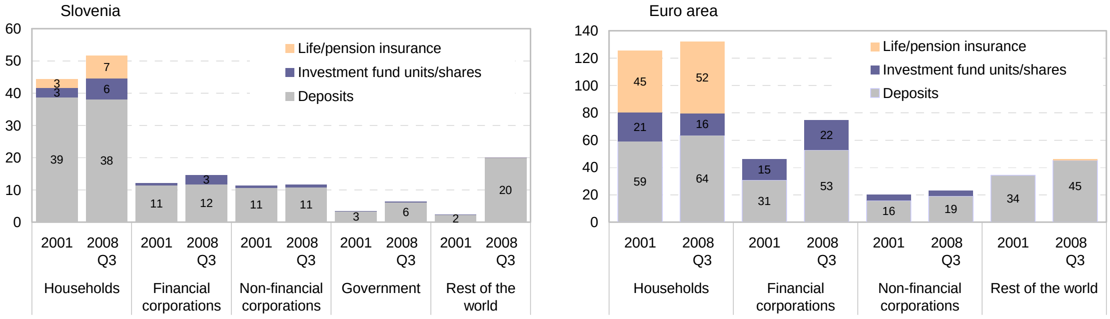
[26] Due to the revision of financial account figures and figures regarding GDP, the initial value for the third quarter of 2007 was adjusted from 177% of GDP to 171% of GDP. The revision of figures also resulted in changes to the values of certain other figures in this section that were published last year.

funds, together with the stagnation of the proportion of other financial intermediaries' assets, points to their inferior position in what is traditionally a banking-dominated financial sector. Following the downturn on the capital markets, the capital losses in the investment fund sector represent the main reason for the absolute decrease of EUR 2 billion in the total assets of non-monetary financial institutions. The trend of a rising proportion of non-monetary financial intermediaries was broken in 2008. The continued development of the non-banking sectors of the financial system and the deepening of the capital market are urgent, but difficult during the recession. In the medium term, this could facilitate the process of gradual change in the method of corporate financing and the development of the pension insurance system. In terms of the overall financial system, a decrease in assets in financial intermediation can be expected in 2009.

Comparison of financial institutions in terms of intermediation of savings

The intensity of the economic crisis in individual countries is directly proportionate to the importance of the financial markets in the functioning of their economies. The exposure of households during the turmoil varies from country to country with regard to the proportion of their financial assets in the form of higher-risk non-banking financial investments and the level of ownership of real estate used as primary residences. In recent years financial risks have been transferred rapidly to savers owing to the shift to non-banking forms of savings, the development of institutional investors and the rerouting of household savings to investments on the capital market. Households were not fully aware of the transfer of risks in the context of the increasing value of capital investments. At the same time, the rapidly growing use of new financial instruments increased the probability of the transfer of risk between sectors and within the financial system, and created a risk assessment environment that lacked transparency.

Figure 5.2: Value of certain financial instruments owned by individual sectors as a percentage of GDP in Slovenia (left) and the euro area (right)



Note: Excludes the central bank.
Sources: Bank of Slovenia, ECB, Eurostat, SORS

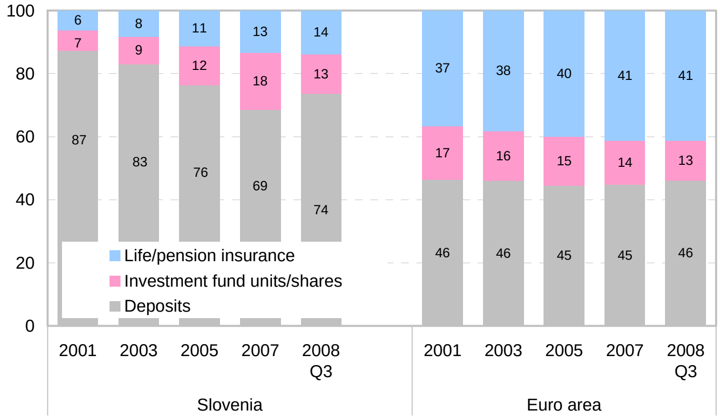
The proportion of life insurance and pension insurance in Slovenia is low compared with the euro area.

The difference in structures remains most evident in the form of provisions for life and pension insurance, while the difference in the depth of the financial system in the euro area is still reflected in the extensive investment in units and shares of investment funds. Slovenian households traditionally invest their financial savings at banks. The only difference in the third quarter of 2008 relative to a year earlier is the decline in the value of financial assets in the form of investment fund units and shares by 4 percentage points to 6% of GDP due to their decreasing value, and partly owing to a migration to other forms of investment. The value of these financial instruments held by financial and non-financial corporations has also decreased to a relatively lesser degree with the regard to the size of their proportion. A similar change is also characteristic of the euro area.

Financial assets from intermediation have increased to 117% of GDP.

Taking into consideration assets from intermediation, the significant difference in the depth of the Slovenian and euro area financial systems has decreased during the financial turmoil. In Slovenia total assets from intermediation rose by 14 percentage points in the year following the third quarter of 2007 to 117% of GDP, while the figure for the euro area remained almost unchanged until the middle of 2008, at 276% of GDP. The relative importance of financial instruments other than bank deposits in assets from intermediation is twice as high in the euro area than in Slovenia. The previously described changes are also reflected in the breakdown of households' financial assets from intermediation.

Figure 5.3: Breakdown of households' financial assets from intermediation in Slovenia and the euro area in percentages



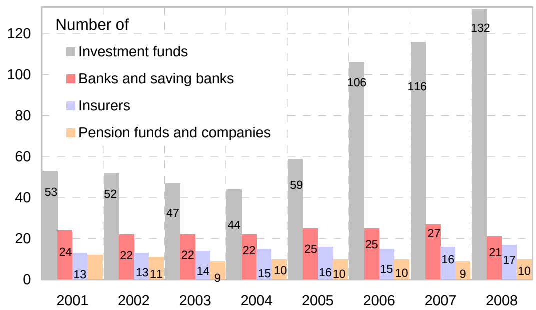
Note: Deposit figures for the euro area include transferable and other deposits.
Sources: Bank of Slovenia, ECB

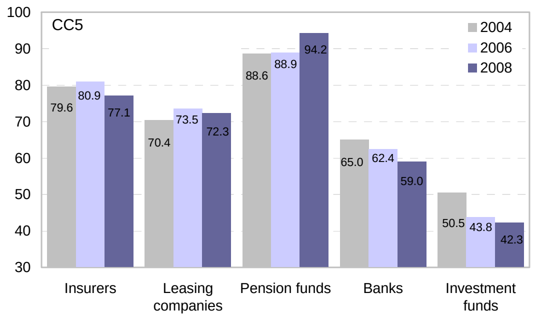
Market concentration in the financial sector

Concentration in the financial system declined in 2008, except in the pension insurance segment.

Pension insurance is the only segment of the Slovenian financial system in which concentration has increased, and is also the segment with the highest level of concentration. This is evidence of the need for changes in the pension system, also in terms of ensuring competition between providers. Similarly worthy of note is the insurance segment, where the number of insurance service providers alone could ensure a comparatively high market deconcentration on the relatively small Slovenian market. It seems, however, that smaller providers are unable to penetrate the market with their range of products and services. It can be concluded that market entry itself is unobstructed and that an adequate level of competition exists. However, the combination of the size, traditional market profile, knowledge of the market and the quality of service of the largest insurers are restricting the more rapid development of smaller insurance service providers.

Figure 5.4: Number of financial institutions of different type (left), and market concentration of the five largest (CC5; right in percentages)





Note: The CC5 index is calculated in terms of total assets, with the exception of leasing companies, for which it is calculated in terms of volume of transactions concluded. Insurers include reinsurance companies, whose total assets relate to the end of the third quarter of 2008. Pension funds do not include the First Pension Fund, as this is a closed fund that does not envisage any more contributions.
Sources: Bank of Slovenia, ISA, SMA, SLA

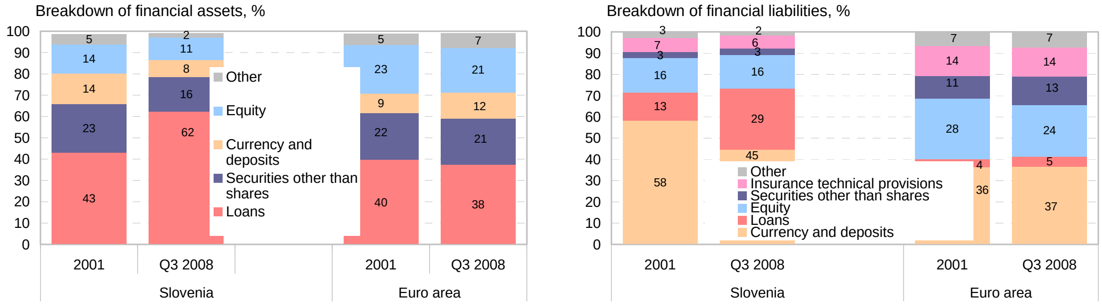
The fiercest competition in the investment fund segment has increased further due to the increasing number of funds. Taking into account the conditions on the capital market, a reversal is possible in the coming years. This will not, however, affect the competitive structure of this segment of the market, which is also widely open to the rest of the world. Changes in investment fund management can be expected. The contraction of the capital markets will hasten the merger of a relatively large number of investment fund management companies or their mergers with banks. The decline in the relatively high concentration of banks, as the largest financial intermediaries, is welcome, while it also reflects two traditional characteristics of the Slovenian banking system. The first is the absence of a system of savings banks, which in several countries of continental Europe represents an important part of the banking system in terms of the large number of institutions and the size of their total assets. The second characteristic is the high market share of the largest bank. There could be further consolidation in the Slovenian banking system in the future. With increasing risks, falling profits and the likely need for further capital injections, pressure will increase particularly on certain smaller banks to merge with other small banks, or to agree to merge with a larger bank.

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

Corporate debt financing impacts the structure of the financial sector's assets.

The structure of the assets of the euro area's financial sector is markedly stable in the medium term, which is not surprising given its depth. Changes in the relatively short period since the outbreak of the financial turmoil can be seen as an increase in deposits and a decrease in equity. For Slovenia the difference in structures is the obvious consequence of banks' lending activities and the prevailing role of banks in the Slovenian financial system. Following the outbreak of the financial turmoil, the increased proportion of loans resulted in a relative decrease in the proportions of other forms of financial assets. The falling value of equity, primarily due to revaluation, resulted in a significant 10 percentage point difference in the proportion of equity in the structure of financial assets between Slovenia and the euro area. There is a lack of cross-ownership between Slovenian financial institutions, and a lack of cross-ownership with non-financial corporations, which is in line with the relatively low level of development of the capital market and the relatively high level of debt financing of Slovenian corporates.

Figure 5.5: Breakdown of the financial sector's financial assets (left) and liabilities (right) in percentages

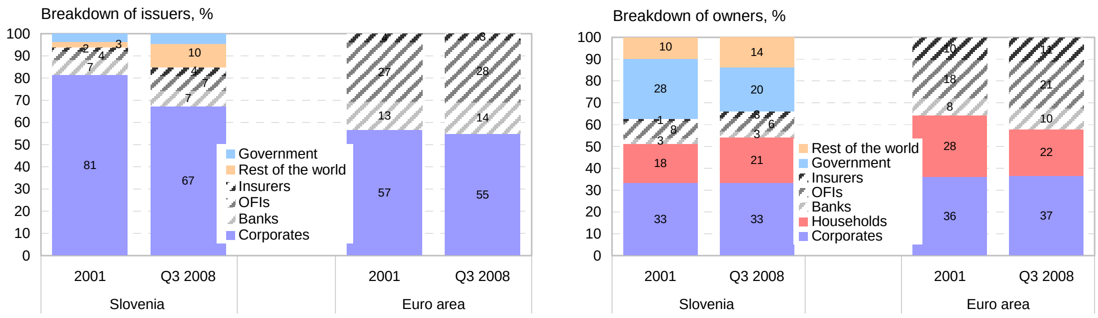


Note: Excludes the central bank.
Sources: Bank of Slovenia, ECB

Borrowing by banks in the rest of the world has impacted the structure of the financial sector's liabilities.

Borrowing by banks, which raised loans in the rest of the world to provide funds to meet domestic credit demand, resulted in the most significant change to the structure of the financial system's financial liabilities. In the context of a deteriorating ratio of deposits (and cash) to loans, the difference relative to the euro area with regard to these two categories was unchanged. In contrast to the euro area, the insurance segment and equity remain less important in the structure of financial assets. Although the figures for the system overall are rough, a comparison indicates that the Slovenian financial system requires additional capital, even in the context of stagnating growth in turnover.

Figure 5.6: Breakdown of equity issuers (left) and owners (right) in percentages



Note: This is the F.5 instrument (shares and other equity) according to the ESA95 definition, which in addition to issued share capital also includes units in investment funds and ownership in other corporate forms such as limited liability companies and unlimited partnerships. At the end of September 2008, issued share capital (regardless of whether listed on the stock exchange) accounted for just over 55% of total equity. The euro area figures exclude the rest of the world and the general government sector.
Sources: Bank of Slovenia, ECB

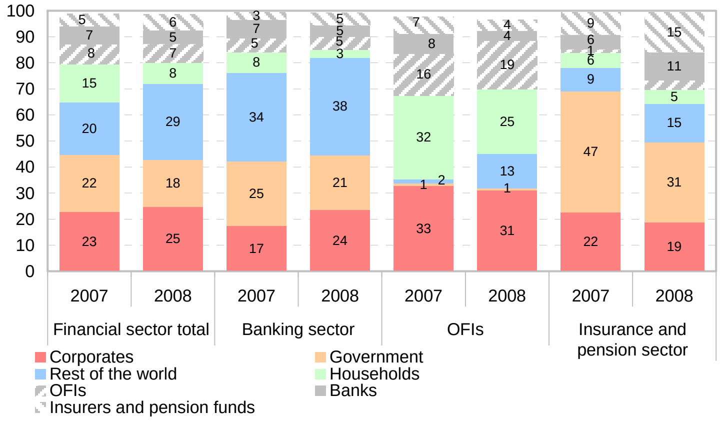
Changes in the breakdown of equity issuers in Slovenia indicate that Slovenian financial institutions are extremely slow in turning to the issue of equity as a means to raise capital. In terms of potential investors, the increase in the share of issued equity by 2 percentage points to 18% over the last year was less significant compared with the fall in the value of NKBM d.d. shares, the price of which fell from EUR 27 at the time of the IPO in autumn 2007 to below EUR 10 a little more than a year later. Taking into account a further deterioration in the situation on the capital markets, the opportunities for financial institutions to successfully raise additional capital have diminished. This could continue to hinder growth in the financial system's total assets in 2010, and the deepening of the shallow capital market.

Capital links in the financial sector

Cross-ownership between domestic financial institutions has declined, while the proportion under foreign ownership has risen.

The already low level of cross-ownership between domestic financial institutions declined further in 2008, to 18%. The integration of the financial system into the international economic environment is reflected in the increase in the proportion under foreign ownership to 29%, owing to an increased proportion under foreign ownership in all three segments of the financial system. The proportion under government ownership is declining. However, that process will slow in 2009 with a capital injection into SID banka.

Figure 5.7: Ownership structure of financial sectors in percentages



Note: Includes direct ownership only.
Sources: CSCC, own calculations

Risks in the financial system

In Slovenia the financial turmoil has a discouraging effect on the already insufficiently dynamic development of non-monetary financial intermediaries, hinders the development of new financial instruments and further exposes financial institutions to risks. It is accompanied by increased prudence in decision-making and a decline in financial transactions by the household sector, which traditionally drives demand for financial instruments with its net financial surpluses. Although hit by the recession, there is demand from the corporate sector for loans and non-banking financial instruments, but under the influence of falling demand, high uncertainty regarding operations, poor operating results and limited possibilities to secure loans. All of the aforementioned hinders the process of improving the structure of the Slovenian financial system, including the deepening of the capital market and the increasing of the links between financial institutions characteristic of developed financial systems. In the context of limited capital links, investment links between financial institutions are sufficiently developed to facilitate the transfer of risk between individual groups of financial intermediaries.

The high lending activity of the domestic banks was primarily driven by demand from non-financial corporations and households. However, the banks also increased their credit exposure to other financial intermediaries by more than EUR 400 million over the first three quarters of 2008. This increase is relatively small compared with previous years, as a result of their adaptation of operations to the tightened conditions on the market. Noteworthy in 2008 was the doubling of banks' exposure to insurers and pensions funds, which they began to support via loans and by increasing capital investments. Nevertheless, banks' total exposure to other financial intermediaries, insurers and pension funds is relatively low, at 5.4% of the banking system's total financial assets. This would only result in the deterioration of the financial system's stability if this exposure was concentrated at a single systemically significant bank, where possible contagion is also mitigated by dispersion among non-banking financial institutions. The risk of contagion spreading from banks to other financial intermediaries via their investments at the former was mitigated by a decrease in exposure to a relatively low level of 7.2%. The exposure of insurers and pension funds via their investments at banks has increased, but remains lower than the level prior to 2005, at 19.9%.

Table 5.2: Investment links between Slovenian financial institutions

	2003	2005	2007	2008Q3	2003	2005	2007	2008Q3
	Domestic banks' exposure to[1]							
	other fin. intermediaries (S.123)				insurers, pension funds (S.125)			
Value (EUR million)	489	869	2,125	2,456	81	57	94	229
Bank invest. in debt securities	19	3	1	4	28	14	14	21
Bank loans granted	283	685	1,840	2,248	20	0	0	70
Bank capital investments	187	180	284	204	33	42	79	137
As % of:								
Total financial assets	2.2	2.2	2.9	4.9	0.4	0.2	0.2	0.5
Bank invest. in debt securities	0.3	0.3	0.0	0.0	0.4	0.2	0.2	0.3
Bank loans granted	2.4	2.4	4.1	6.1	0.2	0.0	0.0	0.2
Bank capital investments	21.0	21.0	15.3	15.9	3.7	3.6	4.5	8.6
	Exposure to domestic banks of[2]							
	other fin. intermediaries (S.123)				insurers, pension funds (S.125)			
Value (EUR million)	491	537	932	726	702	816	984	1,205
Investments in bank deposits	227	355	602	416	438	384	495	635
Investments in bank debt. sec.	196	132	134	128	202	359	384	415
Investments in bank capital	68	51	196	182	62	72	106	156
As % of:								
Total fin. assets of S.123 or S.125	10.3	7.9	8.3	7.2	23.0	20.9	16.5	19.9
Investments in deposits	99.9	81.6	99.1	98.5	99.8	99.4	93.7	97.7
Investments in debt securities	60.1	28.5	37.4	38.6	14.0	15.1	12.2	13.0
Capital investments	2.6	1.8	3.7	5.1	13.9	9.7	5.8	9.4

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

5.2 Domestic financial markets

5.2.1 Money market

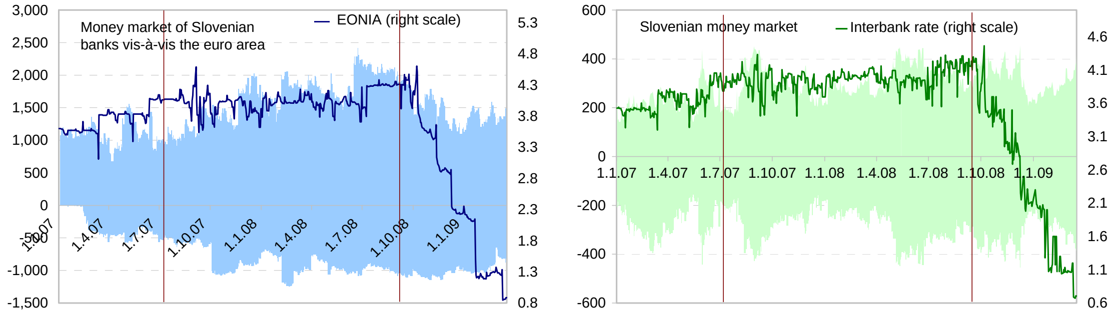
Coordinated cutting of interest rates.

The EONIA and the SI O/N were coordinated in their movements last year. The aforementioned rates were cut in line with the lowering of the ECB's interest rates. The SI O/N and interbank interest rates on the Slovenian market were consistently lower than the EONIA. In 2008 the EONIA averaged 3.87%, the SI O/N 3.76%, and interbank interest rates on the Slovenian money market 3.79%. Last year the EONIA was around 11 basis points higher than the SI O/N, the spread widening slightly in the second half of the year to stand at 20 basis points in the final quarter. The reason lies in the relatively higher level of confidence in trading between Slovenian banks following the collapse of US investment bank Lehman Brothers.

Decrease in the net claims of Slovenian banks on the international unsecured interbank deposit market.

Slovenian banks have been net creditors of the rest of the world on the money market for unsecured euro area interbank loans since the euro was introduced. Over the first three quarters of last year, net short-term financing of the rest of the world was relatively high at EUR 902 million, but fell to just EUR 361 million in the final quarter. The net creditor position against the rest of the world rose again in the first quarter of 2009, to EUR 433 million. The decline in the net position of Slovenian banks against euro area banks on the money market for unsecured interbank loans coincides with the escalation of the financial turmoil. Owing to their long net creditor position against euro area banks on the money market, Slovenian banks were in a relatively sound position when the financial turmoil escalated. With the halt in financing via syndicated loans in autumn 2008, Slovenian banks lowered their stock of interbank short-term unsecured loans to the rest of the world, and simultaneously increased their funding at the ECB. At the same time, Slovenian banks reduced their lending to foreign banks and increased their deposit facility at the ECB as a precaution. In this way, the banks provided for much-needed additional short-term liquidity.

Figure 5.8: Stock of unsecured deposits of Slovenian banks placed and received on the euro area money market (left) and the Slovenian money market (right) in EUR million, and movement of the EONIA (left) and SI O/N (right) in percentages



Note: The vertical lines in the above figures indicate increasing uncertainty on the financial markets in August 2007 (left) and the escalation of the financial turmoil in September 2008 (right).
Source: Bank of Slovenia

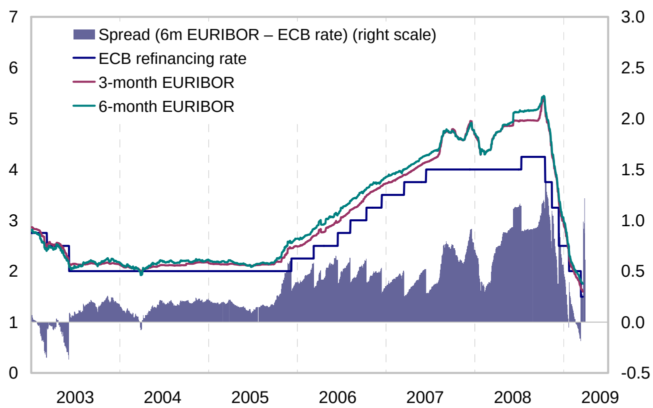
The volume of transactions on the Slovenian interbank unsecured deposit market was down around 15%.

The volume on the Slovenian money market for unsecured interbank deposits averaged EUR 341 million in 2008, down 15% on 2007. There was a sharper decline in the volume of transactions in the second half of the year, particularly in the final quarter, when it stood at less than two-thirds of the previous year's volume. Last year Slovenian banks did not respond to the escalating financial turmoil as they had in 2007, when they compensated for the shocks on the international financial markets by increasing the volume of transactions on the domestic money market; they actually decreased the volume of such transactions and increased their marginal deposit facility at the ECB.

Rapid narrowing of the spread between the ECB's key interest rate and the EURIBOR following the outbreak of the financial turmoil.

After having risen until the first third of October 2008, interest rates on the financial markets fell rapidly in November and December last year, in line with ECB rates. The EURIBOR and other interest rates on the financial markets continued to fall in the first quarter of this year, as banks expected the continued cutting of ECB rates, which were cut five times between October 2008 and 8 April 2009. Following the outbreak of the financial turmoil and multiple cuts in the ECB's key interest rates, the spread between the EURIBOR and the ECB's key interest rate narrowed sharply.

Figure 5.9: Comparison of the EURIBOR and the ECB refinancing rate in percentages



Source: Bank of Slovenia

5.2.2 Capital market

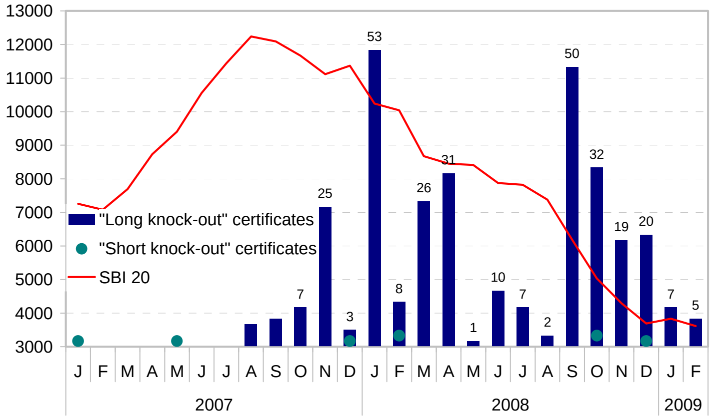
The growth in the SBI 20, which outstripped the growth of leading global stock market indices in 2007, was followed by a sharp fall in 2008. After reaching its peak at 12,242 points at the end August 2007, the SBI 20 fell until the end of 2008, when the negative annual change stood at 67.5%. A positive response by investors was not seen until January 2009, since which time volatility on the capital market has increased sharply. The Ljubljana Stock Exchange suspended trading in individual shares as necessary in the event of excessive daily fluctuations in share prices. The index reached its lowest level in early March 2009, when it fell to 3,408 points, representing an additional fall of 7.8% from the beginning of 2009. Alongside high growth in the past and developments on global and Balkan capital markets, uncertainty regarding the sale of the government's stake in corporates, high net outflows from mutual funds with investments in Slovenian shares and the redemption of retail certificates issued on Slovenian shares also contributed to the fall in share prices. At the end of 2008 the performance of Slovenian corporates in eastern Europe, where national currencies depreciated sharply against the euro, exacerbated the negative disposition of investors.

Negative annual growth in the SBI 20 index stood at 67.5% in 2008.

Contributing to the previous growth in share prices were long knock-out certificates issued on Slovenian shares, which gain in value when the share prices of the underlying instruments rise. In the context of falling share prices in 2008, these certificates had the exact opposite effect compared with 2007. The early knock-out of retail certificates, due to the sale of underlying instruments, further drove the fall in the value of shares on the stock market.

Long certificates that reached the knock-out barrier contributed significantly to the fall in Slovenian share prices in 2008.

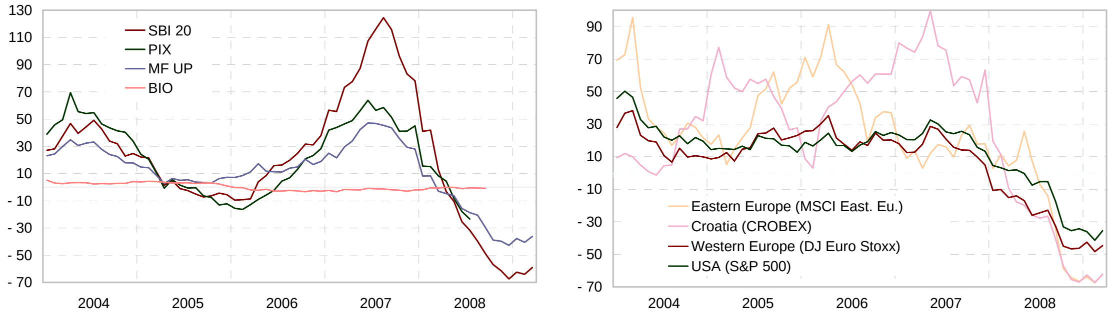
Figure 5.10: Number of retail certificates issued on Slovenian shares or on indices including Slovenian shares that reached the knock-out barrier, and movements in the SBI 20, Slovenia's primary stock market index



Sources: LJSE, Stuttgart Stock Exchange

In July 2008 the Tax on Capital Gains on Derivatives Act entered into force. The purpose of the act is to establish high taxes on speculative short-term gains. In the first year, capital gains on derivatives are taxed at a rate of 40%, the rate falling to 20% in the second year, equal to the rate of taxation on other capital gains.

Figure 5.11: Annual change in domestic (left) and foreign (right) stock exchange indices in percentages



Sources: LJSE, Reuters, SMA, Vzajemci.com, own calculations

Calculation of the PIX investment fund index and the BIO bond index was ceased.

The calculation of the PIX was ceased in July 2008 owing to the falling number of investment company shares included in the index. At the end of July the index was down 28.2% on December 2007. On 1 October 2008 the calculation of the BIO bond index was also ceased owing to insufficient liquidity. This index lost 1.1% of its value over the first nine months of 2008.

The introduction of new financial products is easier with inclusion in the regional group of stock markets from central and eastern Europe.

At the end of June new rules of the Ljubljana Stock Exchange were adopted, introducing a new segmentation of the stock market. It is now divided with regard to type of financial instrument into the share market, the bond market, the investment coupon market, the market for shares in investment companies and the structured products market. The new financial products facilitate the trading of mutual fund investment coupons and the listing of index funds for trading on the stock exchange. In October 2008 the Vienna Stock Exchange took over the Ljubljana Stock Exchange. Thus the Slovenian stock exchange was included in a group of stock exchanges from the regional market of central and eastern Europe. The new infrastructure and capacities facilitate the implementation of a trading and settlement infrastructure for the issuing of investment certificates and other structured products.

Sharp drop in the P/E ratio for listed Slovenian shares in 2008.

The P/E ratio[27] for the SBI 20 was significantly higher than the ratio for leading global stock markets in 2007, which confirms that shares were overpriced, as the ratio's decline in 2008 was again more extreme than the decline experienced by the aforementioned indices.

Table 5.3: P/E ratio for selected indices

	SBI 20	SBI TOP	EURO STOXX 50	S&P 500	DAX
Dec 06	23.5	28.5	12.6	17.7	14.5
Sep 07	34.6	35.1	13.0	18.0	14.0
Dec 07	32.6	33.8	12.5	20.1	13.6
Sep 08	13.2	17.0	10.0	16.0	13.9
Dec 08	8.3	10.6	9.2	13.6	10.4
Mar 09	9.4	15.1	13.0	11.8	15.9

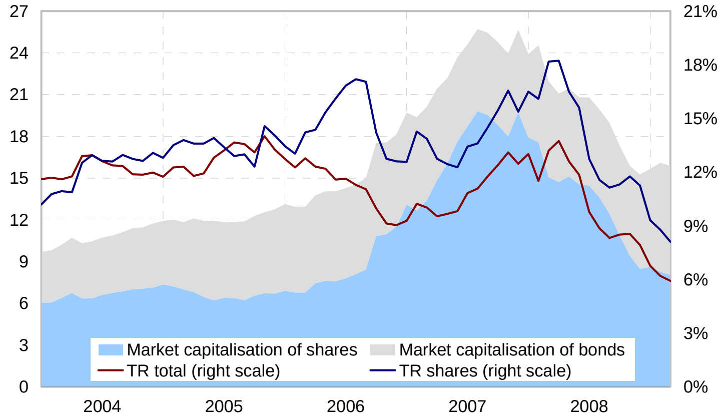
Sources: LJSE, Bloomberg

The market capitalisation of shares declined by 57.1% in 2008, while the volume of trading in shares was down 69%.

The market capitalisation of corporate shares[28] stood at 22.8% of GDP at the end of 2008, compared with 57.3% of GDP a year earlier. The annual decline of 57.1% was mainly the result of falls in share prices, and to a lesser extent the delisting of shares on the Ljubljana Stock Exchange. Shares in Merkur were delisted from the prime market due to acquisition, while shares in ACH and Geodetski zavod Slovenije were delisted from the standard market. The contraction in market capitalisation would have been more severe if new shares had not been listed on the Ljubljana Stock Exchange. Shares in Pozavarovalnica Sava, Zavarovalnica Triglav and Abanka were listed for trading on the standard market. However, there was no significant response from investors due to the adverse situation. The volume of trading in corporate shares[29] was down 69% in 2008, to EUR 953 million. Low liquidity resulted in a decline in the annual turnover ratio (TR). The shortage of liquidity on the Ljubljana Stock Exchange has continued in early 2009. The average monthly volume of trading in shares in 2008 was just 31% of the average monthly volume in 2007, the figure rising to 47% when block trades are excluded.

[27] The P/E ratio is the ratio of the share price to the most recent annual net profit per share.
[28] Investment fund shares are not included in the calculation of the market capitalisation of shares or in the volume of trading in shares.
[29] The volume of trading also includes block trades outside the regulated market.

Figure 5.12: Market capitalisation on the stock exchange in EUR billion, and turnover ratios (TR) in percentages



Note: Excludes listed investment companies and mutual funds. The turnover ratio (TR) is the ratio of annual volume to market capitalisation at the end of the year. The volume includes block trades. Figures for 2009 are for the first quarter.
Source: LJSE

The 14.5% increase in the market capitalisation of bonds and the higher volume in trading confirm investors' flight to safer forms of investment.

Despite the maturing of four government bonds and nine bank bonds, the market capitalisation of bonds was up 14.5%, primarily as a result of the listing of ten new bank bonds, one government bond and three bonds of non-financial corporations. In March 2009 the market capitalisation of bonds was up an additional 15%, at EUR 7.8 billion, owing to the issue of RS64 3-year reference government bonds on the MTS Slovenia market in the amount of EUR 1 billion, 82% of which were purchased by foreign investors. Nearly one-half of the aforementioned bonds were purchased by the banking sector and one-quarter by investment funds. In 2008 the average monthly volume of trading in bonds was 155% of the average monthly volume in 2007, confirming that investors migrated from high-risk to safer forms of investment. The liquidity of the bond market in early 2009 remained at the average level of the previous year.

Table 5.4: Overview of the Slovenian regulated capital market

	2004	2005	2006	2007	2008	Mar 2009
			Shares			
Market capitalisation						
(EUR billion)	7.1	6.7	11.5	19.7	8.5	8.0
As % of GDP	27.2	24.2	38.7	58.7	22.8	21.7
Annual growth (%)	27.3	-5.9	72.0	71.5	-57.1	-46.6
Held by non-residents	4.5	3.3	4.8	5.9	7.1	7.0
Turnover						
(EUR billion)	0.9	0.9	1.5	3.0	1.0	0.1
As % of GDP	3.6	3.4	4.9	9.0	2.6	0.2
Annual growth (%)	49.4	1.0	54.3	109.1	-68.6	-77.4
Annual growth in SBI 20	24.7	-5.6	37.9	78.1	-67.5	-59.1
P/E	24.9	18.7	23.5	32.6	8.3	9.4
Dividend return	1.7	1.6	1.4	1.0	2.7	3.5
			Bonds			
Market capitalisation						
(EUR billion)	4.6	6.0	6.6	5.9	6.8	7.8
As % of GDP	17.6	21.9	22.3	17.6	18.3	21.1
Annual growth (%)	26.4	31.0	9.6	-10.5	14.5	13.6
Turnover						
(EUR billion)	0.47	0.75	0.19	0.17	0.26	0.07
As % of GDP	1.8	2.7	0.6	0.5	0.7	0.2
Annual growth (%)	-12.4	58.1	-74.9	-11.8	54.9	88.2
Annual growth in BIO[1]	4.1	0.9	-3.0	-2.1	-0.9	
Turnover on TUVL						
(EUR billion)		0.49	1.03	0.27		

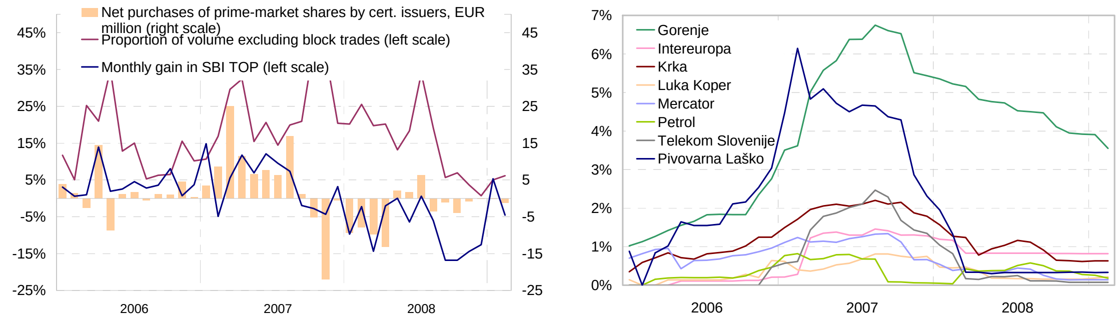
Note: Excludes listed investment companies and mutual funds. The volume includes block trades. The TUVL began operations in September 2005, and ceased in 2008. Only the volume of trading in the first quarter is included for 2009. [1] Calculation of the BIO index was ceased in October 2008.
Sources: LJSE, SORS

Foreign banks' retail certificates on Slovenian corporate shares

Volume of trading in shares stood at EUR 39.2 million in 2008 owing to the sale of underlying instruments of retail certificates that reached the knock-out barrier.

With the fall in share prices on the Ljubljana Stock Exchange, long retail certificates began to reach the knock-out barrier prematurely, as the price of underlying instruments reached a predetermined threshold. Foreign banks made net sales of EUR 27.7 million of Slovenian shares in the final quarter of 2007, and EUR 39.2 million in 2008. They continued to make net sales in the first two months of 2009, in the amount of EUR 1.3 million. The knock-out of retail certificates led to a further fall in the Slovenian SBI TOP index on account of the shallow capital market and the low monthly turnover ratio. Retail certificate issuing banks accounted for 15.6% of the volume of trading in shares on the prime market in 2008.

Figure 5.13: Net purchases and volume of trading in prime-market shares by banks issuing retail certificates on Slovenian shares and indices (left) and proportion of market capitalisation of individual shares accounted for by retail certificate issuing banks in percentages (right)



Sources: CSCC, Bank of Slovenia calculations

Declining proportions of total market capitalisation in individual shares accounted for by retail certificate issuing banks.

As a result, the proportions of total market capitalisation in individual shares accounted for by retail certificate issuing banks were down. These proportions rose over the first three quarters of 2007, before beginning to fall at the end of the third quarter of 2007 and in 2008, as a result of some retail certificates prematurely reaching the knock-out barrier and others reaching full maturity, and owing to the issue of short knock-out certificates. Similar to 2007, the issue of long knock-out certificates on Slovenian shares led to an excessive rise in security prices on the Ljubljana Stock Exchange, while retail certificates prematurely reaching the knock-out barrier triggered an accelerated fall in Slovenian share prices in 2008. Thus retail certificates issued in the rest of the world on Slovenian securities have an increasing impact on the instability of the domestic capital market.

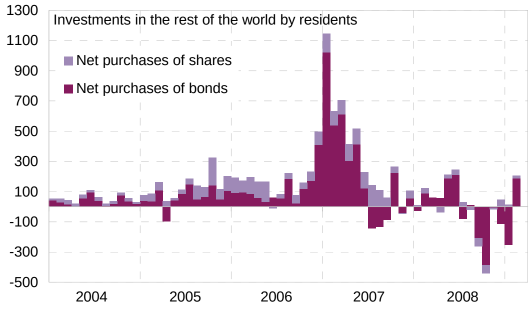
Investment links with the rest of the world

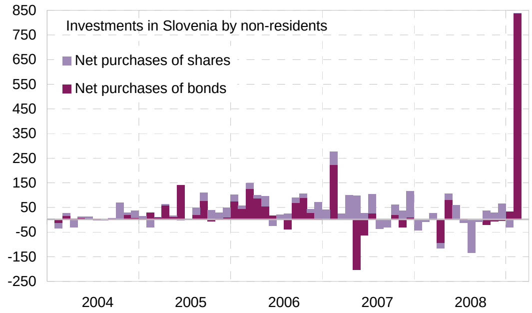
Demand for Slovenian shares from non-residents was down in 2008.

In 2008 non-residents made net purchases of EUR 14 million in Slovenian shares, both listed and unlisted. This represents just 2.6% of net purchases in 2007 or 8.4% of average net purchases between 2004 and 2006, and represents 1.5% of the total volume of trading in shares on the Ljubljana Stock Exchange. Non-residents made net sales of EUR 29 million in Slovenian shares in the first two months of 2009. Lower demand for Slovenian shares is driven by the turmoil on the capital markets. Investors remain uncertain, and are postponing the purchase of shares to the future. Nevertheless, the proportion of the market capitalisation of shares accounted for by non-residents has not declined, having actually increased by 1.1 percentage points to 7.0% between the end of 2007 and March 2009. Non-residents account for 15.1% of all equity of Slovenian issuers. The Ljubljana Stock Exchange is attempting to provide for a deeper financial market and increased liquidity through official presentations of Slovenian financial products to the rest of the world.

The responsiveness to developments on foreign markets improved in 2008. However, the correlation between the movement of the Slovenian and global capital markets declined again in the first quarter of 2009. Stimulus packages to resolve the turmoil have had varying effects in individual countries. Despite this, capital flows remain weak.

Figure 5.14: Monthly net investments by residents in the rest of the world (left) and by non-residents in Slovenia (right) in EUR million





Note: RS63 government bonds issued on the MTS Slovenia market are not included in non-residents' net purchases of bonds in 2008.
Sources: CSCC, Bank of Slovenia, own calculations

The bonds of Slovenian issuers became attractive to foreign investors with the issue of government bonds. In 2008 foreign investors made net purchases of Slovenian bonds in the amount of EUR 865 million. However, excluding the issue of RS63 11-year government bonds in the amount of EUR 1 billion, they made a net disinvestment of EUR 45 million. In the first two months of 2009, non-residents made net purchases of EUR 61 million, the figure rising to EUR 870 million including RS64 3-year government bonds. Interest in the purchase of RS64 bonds, with a yield to maturity of 4.26%, was high. Non-residents accounted for 29.6% of all debt securities at the end of February 2009, compared with 12.9% at the end of 2007.

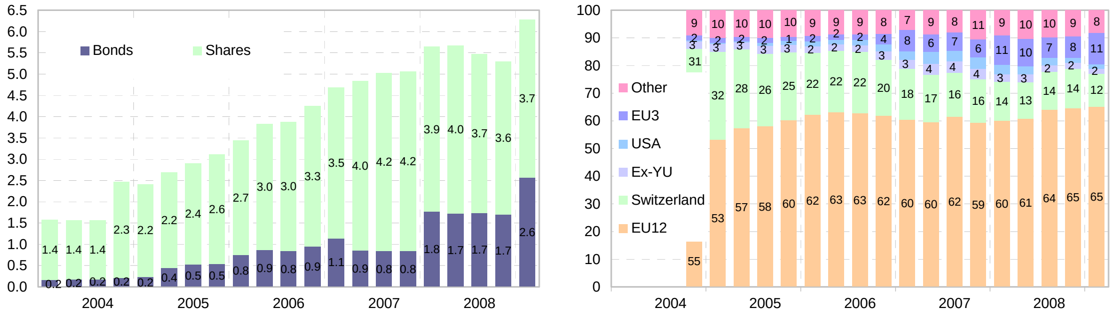
Non-residents increased their investments in Slovenian government bonds.

Table 5.5: Overview of investment links with the rest of the world

	2004	2005	2006	2007	2008	Feb 09
	Residents' investments in the rest of the world					
Shares						
Stock (EUR billion)	0.5	1.5	2.6	4.1	2.3	2.2
As % of GDP	2.2	6.3	11.0	11.8	6.2	5.8
Annual growth (%)	114.6	192.8	73.7	55.9	-43.2	-42.2
In total stock of issued Slovenian equities (%)	2.7	8.0	10.7	11.9	9.4	8.7
Net purchases (EUR billion)	0.23	0.76	0.83	1.02	0.00	0.03
Bonds						
Stock (EUR billion)	0.8	1.5	2.9	5.7	5.3	5.2
As % of GDP	3.4	6.4	12.1	16.4	14.4	13.9
Annual growth (%)	122.8	89.2	89.7	95.2	-5.7	-9.4
In total stock of issued Slovenian debt sec. (%)	13.0	20.6	37.5	87.3	74.6	59.9
Net purchases (EUR billion)	0.43	0.88	1.38	2.87	-0.22	-0.07
	Non-residents' investments in Slovenia					
Shares						
Stock (EUR billion)	2.2	2.5	3.2	4.2	3.6	3.7
As % of GDP	7.4	8.3	10.7	12.2	9.7	9.9
Annual growth (%)	60.1	13.0	28.5	30.6	-14.8	-10.0
In total stock of issued Slovenian equities (%)	11.8	13.5	13.3	12.3	14.7	14.9
Net purchases (EUR billion)	0.09	0.2	0.3	536.7	0.01	-0.03
Bonds						
Stock (EUR billion)	0.2	0.5	0.9	0.8	1.7	2.6
As % of GDP	0.6	1.6	3.0	2.4	4.6	6.9
Annual growth (%)	5.5	172.8	85.2	-7.4	103.2	36.2
In total stock of issued Slovenian debt sec. (%)	2.9	6.7	11.8	12.9	23.8	29.6
Net purchases (EUR billion)	0.05	0.4	0.6	-11.9	0.86	0.87

Note: The 2009 figures are for net purchases in the first two months of the year only. Includes all investments in Slovenia by non-residents, in both listed and unlisted securities. RS63 government bonds are included in non-residents' net purchases of bonds in 2008. RS64 government bonds are included in the figure for 2009.
Sources: CSCC, Bank of Slovenia, SORS, own calculations

Figure 5.15: Stock of non-residents' investments in securities of Slovenian issuers in EUR billion (left), and regional percentage breakdown (right)



Note: Includes investments in listed shares and bonds, and in those not listed on the stock exchange. The 2009 figures relate to the first quarter. EU3: UK, Denmark, Sweden; Ex-YU: former Yugoslav republics.

Sources: CSCC, own calculations

Stock of Slovenian investors' investments in foreign securities.

The stock of Slovenian investors' investments in foreign securities was down 21.6% to EUR 7.7 billion at the end of December 2008, equivalent to 20.6% of GDP. Part of the decline is the result of capital losses, part on account of disinvestment in the rest of the world and the transfer of liquidity to the domestic capital market, which is favourable in a period of difficult access to financing. Residents made net sales of EUR 4 million in 2008, and net purchases of EUR 33 million in the shares of foreign issuers in the first two months of 2009.

Past investment on high-risk, rapidly emerging markets led to a significant decline in investors' assets in 2008 due to capital losses.

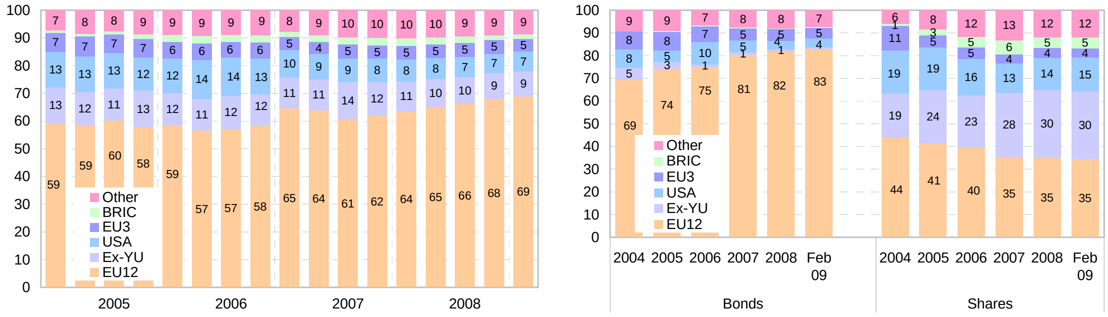
Prevalent among the net sellers of shares from the former Yugoslav republics, the euro area, the EU3, the rapidly emerging BRT countries[30] and China were households, corporates and the sector of other financial intermediaries. The banking and insurance sectors were prevalent among the purchasers of shares of euro area countries and the former Yugoslav republics, the former largely due to the expansion of operations to the Balkan markets. The high exposure of Slovenian investors searching for higher returns in rapidly emerging countries led to a sharp decline in their assets in 2008 owing to the falls in share prices. Prevalent among the net purchasers of shares in the first two months of 2009 were the sector of other financial intermediaries (58%, primarily in shares of euro area countries) and the insurance and pension fund sector (49%), with the majority of investments in corporates from the former Yugoslav republics and the US.

In 2008 residents made net sales of bonds of foreign issuers, in the amount of EUR 216 million. The majority of sales in the amount of EUR 451 million were made by the banking sector, net sales totalling EUR 404 million. Sales were also driven by the need for liquid assets due to the high outflows from mutual funds in the previous year. The insurance sector made net purchases of bonds, primarily of euro area issuers, in the amount of EUR 229 million. Residents made net sales of EUR 67 million in foreign bonds in the first two months of 2009.

In the regional breakdown of residents' investments in the rest of the world, investors withdrew from the US back in 2007, and reduced their investments by an additional 1.5 percentage points last year. More notably, investors reduced their exposure to the former Yugoslav republics by 2.6 percentage points in 2008. The proportion of investments in foreign bonds accounted for by issuers from the euro area rose to 83%, while their corresponding proportion of investments in foreign shares was unchanged, at 35%.

[30] BRT – Bulgaria, Romania and Turkey.

Figure 5.16: Regional breakdown of investments by residents in foreign securities overall (left), and bonds and shares separately (right) in percentages



Notes: The 2009 figures relate to February.
EU3: UK, Denmark, Sweden; BRIC: Brazil, Russia, India, China; Ex-YU: former Yugoslav republics.

Source: Bank of Slovenia

Box 5.1: Development of the financial turmoil and mitigation of its effects in Slovenia

Emergence and development of the financial turmoil in the rest of the world

The financial turmoil intensified in mid-September 2008 with the collapse of Lehman Brothers bank in the US, while declining economic growth in the euro area began to translate into recession. More than a year earlier, with the realisation of credit risk in the US, reports began to surface of widespread high risk and inadequate supervision of real estate lending. This sector of the banking services market represented only one element of a general trend of rising debt and deficits, supported by a policy of low interest rates, increasing production capacities and the overall stimulation of household consumption. The main elements that triggered the financial turmoil were the inadequate supervision of the lending market, the interrelations and size of the largest financial institutions, the scope of their investments in structured financial instruments, and the underestimation of risks.

In one year the financial turmoil and economic crisis spread eastward from the US to Iceland, the United Kingdom and the euro area, and from there to the countries of central and eastern Europe. The latter were affected primarily due to their dependence on inflows of foreign capital, which formed the basis for their high economic growth rates. This dependence was part of Europe's development model, which a number of western European banks implemented via credit expansion. The inability of banks and others investors to continue providing the necessary flows of capital to the countries of central and eastern Europe resulted in increasing pressure for the devaluation of the national currencies in the majority of these countries. The hardest-hit countries of central and eastern Europe were forced to turn to the IMF for assistance to ease external imbalances. The deteriorating liquidity situation confirmed that foreign banks in several central and eastern European countries were highly exposed to risks to which their risk management systems and management boards failed to respond in a timely manner.

Slovenia's rising external borrowing in the years prior to the financial turmoil

The widening of the savings-investment gap in Slovenia in the years prior to the turmoil led to an increase in gross unsecured private external debt from EUR 11.6 billion at the end of 2004 to EUR 30.0 million four years later. This was a period of dynamic economic growth, with rates of 5.9% and 6.8% recorded in 2006 and 2007 respectively. Despite heavy private sector borrowing in the rest of the world and the overheating of the economy, the government continued to borrow abroad, increasing the gross public and publicly secured debt from EUR 3.7 billion at the end of 2004 to EUR 9.1 billion at the end of 2008. Over this period the domestic sectors' net external claims of EUR 0.9 billion became net liabilities of EUR 9.4 billion, while the current account deficit widened to 5.5% of GDP. Taking into account a modest budget surplus, which the government only managed to achieve in 2007 during the period of high economic growth, the room for maintaining a sustainable macroeconomic policy during the recession narrowed. This is offset by Slovenia's integration into the European Monetary Union and the relatively low consolidated general government debt of 22.8% of GDP. Although increasing general government debt during the recession may be justified and appropriate, it would be unacceptable for the government to emerge from the recession overly indebted.

Low stock of investment by Slovenian banks in high-risk US securities and increased dependence on foreign funding

The stock of investments by Slovenian residents in all types of US securities, not only those that proved to be high-risk following the outbreak of the financial turmoil, stood at EUR 757 million in July 2007, the banking sector accounting for just EUR 193 million or one-quarter of this amount. Therefore, Slovenian banks have not been directly affected by the financial turmoil on the asset side, as was the case with financial institutions in the US and western Europe, but indirectly on the liability side. In the positive economic climate in the years prior to the financial turmoil, Slovenia borrowed in the rest of the world to secure that portion of funding not provided by domestic savings. Corporate demand for loans rose owing to relatively low interest rates, a positive climate on traditional export markets, high domestic economic growth, and M&A activities in the corporate sector as part of the process of ownership consolidation. There was also rising demand for loans from the household sector, with a relatively low level of debt, on account of their rising real incomes, and the rising value of their real estate holdings and investments on the capital markets. Given rising real estate prices and capital market indices, the wealth effect was by no means negligible. This position was mirrored on the funding side. Domestic bank savings were insufficient in the context of corporate expansion, the ownership consolidation process and the behaviour of households, which also invested savings in real estate and non-banking forms of financial investments. In 2007, for example, net inflows into mutual funds nearly tripled from the previous year. Slovenian banks responded to the rising demand for loans, which resulted in a widening funding gap, by obtaining funding from the international financial markets to meet the demand for lending to domestic non-banking sectors. The consequence was the increased dependence of banks on conditions on the international financial markets and a change in the structure of banks' sources of funding. This was reflected in an increase in the proportion of funding obtained at foreign banks, from 26.9% at the end of 2005 to 33.7% of total assets at the end of 2008. The coverage of loans to by deposits by non-banking sectors fell to 62%.

Despite the financial turmoil beginning in the middle of 2007, a relatively high level of lending was also seen for the majority of 2008, when banks' claims against non-financial corporations rose by more than EUR 3 billion to EUR 20.0 billion, and by nearly EUR 1 billion to EUR 7.4 billion against the household sector.

Primary means of transfer of the effects of the turmoil to Slovenia

Following the deepening of the financial turmoil in autumn 2008, the conditions under which Slovenian banks obtain funds on the international financial market deteriorated sharply in the context of a general lack of confidence. The regular servicing of their external debt became difficult. Banks subordinated their activities to ensuring the regular servicing of their debt and liquidity requirements, accomplishing both smoothly and effectively since the outbreak of the financial turmoil. At the same time, they have tightened credit standards and reduced lending activity. The latter fell to a significantly lower level in November 2008. This was the first means by which the financial turmoil passed through to Slovenia. The second was the drop in foreign demand, which affected the real sector with the pass-through of the financial turmoil and economic crisis to Slovenia's major trading partners. Companies began intensively adapting current operations, which was evidenced in November 2008 in the sharp year-on-year declines in industrial production (down 14.6%) and merchandise exports (down 14.2%), and the deterioration in the economic sentiment indicator. At the same time, there was a sharp decline in activity in the construction sector, while households began postponing purchases of semi-durables and real estate. By the end of 2008 the economic crisis had spread to the whole economy, with exports in the first two months of 2009 down one-quarter on the previous year. The continuing negative macroeconomic trends were merely confirmed by sharp downward revisions in the economic growth forecasts released in March.

Measures of the Bank of Slovenia

The Bank of Slovenia, as the banking system's supervisory institution, adopted its first measure to mitigate the effects of the financial turmoil in October 2008, by amending the Regulation on the Assessment of Credit Risk Losses of Banks and Savings Banks, which abolished the effects of the prudential filter[1] in the formation of impairments and provisions. The measure had a counter-cyclical effect, as the increase in capital adequacy slowed the contraction of banks' lending activities. The second measure was November's adjustment to the calculation of liquidity ratios for the value of underlying assets at the central bank. Changing the methodology for calculating the liquidity ratio for Category 1 of the liquidity ladder removed the regulatory barrier to drawing a higher level of liquid assets from the ECB. The third measure was taken in November when the Bank of Slovenia called on the management boards of banks to refrain from above-average increases in interest rates on funds in sight savings accounts and shorter-term deposits. In the context of an unlimited government guarantee for bank deposits, the resulting transfer of deposits between banks led to an increase in the instability of deposits, instead of encouraging long-term saving. The announced possible use of measures to sanction continuing inappropriate interest-rate policies proved unnecessary. The Bank of Slovenia also called on the management boards of banks to appropriately assess credit risks in the context of deteriorating economic conditions, and to form an adequate level of impairments. In its fourth measure, in January 2009 the Bank of Slovenia sent four recommendations to the management boards of banks linked to measuring the value and impairments of financial assets during the financial turmoil, for the purpose of compiling final accounts and annual reports for the 2008 financial year. Of importance was the recommendation that objective evidence of the impairment of financial investments in capital instruments also include a significant and longer-term decrease in fair value below historical cost, whereby the Bank of Slovenia defined what constitutes a "longer-term" and "significant" decrease in the value of financial assets. The overall loss thereby estimated from the revaluation of capital instruments in line with the recommendation should be transferred by banks to the income statement, thus providing a more realistic disclosure. The Bank of Slovenia also recommended that banks not allocate distributable profit in an amount equal to loss brought forward in the revaluation reserve, but allocate the majority of profit generated in 2008 to reserves. In its fifth measure, in January 2009 the Bank of Slovenia enhanced the data reporting system of banks by requiring monthly reporting on the formation of impairments and provisions and classified claims from April on, and requested additional information regarding certain forms of collateral. In its sixth measure, at the end of January 2009 the Bank of Slovenia warned banks in writing that some evidence from the examination of the first financial statements for 2008 indicates the possibility that the impairments and provisioning do not fully reflect the deteriorating conditions. It therefore warned banks of the need for the appropriate assessment of investments in financial assets, and the elimination of identified deficiencies in collective impairments that could lead to an underestimation of credit risks. It also recommended that banks retain 2008 profits to increase capital adequacy prior to compiling their final financial statements. All of the above comprise additional measures implemented by the Bank of Slovenia alongside its continued diligent and consistent supervision of banking operations based on valid legislation.

Eurosystem measures

At the first signs of tensions on the money market in August 2007, the Eurosystem began providing extra liquidity via additional operations, and has been acting to ease disruptions on the US dollar money market since December 2007. The Eurosystem responded to the worsening of the financial turmoil in the second half of September 2008 with the following measures:

- additional liquidity: in the scope of a planned six-month longer-term refinancing with full allotment executed on 8 October, the Eurosystem doubled the initially foreseen amount of additional liquidity. On 15 October it expanded the list of eligible collateral for Eurosystem operations to enhance the provision of liquidity, effective until the end of 2009. For the period from 30 October to 31 March 2009, it also announced the provision of longer-term refinancing through a fixed-rate tender procedure with full allotment, the roll-over of a special term refinancing operation maturing on 7 November, two 3-month and one 6-month refinancing operations, and the execution of additional 3- and 6-month longer-term refinancing operations. On 5 March the Governing Council of the ECB ended uncertainty and gradually rising expectations regarding the continuation of the policy of providing operations through a fixed-rate tender with full-allotment after 31 March 2009 by announcing its decision to execute all main refinancing and longer-term refinancing operations in this manner until at least the end of 2009;
- interest rate cuts: from October 2008 until the beginning of April 2009, the Eurosystem cut its refinancing rate from 4.25% to 1.25%, by adjusting other interest rates;
- interventions on the US dollar and Swiss franc markets: due to the sharp increase in short-term US dollar interest rates, on 13 October 2008 the Eurosystem, in cooperation with the central banks of the UK, the US, Japan and Switzerland, announced the execution of US dollar refinancing operations through a fixed-rate tender with full-allotment and maturities of 7, 28 and 84 days. The Eurosystem carried out the first weekly tender on 15 October and suspended overnight lending the following day, but announced a possible rollover, if required. At the same time, it allowed banks to conclude euro / US dollar foreign exchange swaps secured by a counterparty euro deposit at the Eurosystem, and on 20 October began lending Swiss francs via euro / Swiss franc foreign exchange swaps. Slovenian banks were among those who took advantage of this measure to facilitate the management of currency risk.

Slovenian government measures[2]

Since autumn 2008 the Slovenian government has mitigated the effects of the financial turmoil in the context of extremely tight financing conditions on the international markets, while taking into account the Maastricht criterion concerning the government sector's deficit. Additional factors in the context of rapidly deteriorating economic conditions were the expected fall in general government revenues and the need to ensure a sufficiently high, yet long-term sustainable level of government spending to slow the drop in aggregate demand.

1. The Slovenian government adopted its first package of measures, effective until the end of 2010, in November and December 2008:

a) The introduction of an unlimited guarantee by banks, savings banks and the government for the net deposits of eligible depositors. On 7 November 2008 the finance ministers of EU Member States agreed to raise the minimum guarantee on deposits to EUR 50,000, and several EU Member States, including Slovenia, announced an unlimited deposit guarantee on 11 November. In the event of bankruptcy proceedings being initiated, banks and savings banks guarantee to pay a net deposit balance of up to EUR 22,000, while the government guarantees the remainder above this amount. The government also guarantees the repayment of deposits if the institution in bankruptcy is unable to secure sufficient funds to repay guaranteed deposits up to the amount of EUR 22,000. This measure, supported by the Bank of Slovenia, effectively prevented the initial spread of doubt among savers in the Slovenian banking system, as seen by the increase in household deposits at banks in the months that followed.

b) A package of four operational measures aimed at supporting affected financial institutions and at indirectly slowing the decline in the lending activity of banks was adopted in December 2008. Two are aimed at solvent financial institutions unable to obtain funding due to conditions on the international financial markets. At the beginning of 2009 banks estimated that their total requirements for the envisaged state aid in securing resources in the form of funding or guarantees was EUR 6.5 billion until the end of 2009. The first envisaged measure is the issue of government guarantees for liabilities with a maturity of 3 months to 5 years arising from the borrowings of credit institutions in the total amount of EUR 12 billion of principal. The second measure comprises government loans to financial institutions with a maturity of 1 to 5 years. The remaining two measures allow the government to intervene in the operations of financial institutions in difficulties via capital injections, in order to maintain an appropriate level of capital adequacy, and via the purchase of claims. The operationalisation of the measures followed in December 2008 with the issue of decrees. All of the aforementioned measures envisage a restriction on the earnings and fringe benefits of managerial personnel at companies, a restriction on dividend payments and other operational restrictions. With the measures described, which are similar to those of the euro area and European Union, a basis for immediate intervention has been established, should this prove urgent. Nova Ljubljanska banka d.d. requested a government guarantee for the issue of bonds at the beginning of February 2009. In March the government passed a resolution on the issue of a guarantee for liabilities arising from bonds that the aforementioned bank intends to issue on the international financial market. As part of guarantee issuance, in March the government introduced an additional guarantee scheme for corporate loans. There has been no need to date for intervention in financial institutions via capital injections or the purchase of claims, and the procedures for the implementation of such measures have therefore not been triggered.

2. Amendment to the Banking Act (Official Gazette of the Republic of Slovenia, No. 19/2009). At the end of 2008 a regulatory change was adopted as part of ensuring appropriate capital adequacy at banks, based on which the Bank of Slovenia, instead of the general meeting of shareholders, may pass a resolution to increase a bank's share capital by means of non-cash contributions, in order to ensure the necessary economic stability of the bank. The amendment to the law provides the Bank of Slovenia with more flexibility in taking action, as it may implement a measure independently, without issuing a decision on emergency administration proceedings. The amendment to the Banking Act envisages the possible implementation of the measure from the end of March 2009. To date the measure has not been used.

3. Measures by SID banka. In November and December 2008 the state-owned bank provided corporate lending support in the amount of EUR 200 million. Funding was placed through commercial banks, which were required to further increase the value of the loans from their own resources by at least 30%. It also sold 3-year bonds to commercial banks on 23 December 2008 in the amount of EUR 250 million, thus providing banks with eligible collateral for liabilities to the Eurosystem, increasing the potential for drawing on liquid assets. SID banka then deposited the proceeds at banks. It repeated this operation on 9 January 2009 with a second bond issue in the amount of EUR 250 million. Banks subscribed to nearly the full amount of the issue, with SID banka again depositing the majority of the proceeds.

4. Issue of treasury bills. After issuing treasury bills in the amount of EUR 300 million in the final quarter of 2008, the government increased the issue of treasury bills to EUR 876 million in the first quarter of this year. Banks purchased EUR 859 million of the aforementioned treasury bills, the government depositing the majority of the proceeds at banks. On 13 January 2009 the government issued 12-month treasury bills in the amount of EUR 400.2 million and 6-month treasury bills in the amount of EUR 91.6 million. Banks purchased the majority of the issue, namely EUR 395 million and EUR 90 million respectively. The government then deposited EUR 374 million at banks. On 12 March 2009 the government issued 12-month treasury bills in the amount of EUR 349.8 million and 3-month treasury bills totalling EUR 34.4 million. Banks purchased the entire issue of 12-month treasury bills and EUR 24 million of 3-month treasury bills, for a total of EUR 373.8 million. The government then deposited EUR 343.9 million at banks on 12 March. Thus the government increased banks' funding by a total of EUR 717 million in the first quarter of 2009, on the basis of treasury bill issues.

5. Issue of two government bonds. The government raised EUR 2.5 billion with the issue of two reference bonds, primarily to foreign investors, in the first quarter of 2009. On 28 January it issued 3-year reference bonds in the amount of EUR 1 billion with a coupon rate of 4.25% and a yield of 165 basis points over the reference swap rate. Foreign investors purchased 82% of the bonds. Then on 25 March it issued 5-year reference bonds in the amount of EUR 1.5 billion with a coupon rate of 4.25% and a yield of 160 basis points over the reference interest rate. Foreign investors purchased 69% of the bonds. Several years of rising external government debt continued with the issue of the two aforementioned bonds.

6. Guarantee scheme for corporate loans in the amount of EUR 1.2 billion. The government approved the relevant bill on 19 March 2009. However, the National Council delayed its implementation by vetoing it on 2 April. SID banka is expected to issue guarantees to banks in Slovenia to stimulate the financing of investments, working capital and development projects via loans with a maturity of 1 to 10 years. Loans are expected to be issued to bank clients in the three lower-risk credit rating categories. Guarantees for liabilities may amount to a maximum of 80% of all liabilities arising from the loans issued on the basis of the guarantee scheme.

7. Revision to the state budget for 2009 and the Stability Programme for 2009 to 2010. The government passed a revision to the state budget on 26 January 2009, in response to the deteriorating macroeconomic conditions. With an additional EUR 614.4 million, the government will support a number of substantive anti-crisis measures, primarily under the auspices of the Ministry of Labour, Family and Social Affairs, the Ministry of Higher Education, Science and Technology and the Ministry of the Economy. The revision to the state budget provides for a capital injection into SID banka in the amount of EUR 160 million, increasing its capital to EUR 300 million, by means of which the government increased the possible scope of measures that it may implement via SID banka. The revision to the state budget envisages a state budget deficit of 2.9% of GDP, just below the Maastricht criterion, and a consolidated general government deficit of 3.4% of GDP. However, this revision was prepared on the basis of an assumption of 0.6% economic growth in 2009. By the time the revision was approved by the National Assembly at the end of March, the forecasts of economic growth and other key macroeconomic aggregates had deteriorated significantly. Thus the revision to the state budget actually represents a transitional phase in adjusting the budget to the crisis conditions in the 2009 fiscal year, as the government had only just begun to prepare a new revision at that time. According to the latest forecasts by the Ministry of Finance from the end of March 2009, the general government deficit and debt are expected to rise to 3.7% of GDP and 28.8% of GDP respectively. On 23 April the government adopted the Stability Programme for 2009 to 2011, which is based on the IMAD's spring forecast of a 4% decline in economic activity in 2009. The programme envisages a widening of the general government deficit in excess of the Maastricht criterion, and a narrowing over the next two years to bring the deficit back within the aforementioned criterion. The general government's gross debt is expected to increase from 22.8% of GDP in 2008 to 30.5% of GDP and 34.1% of GDP in 2009 and 2010 respectively.

Response of Slovenian banks to the further deterioration of conditions in autumn 2008

a) Adjustment on the funding side. With the deepening of the financial turmoil in autumn 2008, Slovenian banks began borrowing from the Eurosystem to provide current liquidity and the necessary funding to refinance foreign debt and borrowing on the foreign wholesale market. Banks' pool of underlying assets eligible as Eurosystem collateral increased in the context of measures from October 2008 aimed at increasing the potential for drawing on liquidity. By the end of January banks in Slovenia had increased their net borrowing at the Eurosystem to around EUR 1 billion. The proportion of banks' available assets eligible as Eurosystem collateral however never fell below 40%. Liquidity was thus provided, even when needs were greater. However, banks assessed that they cannot earmark these types of short-term funding for lending to non-banking sectors. At the same time banks made large net debt repayments to foreign banks. From November 2008 to March 2009, Slovenian banks made net debt repayments to foreign banks of EUR 1.7 billion, while attempting to increase deposits via their interest-rate policies. With the introduction of an unlimited deposit guarantee, household deposits were up EUR 682 million at the end of February 2009 following a significant decrease in October. Also contributing to this increase were the difficulties faced by households in ensuring greater financial security in the uncertain conditions, and the fall in the value of their other financial investments.

b) The adjustment on the investment side was carried out in two ways: first, banks reduced investments in foreign securities, this reduction providing them the fastest means of response. In October 2008 banks reduced their investment in foreign securities by EUR 522 million, and by an additional EUR 408 million by the end of March 2009. Second, banks decreased the supply of lending by tightening credit standards for all categories of potential borrowers. Corporate lending came to a standstill in November 2008, while households made net repayments to banks. December saw a slight increase in lending activity.

In the context of maintaining the liquidity and solvency of the banking system and the regular servicing of bank debt, the contraction in lending activity was accompanied by a sharp drop in foreign demand. Thus both of the aforementioned ways in which the turmoil was transmitted primarily burdened the corporate sector. It is also evident that the tightening of lending standards by banks was more severe for corporates than for households, which can adapt to the tightened conditions by reducing demand for loans more than corporates are able to.

Effect of government measures on the banking system

SID banka's loan to commercial banks in the amount of EUR 200 million was an emergency measure, by which the government, at least in part, helped the banking system revive frozen corporate lending at the end of 2008. Under the condition that commercial banks earmark loans primarily for companies affected by the turmoil, the aim of the measure was achieved with a concentration of corporate loans in the manufacturing sector and in those sectors that used the loans to finance working capital or merchandise exports. Conditional lending to a specific group of companies could be seen in principle as contentious, as an external influence on the decisions of banks to whom and how much to lend is inappropriate and disrupts banks' operations and the functioning of the market. In the specific case it was understandable that this measure became anti-crisis in nature. The amount of funds drawn from SID banka by the individual banks was in line with the demand of each bank, to which it seems that the assessment of potential borrowers' credit ratings and thus the assessment of credit risk assumed was deferred. Risk assessment must remain the exclusive responsibility of commercial banks during the recession and in the context of urgent anti-crisis measures. Despite the decline in the information capital of banks in profoundly uncertain operating conditions, banks remain the best-qualified to assess credit risk and the best-suited to assume credit risk, by which they ensure the optimal allocation of loans. From this point of view alone the measure was not the best due to the conditions imposed. It was, however, acceptable and effective in the given circumstances. A final assessment will be made later when the quality of the investments is evidenced, and what the causes of a possible deterioration might be.

The issue of bonds by SID banka in December 2008 and January 2009 provided banks with a safe short-term investment, which at the same time also increased bank funding via the depositing of almost the entire proceeds (EUR 474 million). The government also contributed to the increase in the banking system's total assets with the issue of treasury bills in January and March 2009 and the reinvestment of the majority of the proceeds from banks (EUR 373 million and EUR 344 million respectively) in the banking system. The issue of government bonds in February resulted in an increase in the banking system's total assets, primarily on the liability side with an increase in government sector deposits of more than EUR 700 million. The issue of a second government bond at the end of March increased the banking system's funding by an additional EUR 1.3 billion.

New risks arising from anti-crisis measures

The rapid and highly unpredictable development of the financial crisis and its transition to recession requires quick action from the institutions, which is therefore not necessarily optimal. The purpose of proposed measures and their timely implementation must be to ensure the normalisation of the approval of loans to those customers that banks assess as creditworthy borrowers, taking into account current economic conditions. Thus in the first phase of the development of the financial turmoil's effects on the Slovenian banking system, namely from September to December 2008, it was necessary to ensure the funding of banks, which was lost due to the malfunctioning of the wholesale market abroad. Since December 2008 the measures have had to be aimed not only at providing funding, but also at decreasing the asymmetry of information between banks and borrowers regarding creditworthiness, which results in pronounced pro-cyclical behaviour by banks. Only in the third phase, should it follow, will it be necessary to carry out possible capital injections into individual banks, to restructure toxic assets due to incorrect business decision in the past and to appropriately sanction stakeholders.

1. Possible market disruptions. Anti-crisis measures should not disrupt the financial services market, but should act to normalise the extent and maturity of lending. Should the economic crisis continue to worsen and require further measures, financial institutions must remain independent in assessing the risks that they assume. The transparent distribution of the assessment and assumption of risks between financial institutions and the government must be maintained in the anti-crisis instruments.

2. Delayed implementation of measures in the event of a worsening of the economic crisis. By releasing treasury bills and government bonds since January 2009, the government has allowed banks to continue the net repayment of debt at foreign banks and to reduce the number of loans raised at the Eurosystem. Like the provision of liquidity from the Eurosystem, this type of increase in government deposits to fund the banking system is short-term and uncertain due to the unclear answer as to how banks will replace government funding at maturity. At the same time, increased funding by the government has not been reflected in an easing of banks' lending activities since January 2009. The situation in March required the implementation of the measure prepared for the guarantee scheme, which was delayed by the National Council's veto of the Guarantee Scheme Act. The stagnation in lending activity and the spread of the turmoil required a faster response, although part of the reason for low lending activity lies on the demand side.

3. Effectiveness of the government guarantee scheme for corporate lending. The scheme is aimed at providing an appropriate level of medium term corporate lending. A condition for the effectiveness of the guarantee scheme is a sufficient level and an appropriate maturity structure of the funding that banks will require in the context of a likely and simultaneous adjustment in total assets. Banks have slowed corporate lending primarily due to restrictions on the funding side and uncertainty linked to ensuring the refinancing of their debts, and owing to declining information capital and increased prudence in the uncertain conditions of a rapidly slowing business cycle. The guarantee scheme should effectively neutralise these latter factors in particular. Thus due to a shortage of long-term funding, loan demand from good customers is already outstripping the level of loans that banks are willing to approve, without a (partial) government guarantee. Part of the reason is linked to the scope and changing value of the eligible and available real and financial collateral of potential borrowers. If banks determine the latter is relatively low, it could limit the guarantee scheme's stimulative effect on lending activity. This is another reason why the guarantee scheme should be implemented as soon as possible.

4. The risk to refinancing and of imbalances in the contraction of bank balance sheets. Without the ability to replace funding from the foreign wholesale market, Slovenian banks will be faced with the more serious problem of a funding gap in 2009. A shortage of funding will force banks to adjust the asset side of the balance sheet, resulting in a stagnation or even a contraction in total assets. This previously occurred in November 2008 and again in March 2009. Replacing foreign commercial funding with short-term funding from the Eurosystem was a rational business policy of banks. However, short-term liquidity from the Eurosystem is not an appropriate replacement for the funding that banks obtain in normal conditions on the wholesale market in line with a maturity tailored to their business needs. Furthermore, government interventions have only delayed, not prevented, the contraction of the banking system's total assets. A slowdown would be more appropriate, as adjustments due to declining economic growth and demand for loans are becoming unavoidable. What is required is the matching of the maturities of securities issued by the government and its bank deposits, with the possibility of refinancing so that the process of adjusting the banking system's total assets would be gradual and at the same time take into account the trend of economic activity and the pace at which the functioning of the wholesale interbank market normalises. Refinancing risk, together with the search for long-term funding (e.g. by banks issuing their own securities), is one of the core problems faced by the Slovenian banking system in the future.

Risk associated with the effectiveness of credit and income risk management and the responsibility of banks' owners

The worsening of the turmoil in the real sector and the contraction of bank balance sheets will reduce the quality of their investments. It would therefore be appropriate for this limiting process to gradually and evenly ease, thus enabling the banking system to mitigate the adverse effects of a deteriorating credit portfolio. Banks are already under extreme pressure of falling income. While initially operating results were profoundly affected by changes on the capital markets and by activities related to securities-based transactions, the pressure accompanying the spread of the turmoil to the real sector will result in a deterioration in the credit portfolio. In the context of an appropriate increase in impairment and provisioning costs, banks must, in accordance with the principle of acting with the diligence of a good manager, improve the effectiveness and consistency of the recovery of bad debts, thus mitigating exposure to rising income risk. Rising credit and income risk requires an active role on the part of not only management boards, but also supervisory boards. The owners of banks must consistently assert the responsibility of supervisory board members, and with them ensure that banks adapt to the increasing risks from banking operations. Bank owners are expected to be responsible owners and to fully assume this responsibility, without relying on government assistance. This is solely justified if the potential collapse of a specific bank threatens the stability of the entire financial system. In this context owners are faced with an important challenge this year: to diligently verify whether the capital of their banks reflects the increased risk exposure, and to provide additional capital when the need arises.

[1]Undisclosed impairments and provisions are an original own funds deduction item arising from the difference between actual impairments and provisions for collectively assessed financial assets and liabilities assumed under off-balance sheet items, and legally defined impairments and provisions in accordance with the regulation on the assessment of credit risk losses. This is the so-called prudential filter, which was temporarily abolished in October 2008.
[2] The article is limited to those measures that are significant in terms of context. All measures implemented by the Slovenian government to mitigate the effects of the financial turmoil are presented at:
http://www.vlada.si/si/teme_in_projekti/aktivno_proti_financni_in_gospodarski_krizi/.

6 BANKING SECTOR

6.1 Structural features of the banking sector

The ratio of the banking system's total assets to GDP continued to increase significantly in 2008, but Slovenia still trails the euro area average by a long distance according to this indicator. Having declined in 2007 as a result of the privatisation of Nova Kreditna banka Maribor, the percentage of the banking sector under government ownership rose again to finish 2008 at its level of the end of 2006 as a result of the increase in the government holding in SID banka. The trend of diminishing market concentration continued last year, but concentration nevertheless remains above the EU average.

Banking sector size and changes of status

The number of banks fell by three in 2008.

There were 18 banks, three savings banks and three branches of foreign banks operating in Slovenia as at the end of 2008. The total number of credit institutions was down three on the previous year, Nova Ljubljanska banka having taken over NLB Koroška banka, NLB Banka Zasavje and NLB Banka Domžale in May 2008. KD banka commenced trading as a newly established bank on 2 March 2009.

The number of notifications continues to rise.

In 2008 the Bank of Slovenia received 66 notifications of the direct provision of banking services and other mutually recognised financial services, and no notifications of the provision of services via a branch. Supervisory institutions gave notifications of the direct provision of banking services or mutually recognised financial services for a total of 241 credit institutions and special financial institutions, primarily from Austria, the UK and Germany.

The banking system's total assets stood at 128% of GDP at the end of 2008.

Banks remain by far the most important financial intermediaries, while the share of savings banks is negligible. Banks had total assets of EUR 47.5 billion in December 2008, while those of savings banks stood at EUR 319.7 million. The banking system's total assets thus stood at approximately 128% of GDP.

Nominal growth in total assets was 12.2%, down significantly on 2007, but at the level achieved in 2004. In addition to two branches of foreign banks, growth of over 50% was recorded by SID banka, as a result of borrowing on the international bank market and EUR 500 million of bonds issued in late 2008 and early 2009 to encourage the financing of the economy.

The ratio of total assets to GDP is increasing, but remains well behind the EU average.

The ratio of the total assets of Slovenian banks to GDP has increased from year to year, but is nevertheless still 2.5 times lower than the EU average.

Table 6.1: Total assets of banks compared with GDP

	2004	2005	2006	2007	2008
Total assets of banks (EUR million)	23,691	29,287	33,868	42,343	47,498
GDP - current prices (EUR million)	27,073	28,704	31,008	34,471	37,126
Total assets (as % of GDP)	87.5	102.0	109.2	122.8	127.9
Ratio of growth in total assets to GDP growth	1.6	3.9	2.0	2.2	1.6
No. of bank employees	11,534	11,632	11,714	11,878	

Source: Bank of Slovenia

Bank ownership

Ten banks were under majority domestic ownership at the end of 2008.

There were eight subsidiary banks and three branches of foreign banks under majority foreign ownership at the end of 2008. Two banks were under full domestic ownership (compared with six at the end of 2007), while eight banks were under majority domestic ownership, of which half had less than 3% foreign equity. The proportion of equity held by non-residents increased slightly in 2008, primarily as a result of an increase in the foreign owner's holding in Banka Koper. The proportion held by foreign persons in terms of total assets at the end of 2008 was 2.9 percentage points higher than that in terms of equity. Government ownership increased by 2.6 percentage points last year, primarily as a result of the increase in the government holding in SID banka, which is the only bank in Slovenia under direct majority government ownership. As a result of the aforementioned increase, the overall government holding returned to its level of the end of 2006, having fallen in 2007 as a result of the privatisation of Nova Kreditna banka Maribor.

Table 6.2: Ownership structure of the banking sector (in terms of equity)

(%)	2004	2005	2006	2007	2008
Central government	19.1	18.2	17.9	15.1	17.7
Other domestic entities	48.6	46.9	44.4	47.2	44.1
Non-residents	32.4	34.9	37.7	37.8	38.2
Non-residents (over 50% control)	16.5	19.4	27.7	26.8	27.6
Non-residents (under 50% control)	15.9	15.5	10.0	11.0	10.6

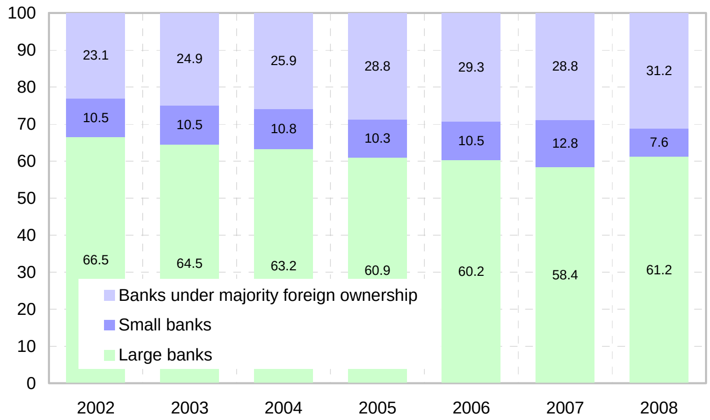
Source: Bank of Slovenia

After Nova Kreditna banka Maribor became the second bank in Slovenia to have its shares listed on the Ljubljana Stock Exchange's regulated securities market at the end of 2007, shares in Abanka Vipa were also listed on the Ljubljana Stock Exchange in October 2008.

The market share of the small banks fell as a result of the takeover of three banks by NLB.

In the subsequent analysis, the banks are divided into three groups: the large and small domestic banks, and the banks under majority foreign ownership. There is no overlap between the groups, so each bank is classified into one group only. The size of the bank is determined by its total assets. All the banks under majority foreign ownership are placed in the same group, regardless of size, owing to differences in their behaviour and operational methods. Despite this division for analytical purposes, all euro area banks are treated the same irrespective of ownership. As a result of the takeover of three banks by Nova Ljubljanska banka in May 2008, the market share of the small banks fell during the year, and the share of the large banks increased.

Figure 6.1: Market shares of banks under majority foreign ownership and under majority domestic ownership in terms of total assets in percentages



Source: Bank of Slovenia

Concentration in the banking sector

Concentration continued to diminish, other than in the segment of liabilities to non-banking sectors.

The trend of diminishing market concentration in the Slovenian banking sector continued in 2008, as a result of the rapid growth of the banks under majority foreign ownership and the small banks. An exception is liabilities to non-banking sectors, where concentration increased, primarily as a result of liabilities to households. The takeover of three subsidiary banks by Nova Ljubljanska banka increased the concentration in liabilities to households. There was an increase in the concentration of loans to households for the same reason, but the concentration of total loans to non-banking sectors nevertheless declined slightly.

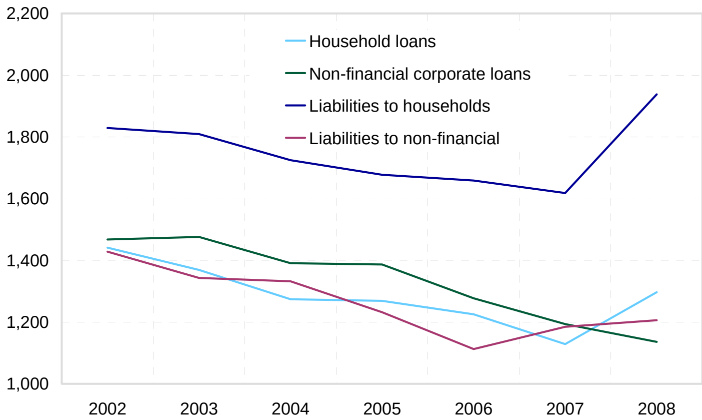
Concentration in Slovenia is higher than the euro area average, although the gap is diminishing, which is reflected in the market share of the five largest banks, which in 2008 was just 4.7 percentage points higher than the unweighted euro area average for 2007.

Table 6.3: Market concentration of the Slovenian banking market as measured by the Herfindahl-Hirschman index, and market share of the top three/five banks

	2004	2005	2006	2007	2008	Change 2008/2007
Total assets	1,472	1,395	1,342	1,313	1,282	-31
Total assets (euro area)	599	642	630	654		
Unweighted	997	1,029	996	1,006		
Loans to non-banking sectors	1,310	1,307	1,232	1,214	1,210	-4
Liabilities to non-banking sectors	1,570	1,462	1,434	1,477	1,616	139
Liabilities to banks	1,278	1,339	1,236	1,170	1,034	-136
	Market share of top 3 banks (%)					
Total assets	52.0	50.6	50.0	49.0	47.9	-1.1
Loans to non-banking sectors	50.5	49.2	48.0	47.0	46.6	-0.4
Liabilities to non-banking sectors	55.3	54.1	54.0	54.2	56.6	2.4
Liabilities to banks	49.0	49.7	48.0	41.4	36.4	-5.0
	Market share of top 5 banks (%)					
Total assets	65.1	63.6	62.7	59.9	59.4	-0.5
Total assets (euro area)	41.6	42.6	42.8	44.1		
Unweighted	54.2	54.9	54.4	54.7		
Loans to non-banking sectors	64.2	62.6	61.3	58.4	59.3	0.8
Liabilities to non-banking sectors	68.9	67.3	66.7	65.8	65.7	-0.1
Liabilities to banks	62.0	62.9	61.4	50.9	51.2	0.3

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

Figure 6.2: Market concentration in bank operations with non-banking sectors as measured by the Herfindahl-Hirschman index



Source: Bank of Slovenia

6.2 Banks' assessments of demand for loans and credit standards[31]

Demand for corporate loans

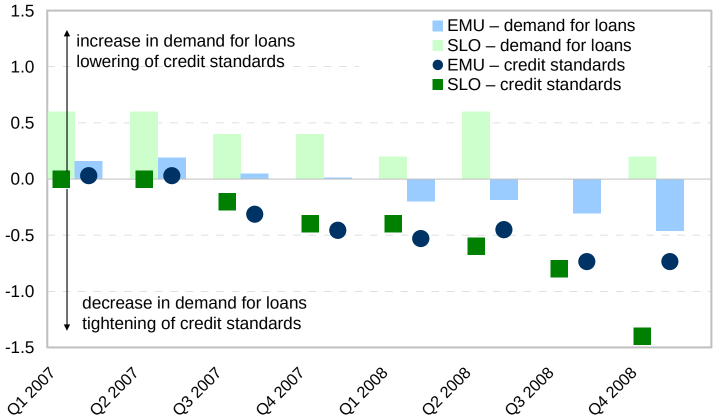
Corporate demand for loans in Slovenia almost entirely froze in the second half of 2008.

The results of the quarterly bank lending survey show that the moderately increasing corporate demand for loans in Slovenia and the euro area began to decline in the third quarter of 2007. It continued to decline in the euro area in each quarter of 2008. The decline was more pronounced towards the end of the year, when corporates were already making intensive operational adjustments to the decline in demand. Corporate demand for loans in Slovenia remained positive in 2008. The demand for short-term loans from large corporates led to a certain level of growth in the second quarter, but demand almost froze in the second half of the year. It was maintained at this level primarily by demand for

[31] The ESCB supplements the prevailing quantitative information with its Bank Lending Survey. The results for the euro area are published regularly on http://www.ecb.int/stats/money/lend/html/index.en.html. Methodological limitations mean that the results for Slovenia and for the euro area as a whole are not directly comparable, and the substantive conclusions are less solid than in quantitative analysis.

financial resources for funding inventories and working capital, and demand for loans for debt restructuring.

Figure 6.3: Demand for corporate loans and credit standards



Sources: ECB, Bank of Slovenia

Terms and standards of corporate lending

Banks tightened credit standards moderately from the outbreak of the financial turmoil in the middle of 2007, and more sharply in the second half of 2008.

During the onset of the spread of the financial turmoil from the US to the euro area in autumn 2007, banks responded to the changed circumstances by tightening their credit standards[32] to a limited extent, subsequently tightening them by an equal measure by summer 2008. A sharper tightening followed in the second half of 2008, as banks in Slovenia and the euro area responded to the completion of the spread of the financial turmoil to the other sectors of the economy. This was reflected in more solid forecasts of a continuing deterioration in economic trends, in an increase in uncertainty of operation and a deterioration in the performance of individual corporates and sectors, and in a continuation of the adverse trends on the capital markets. In part banks in Slovenia also tightened their credit standards in the second half of 2008 as a result of certain other factors, including difficulties in accessing funding and the risks associated with securing claims. Having been gradually increasing from the middle of 2007 onwards, bank margins increased more sharply in the final quarter of 2008. The ongoing tightening of certain terms for approving loans – non-interest expenses, size of loan, maturity and other contractual provisions – was more notable by the third quarter of 2008, particularly in the form of increased conservativeness in limiting the size of loans and the required collateral.

Demand for household loans and credit standards

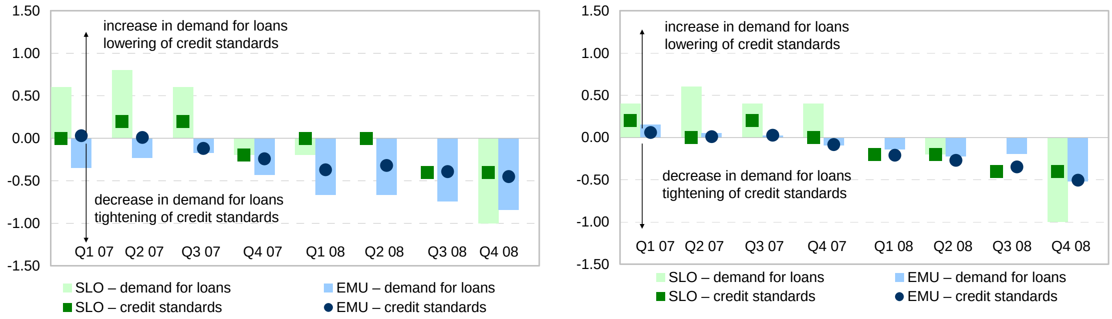
In contrast to corporate loans, demand for household loans declined significantly in the final quarter of 2008.

Demand for housing loans at Slovenian banks was already declining notably at the end of 2007, and declined sharply toward the end of 2008. The first of the aforementioned declines was in part related to the response of households to the decline in the value of their financial investments and to the financial turmoil. At the same time it can be concluded that the nature of the Slovenian real estate market was also a factor in the decline and continuing stagnation in demand for housing loans in 2008. The level of real estate prices had grown relatively high after a long period of increase relative to households' disposable income. The deterioration in economic conditions in the final months of 2008 led to a sharp decline in demand for housing loans associated with the aforementioned state of the real estate market, on which expectations of price falls had arisen. Slovenian banks tightened the credit standards for housing loans to a small measure in the final months of 2007, one quarter later than in the euro area, and did so again in the second half of 2008. The main reason for the tightening was the deterioration in the economic climate and the expected price developments on the real estate market in the context of a sharp decline in volume. Banks primarily raised their margins and tightened their loan collateral terms.

Demand for housing loans in Slovenia stagnated for most of 2008, and then fell sharply towards the end of the year. This fall was associated with a decline in purchases of consumer goods and a decline in consumer confidence. The slow tightening of credit standards that was a feature of the whole of 2008 was more pronounced in the second half of the year.

[32] Credit standards are defined in the survey as internal guidelines or criteria that reflect the bank's lending policy. Lending terms are specific contractual obligations or elements of an agreement between bank and borrower.

Figure 6.4: Household demand for housing loans (left) and consumer loans (right), and changes in credit standards



Source: ECB, Bank of Slovenia

A comparison between corporates and households in respect of the data for the tightening of credit standards and the change in demand for loans shows that banks have recently been more prepared to finance households, but in contrast to corporates, household demand for loans has fallen significantly.

6.3 Changes in balance sheet structure

The sharp decline in lending growth in 2008 matched the simultaneous decline in the pace of bank borrowing in the rest of the world.

A feature of 2008 was the relatively rapid decline in bank lending. Growth in loans to non-banking sectors, which stood at close to 40% at the beginning of the year, had fallen below 20% by the end of the year, and to merely just over 13% by the end of the first quarter of 2009. Bank investments in securities continued to fall. The proportion of total assets accounted for by securities declined last year, but by less than in previous years. Loans to non-banking sectors accounted for more than 70% of total assets at the end of 2008. Growth in deposits by non-banking sectors did not deviate from previous years, but the pace of borrowing from banks in the rest of the world fell rapidly. This actually switched to net repayments in the final months of last year and the first quarter of this year.

Table 6.4: Market shares and growth in total assets and loans to non-banking sectors by bank group in percentages

(%)	Market shares					Growth rates				
	2005	2006	2007	2008	Mar 09	2005	2006	2007	2008	Mar 09
Total assets										
Large banks	60.9	60.2	61.5	61.2	61.9	18.8	13.9	26.5	7.2	7.7
Foreign banks	28.8	29.3	28.8	31.2	30.2	37.1	17.9	22.7	21.8	12.6
Small banks	10.3	10.5	9.8	7.6	7.9	20.0	22.6	22.0	18.2	18.9
Total	100	100	100	100	100	23.6	15.6	25.0	12.2	10.0
Loans to non-banking sectors										
Large banks	58.7	56.5	56.4	56.4	56.5	21.7	21.7	37.5	12.6	11.2
Foreign banks	31.9	33.8	34.1	36.4	36.2	36.2	33.7	40.0	25.7	15.8
Small banks	9.4	9.8	9.5	7.2	7.3	22.4	35.9	42.0	22.0	17.1
Total	100	100	100	100	100	26.1	26.4	38.6	17.7	13.2

Source: Bank of Slovenia

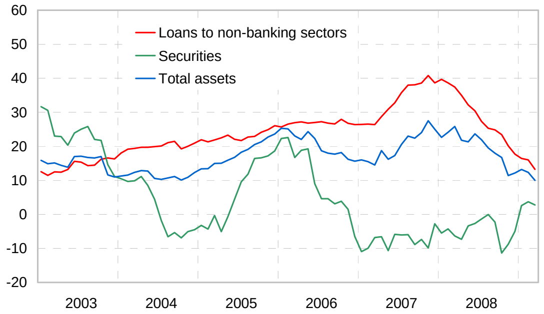
6.3.1 Major factors in the decline in lending growth in 2008

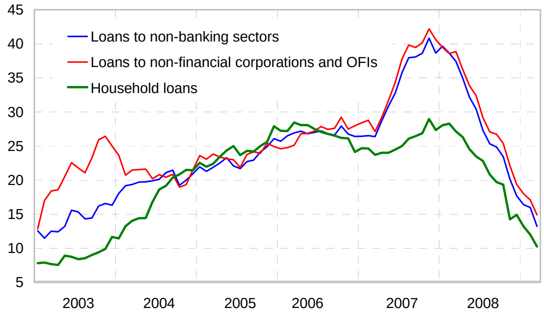
A decline in growth in loans to non-banking sectors.

There were several factors in the decline in lending growth: 1) the tightening of terms on bank funding in the rest of the world, in particular since the escalation of the financial turmoil in autumn 2008; 2) the tightening of credit standards undertaken by banks because of the deterioration in the economic climate; 3) the rise in real interest rates; and 4) a base effect, as the previous year saw lending significantly in excess of the long-term average.[33]

[33]Lending growth in 2007 was well above average as a result of the climate in Slovenia and in the rest of the world, low interest rates and the loan financing of M&A activities at certain corporates.

Figure 6.5: Year-on-year growth in bank investments and loans to non-banking sectors in percentages





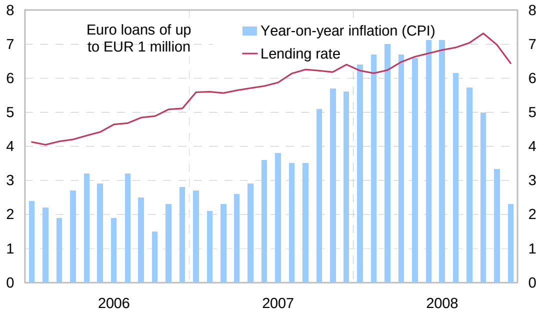
Sources: Bank of Slovenia

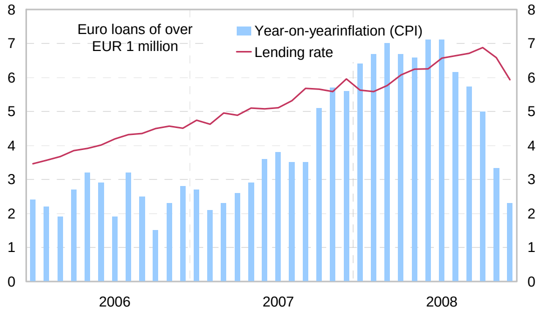
Movement of interest rates and inflation as a factor of demand for loans

While the gap between the lending rate and the rising year-on-year inflation rate declined rapidly in 2007 and was one of the main factors in the increase in demand for loans, last year saw the reverse process. By the first months of 2008 ex post real interest rates on loans had become negative. However, as a result of the rapid fall in inflation in the second half of 2008, and in the context of the significantly slower decline in interest rates, these not tracking the decline in the EURIBOR as banks primarily increased their premiums in the crisis conditions, the gap was rapidly neutralised, and began to widen in the following months. The increase in the gap between lending rates on corporate loans and annual inflation in the second half of 2008 further contributed to the decline in corporate demand for loans.

The increase in the gap between interest rates on corporate loans and inflation reduced the demand for loans.

Figure 6.6: Interest rates on corporate loans of up to EUR 1 million (left) and over EUR 1 million (right) and annual inflation in percentages



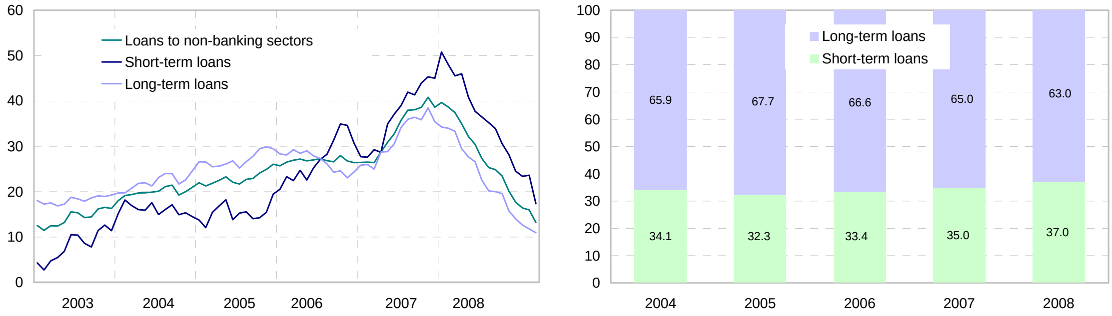


Source: Bank of Slovenia

6.3.2 Structure of assets

Growth in short-term loans outpaced growth in long-term loans throughout last year. The proportion of the stock of loans to non-banking sectors accounted for by short-term loans increased by 2 percentage points last year to 37%.

Figure 6.7: Year-on-year growth in loans to non-banking sectors by maturity, and percentage breakdown of loans to non-banking sectors by maturity



Source: Bank of Slovenia

Growth in foreign currency loans to non-banking sectors fell rapidly last year. Foreign currency loans accounted for a relatively low 6% of loans to non-banking sectors. The proportion accounted for by foreign currency loans is highest in household loans, the figure reaching 12.3% in March 2009.

Table 6.5: Structure of and growth in balance sheet items in the banking sector at year-end in percentages

					Growth rate (%)				
	2005	2006	2007	2008	2005	2006	2007	2008	Mar 09
Total assets (EUR million)	29,287	33,868	42,343	47,498	23.6	15.6	25.0	12.2	10.0
Assets	Structure (%)								
Cash	2.0	3.1	1.4	2.6	1.9	76.3	-42.9	105.9	28.7
Loans to banks	9.8	9.1	9.6	8.5	35.6	6.8	32.8	-1.2	4.0
Loans to non-banking sectors	55.1	60.3	66.8	70.1	26.1	26.4	38.6	17.7	13.2
Corporate loans	33.8	36.5	40.2	42.2	22.5	24.8	37.8	17.6	14.1
Households loans	13.9	14.9	15.2	15.6	28.0	24.1	27.1	14.9	10.2
Loand to govrnment	2.3	1.7	1.1	1.1	11.6	-13.8	-18.9	8.9	21.3
Loans to others	5.1	7.1	10.3	11.3	59.4	61.3	80.7	23.3	13.5
Financial assets/securities	28.6	23.3	18.2	15.3	21.4	-5.7	-2.2	-5.7	3.3
Government	9.2	8.0	10.1	8.6	7.9	0.5	57.5	-4.8	9.3
Capital investments	1.2	1.3	1.5	1.3	11.6	19.9	43.9	2.0	4.1
Other assets	3.2	3.0	2.4	2.1	-2.2	8.0	2.5	-1.7	-13.4
Liabilities									
Liabilities to banks	28.7	31.9	38.0	40.6	80.0	28.6	49.0	19.8	7.8
To foreign banks	26.9	29.9	34.0	33.7	86.4	28.1	42.5	11.1	-0.5
Liabilities to non-banking sectors	54.7	51.7	45.8	43.4	8.8	9.3	10.7	6.3	10.8
To corporates	14.8	14.1	11.4	10.0	11.6	10.3	0.7	-1.3	3.6
To households	36.0	33.4	29.2	28.4	6.0	7.4	9.3	9.2	8.9
To government	3.0	3.3	3.6	3.9	53.4	28.5	35.6	22.9	43.7
To others	0.9	0.8	1.6	1.0	-15.6	6.9	139.0	-30.7	-4.2
Liabilities from securities	3.4	2.9	2.3	2.6	5.7	-1.6	-1.3	30.6	54.6
Other liabilities	5.1	4.6	3.9	3.9	15.8	3.3	6.3	13.8	31.6
Provisions	0.6	0.5	0.5	0.4	-64.1	2.2	12.6	-16.0	-13.1
Subordinate liabilities	2.4	2.9	3.5	3.4	18.4	40.0	48.1	8.6	9.0
Capital	8.5	8.4	8.4	8.4	29.6	14.3	25.2	12.4	7.1

Note: The category of financial assets is wider than securities in methodological terms, and also includes available-for-sale loans, and certain available-for-sale securities with the function of capital investments.

Source: Bank of Slovenia

A decline in the proportion of bank assets accounted for by securities.

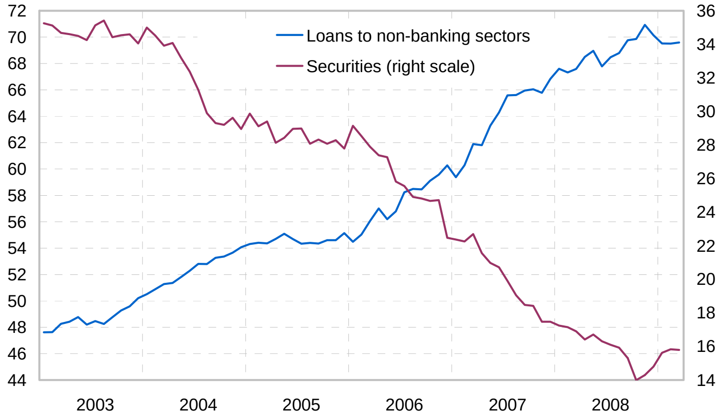
Last year saw a continuation in the trend of decline in the proportion of the banking system's total assets accounted for by securities, albeit more slowly than in previous years. The stock of securities on bank balance sheets declined by EUR 369 million, or by 2.2 percentage points in terms of total assets. The previous year the figure had declined by more than 5 percentage points. One reason for the slowdown in the decline was the rapid decline in lending growth, and the resulting relatively rapid decline in growth in total assets. Towards the end of last year and in the first quarter of 2009 the proportion of total assets accounted for by securities rose again as a result of the uncertainty on the financial markets and increased subscription to securities.

Decline in investments in securities at banks

The adverse movements on the capital market were also reflected last year in bank investments in securities. As a result of changes in market value and sales, financial assets held for trading declined by more than a quarter to EUR 1.2 billion. Available-for-sale financial assets, primarily debt securities, declined by just under 7% to EUR 4.5 billion. Bank investments in this balance sheet item were revalued, and the effects disclosed in revaluation adjustments to equity. Later, in November and December, banks transferred this negative effect to last year's income statement, on the basis of a letter from the Bank of Slovenia. Nevertheless the category declined by relatively little, as a result of banks investing more heavily in Slovenian treasury bills and bank bonds issued at the end of 2008, and not in equities.

The stock of held-to-maturity financial assets increased by 39.6% last year to EUR 1,385 million, primarily as a result of banks disclosing a portion of the Slovenian treasury bills and bank bonds in this category. Banks also created impairments for a portion of the held-to-maturity financial assets. Investments in securities, irrespective of disclosure category, declined by 5% to EUR 7 billion. Government bonds were the largest item, at just over EUR 4.1 billion at the end of 2008.

Figure 6.8: Percentage of total assets accounted for by loans to non-banking sectors and securities



Source: Bank of Slovenia

Comparison of the asset structure of Slovenian banks and EU banks

Table 6.6: Comparison of certain balance sheet asset items at Slovenian banks and EU banks reporting under the IFRS in percentages

(%)	2007		2008
	Medium-sized EU banks[1]	Small EU banks[1]	Slovenia
Cash	2.4	3.6	2.6
Loans to banks	6.3	7.8	8.5
Loans to non-banking sectors	65.5	59.1	70.1
Financial assets/securities	12.6	12.3	15.3

Note: [1] Domestic banks from EU Member States reporting under the IFRS.
Sources: Bank of Slovenia, ECB: EU Banking Sector Stability, November 2007

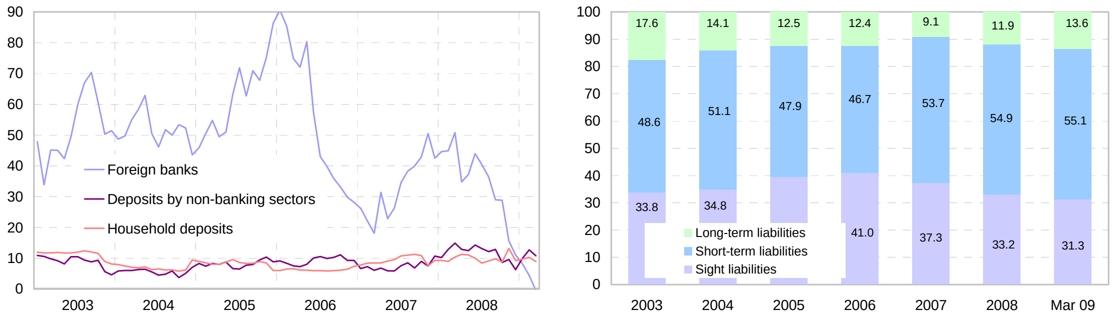
A comparison of the asset structure of the Slovenian banking system with that of medium-size EU banks reveals that the proportion of total assets accounted for by loans to non-banking sectors in Slovenia is higher than that of medium-size and small EU banks. The proportion of total assets accounted for by securities at Slovenian banks still exceeds that at EU banks of comparable size, although the gap has narrowed in recent years.

6.3.3 Bank funding

Last year's increase in deposits by non-banking sectors was comparable to previous years.

The gap between growth in loans to non-banking sectors and growth in deposits by non-banking sectors narrowed in 2008. The net increase in deposits by non-banking sectors amounted to EUR 1.2 billion last year (compared with EUR 1.8 billion the previous year). At EUR 1.1 billion, the net increase in household deposits was comparable to the previous year. In the context of relatively unchanged growth in deposits, the escalation of the turmoil and the associated restrictions on funding in the rest of the world forced banks to reduce the pace of their lending to non-banking sectors.

Figure 6.9: Growth in funding (left) and breakdown of banks' short-term and long-term liabilities to non-banking sectors (right) in percentages

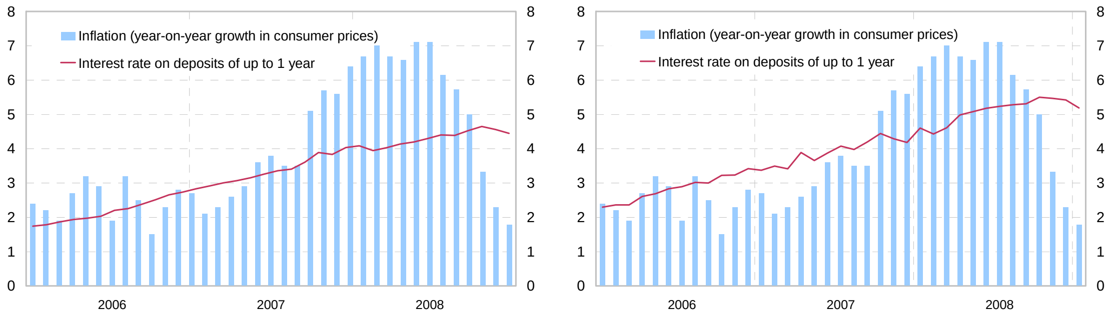


Source: Bank of Slovenia

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

The proportion of deposits by non-banking sectors accounted for by long-term deposits increased last year. The figure stood at 11.9% at the end of 2008, although deposits of between 1 and 2 years account for the vast majority. Alongside the adverse conditions on the capital markets and the unlimited guarantee for deposits at banks and savings banks introduced by the Slovenian government in autumn 2008, another factor in the increase in the proportion of long-term deposits was positive ex post real interest rates. Deposits accounted for 43.4% of total liabilities at the end of 2008.

Figure 6.10: Interest rates on deposits of up to 1 year (left) and on deposits of more than 1 year (right), and inflation rate in percentages



Source: Bank of Slovenia

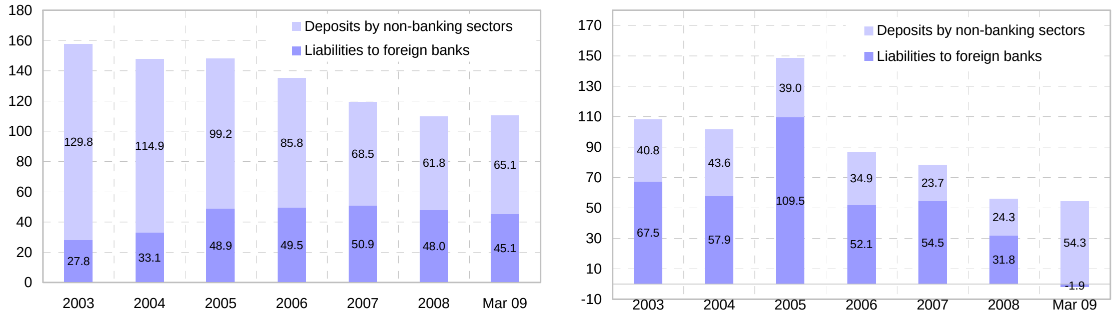
The banks under majority foreign ownership primarily funded themselves via banks in the rest of the world last year, and the banks under majority domestic ownership via deposits by non-banking sectors.

Having funded more than half of the increase in total assets by borrowing from banks in the rest of the world in the previous year, banks reduced this figure to approximately 31% last year. The bank groups differ in their funding methods. At the end of 2008 liabilities to banks in the rest of the world accounted for more than a quarter (27.5%) of the total liabilities of the large banks under majority domestic ownership, while the figure at the banks under majority foreign ownership was more than half (52.3%), and the figure at the small domestic banks was just 6.8%. Deposits by non-banking sectors are still the most important source of funding, particularly at the domestic banks. At the end of 2008 they accounted for 50.5% of total liabilities at the large domestic banks, 58% at the small domestic banks, and just 31.3% at the banks under majority foreign ownership. The same is true of household deposits, which account for slightly less than a third of total liabilities at the large and small domestic banks, but merely just under a fifth at the banks under majority foreign ownership.

Coverage of loans by deposits by non-banking sectors declined last year.

That liabilities to foreign banks are a less stable source of funding than household deposits for the banks under majority domestic ownership was confirmed in autumn 2008, i.e. during the escalation of the financial turmoil, when the banks under majority domestic ownership, the large banks in particular, began making debt repayments in the rest of the world. Attention should therefore be drawn to the importance of funding via deposits by non-banking sectors to operational stability. The trend of decline in the coverage of loans by deposits by non-banking sectors continued last year, albeit with less intensity. The ratio of deposits by non-banking sectors to loans stood at 61.8% at the end of the year, significantly less than the EU average. The aforementioned ratio began to improve in the first months of 2009.

Figure 6.11: Percentage coverage of loans to non-banking sectors by liabilities to foreign banks and by deposits by non-banking sectors in terms of stock (left) and in terms of nominal increase (right)



Source: Bank of Slovenia

One consequence of the differing structure of funding for the individual bank group is relatively large differences in growth in loans. At the end of 2008 the coverage of loans to non-banking sectors by deposits stood at just over 74% at the large banks under majority domestic ownership, at just under 86% at the small domestic banks, and at merely just over 38% at the banks under majority foreign ownership. The coverage of loans by liabilities to foreign banks was close to two-thirds (63.9%) at the banks under majority foreign ownership at the end of 2008, compared with 42.6% at the large domestic banks and just 10.3% at the small domestic banks. This year there has been a sharp turnaround in borrowing in the rest of the world. Should the process of debt repayments by Slovenian banks on the foreign wholesale market continue at the pace of the first quarter of 2009, a sharp deleveraging will follow in the months ahead. Encouraging domestic saving is a lengthy process, while the issue of debt securities by banks will be very difficult in the unstable financial conditions and in the context of a highly contingent government guarantee.

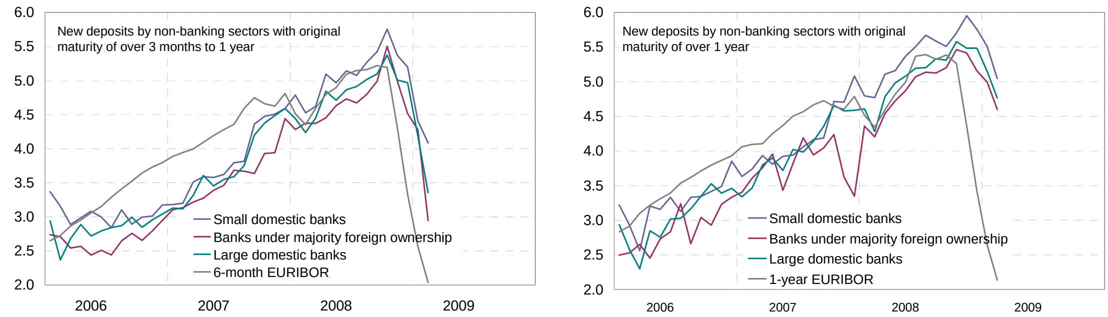
A contraction in bank balance sheets expected in 2009.

Interest rates on deposits by non-banking sectors

All the bank groups raised interest rates for the majority of last year, these peaking in October and November. The importance of deposits by non-banking sectors as a source of funding varies relatively greatly from bank group to bank group. As at December 2008, deposits accounted for 57% of total funding at the small banks, just over a half at the large banks, and less than a third at the banks under majority foreign ownership. Last year the small banks also continued to play a leading role in offering higher interest rates on short-term and long-term deposits compared with the other bank groups. Their greater sensitivity to increased lack of confidence on the part of customers means that the small banks responded most strongly to the uncertainty and lack of confidence on the interbank market, which in October 2008 was also partly reflected in a lack of confidence on the part of depositors. Their higher interest rates prevented deposits from migrating to other, larger banks. Last year interest rates rose by an average of 1 to 1.2 percentage points, depending on the bank group, before falling to their level of 2007 at the beginning of this year.

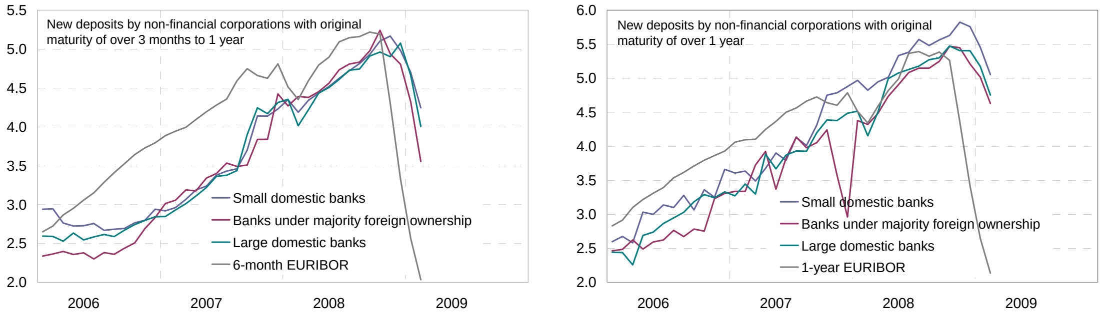
Competition between banks in deposit rates. The small banks offered higher interest rates in the short-term and long-term deposit segments.

Figure 6.12: Interest rates on new deposits by non-banking sectors in percentages



Source: Bank of Slovenia

Figure 6.13: Interest rates on new household deposits of 3 months to 1 year (left) and of more than 1 year (right) in percentages

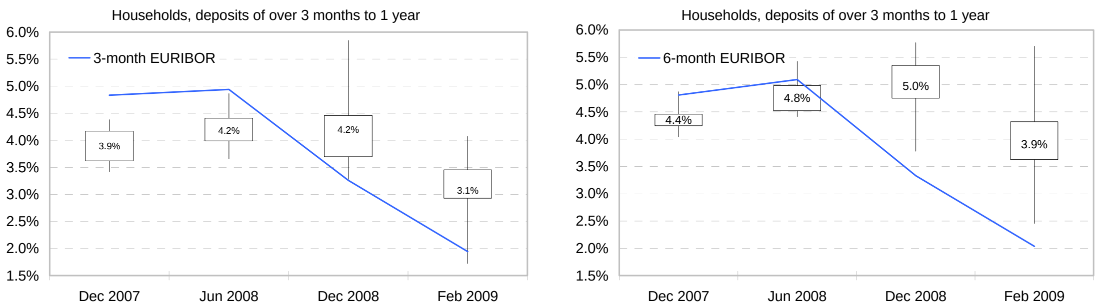


Source: Bank of Slovenia

Competition between banks in interest rates on deposits by non-banking sectors.

The small domestic banks had raised their interest rates above the EURIBOR in the long-term segment the previous autumn, while in the short-term segment of household saving interest rates remained behind the EURIBOR at all the bank groups. Long-term deposits made the largest contribution to the increase in deposits in 2008, particularly those with a maturity of between 1 and 2 years. Long-term deposits accounted for approximately 60% of the total net increase in household deposits. The small domestic banks increased their household deposits by 18.8%, followed by the banks under majority foreign ownership with an increase of 14.4% and the large banks with an increase of 8.5%.

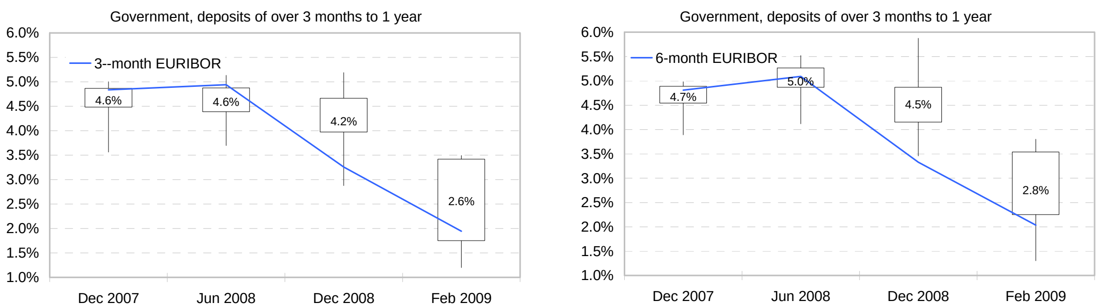
Figure 6.14: Concentration of interest rates on short-term household deposits by quartile



Source: Bank of Slovenia

The figures for interest rates on new household deposits show that their dispersal between banks has increased markedly since the escalation of the financial turmoil. In the segment of deposits of between 3 months and 1 year, the spread between the minimum and maximum interest rates widened by 2.3 percentage points (to 3.2 percentage points), an indication of the increase in competition between banks to attract domestic deposits.

Figure 6.15: Concentration of interest rates on short-term government deposits



Source: Bank of Slovenia

An increase in the dispersal of interest rates on bank deposits in the first months of 2009.

As a result of the increase in government deposits at banks in the first months of 2009 – they increased by EUR 1.2 billion in January and February – competition between banks has also increased in this segment. The spread between the minimum and maximum interest rates widened by 1 percentage point (to 2.3 percentage points).

Banks tried to attract new deposits, from the household and government sectors in particular, by raising interest rates. The competition between banks over deposits by non-banking sectors in the conditions of the general government guarantee for deposits is however introducing new risks into the system, as savers ignore the importance of the security of their deposits when choosing a bank in the search for the highest interest rate offer.

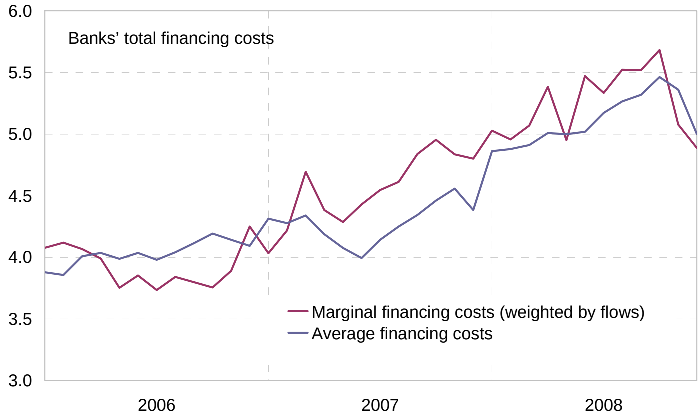
Average and marginal funding costs of banks

Banks' marginal and average funding costs began to fall at the end of 2008.

The rise in deposit rates in the first ten months of last year was also reflected in an increase in banks' marginal and average funding costs.[34] Banks' estimated marginal funding costs before tax rose by more than 1 percentage point over the aforementioned period to 5.87%, in which higher interest rates on new loans in the rest of the world and a decline in bank share prices were factors alongside higher interest rates on new bank deposits. Banks' average funding costs also increased in line with the rise in marginal costs, reaching a high of 5.7% in October 2008.

A relatively sharp turnaround in both measures of banks' funding costs then followed in the next months of last year, and they are expected to continue falling for the majority of 2009.

Figure 6.16: Banks' weighted average and weighted marginal funding costs in percentages



Source: Bank of Slovenia

Comparison of the liability structure of Slovenian banks and EU banks

The decline in the proportion of banks' funding accounted for by deposits by non-banking sectors means that this figure remains low compared with comparable banks in the EU. The proportion of Slovenian banks' funding accounted for by issued securities also remains significantly lower than in the EU.

Table 6.7: Comparison of selected balance sheet liability items at Slovenian banks and at EU banks reporting under the IFRS in percentages

(%)	2007		2008
	Medium-sized EU banks[1]	Small EU banks[1]	Slovenia
Liabilities to banks	11.08	13.50	40.6
Liabilities to non-banking sectors	50.14	65.22	43.4
Liabilities from securities	22.08	3.25	2.6
Other	0.50	0.29	0.4
Subordinated liabilities	2.08	1.14	3.4
Equity	5.71	10.32	8.4

Note: [1] Domestic banks from EU Member States reporting under the IFRS.
Source: Bank of Slovenia

[34] Banks' funding costs are calculated on the basis of the movement of interest rates (on deposits by non-banking sectors, on liabilities to foreign banks, and on their own debt securities) and the estimated costs of equities. The estimated return on equity before tax using a two-stage dividend discounting model is used in the calculation of the latter.

6.3.4 Slovenian banks in the altered funding conditions since autumn 2008

Last autumn banks compensated for the loss of funding on the interbank market with an increase in borrowing at the Eurosystem.

The tightening of conditions on the international financial markets, which was reflected in great difficulty for banks in accessing funding in the rest of the world, a shortening of maturities on new loans and an increase in premiums over the EURIBOR, brought a relatively rapid increase in autumn 2008 in the funding of Slovenian banks via the Eurosystem, which replaced a significant portion of short-term interbank funding.

When the turmoil began to be reflected in a contraction of funding obtained on foreign wholesale markets last autumn, banks initially reduced their net position against the rest of the world on the interbank market of unsecured deposits, and increased borrowings from the ECB, which rose from EUR 0.2 billion in September 2008 to approximately EUR 0.9 billion in March 2009. Banks were however trying to attract more household deposits by means of an active interest rate policy. These increased by approximately EUR 0.7 billion between September 2008 and March 2009, while banks reduced their investments in foreign securities by EUR 1.1 billion, and made net repayments of EUR 1.6 billion on the wholesale market in the rest of the world. The problem of refinancing at banks in the rest of the world thus sharply transformed in November into restrictions on lending to non-banking sectors. Between that time and the end of March 2009, monthly corporate lending averaged just EUR 54 million. Household lending also stalled completely.

Government measures merely addressed banks' funding problems in the short-term.

Several financial operations with direct or indirect government support then followed during the first four months of this year, which temporarily addressed banks' funding problems. In the context of these operations, bank indebtedness at the ECB declined slightly in the first quarter of 2009.

Without these operations and the possibility of drawing on funds from the Eurosystem, the rationing of the supply of loans would have been even heavier, which would have been reflected in an even larger slowdown in growth or even a contraction in the banking system's total assets.

Refinancing risk in the rest of the world.

In the banking system there is increasing refinancing risk or the risk of an uncontrolled deleveraging process. Banks must prepare themselves for the pressure that will arise when issued securities and deposits mature, and must act to increase new long-term funding to compensate for the loss of funding on the wholesale interbank market in the rest of the world. Banks have the greatest possibilities in the issue of debt securities, which could be offered for sale on foreign markets and to domestic institutional investors.

Off-balance-sheet items and fiduciary operations

At 14.8%, last year's growth in off-balance-sheet items exceeded growth in total assets by just 2.2 percentage points, significantly less than in the previous year, when the gap was more than 14 percentage points. The majority of the increase in off-balance-sheet items came from guarantees received, whose increase of EUR 7.9 billion exceeded the total net increase in off-balance-sheet items. The ratio of off-balance-sheet items to total assets declined slightly last year to finish the year at 159.4%.

Table 6.8: Structure of and growth in off-balance-sheet items in the banking sector at year end in percentages

						Growth rate (%)				
	2005	2006	2007	2008	Mar 09	2005	2006	2007	2008	Mar 09
Off-balance sheet items (EUR million)	39,779	49,465	68,408	75,729	80,746	26.3	24.3	38.3	14.8	2.8
	Structure (%)									
Letters of credit	0.5	0.3	0.3	0.2	0.1	52.5	-13.9	18.6	-37.2	-51.1
Guarantees and assets pledged as collateral	6.1	5.4	4.5	4.5	4.1	15.8	10.8	15.4	9.9	10.3
Assumed financial liabilities	9.4	8.1	7.5	5.8	5.1	21.7	6.9	28.6	-15.2	-21.0
Derivates	12.2	13.0	16.3	14.8	15.0	36.8	32.0	73.2	0.6	3.6
Depo and other securities records	13.4	13.4	12.1	7.7	8.2	30.7	24.7	24.2	-29.8	-19.3
Records of written-off claims	0.3	0.2	0.2	0.2	0.2	-15.0	1.2	18.6	34.4	24.5
Other off-balance sheet items	58.2	59.5	59.2	66.9	67.3	25.5	27.3	37.4	25.3	8.4
Warranties received	36.3	36.9	37.0	43.8	45.0	19.6	26.3	38.6	31.2	6.9
Guarantees and gov. sureties received	2.9	2.3	2.0	3.0	3.0	22.5	-3.3	21.1	65.2	29.8
Other	18.9	20.4	20.2	20.2	19.4	38.7	33.9	37.2	10.5	9.2

Source: Bank of Slovenia

6.4 Profitability and performance indicators

A decline in the banking system's profit in 2008.

In 2008 banks generated EUR 304 million of pre-tax profit, down 62% on the previous year. The main factor in the decline in profit on the income side was the decline in non-interest income, while the main factor on the expense side was the increase in impairment and provisioning costs.

Table 6.9: Banking sector income statement

	Amount (EUR million)			Growth rate (%)				Proportion of gross income (%)			
	2006	2007	2008	2006	2007	2008	Mar 09	2006	2007	2008	Mar 09
Net interest	689.8	816.4	938.8	9.2	18.3	15.0	-6.8	56.7	57.0	69.4	67.0
Net non-interest income	525.8	616.7	414.7	26.0	17.3	-32.7	7.7	43.3	43.0	30.6	33.0
of which fees and commissions	308.5	336.3	338.8	9.5	9.0	0.7	-7.6	25.4	23.5	25.0	26.3
of which net gain/loss on financial assets held for trading	97.2	135.7	-114.6	37.2	39.7	-184.4	-130.3	8.0	9.5	-8.5	6.1
Gross income	1215.6	1433.0	1353.6	15.9	17.9	-5.5	-2.4	100	100	100	100
Operating costs	702.1	755.9	772.6	8.5	7.7	2.2	2.0	57.8	52.7	57.1	59.2
Labour costs	367.4	401.8	410.1	7.3	9.4	2.1	6.3	30.2	28.0	30.3	33.9
Net income	513.5	677.1	580.9	28.0	31.9	-14.2	-8.3	42.2	47.3	42.9	40.8
Net provisioning and impairments	119.8	163.0	276.9	-14.5	36.0	70.0	….	9.9	11.4	20.5	23.2
Pre-tax profit	393.7	514.2	304.0	50.7	30.6	-40.9	-61.8	32.4	35.9	22.5	17.6
Taxes	90.9	102.5	54.3	75.5	12.8	-47.0	-57.1	7.5	7.1	4.0	3.7
Net profit	302.8	411.7	249.7	44.6	36.0	-39.3	-62.9	24.9	28.7	18.4	13.9

Source: Bank of Slovenia

Net interest income and interest margin

A change in the breakdown of gross income.

The increase in the proportion of gross income accounted for by net interest to 69.4% was primarily the result of the decline in non-interest income, while growth in net interest income was still relatively high last year. The main factors in last year's relatively high growth in net interest income were the surplus of interest-bearing assets over interest-bearing liabilities, an increase in the proportion of interest-bearing assets accounted for by loans, and the further rise in lending rates over the majority of the year. Interest rates on liabilities to foreign banks, which in the previous year were higher than interest rate on deposits by non-banking sectors, fell relatively rapidly last year, as they are predominantly tied to the EURIBOR.

Table 6.10: Average effective asset and liability interest rates calculated from interest income and expenses, interest spread and net interest margin in percentages

(%)	2003	2004	2005	2006	2007	2008
Avarage asset interest rate	7.52	5.78	4.90	4.90	5.60	6.20
Avarage liability interest rate	4.44	3.04	2.44	2.62	3.39	4.15
Effective interest rate spread	3.08	2.74	2.46	2.22	2.12	2.05
Net interest margin on interest-bearing assets	3.35	2.87	2.62	2.37	2.33	2.20

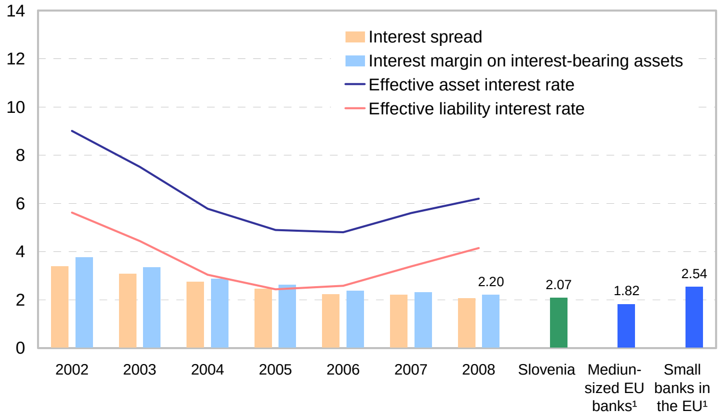
Source: Bank of Slovenia

The interest spread and net interest margin declined last year.

Effective asset interest rates[35] rose last year, by 0.6 percentage points. Effective liability interest rates also rose, by 0.8 percentage points. The main factor in the rise in effective asset interest rates was the change in the structure of interest-bearing assets in favour of better-remunerated loans. This was followed in the final quarter of last year by a slowdown in the effective asset interest rate, and by a fall in the first quarter of 2009. The main factor in the rise in effective liability interest rates, which reached 4.4% in the final quarter of last year, was interest rates on liabilities to foreign banks being tied to the EURIBOR. Deposits followed the general trend of rising interest rates in most months of last year, and then underwent a delayed downward adjustment in 2009. Banks were therefore also exposed to a certain risk of the loss of net interest income in 2009.

[35] The effective asset interest rates are calculated as the ratio of interest income to interest-bearing assets, while the effective liability interest rates are expressed as the ratio of interest expenses to interest-bearing liabilities.

Figure 6.17: Average effective asset and liability interest rates calculated from interest income and expenses, interest spread and interest margin in percentages



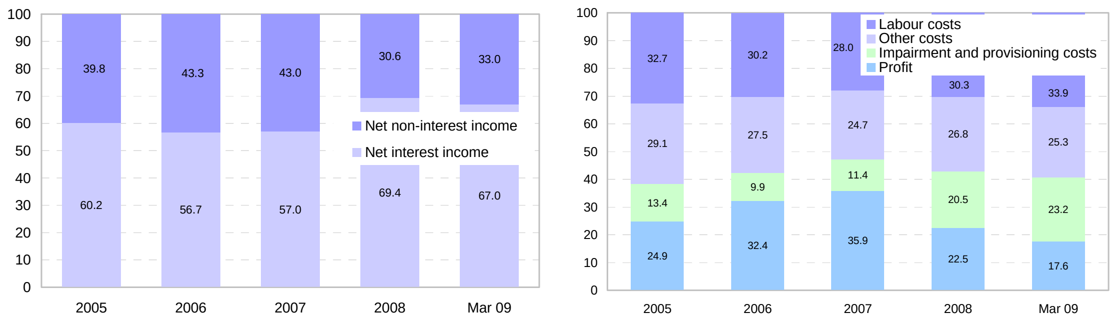
Note: [1] The separate figures for the interest margin are for 2008 in Slovenia and for 2007 for EU Member States reporting under international accounting standards, and were calculated as the ratio of net interest income to total assets. The interest margin for EU banks was taken as the net interest margin for medium-size banks and small banks.
Sources: Bank of Slovenia, EU Banking Sector Stability, November 2008

Net non-interest income

The severely adverse trends on capital markets meant that the importance of net non-interest income to the banking system's income was significantly less last year than in the previous year.

As a result of the sharp decline in income from trading in financial assets caused by securities valuations, the banking system's non-interest income last year was down almost a third on the previous year. The proportion of gross income accounted for by net non-interest income declined by 12.6 percentage points to 30.6%. Last year banks also generated a loss in their non-interest income in the amount of EUR 114.6 million from financial assets and liabilities held for trading, having generated a gain of EUR 135.7 million from this source in the previous year. Growth in net fees and commissions declined all year, to reach just 0.7% by the end of the year. Even in the previous year warning was given that greater variability in stock market prices could result in greater variability in banks' profits. The dislocations on stock markets and the fall in prices meant that banks disclosed a loss from net non-interest income.

Figure 6.18: Proportion of banks' gross income accounted for by net interest and non-interest income (left) and disposal of gross income (right) in percentages



Source: Bank of Slovenia

Gross income structure of Slovenian banks and EU banks

In 2008 net interest income accounted for a higher proportion of gross income at banks in Slovenia than at EU banks of comparable size.

Table 6.11: Gross income structure of Slovenian banks and EU banks

	Income as a proportion of gross income (%)		
	Medium-sized EU banks (2007)	Small banks in the EU (2007)	Slovenia 2008
Net interest	61.7	47.4	69.4
Non-interest income	38.3	52.4	30.6

Sources: Bank of Slovenia, ECB: EU Banking Sector Stability, November 2007

Banks' operating costs

A need for greater rationalisation of bank operations.

Growth in banks' operating costs was outpaced by growth in total assets by more than 10 percentage points last year. The ratio of operating costs to gross income increased by several percentage points to 57.1%. The large domestic banks were the most effective at cost control, and succeeded in reducing costs. The decline in net interest income and rising impairment costs mean that banks will be forced to sharply rationalise their operations in 2009.

Table 6.12: Year-on-year growth in operating costs by bank group in percentages

(%)	Total	Large banks	Foreign banks	Small banks
2004	3.6	2.1	7.6	2.6
2004	3.6	1.9	7.6	5.0
2005	5.8	2.2	12.7	13.6
2006	8.5	9.5	6.3	7.5
2007	7.7	5.7	12.0	8.1
2008	2.2	-1.2	9.3	3.8

Source: Bank of Slovenia

Growth in impairment and provisioning costs last year strongly outpaced growth in loans to non-banking sectors.

Banks created EUR 277 million of impairments and provisions in 2008, of which more than two-thirds was in the final quarter. Impairments of financial assets measured at amortised cost, and provisions for off-balance-sheet liabilities and impairments of available-for-sale financial assets were up significantly on the previous year. While the former increased by about a fifth, the latter increased by EUR 99 million to EUR 101 million. Banks began rapidly creating the latter in the final quarter of 2008, when the effects of the valuation of held-for-sale securities, which previously had been disclosed in the form a negative adjustment to equity in the balance sheet, were transferred to the income statement. Growth in impairment and provisioning costs strongly exceeded credit growth last year. The ratio of impairment and provisioning costs to gross income almost doubled last year to 20.5%.

Table 6.13: Loans, and impairment and provisioning costs

(%)	Large banks	Small banks	Foreign banks	Banking system
Growth in loans to non-banking sectors in 2008	12.6	22.0	25.7	17.7
Growth in provisions and impairments in 2008	66.0	17.3	182.5	70.0
Provisioning and impairments/gross income in 2008	23.8	27.6	11.6	20.5
Provisioning and impairments/gross income in 2007	12.5	20.8	4.8	11.4

Source: Bank of Slovenia

Comparison of the operating cost structure of Slovenian banks and EU banks

The ratio of operating costs to average total assets at Slovenian banks still exceeds the 1.6% achieved by medium-size EU banks, but the figure is converging. The ratio of labour costs to gross income at Slovenian banks is comparable to that at EU banks of comparable size.

Table 6.14: Breakdown of operating costs, cost-to-income ratio (CIR) and coverage of operating costs by non-interest income at banks in Slovenia and the EU in percentages

(%)	2007		2008
	Medium-sized EU banks	Small banks in the EU	Slovenia
Labour costs	58,0	55,7	57,3
Administrative costs	34,6	38,0	30,6
Other costs	7,3	6,3	12,2
Operating costs	100,0	100,0	100,0
CIR (operating costs/gross income)	52,7	61,6	59,2
Non-interest income/operating costs	72,9	85,2	55,7

Sources: Bank of Slovenia, ECB: EU Banking Sector Stability, November 2007

Bank performance indicators

ROE at Slovenian banks halved last year.

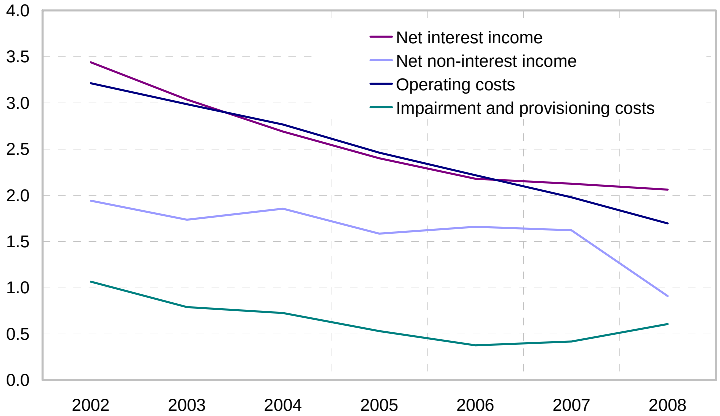
The banking system's ROE declined by 8.2 percentage points last year to 8.1%. The main factors in the decline were the significant fall in non-interest income and the increase in impairment and provisioning costs. The interest margin on total assets declined slowly to reach 2.2% at the end of the year. The non-interest margin fell below 1% last year.

Table 6.15: Bank performance indicators in percentages

(%)	2003	2004	2005	2006	2007	2008
ROA	1.00	1.06	1.00	1.25	1.36	0.67
ROE	11.89	12.72	12.72	15.07	16.29	8.08
Costs/gross income	63.28	62.32	61.74	57.76	52.75	57.08
Interest margin on interest-bearing assets	3.35	2.94	2.62	2.37	2.33	2.20
Interest margin on total assets	3.05	2.70	2.42	2.19	2.16	2.07
Non-interest margin	1.63	1.72	1.60	1.67	1.64	0.92
Gross income/average assets	4.68	4.42	4.02	3.86	3.80	2.99

Source: Bank of Slovenia

Figure 6.19: Net interest income, net non-interest income, operating costs and net provisioning as a percentage of average assets

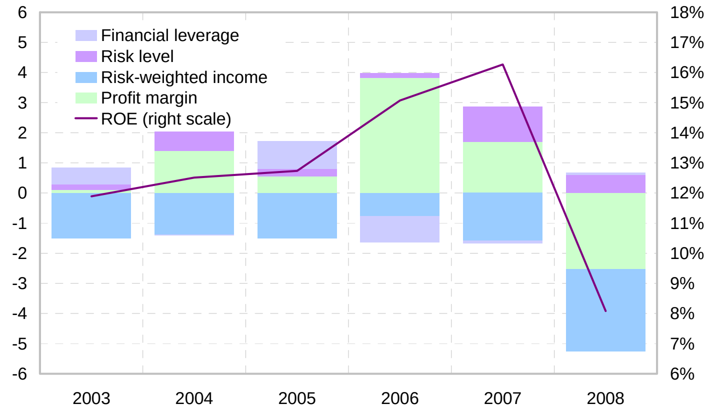


Source: Bank of Slovenia

Breakdown of profitability into components.

The movement of ROE can be analysed by breaking down profitability into four components: the profit margin, risk-weighted income, risk level and financial leverage.[36]

Figure 6.20: Movement in ROE, and impact of four factors on the direction of the movement in ROE



Source: Bank of Slovenia

The profit margin and risk-weighted income acted to reduce profitability in 2008.

A decline in the profit margin and risk-weighted income acted to reduce banks' profitability last year, each component contributing approximately equally. The risk level and financial leverage acted to increase profitability, albeit minimally.

The profit margin had a pronounced impact in reducing profitability, as pre-tax profit declined significantly more than gross income. Risk-weighted income also declined last year, acting to reduce profitability, as a result of an increase in risk-weighted assets in the context of a decline in gross income. Financial leverage last year was comparable to the two previous years.

[36] For an example of the calculation of the breakdown of ROE, see *Financial Stability Review* 2006:2, Sveriges Riksbank, p 36, and Bank of England: *Financial Stability Review*, December 2003. The ratios are defined as follows in this case: a) profit margin = pre-tax profit / gross income; b) risk-weighted income = gross income / risk-weighted assets; c) risk level = risk-weighted assets / total assets, and d) financial leverage = total assets / equity.

Table 6.16: Breakdown of ROE into four factors

Year	Profit margin: pre-tax profit / gross income	*	Risk-weighted income: gross income / risk-weighted assets	*	Risk level: risk-weighted assets / total assets	*	Financial leverage: total assets / capital	=	Profitability: ROE
2005	0.25		0.06		0.65		12.82		0.13
2006	0.32		0.06		0.66		12.12		0.15
2007	0.36		0.05		0.71		12.05		0.16
2008	0.22		0.04		0.77		12.17		0.08

Source: Bank of Slovenia

Profitability of Slovenian banks and EU banks

Table 6.17: Bank performance indicators in percentages

	2007		2008
(%)	Medium-sized EU banks	Small EU banks	Slovenia
Net interest/total assets	1.82	2.54	2.07
Non-interest income/total assets	1.13	2.81	0.92
Gross income/total assets	2.95	5.36	2.99
Operating costs/total assets	1.55	3.30	1.71
Operating profit/total assets	1.40	2.06	1.28
Provisioning and impairment costs (and other)/total	0.31	0.18	0.61
Pre-tax profit/total assets	1.14	1.90	0.67
ROE[1]	15.43	14.52	8.08

Note: [1] ROE calculation for EU banks is based on Tier 1 capital (EU Banking Sector Stability, November 2007), and consolidated data. It should be noted that for both EU bank groups compliant with the IFRS, consolidated data is used and profitability is calculated on the basis of Tier I capital. In Slovenia the profit is that of the entire unconsolidated banking system, based on total capital.

Sources: Bank of Slovenia, ECB: EU Banking Sector Stability, November 2007

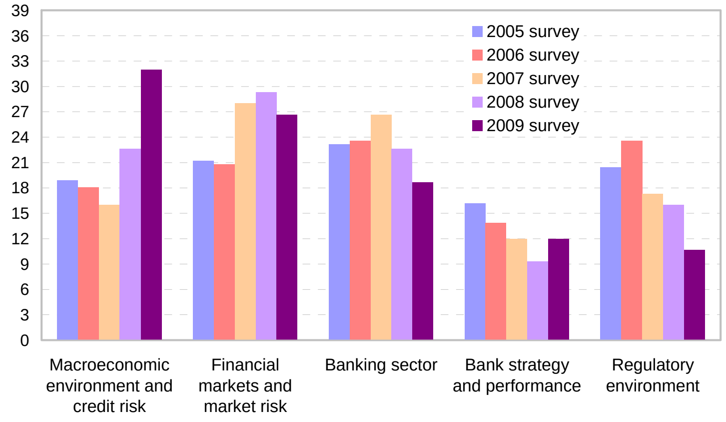
6.5 Risks in the banking sector

Survey of major risks

In March 2009 banks warned strongly of the risks associated with a deterioration in the macroeconomic climate.

The results of a survey conducted on a small sample of banks in March 2009 reflect the harsher macroeconomic climate. This foremost comprises a reversal in the credit cycle, a decline in economic growth and a deterioration in the international environment. Banks are united in the assessment that the adverse impact of the aforementioned factors will increase in the period to March 2010. There is also a certain level of concern, albeit smaller, over the anticipated changes on the real estate market. The economic crisis is leading to a deterioration in clients' financial positions, and is beginning to reduce the quality of banks' claims. Given the usual delay required for the conditions described to be fully reflected in banks' performance figures, the increased risks could be an indication of a decline in portfolio quality.

Figure 6.21: Results of 2005 to 2009 surveys on main origins of risk for the coming year in percentages[37]



Sources: Bank of Slovenia, annual bank surveys

As a result of the expected continuation of the disruptions to the financial markets, the assessment of refinancing risk remains high...

The expectations of relatively high risk as a result of conditions on the financial markets have remained high for three consecutive years. The responses reflect the risk of disruptions to the financial markets as a result of insufficient liquidity and difficulties in accessing the necessary funding. This is to a lesser extent joined with concerns over possible changes in interest rates on the financial markets and in the exchange rates of certain currencies against the euro, and the awareness of a potential further deterioration in conditions on the capital markets. Among the remaining types of risk, the importance of risks associated with banks' business strategies again declined compared with the previous year. Although this risk is still accompanied by a certain level of concern over competitive pressures and changes in corporate governance, this part of the responses can also be viewed as a reflection of the risk of securing the necessary funding on the financial markets. Further evidence comes from the finding that the key problem for banks is of a macroeconomic nature, i.e. the reversal in the credit cycle typical of a recession and a funding gap that is making it harder for banks to secure the appropriate funding as a result of uncertainty on the financial markets.

… in the context of an indication of rising income risk.

Business strategy and the regulatory environment account for less than a quarter of the risks that banks assess that they will be exposed to in the period to spring 2010. The small increase in the risk associated with business strategy is a reflection of the need to adapt to the harsher climate, and, in all likelihood, also a deterioration in performance and rising income risk. Despite the relative decline in the importance of the risk presented by the regulatory environment, here banks consider regulatory changes at the international level (valuation of assets in the financial statements) and the reporting burden to be a significant risk.

6.6 Liquidity risk and refinancing risk

The turmoil on the international financial markets had a relatively strong impact on Slovenian banks that had borrowed in the rest of the world. The increased lack of confidence between banks and the fear of liquidity shortages brought a relatively sharp tightening of refinancing terms, a shortening of funding maturities and, towards the end of 2008, even the non-rollover of funding, i.e. debt repayments in the rest of the world.

Major exposure to the risk associated with the refinancing of liabilities to the rest of the world is primarily faced by the banks under majority domestic ownership, a larger proportion of whose total liabilities carry shorter maturities. Since the sharp tightening in funding conditions in the autumn months, banks have for some time been actively competing over interest rates on deposits by non-banking sectors, but have only partly replaced the loss of funding from foreign banks. The government was the main factor in securing additional funding on the banking system's liability side in the first months of 2009.

The increased lack of confidence on the international financial markets last autumn did not reduce Slovenian banks' liquidity ratios. These actually increased, as a result of

[37] The sum of the columns for each year is 100%.

changes in methodology and the issue of government securities and SID banka securities at the end of last year and the beginning of this year. However, even without the aforementioned institutional changes the liquidity ratios show an improvement in the banking system's liquidity. The coverage of loans to non-banking sectors by deposits by non-banking sectors continued to decline last year, albeit at a slower pace.

6.6.1 Impact of the instability on the financial markets on banks' funding conditions in the rest of the world

Since the outbreak of the turmoil on the financial markets, the proportion of total liabilities accounted for by liabilities to foreign banks has declined slightly.

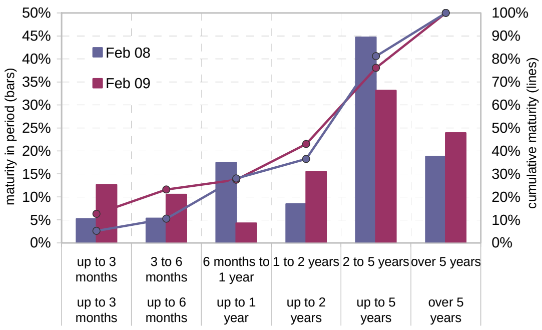
Bank borrowing in the rest of the world was primarily important in the first half of 2008. After the escalation of the financial turmoil last September banks were forced to operate in conditions of significantly limited foreign funding. Liabilities to foreign banks stood at EUR 15.2 billion at the end of February 2009, equivalent to approximately 32% of total assets, down 2.4 percentage points on a year earlier. The current rate of growth in liabilities to foreign banks slowed sharply last year, to stand at just 4% at the end of February 2009. The majority of net funding in the rest of the world last year was generated by the banks under majority foreign ownership, which accounted for EUR 1.4 billion of the total of EUR 1.6 billion. It is easier for the banks under majority foreign ownership, which primarily borrow from their parent banks, to access funding in the rest of the world, but even their borrowing declined significantly in the second half of the year, the average maturity of the loans shortening.

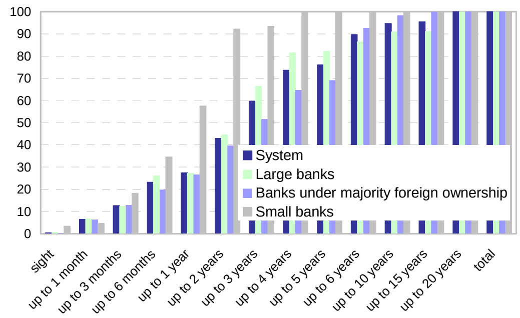
More short-term funding from banks in the rest of the world. A decline in funding in the rest of the world at the large banks compared with the previous year.

At 27.5%, the proportion of short-term liabilities in February 2009 was comparable to last February's figure of 28.1%, but there was a significant change in the maturity breakdown over the course of one year. The proportions of the total accounted for by liabilities of up to 3 months and liabilities of up to 6 months increased, while the proportion accounted for by liabilities of between 6 months and 1 year declined relatively sharply. The proportion of debt with a maturity of up to 1 year as at February 2009 was approximately equally favourable at the large domestic banks (27.3%) and the banks under majority foreign ownership (26.7%), but was a relatively high 57.5% at the small domestic banks. In terms of the debt maturing in the six months following February 2009, the banks under majority foreign ownership will see 19.7% of all liabilities to the rest of the world mature, the large banks 26.2%, and the small banks 34.6%, the small banks also facing the fastest maturing of liabilities to banks in the rest of the world over the coming years. This shows the relatively high exposure of domestic banks to the risk of refinancing in the rest of the world in the coming months.

There are also great differences between the bank groups in the segment of maturities of 5 to 7 years, where the banks under majority foreign ownership held almost a quarter of their liabilities to foreign banks as at the end of February 2008, and the large banks just 4.3%. The small domestic banks only held liabilities to banks in the rest of the world of up to 4 years. In February 2009 the vast majority (72.5%) of banks' total liabilities to banks in the rest of the world still had maturities of more than 1 year, and just under a quarter had maturities of more than 5 years.

Figure 6.22: Maturity of liabilities to foreign banks by maturity interval (left) and bank group (right) in percentages





Source: Bank of Slovenia

Table 6.18: Maturity of liabilities to foreign banks and maturity breakdown as at 28 February 2009 for the banking system and by bank group in percentages

	Cumulative maturity to foreign banks				Breakdown of liabilities by maturity			
(%)	System	Large banks	Banks under majority foreign ownership	Small banks	System	Large banks	Banks under majority foreign ownership	Small banks
Total (EUR million)	15,238	7,615	7,376	247				
Overnight, sight	0.4	0.6	0.1	3.4	0.4	0.6	0.1	3.4
Up to 1 mo	6.5	6.6	6.3	4.6	6.0	6.0	6.2	1.3
Over 1 to 3 mos	12.7	12.4	12.8	18.2	6.2	5.7	6.5	13.6
Over 3 to 6 mos	23.2	26.2	19.7	34.6	10.5	13.8	7.0	16.3
Over 6 mos to 1 yr	27.5	27.3	26.7	57.5	4.3	1.1	6.9	23.0
Over 1 yr to 2 yrs	43.0	44.6	39.6	92.2	15.5	17.3	13.0	34.6
Over 2 yrs to 3 yrs	59.7	66.5	51.5	93.4	16.7	21.9	11.9	1.2
Over 3 yrs to 4 yrs	73.7	81.6	64.6	100.0	14.0	15.1	13.1	6.6
Over 4 yrs to 5 yrs	76.1	82.2	69.0		2.4	0.6	4.4	
Over 5 yrs to 7 yrs	89.7	86.5	92.6		13.6	4.3	23.6	
Over 7 yrs to 10 yrs	94.7	91.0	98.2		5.0	4.5	5.6	
Over 10 yrs to 15 yrs	95.5	91.1	99.9		0.8	0.1	1.6	
Over 15 yrs to 20 yrs	100.0	100.0	100.0		4.5	8.9	0.1	
Over 20 yrs								
Total					100.0	100.0	100.0	100.0

Source: Bank of Slovenia

The volume of banks' new loans raised in the rest of the world declined in 2008.

Last year the financial turmoil was reflected in a decline in new loans raised in the rest of the world, particularly at the banks under majority domestic ownership. In the second half of the year in particular, the majority of new borrowing in the rest of the world, close to three-quarters, was raised by the banks under majority foreign ownership. The large domestic banks made debt repayments in the final quarter of 2008. Similarly in the first two months of 2009, the large domestic banks again raised no new loans in the rest of the world.

Table 6.19: New loans of banks raised at banks in the rest of the world, by maturity and currency

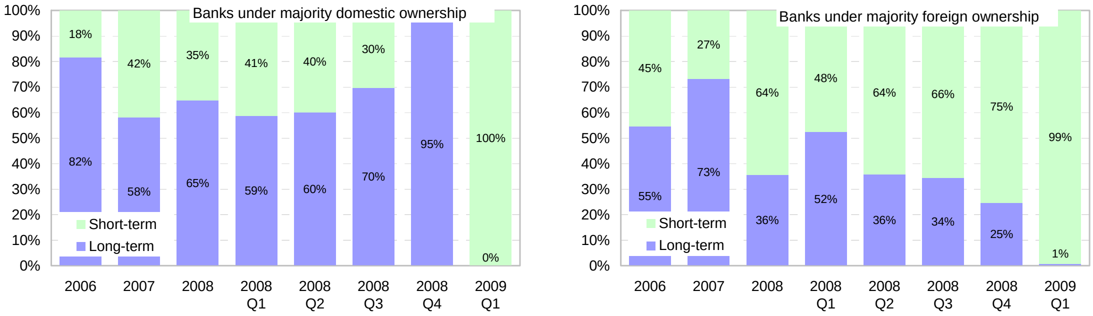
	Loans by maturity (EUR million)			Breakdown by currency (%)			
	Total	Short-term	Long-term	CHF	EUR	SIT	USD
2006	1,904.2	539.2	1,365.0	6.8	87.8	5.4	0.0
2007	5,304.8	1,877.8	3,426.9	8.2	91.5	-	0.3
2008	4,862.0	2,408.8	2,453.2	5.2	93.5	-	1.3
2008 Q1	618.5	284.6	333.8	6.2	93.8	-	0.0
2008 Q2	2,376.7	1,068.8	1,307.9	2.2	97.1	-	0.7
2008 Q3	970.2	565.2	405.0	9.1	86.1	-	4.8
2008 Q4	896.6	490.1	406.5	8.2	91.8	-	0.0

Source: Bank of Slovenia

Short-term funding in the rest of the world prevailed in 2008.

The proportion of new loans accounted for by short-term loans rose to a half in 2008, having stood at just over a third in the previous year. Even the banks under majority foreign ownership, which last year raised a half of all new loans, primarily relied on short-term funding.

Figure 6.23: Maturity breakdown of new loans for banks under domestic ownership (left) and banks under majority foreign ownership (right) in percentages

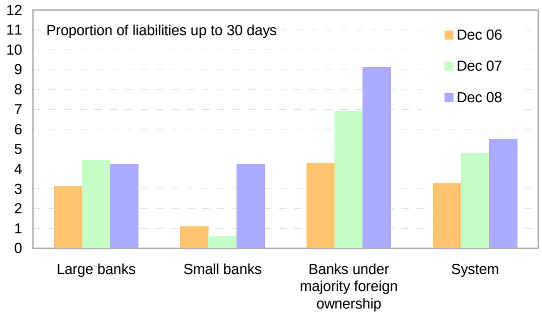


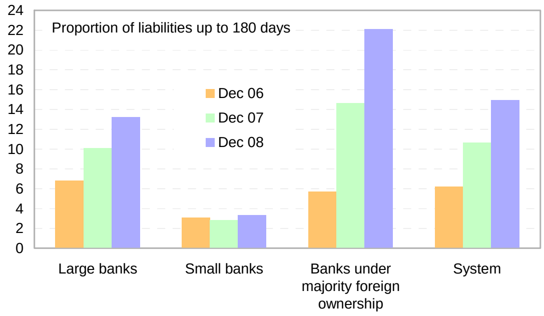
Source: Bank of Slovenia

Shortening of maturities on loans raised in the rest of the world.

With regard to the movements in liabilities to foreign banks as a proportion of liabilities to foreign and domestic creditors in terms of the liquidity ladder, the banks under majority foreign ownership are the most sensitive in the segment of maturities of up to 30 days, the proportion of total liabilities accounted for by liabilities to foreign banks increasing last year to above 9% for these banks. The situation is similar for liabilities with a residual maturity of up to 180 days: at the banks under majority foreign ownership, the proportion of total liabilities accounted for by liabilities to foreign banks is more than a fifth. Here it should be noted that the banks under majority foreign ownership are primarily exposed to their parent banks.

Figure 6.24: Liabilities to foreign banks as a proportion of total liabilities with a residual maturity of up to 30 days (left) and up to 180 days (right), by bank groups



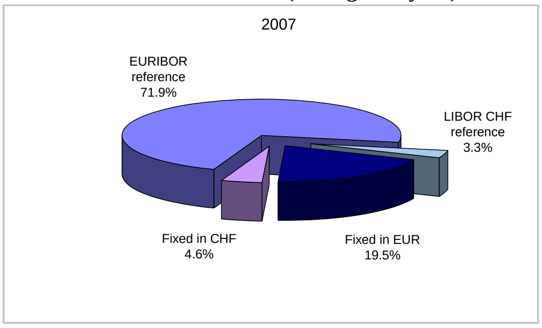


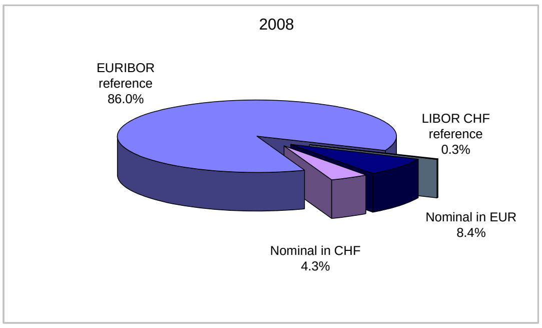
Source: Bank of Slovenia

Increasing proportion of loans tied to the EURIBOR.

In the context of shortening maturities, the breakdown of borrowing in the rest of the world also changed last year. There was a decline in the amount of bank borrowing in the rest of the world in Swiss francs. The largest increase was in the proportion accounted for by loans in euros tied to the EURIBOR, which stood at 86% in 2008. By contrast, the proportion accounted for by loans with a fixed interest rate declined last year. Having stood at more than 19% the previous year, it halved in 2008.

Figure 6.25: Breakdown of banks' new loans in the rest of the world by type of remuneration (average for year)



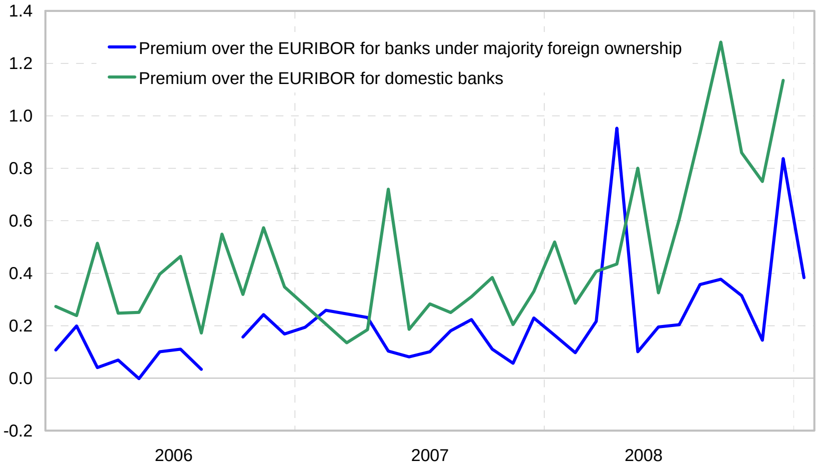


Source: Bank of Slovenia

A rise in risk premiums on borrowing in the rest of the world.

The financial turmoil was reflected in the higher risk premiums over reference interest rates charged by banks. In their new borrowing in the rest of the world the banks under majority foreign ownership achieved an average premium over the EURIBOR of just over 0.3 percentage points in 2008, compared with less than 0.2 percentage points the previous year. The banks under majority domestic ownership borrowed at less favourable terms in the rest of the world. The premium over the EURIBOR on their borrowing averaged 0.7 percentage points, having doubled from the previous year.

Figure 6.26: Premium over the EURIBOR for banks' loans raised in the rest of the world, with regard to majority ownership, in percentage points



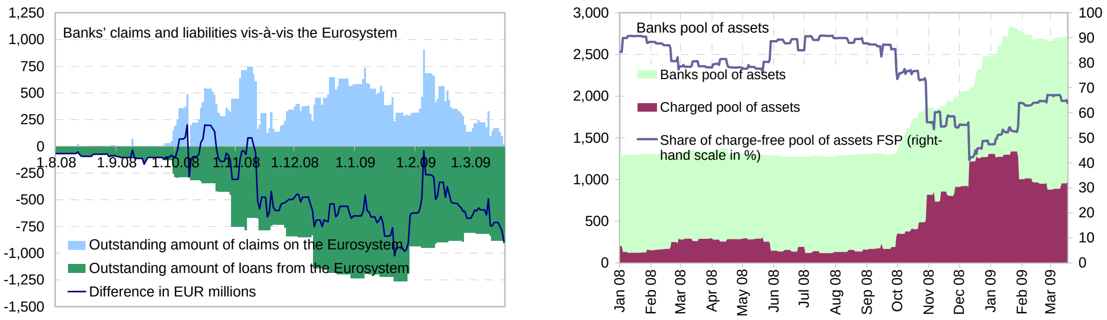
Source: Bank of Slovenia

Bank funding at the Eurosystem and deposits by the Slovenian Ministry of Finance

Last autumn banks compensated for the loss of funding on the interbank market by increasing borrowing from the Eurosystem.

The sharp deterioration in liquidity conditions on international financial markets, which was reflected in great difficulty for banks in accessing funding in the rest of the world, in shortening maturities on new loans and in rises in premiums over the EURIBOR, resulted in a relatively rapid increase in bank funding via the Eurosystem last autumn. Monetary policy instruments also replaced a significant portion of the interbank market in Slovenia.

Figure 6.27: Commercial banks' claims, liabilities and net position vis-à-vis the Eurosystem in EUR million (left), and pool of eligible collateral at the Eurosystem in EUR million (right)



Source: Bank of Slovenia

Since last October banks have also begun to rapidly increase the pool of eligible collateral for Eurosystem operations. These are securities accepted as collateral at the ECB, which allow banks to secure liabilities to the Eurosystem disclosed via monetary instruments. The volume of the pool, which fluctuated around EUR 1.3 billion for the majority of last year, had risen to EUR 1.8 billion by the end of last October, to EUR 2.5 billion by the end of the year, and to almost EUR 3 billion by the first weeks of April 2009. Despite the increase in the pool, the proportion that is free fell below 50% last December. The proportion of the pool of eligible collateral at the ECB that is free rose again over the following months, to reach close to two-thirds by the beginning of April. [38]

Banks responded to last year's altered circumstances in two ways: a) their net position against the rest of the world on the interbank market of unsecured deposits declined, from an average of EUR 803 million last September to an average of just EUR 209 million last December, and b) borrowing from the ECB began to increase rapidly. Slovenian banks held almost no liabilities to the ECB as late as last September, but these rose to over EUR 1.2 billion over the final months of the year. However, volume on the interbank money

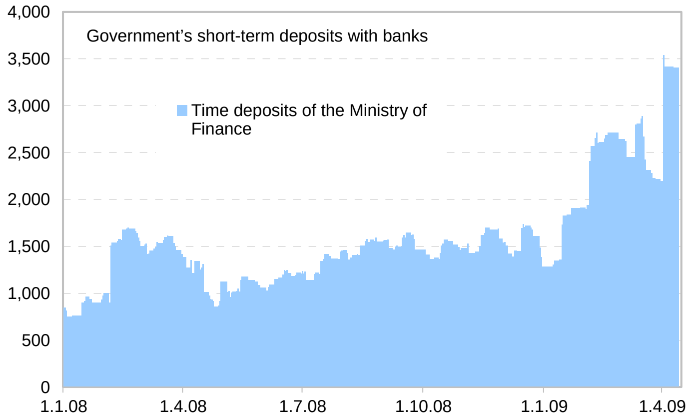
[38] The increase in the pool of eligible collateral at the ECB achieved by banks can also be interpreted as banks' readiness for the anticipated introduction of longer-maturity instruments for long-term ECB refinancing operations.

market in Slovenia was unchanged, interbank claims and liabilities amounting to between EUR 300 million and EUR 350 million in the final quarter of 2008.

The stock of short-term interbank deposits at banks by the Slovenian Ministry of Finance increased sharply in the first months of 2009.

The amount of bank borrowing from the Eurosystem declined slightly in the first months of 2009, as the market of Ministry of Finance deposits began to replace banks' short-term funding from the Eurosystem. Two Slovenian government Eurobond issues on international financial markets and issues of Slovenian treasury bills were followed by several auctions for short-term deposits of government funds with banks, and an auction of long-term loans. The stock of bank deposits by the Slovenian Ministry of Finance exceeded EUR 3.4 billion by 10 April 2009.

Figure 6.28: Stock of short-term deposits by the Slovenian Ministry of Finance at banks in EUR million



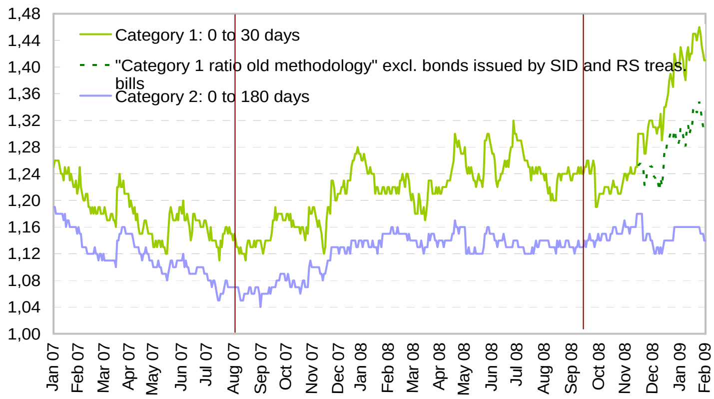
Source: Bank of Slovenia

6.6.2 Liquidity ratios

The average of the Category 1 liquidity ratio in 2008 was higher than in 2007.

The Category 1 liquidity ratio averaged 1.25 in 2008, up 0.05 on the previous year. It rose to around 1.3 by the end of the year, and rose further to around 1.4 during the first months of 2009. The rise in early December was the initial consequence of the amendment of the Regulation on the Minimum Requirements for Ensuring an Adequate Liquidity Position at Banks.[39] In the following months a rise in the ratio was brought by certain bank operations linked to the effects of operations related to the issue of SID banka bonds, subscriptions to Slovenian treasury bills made by banks and the return government deposits at banks.[40] The aforementioned effects led to a larger rise in the ratios[41] than banks would otherwise have recorded.

Figure 6.29: Daily liquidity ratios for Categories 1 and 2 of liquidity ladder



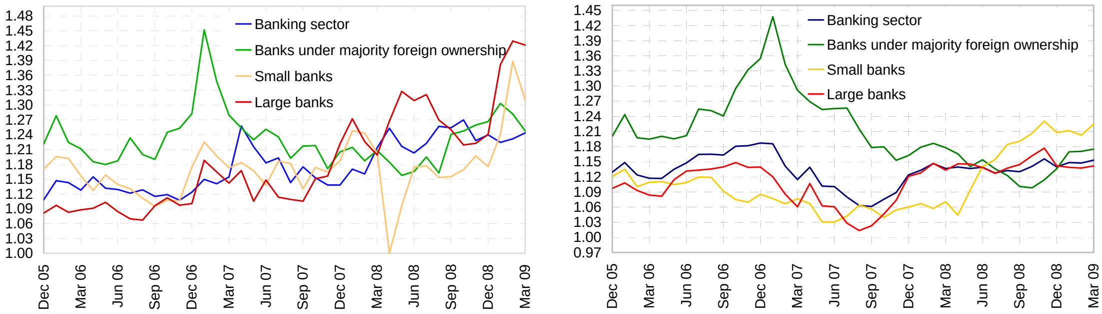
Note: The two vertical lines on the figure denote the rise in uncertainty on the financial markets in August 2007 (on the left), and the escalation of the financial turmoil in September 2008 (on the right).
Source: Bank of Slovenia

[39] As of 1 December 2008 there has been no need for banks to deduct their collateral deposited with the Bank of Slovenia from the base for calculating the ratio for Category 1 (up to 30 days).
[40] For more on this, see Section 6.2 (p 65).
[41] The Category 2 liquidity ratio is of an informative nature only, and must merely be reported by banks to the Bank of Slovenia.

A sharp increase in the Category 1 liquidity ratio at the end of 2008 and in the first months of 2009.

The largest decline in the liquidity ratio last year was recorded by the banks under majority foreign ownership, where it declined by 0.04 to 1.21. The small domestic banks recorded the lowest ratio (1.17), although this was comparable to the previous year. The large domestic banks recorded the highest ratio: their average of 1.26 was up 0.11 on the previous year. The Category 1 liquidity ratio at this bank group was around 1.4 at the beginning of 2009.

Figure 6.30: Liquidity ratios for Categories 1 (left) and 2 (right) of liquidity ladder by individual bank group, monthly averages



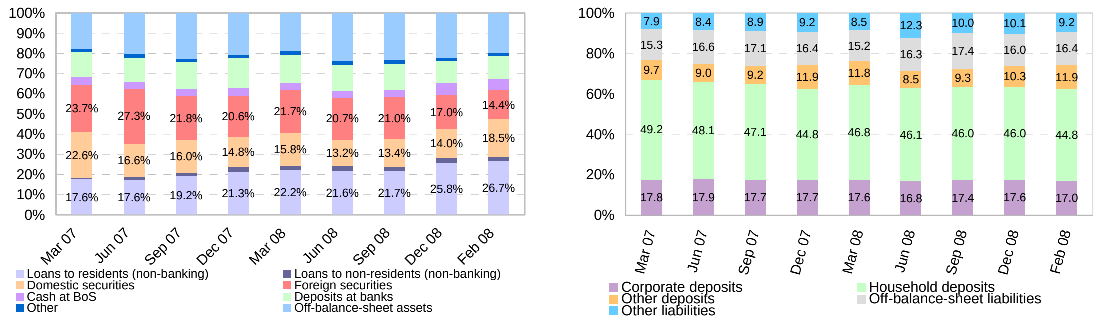
Source: Bank of Slovenia

In the formation of the average Category 1 liquidity ratio there were again structural changes in investments last year on the side of categories included in the coverage of the ratio.

An increase in the proportion of assets included in the coverage of the Category 1 ratio accounted for by lending to non-banking sectors and domestic securities.

The proportion of loans to non-banking sectors gradually increased in the second half of 2008. Having stood at 21.6% in June, it was approaching 27% by February 2009. The increase in this proportion of the coverage of the ratio was the result of short-term lending to non-banking sectors. By contrast, there was an increase in the proportion accounted for by domestic securities and a decline in the proportion accounted for by foreign securities of 6.3 percentage points at the end of last year and in the first quarter of 2009.

Figure 6.31: Structure of assets (left) and liabilities (right) taken into account in the calculation of the Category 1 liquidity ratio (with a residual maturity of up to 30 days) in percentages

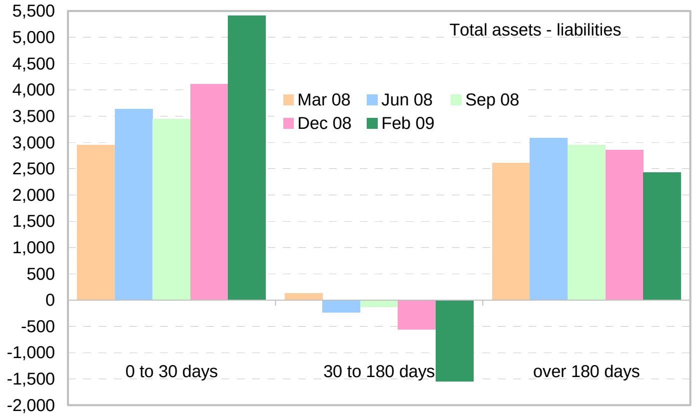


Source: Bank of Slovenia

Liquidity gap

The liquidity gap, calculated as the difference between total assets and liabilities defined in the liquidity ladder methodology, was long for the category with a residual maturity of up to 30 days. Because this category includes investment-grade investments in government securities and foreign marketable securities rated BBB or higher, irrespective of residual maturity, this is reflected in a long liquidity gap. The pronounced increase in the long gap in a positive direction in 2009 was the result of an increase in the stock of government securities on bank balance sheets. As a result banks have a short gap in the category with a residual maturity of 30 to 180 days. The long liquidity gap in the third category of the liquidity ladder has been shortening since last June as a result of shorter-term funding.

Figure 6.32: Liquidity gap as the difference between total assets and liabilities defined in the liquidity ladder methodology in EUR million



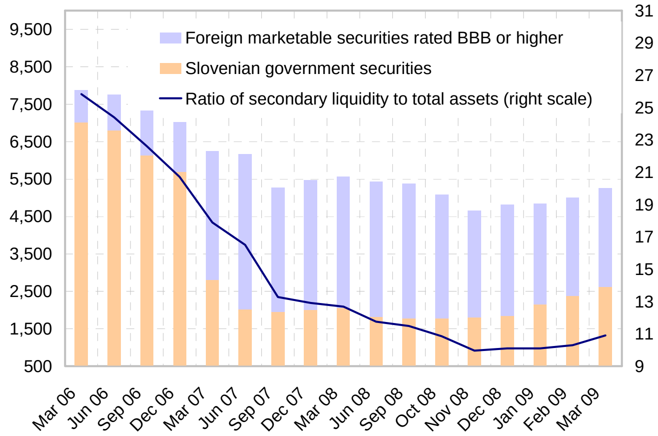
Source: Bank of Slovenia

6.6.3 Other structural liquidity indicators

A slowdown in the decline in the proportion of total assets accounted for by secondary liquidity.

The proportion accounted for by secondary liquidity fell below 13% at the beginning of last year, but the decline then slowed. The average in late 2008 and early 2009 was slightly in excess of 10%.

Figure 6.33: Changes in the amount of secondary liquidity (monthly averages in EUR million) and as a proportion of total assets in percentages



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

A smaller deterioration in certain structural liquidity indicators in 2008 than in the previous year.

Certain structural liquidity indicators reflecting ratios between liquid balance sheet items deteriorated again in 2008, but the deterioration was less pronounced than in the previous year. After the escalation of the financial turmoil, the pace of lending and the pace of bank borrowing in the rest of the world began to decline rapidly in the final quarter of 2008. Banks made net repayments to banks in the rest of the world in the final two months of 2008 and the first months of 2009, which actually resulted in a slight improvement in certain structural liquidity indicators in the first quarter of 2009.

The coverage of loans to non-banking sectors by deposits fell to 62% at the end of 2008.

The ratio of deposits by non-banking sectors to loans to non-banking sectors fell to around 62% in 2008, the lowest figure in recent years. Even at the end of 2005, loans to non-banking sectors were fully covered by deposits. Among other selected indicators, the largest decline of 13.4 percentage points last year was recorded by the coverage of short-term loans by short-term deposits, which reached 91.7%. Last year lending to non-banking sectors was primarily short-term. By contrast, long-term saving at banks by non-banking sectors increased more. The small domestic banks still had relatively high coverage of loans by deposits (around 86%) at the end of 2008. The figure was around three-quarters at the large domestic banks, and merely just over 38% at the banks under majority foreign ownership. The proportion of total assets accounted for by debt securities also declined in 2008. The ECB liquidity indicators, which show the ratio of the sum of cash and claims against banks to liabilities to banks and the ratio of liabilities to foreign banks to total assets were comparable to the previous year. The ratio of liabilities to foreign banks to loans to non-banking sectors improved as a result of the debt repayments in the rest of the world and the stagnation of bank lending in late 2008 and early 2009.

A rise in the proportion of total deposits by non-banking sectors accounted for by the top 30 depositors in the first months of 2009.

The proportion of total deposits by non-banking sectors accounted for by the top 30 depositors declined in 2008, having remained unchanged for the two previous years. This indicator rose significantly in the first two months of 2009, to pass a quarter.

Table 6.20: Selected ratios in balance sheet items defining bank liquidity in percentages

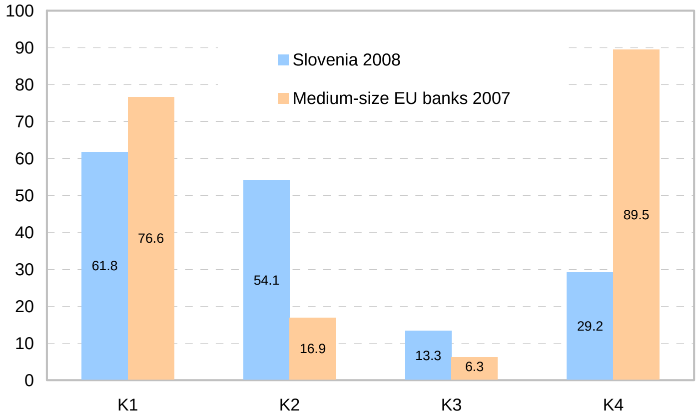
(%)		Large banks	Small banks	Banks under majority foreign ownership	Total
Ratio of deposits by non-banking sectors to loans by non-banking sectors	2005	110.9	136.6	69.1	99.2
	2006	99.5	122.5	54.2	85.8
	2007	80.0	92.2	43.7	68.5
	2008	74.1	85.8	38.1	61.8
	Mar 09	79.6	89.2	37.6	65.1
Ratio of short-term deposits to short-term loans to non-banking sectors	2005	154.8	121.4	138.4	146.9
	2006	122.1	111.3	117.6	119.8
	2007	113.3	94.3	89.5	105.1
	2008	95.6	86.3	84.7	91.7
	Mar 09	104.7	92.5	80.7	97.1
Ratio of liabilities to foreign banks to loans to non-banking sectors	2005	38.3	14.3	76.1	48.9
	2006	40.4	13.2	72.9	49.5
	2007	47.0	9.7	66.0	50.9
	2008	42.6	10.3	63.9	48.0
	Mar 09	39.3	9.9	61.5	45.1
Ratio to liabilities to foreign banks to total assets	2005	20.3	7.1	46.6	26.9
	2006	22.9	7.2	50.6	29.9
	2007	29.0	6.2	52.3	34.0
	2008	27.5	6.8	52.3	33.7
	Mar 09	24.9	6.5	51.2	31.4
Ratio of debt securities to total assets	2005	29.5	28.9	19.4	26.5
	2006	24.8	20.3	13.5	21.2
	2007	19.9	17.0	7.2	16.0
	2008	17.3	14.8	5.8	13.5
	Mar 09	18.2	18.0	6.5	14.6
ECB liquidity indicator (ratio of cash and claims to liabilities to banks)	2005	48.4	98.7	30.3	41.3
	2006	45.5	116.0	25.1	38.2
	2007	37.3	48.8	16.9	29.4
	2008	39.6	55.8	14.8	29.2
	Mar 09	43.6	49.4	10.8	29.0
Proportion of total deposits by non-banking sectors accounted for by the 30 largest depositors	2005	19.0	40.0	20.7	21.2
	2006	19.9	41.3	19.9	21.9
	2007	20.8	33.2	20.8	21.9
	2008	19.3	30.3	21.2	20.8
	Feb 09	25.1	32.6	24.3	25.7

Source: Bank of Slovenia

A comparison of structural liquidity indicators with the EU average.

Because the coverage of loans by deposits by non-banking sectors in the Slovenian banking system declined further last year, it also changed compared with the EU average. Coverage in Slovenia at the end of 2008 was 14.8 percentage points lower than the average coverage of loans by deposits by non-banking sectors at medium-size EU banks at the end of 2007. Last year the values of indicators showing the ratio of liabilities to banks to loans to non-banking sectors and the proportion of total assets accounted for by debt securities still significantly exceeded the EU average values. In contrast, the liquidity indicator (the ratio of cash and claims against banks to liabilities to banks) is three times higher on average in the EU than in Slovenia.

Figure 6.34: Comparison of liquidity indicators for the Slovenian banking sector and medium-size EU banks



Note: K1 – ratio of deposits by non-banking sectors to loans to non-banking sectors.
K2 – ratio of liabilities to banks to loans to non-banking sectors.
K3 – proportion of total assets accounted for by debt securities.
K4 – ratio of the sum of cash and claims against banks to liabilities to banks.
Sources: Bank of Slovenia, ECB (EU Banking Sector Stability)

6.7 Credit risk

Credit growth declined sharply in 2008, and given the reversal of the credit cycle and the negative economic growth the forecasts for 2009 are not optimistic. Banks tightened credit standards regarding the size of approved loans and the required collateral. The adverse trends on the capital markets forced banks to reduce securities collateral and to make more use of less-risky forms as collateral. The shortening of loan maturities nevertheless means that the proportion of new loans that are unsecured is increasing, which is increasing credit risk at banks. The increase in the number of days past due in loan repayments points to a sharp increase in credit risk in 2009.

Pro-cyclical behaviour by banks will be one of the key risk factors during the contraction of economic activity, and the transition into recession in 2009. Economic growth was still high last year, although lower than in the previous year. The gap between falling growth in all loans and rising growth in bad loans is widening. Banks were assessing clients primarily on the basis of current business results, which reflected the favourable economic climate, and under the pressure of competition. In the decision of whether to finance individual clients, the key is greater emphasis on the whole period of potential exposure to the individual client and to factors that are known to have an impact on individual clients and to increase their risk to banks. A longer-term and forward-looking view of client quality would allow for greater stability in credit assessments and credit risk in the banking sector, even in a less favourable economic climate.

Banks reduced their exposure to the rest of the world and simultaneously increased the relative level of impairments on such claims. There was also an increase in exposure to Balkan countries, but banks do not see this region as particularly risky, despite the macroeconomic instability (depreciation of local currencies, outflow of capital). On a sectoral basis, exposure to the financial intermediation sector increased sharply, particularly at the large banks.

Credit standards

Credit growth declined most at the large domestic banks.

The decline in credit growth in 2008 was particularly evident at the large domestic banks, which recorded the largest decline in lending activity. In addition to the great restrictions on obtaining foreign funding, the large domestic banks were also more affected than the other two bank groups by the structure of maturing existing debt to the rest of the world, which was most unfavourable at the large banks. The decline in credit growth also accelerated at the banks under majority foreign ownership in the early months of 2009. The reversal of the credit cycle will thus be more pronounced and longer-lasting in the context of negative economic growth, as a result of banks' difficulties in refinancing their liabilities to the rest of the world.

Banks tightened credit standards in the second half of 2008 as a response to increasing uncertainty in operations and unfavourable forecasts for the ongoing development of the crisis in the financial and real sectors, and also to pessimistic forecasts of access to funding (see Section 6.2). The tightening of credit standards is seen primarily in the form of greater conservativeness regarding the size of approved loans and the collateral required for them.

Table 6.21: Year-on-year growth in loans to non-banking sectors by bank group in percentages

	2005	2006	2007	2008	Mar 09
	Loans to non-banking sectors				
Large banks	21.7	21.7	37.5	12.6	11.2
Small banks	22.4	35.9	42.0	22.0	17.1
Banks under majority foreign ownership	36.2	33.7	40.0	25.7	15.8
Total	26.1	26.4	38.6	17.7	13.2

Source: Bank of Slovenia

Loan-to-income (LTI) ratio

A decline in the proportion of loans with an LTI ratio of more than 50%.

In 2008 banks saw no change in their average LTI ratio. In practice the terms of household borrowing tightened slightly, and demand for household loans declined slightly. The actual proportion of new loans on which the LTI ratio is more than 33% declined for housing and consumer loans. The proportion of new loans on which the LTI ratio exceeds 50% also declined.

Table 6.22: Loan-to-income (LTI) ratio

	Average maximum LTI under bank's business policy	Actual proportion of newly approved housing loans with		Actual proportion of newly approved consumer loans with	
		LTI >= 33%	LTI >= 50%	LTI >= 33%	LTI >= 50%
2007	54.3	58.0	18.0	49.3	10.4
2008	54.3	52.6	16.4	46.0	9.8

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

Maturity of new loans

A shortening of maturities of corporate loans and short-term household loans. Longer maturities of housing loans.

Banks tightened their credit standards regarding the maturity of new loans in 2008, particularly in the final months of the year. The proportion of new corporate loans accounted for by long-term loans fell to 44% in the final quarter of 2008, compared with 66% in 2007. Standards were also tightened on consumer loans to households during 2008, the proportion accounted for by short-term loans reaching 28%, up 10 percentage points on 2007. The reverse was the case for housing loans, whose average maturity lengthened as a result of growth in loans with a maturity of more than 20 years, the proportion of which exceeded 40% in 2008.

Repayment method

A small proportion of bullet loans.

Some banks allow borrowers to repay the entire principal at maturity. A survey reveals that the majority of these bullet loans (two-thirds in 2008) were short-term. The volume in 2008 was down 24% on 2007. Bullet loans accounted for 0.8% of loans to non-banking sectors, and 3.7% of total household loans, down 1 percentage point on 2007.

The proportion of loans on which banks offer combined financial products in conjunction with selected management companies (a leveraged lombard loan)[42] is also low. In these types of loans risk is tied to the relatively high concentration of investments in a limited range of investment funds of the same management company, with a large number of

[42] A leveraged lombard loan is a loan in which the borrower may pledge as collateral securities, transferable investment coupons or receivables for payment of the redemption unit value of non-transferable investment coupons. The highest leverage of a loan did not exceed four times the ratio of the loan raised to the own funds invested in securities or mutual fund units.

borrowers. Bullet loans paid by means of a capital investment accounted for 0.1% of all household loans in 2007, but just 0.03% in 2008 (or EUR 2.3 million).

Loan-to-value (LTV) ratio

A lower LTV ratio on new loans with real estate collateral.

Banks saw a decline in the average LTV ratio of corporate and household loans with real estate collateral in 2008. The maximum LTV ratio on corporate loans with real estate collateral allowed by internal bank standards ranged between 50% and 75% in 2008, compared with a range of 50% to 85% in 2007. Banks' internal requirements for the ratio on housing loans were most commonly in a similar range. The actual ratios on new loans were lower, averaging 58.2% on corporate loans and 52% on housing loans in 2008.

Table 6.23: Average loan-to-value (LTV) ratio for loans with real estate collateral

	Real estate LTV	
	2007	2008
Corporate loans	66.8	58.2
Non-housing loans to households	53.6	47.0
Housing loans	60.5	52.0

Note: LTV – ratio of loan to value of pledged collateral.
Source: Bank survey

An increase in the LTV ratio on loans with securities collateral.

By contrast, the LTV ratio on loans with securities collateral increased in 2008. Here it should be noted that these loans often have other forms of collateral in addition to the securities, particularly since such collateral became more risky for banks as a result the fall in stock market prices.

Table 6.24: Average loan-to-value (LTV) ratio for loans with securities collateral

	LTV – securities and/or mutual fund units (%)		Loans whose LTV rose above the internally defined LTV in 2008		Loans for which banks obtained additional collateral in 2008	
	2007	2008	EUR million	Share in total loans to companies	EUR million	Share in total loans to companies
Corporate loans	59.5	65.0	656.7	2.9	390.2	1.7
Non-housing loans to households	35.8	36.9	43.9	1.1	14.8	0.4
Housing loans	19.7	32.5	1.0	0.0	0.0	0.0

Note: LTV – ratio of loan to value of pledged collateral.
Source: Bank survey

An increase in loans with securities collateral on which banks demand additional collateral.

As a result of the fall in prices of securities used as collateral for bank loans, there was a sharp increase in the amount of loans on which the LTV ratio exceeded the internal requirements. Such loans represented 27% of the stock of loans with securities as the primary form of collateral, and 2.9% of the total stock of corporate loans at the end of 2008. Banks obtained additional collateral for 60% of such loans in 2008.

6.7.2 Loan collateral

Breakdown of loan collateral based on survey data

Tightened bank standards for loan collateral in 2008.

As a result of the decline in the coverage of loans whose value was sharply reduced by the financial turmoil, banks tightened their collateral standards. The most evident change in collateral requirements for new corporate loans in 2008 was the decline in the proportion with collateral in the form of securities and mutual fund points, and the increase in the proportion with real estate collateral.

Judging by survey results, banks held a greater proportion of unsecured corporate loans at the end of 2008 than a year earlier, but this was probably more the result of the shortening of maturities than looser collateral requirements in this segment. More than 80% of new corporate loans in 2008 were short-term, while the proportion of loans that were unsecured was less than 50%.[43]

[43] A breakdown of loans is given by the primary form of insurance. If a loan has no form of security or the only form of security is a bill of exchange, it is classified as unsecured. If the prevailing form of loan collateral is real estate, the loan is classified as secured by real estate. If the loan is primarily secured with an insurer, it is classified as secured with an insurer. If the primary form of loan collateral is securities or mutual fund points, it is deemed to be secured in its entirety by this form of collateral. All other loans with other primary forms of security are classified in their entirety as "other".

Table 6.25: Breakdown of corporate loans by type of collateral in percentages

(%)	Outstanding loans		Newly approved loans	
	2007	2008	2007	2008
Type of collateral				
Secured loans	74.1	73.0	51.8	53.1
Real estate collateral	19.2	21.0	10.8	12.5
Insured at insurer	0.0	0.1	0.1	0.3
Securities or mutual funds units as collateral	9.1	8.6	8.3	7.2
Other froms of collateral	45.7	43.2	32.5	33.2
Unsecured loans	25.8	27.0	48.2	46.9

Source: Bank survey

There was a pronounced decline in the proportion of new housing loans that were unsecured. There was an increase in the proportion of loans with real estate collateral, which retained its position as the prevailing form of security.

Table 6.26: Breakdown of housing loans by type of collateral in percentages

(%)	Outstanding loans		Newly approved loans	
	2007	2008	2007	2008
Type of collateral				
Secured loans	95.6	95.8	76.0	87.5
Real estate collateral	59.1	67.8	44.0	60.0
Insured at insurer	17.8	14.5	9.0	6.4
Securities or mutual funds units as collateral	0.3	0.2	0.2	0.2
Other froms of collateral	18.4	13.2	22.9	20.9
Unsecured loans	4.4	4.2	23.4	12.5

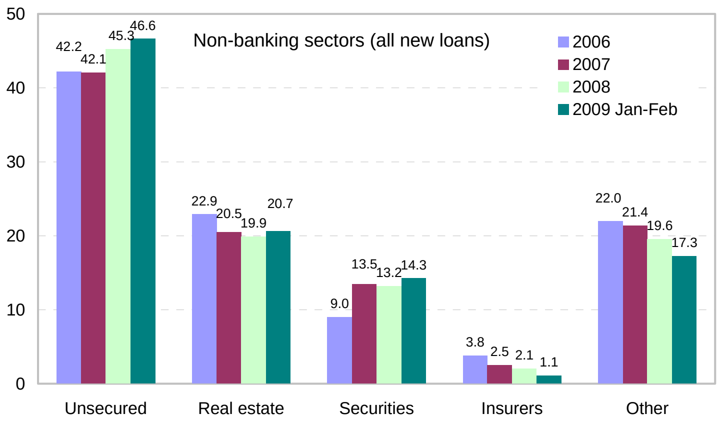
Source: Bank survey

Breakdown of collateral for newly approved loans

The proportion of unsecured new loans is increasing.

Among new loans to non-banking sectors, the largest increase in the proportion of unsecured loans[44] in 2008 was recorded by other financial institutions, the figure averaging 62%. This figure declined again to 48.4% in early 2009. The proportion of loans to non-financial corporations that were unsecured also continued to increase in the first months of 2009.

Figure 6.35: Breakdown of collateral of new loans to non-banking sectors in percentages

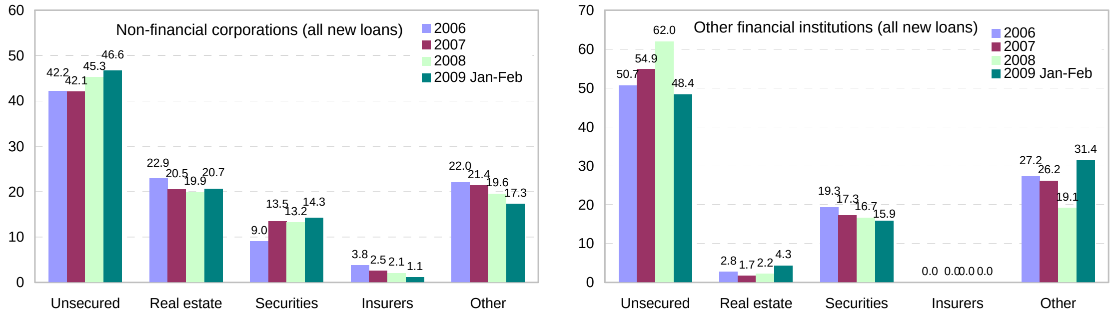


Source: Bank of Slovenia

The least favourable breakdown of collateral for banks is that of loans to other financial institutions, which in addition to a high proportion of unsecured loans also have the highest proportion of loans with securities collateral, at 16.7% in 2008. In early 2009 the proportion of unsecured loans declined, in favour of other forms of security, to below the value recorded in 2006, when the credit growth began to accelerate.

[44] Unsecured loans also include loans with collateral in the form of bills of exchange.

Figure 6.36: Breakdown of collateral of all new loans to non-financial corporations (left) and other financial institutions (right) in percentages



Source: Bank of Slovenia

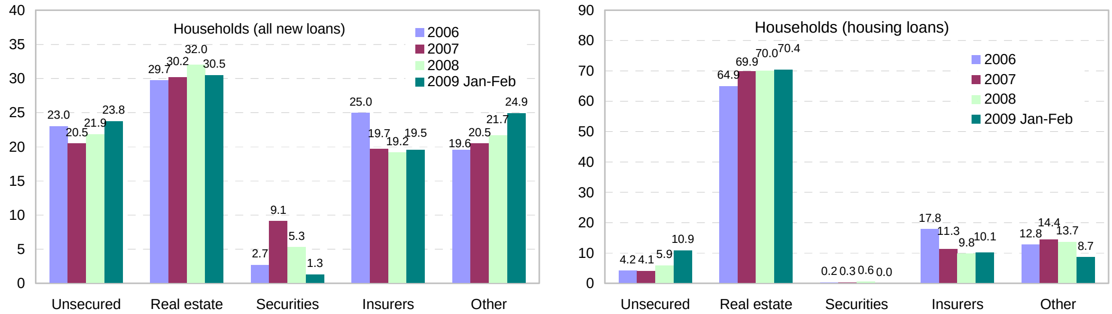
The proportion of loans with securities collateral declined sharply for household loans and slightly for loans to other financial institutions. Loans with securities collateral accounted for 5.3% of household loans in 2008, down almost 4 percentage points on 2007. The proportion continued to decline in early 2009, to 1.3% during the first two months of the year. The proportions of unsecured loans and loans with other forms of security (other than real estate collateral and secured with insurers) are also increasing for household loans.

A decline in the proportion of new household loans with securities collateral.

There was no significant change in the breakdown of the security for new housing loans in 2008. More than 70% of new housing loans are secured by means of real estate collateral, while the use of securities as the primary form of collateral on such loans is exceptional.

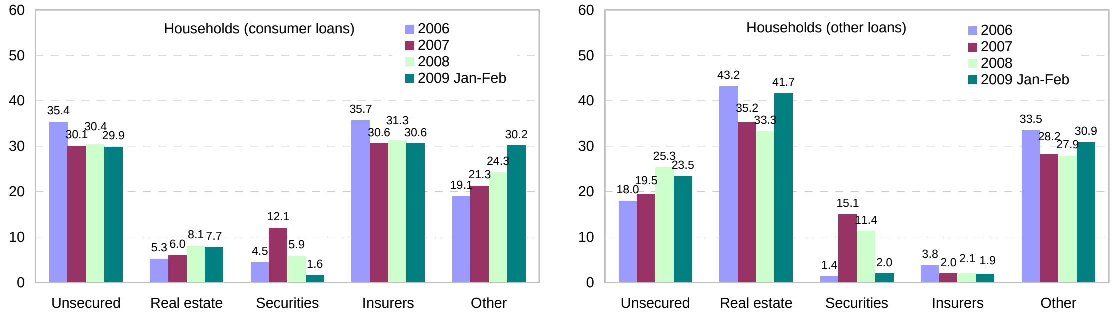
70% of housing loans are secured by real estate.

Figure 6.37: Breakdown of collateral of all new loans to households (left) and housing loans to households (right) in percentages



Source: Bank of Slovenia

Figure 6.38: Breakdown of security of all new consumer loans (left) and other loans to households (right) in percentages



Source: Bank of Slovenia

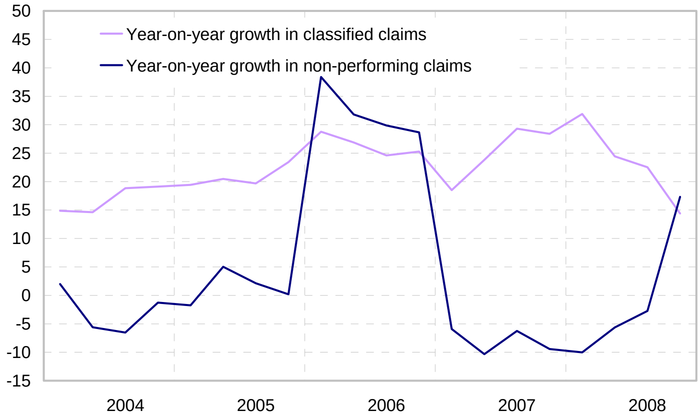
Portfolio quality

After high optimism in the risk assessment of claims in 2007, under the influence of a favourable climate and high credit growth, banks made no significant adjustment to their credit risk assessments for the majority of 2008. Only towards the end of the year, when the signals from the economy and the macroeconomic forecasts had become more alarming, did banks begin to significantly alter their risk assessments of the credit portfolio.

A deterioration in the quality of the credit portfolio in the final quarter of 2008.

In the context of a sustained slowdown in credit growth in 2008, banks' non-performing claims (rated D and E) maintained negative growth over the first three quarters. They rose sharply in the final quarter, by 15.6% on the previous quarter and by 17.3% in year-on-year terms. Year-on-year growth in classified claims halved by the end of 2008, to 14.4%. Debtors' increased arrears in repayments in early 2009 and the continuing forecasts of the development of the economic and financial crisis suggest that banks' credit portfolio will continue to deteriorate. While credit growth is declining, a large portion of classified claims will be moved to higher-risk ratings. The gap between growth in classified claims and non-performing claims will widen rapidly.

Figure 6.39: Year-on-year growth in classified and non-performing claims in percentages



Source: Bank of Slovenia

An increase of 0.2 percentage points in the coverage of classified claims by impairments in the final quarter of 2008 to 3.0% as an indication of rising credit risk.

Coverage of classified claims by impairments declined until the end of the third quarter of 2008, reaching 2.8% at the end of September, down 0.2 percentage points on a year earlier. Coverage then increased by 0.2 percentage points to reach 3.0% by the end of the year, a clear indication of the expected trend of increasing credit risk in 2009.

Table 6.27: Breakdown of classified claims and coverage of claims by impairments and provisions

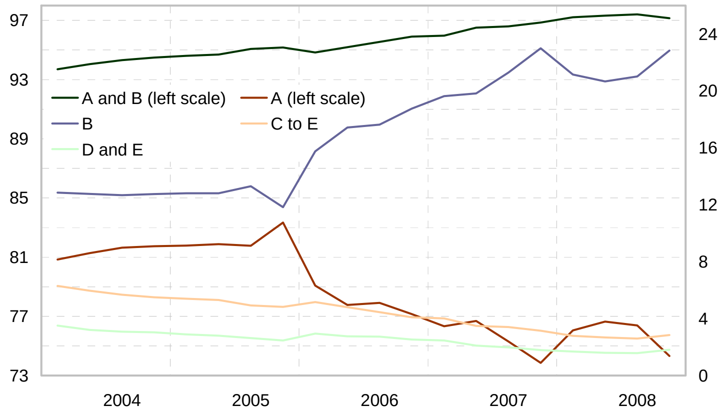
	31 December 2007			31 December 2008		
	Classified claims	Impairments	Coverage of claims by impairments (%)	Classified claims	Impairments	Coverage of claims by impairments (%)
Total (EUR million)	40,542	1,311	3.2	46,381	1,390	3.0
	Structure (%)			Structure (%)		
A	73.9	8.5	0.4	74.3	8.9	0.4
B	23.0	33.7	4.7	22.8	34.7	4.5
C	1.4	10.0	23.9	1.0	8.6	24.9
D	0.7	14.3	65.7	1.0	20.8	62.4
E	1.1	33.4	100.0	0.8	27.1	100.0

Source: Bank of Slovenia

A decline in the proportion of claims with the lowest risk rating.

The proportion of claims rated A declined by 2.1 percentage points in the final quarter, while the proportion of claims rated B increased by 1.8 percentage points, and the proportion of claims rated D also increased to a lesser extent. Nevertheless the proportion of classified claims rated as less risky loans (A and B) remained high at 97.2%. The proportion of non-performing claims (rated D and E) last year remained the same as the previous year at 1.8%. Their high growth in the final quarter merely compensated for the decline in the first nine months of the year.

Figure 6.40: Percentage of total classified claims rated A and B, C to E (bad claims) and D and E (non-performing claims)



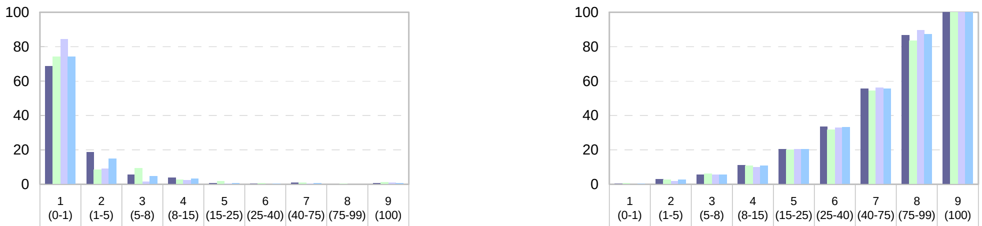
Source: Bank of Slovenia

The banks under majority foreign ownership have a higher proportion of classified claims in the first, lowest-risk rating than the other bank groups, at 84.5%. The figure was similar to a year earlier, and similarly there was no change in the proportion of non-performing claims over this period either. The banks under majority foreign ownership have the lowest proportion of non-performing claims, but they form the largest relative impairments for such claims, coverage amounting to 86.4%. Coverage of non-performing claims by impairments stood at 80.3% at the small domestic banks, and 75.4% at the large banks. Coverage of non-performing claims by impairments declined at all the bank groups in the last year. This indicates that banks have formed a lower level of impairment for claims that have been transferred to less favourable ratings than for the existing claims in these rating categories.

The small banks are notable for the lowest proportion of the highest-quality claims, and the largest proportion of non-performing claims.

The small banks are showing more prudence in rating claims than the other two bank groups. This group has the highest coverage of classified claims by impairments, and increased its coverage relative to 2007 by more than the other two groups. The proportion of lower-risk claims (rated A and B) is 94.9% at the small banks, compared with 97% at the large banks and 97.7% at the banks under majority foreign ownership. The small banks were the only bank group to see a decline in the proportion of less-risky claims in 2008, by 0.8 percentage points on the end of 2007. At the same time the small banks recorded the highest proportion of non-performing claims (rated D and E), at 2.6%. The large domestic banks recorded and increase in their proportion of non-performing claims by 0.1 percentage points to 1.7%, the same as the banks under majority foreign ownership.

Figure 6.41: Breakdown of classified claims by credit rating defined by the range of impairments created (left) and average coverage of classified claims by impairments (right) by bank group for the end of 2008 in percentages



	1 (0-1)	2 (1-5)	3 (5-8)	4 (8-15)	5 (15-25)	6 (25-40)	7 (40-75)	8 (75-99)	9 (100)
Large banks	68.7	18.7	5.7	3.9	0.8	0.4	0.9	0.2	0.7
Small banks	74.3	8.4	9.4	2.7	1.8	0.7	1.0	0.3	1.3
Banks under majority foreign ownership	84.5	9.1	1.7	2.4	0.3	0.2	0.5	0.2	1.0
Total	74.3	14.9	4.7	3.3	0.7	0.4	0.8	0.2	0.8

	1 (0-1)	2 (1-5)	3 (5-8)	4 (8-15)	5 (15-25)	6 (25-40)	7 (40-75)	8 (75-99)	9 (100)
Large banks	0.4	3.0	5.7	11.0	20.6	33.5	55.5	86.9	100.0
Small banks	0.6	2.8	6.2	10.9	20.2	31.8	54.4	83.7	100.0
Banks under majority foreign ownership	0.2	1.9	5.8	10.0	20.4	33.1	56.2	89.6	100.0
Total	0.4	2.8	5.8	10.8	20.5	33.2	55.6	87.5	100.0

Source: Bank of Slovenia

Days past due in loan repayment

An increase in the proportion of classified assets with arrears in repayment.

In the final quarter of 2008 banks saw a large decline in the quality of the credit portfolio with an increase in clients' arrears in making repayments. The proportion of past-due classified assets stood at 6.6% in September, but increased to 9.8% in the final quarter of 2008. The most notable increase was in the proportion of total classified assets that were up to 30 days past due, by 2 percentage points to 4.7%, an indication that the new arrears were primarily occurring in the final months of the year. In the event of the continued tightening of management terms, arrears in the repayment of loans will rapidly lengthen. The proportion of classified assets for whose repayment the debtors are more than 90 days in arrears increased by slightly less in 2008, by 1.2 percentage points, to 3.9%. A more pronounced increase is expected in 2009.

From the point of view of arrears in repayment, the largest credit risk to banks is represented by clients in the sectors of corporates, OFIs and non-residents, which repay 12% of their classified assets in arrears. The proportion of non-residents' classified assets that were more than 90 days past due stood at 7.3%, up 1.8 percentage points on a year earlier. The proportion of corporates' classified assets that were more than 90 days past due increased to 3.2%, up just under 1 percentage point on the end of 2007.

Table 6.28: Breakdown of classified claims as at 31 December 2008 by sector in terms of the number of days past due

	Classified claims		No delay	Up to 30 days	31 to 90 days	91 to 180 days	Over 180 days
Total (EUR million)	46,380		41,812	2,198	585	446	1,338
		Structure (%)					
Corporates including OFIs	58.7	100.0	88.3	7.3	1.3	0.9	2.3
Households and sole proprietors	18.6	100.0	98.0	0.7	0.2	0.2	0.9
Non-residents	15.7	100.0	87.7	1.9	3.1	2.4	4.9
Government	2.5	100.0	74.7	2.1	-	0.1	23.1
Banks and saving banks	4.3	100.0	99.1	-	0.0	-	0.9
Central bank	0.2	100.0	100.0	-	-	-	-
Other	0.1	100.0	100.0	-	-	-	-
Total	100.0	100.0	90.2	4.7	1.3	1.0	2.9

Source: Bank of Slovenia

The large banks are most exposed to credit risk as measured by arrears in repayment.

The banks under majority foreign ownership are less exposed to credit risk than the domestic banks according to the indicator of arrears in repayment. In their portfolios 8.1% of claims were in arrears at the end of 2008, compared with almost 11% at the domestic banks. The largest risk was at the large domestic banks, where 4.5% of classified claims were more than 90 days past due, compared with 2.6% at the small banks and 2.9% at the banks under majority foreign ownership.

Table 6.29: Breakdown of classified claims as at 31 December 2008 by individual bank group in terms of the number of days past due

	Classified claims	No delay	Up to 30 days	31 to 90 days	91 to 180 days	Over 180 days
Total (EUR million)	46,380	41,812	2,198	585	446	1,338
			Structure (%)			
Small banks	100.0	89.2	6.7	1.5	0.7	1.9
Banks under majority foreign ownership	100.0	91.9	4.2	1.0	0.8	2.1
Large banks	100.0	89.3	4.8	1.4	1.1	3.4
Total	100.0	90.2	4.7	1.3	1.0	2.9

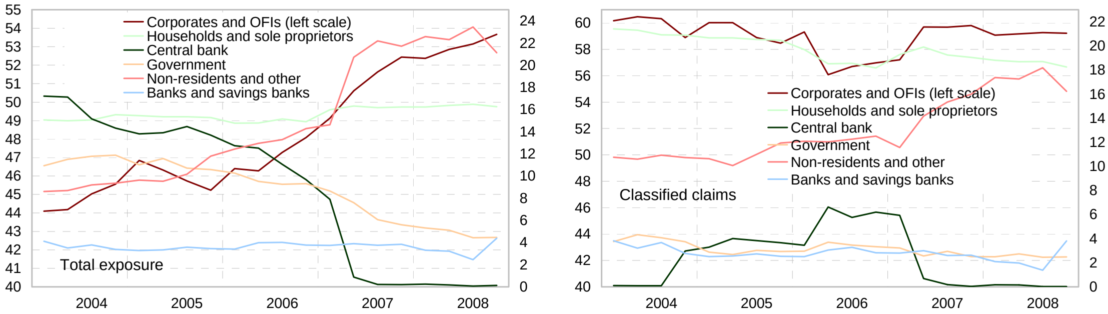
Source: Bank of Slovenia

Portfolio diversification

An increase in the proportion of exposure to corporates, and a decline in exposure to non-residents at the end of the year.

The increase in total bank exposure to corporates and the decline in exposure to the government sector continued in 2008. Total exposure to corporates, which comprise the predominant sector, accounted for 53.7% of total exposure at the end of 2008, up 1.3 percentage points on a year earlier. Exposure to non-residents, which leapt in 2007, has been declining since the summer of 2008. Exposure to banks and savings banks increased at the end of the year.

Figure 6.42: Percentage breakdown of total bank exposure (left) and classified claims (right) by sector



Source: Bank of Slovenia

Classified assets comprise both on-balance-sheet and off-balance-sheet bank claims that banks classify into credit ratings in terms of their quality.

A large increase in exposure to the financial intermediation sector at the large domestic banks.

The proportion of banks' classified claims accounted for by non-residents declined by 1.7 percentage points, primarily as a result of a decline in exposure to foreign financial institutions, from 8.2% in 2007 to 6.5% in 2008. The proportion accounted for by classified claims against foreign non-financial institutions remained high, as in 2007, at 9.2%. The banking system's large exposure to the manufacturing sector has displayed a trend of decline in recent years. A prominent sector is financial intermediation, which in 2008 accounted for 15.6% of total classified claims, and recorded the highest growth in classified claims during the year. The main increase in exposure to this sector was recorded by the large domestic banks, where the figure rose by 4.1 percentage points to 17.6%. This sector represents a major credit risk to banks, not only because of its high proportion in the sectoral breakdown, but also because of the lower diversification of risk between relatively few entities, in contrast to the numerous and diverse branches of manufacturing.

Table 6.30: Breakdown of classified claims by sector in percentages

	Proportion of classified claims (%)				
	2004	2005	2006	2007	2008
Agriculture and mining	0.7	0.7	0.6	0.6	0.6
Manufacturing	17.4	16.9	15.3	14.5	14.3
Electricity, gas and water	1.8	1.7	1.5	1.7	1.7
Construction	5.6	5.8	5.8	6.6	6.7
Trade	14.0	13.4	12.0	11.1	10.9
Transportation and storage	5.2	4.9	4.6	4.6	4.7
Hotels and restaurants	1.5	1.6	1.6	1.5	1.5
Information and communication	2.2	1.4	1.5	1.6	1.5
Financial and insurance activity	13.1	14.3	17.6	13.1	15.6
Real estate activities	1.2	1.4	2.2	2.5	2.4
Professional scientific and technical activities	4.3	4.5	4.4	4.6	4.3
Public services	3.5	3.5	4.0	3.4	3.4
Households	18.5	17.7	17.0	16.6	16.4
Sole proprietors	0.1	0.2	0.2	0.2	0.2
Foreign non-financial institutions	3.7	4.2	5.3	9.2	9.2
Foreign financial institutions	6.9	7.8	6.2	8.2	6.5
Other	0.3	0.0	0.0	0.0	0.0
Total (EUR million)	20,427	25,209	31,581	40,544	46,380
Herfindahl-Hirschman index	1,175.7	1,163.3	1,147.9	1,046.0	1,073.6

Source: Bank of Slovenia

Negative growth of classified claims against foreign financial institutions, while growth in claims against domestic sectors mostly exceeded 10%.

Growth in classified claims in 2008 was just half of that in 2007. Claims against foreign financial institutions recorded negative growth. In years of a strong economic climate, the boom in lending activity is most intensively reflected in financing of the rest of the world, and similarly during a contraction in credit growth it records the largest decline. Banks maintained double-digit growth with the majority of other sectors.

Table 6.31: Year-on-year growth in classified claims by sector in percentages

	Year-on-year growth in classified claims (%)				
	2004	2005	2006	2007	2008
Agriculture and mining	16.6	19.0	12.2	19.0	21.6
Manufacturing	17.6	19.9	13.5	21.7	12.4
Electricity, gas and water	-12.3	18.0	13.2	45.1	11.2
Construction	24.7	28.6	24.9	47.1	16.0
Trade	19.2	18.2	12.2	18.9	12.3
Transportation and storage	6.9	15.8	19.6	26.2	18.2
Hotels and restaurants	12.2	28.7	31.2	17.3	18.1
Information and communication	19.9	-18.4	34.4	33.1	7.7
Financial and insurance activity	50.1	34.8	53.9	-4.5	35.9
Real estate activities	30.3	44.4	98.1	45.0	13.0
Professional scientific and technical activities	15.2	27.9	22.0	35.8	6.2
Public services	-0.5	23.9	45.0	8.2	14.2
Households	16.3	18.1	20.2	25.6	13.2
Sole proprietors	-4.2	50.8	25.0	30.5	14.2
Foreign non-financial institutions	45.5	40.1	58.2	120.8	14.5
Foreign financial institutions	6.8	40.1	-0.7	69.5	-9.3
Other	-10.2	-97.9	-31.0	-13.5	1913.0
Total	19.1	23.4	25.3	28.4	14.4

Source: Bank of Slovenia

Increased risk assessments of non-resident clients at all bank groups.

All bank groups awarded non-resident clients higher risk assessments in 2008, and increased their coverage of these claims by impairments. In so doing, they assessed foreign non-financial institutions as significantly less risky than financial institutions in the rest of the world.

Banks, particularly the large domestic banks, class sole traders and proprietors as their highest-risk client segment. The only sector that banks assessed as more risky in 2008 than in 2007 was agriculture, forestry, fishing and mining. Despite banks' increased exposure to the financial intermediation sector, in particular at the large banks, the risk assessment of this sector at the large banks actually decreased by 0.3 percentage points to 1.5%, making it their third lowest sector in terms of risk.

Table 6.32: Breakdown and average risk (coverage of claims by impairments) of classified claims in 2008 by bank group in percentages

	Classification structure				Impairment as a percentage of classified claims			
	Banking sector	Large banks	Small banks	Banks under majority foreign ownership	Banking sector	Large banks	Small banks	Banks under majority foreign ownership
Agriculture and mining	0.6	0.6	0.8	0.6	8.3	8.8	16.3	5.0
Manufacturing	14.3	14.0	13.9	14.8	4.6	5.7	5.4	2.6
Electricity, gas and water	1.7	1.4	1.0	2.3	1.1	1.2	7.2	0.5
Construction	6.7	7.1	9.2	5.5	3.6	3.7	4.4	3.2
Trade	10.9	9.5	12.8	13.2	4.3	4.7	8.1	2.9
Transportation and storage	4.7	4.8	1.0	5.3	1.3	1.5	2.9	0.8
Hotels and restaurants	1.5	1.3	1.3	2.0	4.2	5.4	8.0	2.1
Information and communication	1.5	1.5	0.5	1.6	2.1	2.8	4.2	0.8
Financial and insurance activity	15.6	17.6	13.7	12.3	1.3	1.5	2.1	0.5
Real estate activities	2.4	2.1	3.0	2.9	2.8	3.3	3.7	1.9
Professional scientific and technical activities	4.3	3.7	9.0	4.4	4.1	4.7	4.6	3.0
Public services	3.4	3.0	3.6	4.0	1.0	1.3	1.3	0.6
Households	16.4	15.1	8.7	20.6	3.3	3.1	5.0	3.4
Sole proprietors	0.2	0.1	1.0	0.1	11.8	19.1	5.9	9.9
Foreign non-financial institutions	9.2	11.5	14.0	3.9	3.5	3.7	2.3	3.9
Foreign financial institutions	6.5	6.5	6.5	6.4	0.7	0.7	0.8	0.8
Other	0.03	0.02	-	0.1	3.3	3.3	-	3.3
Total	100.0	100.0	100.0	100.0	3.0	3.3	4.3	2.3

Source: Bank of Slovenia

Banks raised their risk assessments of all sectors in the final quarter of 2008. The largest rises were in the small domestic banks' risk assessments of almost all sectors.

The banks under majority foreign ownership are more optimistic than the domestic banks in their risk assessments of almost all sectors and client segments. Only in the household and non-resident sectors do the foreign banks disclose greater coverage of claims by impairments.

Exposure to the rest of the world

A decline in total exposure to the rest of the world in 2008.

The total exposure of Slovenian banks to the rest of the world declined by nearly 3.1%, to stand at EUR 11.8 billion at the end of 2008. Exposure to EU Member States declined in particular, by 10%, taking their proportion of the total down almost 5 percentage points. Exposure to the wealthier Member States fell, while exposure to Member States from eastern and central Europe actually increased. Exposure to the former Yugoslav republics also increased, by 4.7 percentage points.

Table 6.33: Total banking sector exposure to country groups in percentages

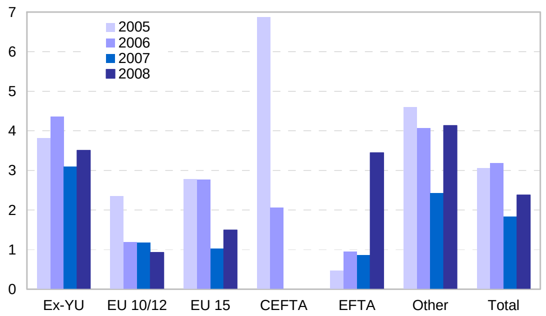
	Proportion (%)			
	2005	2006	2007	2008
EU	67.8	62.6	67.6	62.7
EFTA	4.8	4.4	2.7	3.4
Former Yugoslav republics	16.8	20.6	22.4	27.1
CEFTA[1]	1.0	1.3	-	-
Other	9.6	14.8	7.2	6.7
Total (EUR million)	4,868	6,447	12,171	11,797

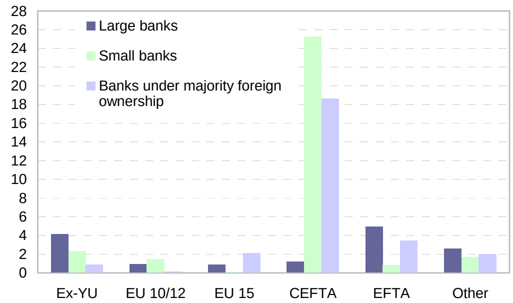
Note: [1] Until 2006 these figures only include Romania and Bulgaria, which joined the EU in 2007.
Source: Bank of Slovenia

An increase in coverage of claims against the rest of the world by impairments, albeit less than for domestic clients.

Credit risk assessments of clients in the rest of the world were tightened in 2008. Coverage of claims by impairments increased from 1.8% to 2.4%. The risk assessment of EFTA countries increased sharply, as a result of the rise in the risk assessment for Iceland to 80% in 2008. Exposure to Iceland accounts for 0.16% of total bank exposure. Despite the increased perception of risk vis-à-vis the rest of the world, according to bank assessments these claims were less risky than claims against domestic clients, for which banks created impairments of 3.1%.

Figure 6.43: Coverage of classified claims by impairments for banking sector (left) and for bank groups at the end of 2008 (right) by country group in percentages





Note: Until 2006 these figures only include Romania and Bulgaria, which joined the EU in 2007.
Source: Bank of Slovenia

The domestic banks raised their risk assessments of the former Yugoslav republics.

In the context of continuing growth in exposure to the former Yugoslav republics, the domestic banks also raised their risk assessments of the region, increasing their coverage of classified claims by impairments from 3.1% in 2007 to 3.5% in 2008. This was particularly the case at the large banks, while the banks under majority foreign ownership assessed these countries as less risky than in 2007, with coverage of just 0.9% of classified claims by impairments. The banks under majority foreign ownership also became more optimistic in their assessment of the credit risk presented by the nine other countries that joined the European Union with Slovenia.

The risk of claims against the former Yugoslav republics decreased at all the bank groups, coverage of these claims by impairments declining by 1.3 percentage points from the end of 2007 to 3.1%. The small banks and the banks under majority foreign ownership recorded the largest declines in coverage. The highest risk assessments of the region continue to be those of the large banks, although their coverage also declined slightly. The small domestic banks created the highest coverage for claims against EFTA countries, while the banks under majority foreign ownership did so for claims against the EU15.

Box 6.1: Exposure to Balkan countries[3]

At EUR 3.4 billion, exposure to Balkan countries accounted for 29% of banks' total exposure to the rest of the world of EUR 11.8 billion at the end of 2008.

The decline in exposure to Balkan countries was slower than that of exposures to other countries. While the proportion of banks' total exposure accounted for by exposure to the rest of the world declined by 1.7 percentage points to 15.7%, the proportion accounted for by Balkan countries actually increased slightly, to 6.5%. Whereas all the bank groups sharply increased their exposure to Balkan countries in 2007, by between 95% and 116%, during 2008 there were considerable differences. The banks under majority foreign ownership maintained high growth of 56.6%, while growth declined to 8.2% at the small domestic banks and 15.3% at the large domestic banks.

The stock of classified claims against the Balkans exceeded EUR 3 billion. The proportion of total exposure to the rest of the world accounted for by the region increased from 36% in 2007 to 41.5% in 2008. The proportion of total exposure to the rest of the world accounted for by the Balkans was similar at both the small and large domestic banks, at around 45%. The proportion was lower at the foreign banks, at 27.9%, but had increased the most over the course of one year.

Croatia and Serbia account for 65% of total exposure to the Balkans. Growth in claims against Croatia declined to below 10% in 2008, reducing the proportion of total exposure to Balkan countries that they account for by 3 percentage points. With claims against all the former Yugoslav republics recording slow growth in 2008, growth in exposures to Bulgaria and Romania was more notable, at 60% and 96% respectively.

Classified claims against Croatia and Romania consist almost exclusively of claims against non-financial corporations. In the other countries, the proportion of classified claims accounted for by financial corporations ranges from 10% in Serbia to 45% in Bulgaria. The highest risk assessments of the Balkan countries are given to Croatia, Serbia, and Bosnia and Herzegovina. The largest deterioration from the previous year was recorded by the risk assessment of clients from Serbia, which rose to 5.3% coverage of claims by impairments.

Table 6.34: Classified claims against Balkan countries (left) and coverage of classified claims by impairments in percentages (right)

	Dec 06	Dec 07	Dec 08
	classified claims (EUR million)		
Total	31,773	40,542	46,381
Rest of the world	3,642	7,039	7,270
Balkan countries	1,193	2,535	3,017
	Year-on-year growth rate (%)		
Total	25.5	28.4	14.4
Rest of the world	20.0	93.3	3.3
Balkan countries	72.4	112.5	19.0
	Structure of classified claims against Balkan countries (%)		
Croatia	30.1	38.0	34.9
Bosnia and Herzegovina	16.3	14.2	14.9
Serbia	23.9	28.6	29.8
Montenegro	5.4	11.3	11.2
Macedonia	7.9	4.0	3.6
Bulgaria	4.9	3.5	4.7
Romania	0.9	0.4	0.6

	Dec 06	Dec 07	Dec 08	Change
All classified claims	3.9	3.2	3.0	-0.2
Claims against the rest of the world	3.2	1.8	2.4	0.6
Balkan countries	4.2	3.1	3.4	0.3
Croatia	4.8	3.4	3.3	-0.1
Bosnia and Herzegovina	5.0	3.2	2.8	-0.4
Serbia	6.0	3.9	5.3	1.5
Montenegro	2.4	1.0	1.1	0.1
Macedonia	1.0	0.9	0.9	0.0
Bulgaria	2.3	1.7	0.7	-1.0
Romania	0.8	2.4	1.0	-1.4

Source: Bank of Slovenia

While all the bank groups assess their exposures to the rest of the world as more risky than in 2007, they present a less uniform picture in their risk assessments of the Balkan countries. Only at the large domestic banks did coverage of claims against the region by impairments increase in 2008, and the risk assessments are higher there than at the other two bank groups. The banks under majority foreign ownership disclose a very low coverage of claims by impairment of 0.9%, significantly less than that of the domestic banks, the large banks in particular, where the figure is 4%.

Table 6.35: Coverage of classified claims by impairments by bank group in percentages

	All classified claims			Classified claims against the rest of the world			Classified claims against Balkan countries		
	Dec 07	Dec 08	Change	Dec 07	Dec 08	Change	Dec 07	Dec 08	Change
Large banks	3.6	3.3	-0.3	1.9	2.6	0.6	3.4	4.0	0.6
Small banks	3.9	4.3	0.4	1.1	1.8	0.7	2.2	2.1	-0.1
Banks under majority foreign ownership	2.4	2.3	-0.1	1.8	2.0	0.2	1.5	0.9	-0.6

Source: Bank of Slovenia

[3] Includes the former Yugoslav republics, Bulgaria and Romania.

Large exposures

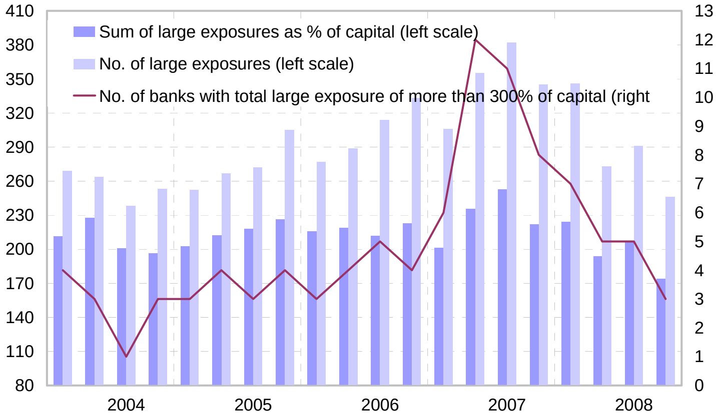
The number and sum of large exposures both declined in 2008. The number of large exposures fell by 99 in 2008 to 246. The sum of large exposures also fell, from 222% to 174% of the banking system's capital. The record values for large exposures in 2007 were partly as a result of lending for M&A activities, and this form of lending slowed in 2008.

A decline in the number and sum of large exposures in 2008.

The number of banks whose sum of large exposures is over 300% of their capital fell to three, thanks to the banks under majority foreign ownership. The sum of large exposures was over 300% of capital at seven banks at the end of 2007. Capital injections were a significant factor in this favourable development in 2008.

A decline in the number of banks whose sum of large exposures is over 300% of their capital.

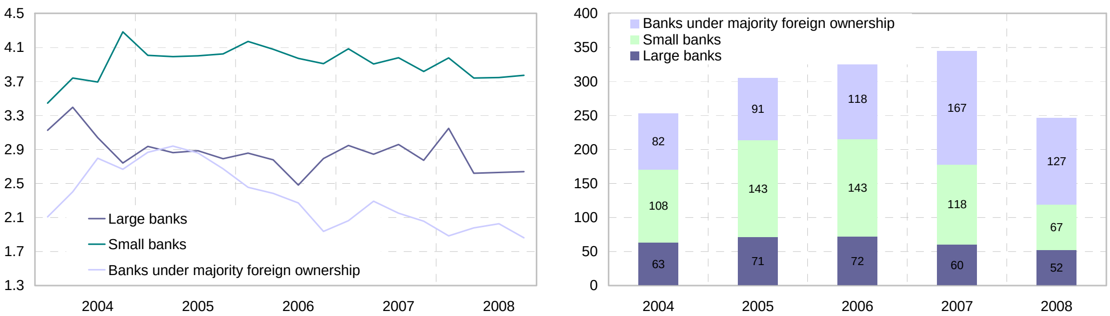
Figure 6.44: Sum and number of banking sector's large exposures



Source: Bank of Slovenia

Exposure to credit risk as measured by large exposures declined for all the bank groups in 2008. The largest falls in the average size of large exposures were recorded by the banks under majority foreign ownership, where it declined by 0.19 percentage points to 1.86% of regulatory capital, and the large banks, where it declined by 0.13 percentage points to 2.64%.

Figure 6.45: Average size of large exposures as a percentage of regulatory capital (left) and number of large exposures (right) by bank group



Source: Bank of Slovenia

Box 6.2: Bank exposure to other financial institutions (OFIs)[4] and non-financial corporations, including corporate M&A activities

Banks increased their loans to OFIs in 2008, at a slower pace than in the previous year. Annual growth was down a half at 33.8%. OFIs accounted for 8.5% of total loans to non-banking sectors at the end of 2008, and for the same proportion at the end of March 2009. The main component of loans to OFIs was loans to leasing companies, the proportion that they account for falling by 4.4 percentage points to 56.1%, while there was an increase in the proportion accounted for by loans to other financial corporations, some of which were included in the process of ownership consolidation.

Thus other financial corporations and non-financial corporations included in M&A activities in previous years were last year faced with higher loan costs and lower securities prices on the capital markets. In order to service the predominantly short-term loans, they were forced to earmark assets not deemed essential for the business operations, or to renew the loan agreements at maturity. Shares in certain acquired companies were delisted from the stock market after acquisition. In these instances the acquiring companies were primarily exposed to liquidity risk in the settlement of their loan obligations. In other cases, where the shares in the acquired companies remained listed on the stock market, the acquiring companies had additional problems caused by the large falls in the prices of the shares pledged as collateral for the loans. Lower corporate earnings are also making it harder to repay loans raised to finance M&As, thereby reducing their creditworthiness.

Table 6.36: Stock of loans approved by domestic banks for OFIs and selected non-financial corporations assumed to be involved in M&A activities

	Outstanding amount				Valuation change		Annual growth	
	Dec 06	Dec 07	Dec 08	Mar 09	Dec 07	Dec 08	Dec 07	Dec 08
(EUR million)								
Other financial corporation	1,306	1,958	2,559	2,595	652	601	49.9	30.7
Leasing[1]	796	1,186	1,436	1,492	390	250	49.0	21.1
M&A activity[2]	172	227	373	361	55	146	31.8	64.4
Other	338	546	750	743	208	205	61.4	37.5
Non-financial corporations – M&A activity[2]	473	1,176	1,286	1,246	703	110	148.4	7.6
Structure (%)								
Other financial corporation	100.0	100.0	100.0	100.0	100.0	100.0		
Leasing[1]	61.0	60.6	56.1	57.5	59.8	41.6		
M&A activity[2]	13.2	11.6	14.6	13.9	8.4	24.3		
Other	25.9	27.9	29.3	28.6	31.8	34.1		

Notes: [1] Leasing: Sector J64.91 under the SKD 2008.
[2] OFIs and non-financial corporations known to have been involved in the M&A activities of other corporates on the basis of information released publicly. The figure in the table includes 68 such corporates, and their total loans, irrespective of purpose.
Source: Bank of Slovenia

Loans to financial corporations involved in M&A activities increased by 64.4% in 2008. Total loans to financial corporations and non-financial corporations involved in M&A activities increased by 18%, significantly less than the annual increase of 117% in 2007. The analysis only includes corporates established for the purpose of acquiring other corporations, and other undertakings registered as pursuing other business activities and included in the financing of purchases of equity holdings. The estimated volume of lending for M&A activities cited in the table therefore merely represents the potential upper limit, and differs from (is greater than) the bank figures obtained from surveys, which have more accurate information as to the purpose of loans.

Growth in new loans to corporates involved in M&A activities was extremely high in 2007 at 144%, but declined to 25% in 2008. The increase in growth in new loans to such corporates in the first quarter of 2009 was the result of their borrowing being primarily short-term.

Exposure to holding companies[5]

Exposure to holding companies has increased at an above-average pace in the last two years, and exceeded EUR 3 billion at the end of 2008. The slowdown in bank lending activity in 2008 also affected holding companies, but less than other commercial entities. Borrowing by financial holding companies continued to grow at extremely high rates until September, and it was only in the final quarter that it slowed sharply.

As a result of the above-average growth in borrowing and the effect of the large fall in stock market prices on the value of their capital, the debt-to-equity ratio at holding companies increased sharply in 2008. Nevertheless the ratio is still significantly lower than in the economy as a whole.

Table 6.37: Exposure to holding companies

	Exposure					Ratio of debt to equity financing (%)	
	EUR million	Annual growth rates (%)					
	Dec 08	Jun 07	Dec 07	Jun 08	Dec 08	Dec 07	Dec 08
Holdings – non-financial	2,517	49.9	51.4	18.7	13.0	61.3	95.5
Holdings – financial	498	56.8	45.3	46.7	23.8	31.8	71.0
Holdings – total	3,015	50.8	50.4	22.6	14.6	55.7	91.2
		Share of holdings in total banks' exposure; %					
		5.2	5.3	5.4	5.5		

Source: Bank of Slovenia

At 2.2%, coverage of claims against holding companies by impairments is lower than the average for all classified claims of 3%. This coverage increased in the final quarter of 2008. Impairments of claims against holding companies almost doubled in the final quarter of 2008, a significantly higher rate of growth than total bank impairments (which were up 5.9% on September 2008). Despite the slight increase in prudence, as evidenced by the increase in impairments, banks assess the credit risk in respect of holding companies as measured by the coverage of classified claims by impairments as lower than the risk in respect of other sectors. Given holding companies' liquidity problems in the final months of 2008, a deterioration in credit ratings can be expected in the future.

Table 6.38: Coverage of classified claims against holding companies by impairments

	Impairment as a percentage of claims				Increase in impairment (%)			
	Jun 07	Dec 07	Jun 08	Dec 08	Jun 07	Dec 07	Jun 08	Dec 08
Holdings – non-financial	1.5	1.6	1.5	2.3	-11.5	19.3	19.1	62.9
Holdings – financial	1.3	1.4	1.2	1.6	49.8	57.7	39.4	44.1
Holdings – total	1.5	1.5	1.5	2.2	-6.8	23.6	21.6	60.3
Total classified assets	3.5	3.2	2.9	3.0	6.3	6.3	2.1	6.7

Source: Bank of Slovenia

Holding companies' arrears in settling past-due liabilities to banks increased sharply in the final quarter. The amount of holding companies' past-due classified claims at the end of 2008 was five times higher than in September. The main increase was in arrears of up to 30 days, an indication that they only arose in the final month of the year. As a result of increasing arrears on shorter maturities, the average number of days past due for clients in arrears declined, but can be expected to increase in the coming months.

The proportion of banks' total past-due classified claims accounted for by holding companies increased from 3.4% to 9% over the aforementioned three months, an indication of banks' increased exposure to credit risk from this sector. The high proportion of holding companies in arrears relative to their proportion of total bank exposure is an indication that banks are exposed to a higher level of credit risk at holding companies than they themselves assess according to the below-average coverage of claims by impairments.

Table 6.39: Holding companies' arrears in settling liabilities to banks

	Classified claims on holdings; EUR million		Share of claims in arrears in classified claims on holdings		Average number of days in arrears
	Total	in arrears	Total	of which in arrears over 90 days	
Dec 07	2,455.3	50.0	2.0	0.2	59.9
Jun 08	2,691.4	74.2	2.8	0.8	50.8
Dec 08	2,816.5	276.1	9.8	1.3	33.4

Source: Bank of Slovenia

Holding companies account for a relatively low proportion of banks' total exposure. The group of holding companies that act more like investment funds or are involved in M&A activities will see their operating conditions worsen as a result of the financial turmoil and economic crisis.

[4] OFIs include all financial corporations other than banks and the central bank. These are non-bank financial institutions and institutional sectors: other financial intermediaries (S.123), financial auxiliaries (S.124), and insurance corporations and pension funds (S.125).
[5] The majority of holding companies in Slovenia are registered as non-financial corporations (S.11), while only a minority are registered as other financial intermediaries (S.123). Both groups are included in the analysis.

6.8 Interest-rate risk

Banks are still exposed to the risk of a rise in interest rates, but not in the short-term sub- balance sheet.

Despite the further deterioration in conditions on the financial markets, interest-rate risk as measured by the difference between the average repricing periods for asset and liability interest rates continued to decline. Banks remain exposed to the risk of a rise in interest rates.

The effects of the financial turmoil were reflected more strongly in indicators showing a short-term view of interest-rate risk. The one-year cumulative gap, which used to be long, became short during 2008. The harsher climate at the end of the year forced banks to make use of short-term refinancing, which further shortened the gap.

The increase in the positive interest-rate gap from six months to one year in the final quarter of 2008 could temporarily make the cumulative one-year interest-rate gap long again, which would expose banks to the risk of a fall in interest rates. Given the already very low level of interest rates, this risk would primarily be short-term.

There were no significant changes in the currency breakdown of interest-sensitive items. The interest-rate gaps for individual currencies reveal an exposure to interest-rate risk primarily in domestic currency. Exposure to interest-rate risk in balance sheet items that disclose claims and liabilities in Swiss francs is only increasing for maturities of more than 5 years.

The mismatching of balance sheet items with regard to ties to reference interest rates increased in 2008, in the context of a significant decline in reference interest rates at the end of the previous year. This sharply exposed banks to the risk of lower interest income, which will be reflected in bank performance in 2009 should interest rates remain low.

Two key segments of option risk are changes in sight deposits and prepayments of other claims and liabilities. The proportion of items with the option of prepayment is primarily increasing on the asset side, while on the liability side it remains small and stable.

6.8.1 Average repricing periods for interest rates

Banks are still exposed to the risk of a rise in interest rates.

Interest-rate risk as measured by the difference between the average repricing periods for asset and liability interest rates continued to decline in 2008. At the end of the year the average repricing period for asset interest rates was 4.7 months longer than the average repricing period for liability interest rates, the difference having stood at 5.7 months at the end of 2007. The trend of decline in the difference continued in the first months of 2009. Banks continue to be exposed to the risk of a rise in interest rates, but to a lesser extent than in previous years.

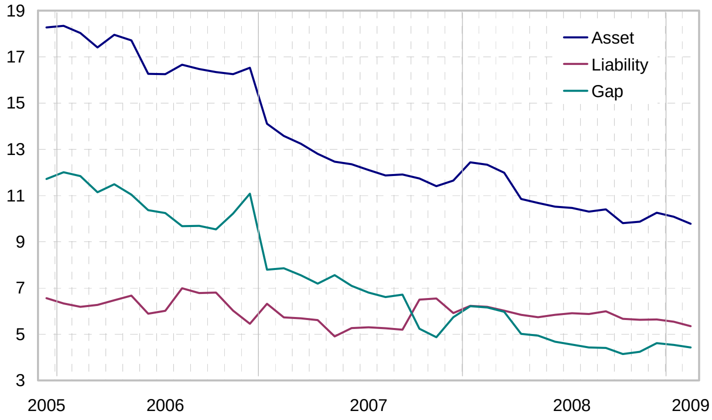
The average repricing period for asset interest rates shortened to 10.3 months.

Credit growth was still extremely high in the first months of 2008, but began to slow in the second half of the year as a result of the escalation of the financial turmoil. Growth in short-term loans strengthened. About 97% of new loans in 2008 carried a short-term fixed interest rate or a variable interest rate. As a result the average repricing period of asset interest rates shortened, to stand at 10.3 months at the end of the year.

The average repricing period for liability interest rates remained almost unchanged at 5.6 months.

As a result of the harsher conditions on the international financial markets, Slovenian banks raised funding from foreign banks with a shorter average maturity, while a portion of their funding comprised short-term borrowing from the Eurosystem. Having already declined to around 5.7 months by the end of 2007, the average repricing period for liability interest rates declined further in 2008. It had reached 5.6 months by the end of the year, and declined further in the first months of 2009. The average is being raised by individual banks under majority foreign ownership whose parent banks provide them with longer-term funding with a longer repricing period.

Figure 6.46: Average repricing period for asset and liability interest rates (months)

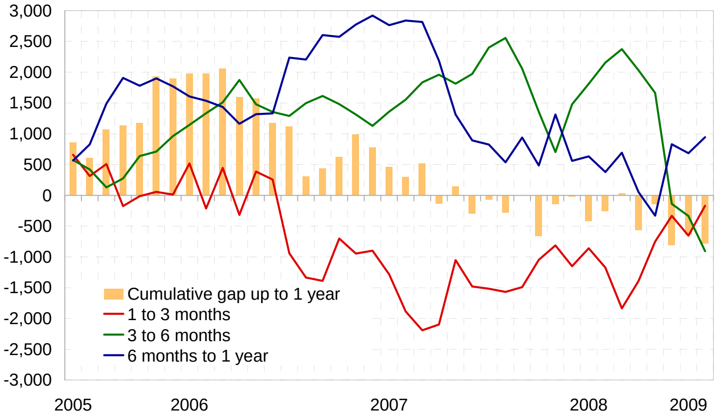


Source: Bank of Slovenia

The indicators of the average repricing period of asset and liability interest rates include all items irrespective of the repricing period. Banks can primarily respond to the situation on the markets via items maturing within a short time horizon. Other indicators providing a shorter-term assessment of interest-rate risk are therefore presented below.

6.8.2 Interest-rate gap

Figure 6.47: Gap between interest-sensitive assets and liabilities by individual time intervals in EUR million



Source: Bank of Slovenia

Analysis of the cumulative interest-rate gap of up to 1 year reveals that banks managed the effects of the instability on the financial markets in 2007, and partly closed the interest-rate gap. The escalation of the financial turmoil at the end of 2008 entirely altered the possibility of managing the interest-rate gap.

A shortening of the maturities of investments in the shortest interest-rate gap.

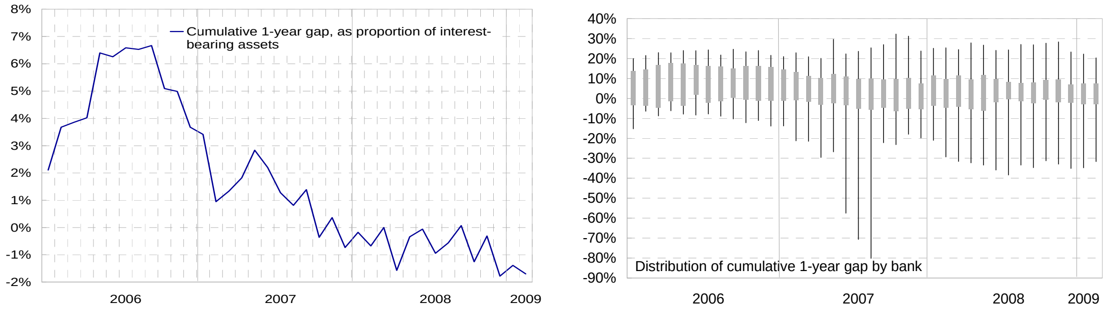
The interest-rate gap of up to 3 months, which became sharply negative in 2007, was gradually closed by banks in 2008 as they increased investments with this maturity. The remaining bank funding with a maturity of up to 3 months is stable in the amount of just over EUR 5 billion.

The long position in the category of 3 months to 6 months became short in December as a result of refinancing at the Eurosystem.

Banks recorded an extremely long position in the category of 3 months to 6 months over the first ten months of 2008. The refinancing difficulties in the rest of the world were reflected in the Slovenian banking system with a slight delay. In November banks began to obtain significant amounts of funding with a maturity of up to 6 months from the Eurosystem. The amount of funding in this category increased by EUR 1.4 billion in December alone, while there was a simultaneous decline in investments of EUR 305 million. The position in the aforementioned category became short, primarily as a result of the shortening maturity of funding. The renewed lengthening of the position in the interest-rate gap of 6 months to 1 year from the final quarter of 2008 was primarily a reflection of interest rate competition between banks to attract deposits by non-banking sectors. This change also points to the possibility of the cumulative interest-rate gap with a maturity of up to 1 year temporarily lengthening in the future, after being short for two years. This is particularly the case should the Eurosystem allow banks to draw on funds of longer maturity. This would increase the sensitivity of income to a further fall in interest rates, at least in the short term. Given that interest rates are already low, the risk of a fall in interest rates would only be temporary.

The distribution of the 1-year cumulative interest-rate gap by bank is an indication of the significant decline in the gap at a large number of banks, whereby the deviation from the average short interest-rate gap is greater downwards than upwards.

Figure 6.48: Cumulative 1-year gap of the banking sector as a proportion of interest-bearing assets (left) and distribution of banks (right)



Source: Bank of Slovenia

The lengthening of the cumulative interest-rate gap would temporarily expose banks to the risk of a fall in interest rates.

The interest-rate gap of up to 1 year reveals that bank exposure to interest-rate risk at the end of 2008 was small, and for the moment is sensitive to a rise in interest rates. Banks have become more exposed than in the past to a change in interest rates on the funding side that the investment side will be unable to wholly follow.

6.8.3 Basis risk

Gaps by currency

Growth in interest-sensitive assets stood at 13%, while growth in interest-sensitive liabilities was 12%.

Interest-sensitive assets amounted to EUR 45.4 billion at the end of 2008, and interest-sensitive liabilities to EUR 42.4 billion. At 11.9%, growth in interest-sensitive liabilities was only slightly outpaced by the growth of 13.1% in interest-sensitive assets. Both rates were significantly down on 2007, when they were around 26%.

The proportions of interest-sensitive assets and interest-sensitive liabilities remain high.

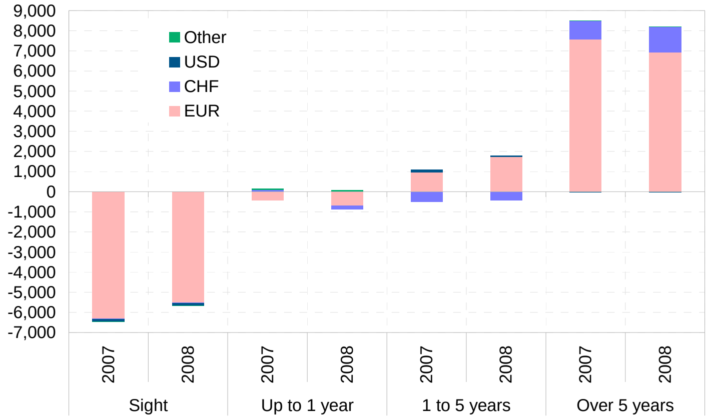
There were almost no changes in the currency breakdown of interest-sensitive items in 2008. The proportion of total interest-sensitive assets accounted for by domestic currency is 93.2%, while the proportion on the liabilities side is 94.1%. The proportion of interest-sensitive assets in Swiss francs increased by merely 0.3 percentage points at the expense of items in US dollars, while on the liability side the proportion increased by just 0.1 percentage points.

Since items in different currencies are not typically tied to changes in the same interest rates, the differences in the currency breakdown of interest-sensitive assets and liabilities indicate banks' exposure to interest-rate risk (basis risk). In 2008 the position in the category of 1 to 5 years lengthened at the expense of a shortening of the long position in the category of more than 5 years, and an additional shortening of the short position in the category of up to 1 year.

In the category of more than 5 years, the position in Swiss francs lengthened as a result of lending.

Banks are primarily exposed to interest-rate risk in domestic currency and in Swiss francs. In 2008 the position in domestic currency in the category of 1 to 5 years lengthened at the expense of a shortening of the positions in the categories of up to 1 year and more than 5 years. By contrast, the position in Swiss francs in the category of more than 5 years lengthened by EUR 345 million.

Figure 6.49: Currency breakdown of net interest-rate positions by individual category of residual maturity in EUR million



Source: Bank of Slovenia

Gaps by type of reference interest rate

Interest-rate risk from mismatches in relation to the type of reference interest rate rose again in 2008.

An additional source of interest-rate risk is mismatching in the structure of interest-sensitive assets and liabilities, in relation to the type of reference interest rate. Banks' exposure to interest-rate risk as a result of this mismatching increased in 2008 for the second consecutive year. The proportion of items tied to reference interest rates increased by 5 percentage points on the asset side to 65%, but merely by just under 1 percentage point on the liabilities side to 39%. The gap between the proportion of interest-sensitive assets and liabilities tied to a reference interest rate thus increased to 26 percentage points in 2008. In the first months of 2009 there was indication of a change in the trends seen in recent years, the proportions of the aforementioned items declining on both the assets and liability sides. The reason was the sharp decline in the EURIBOR in recent months.

90% of interest-sensitive assets and liabilities with a reference interest rate are tied to the EURIBOR of varying maturities.

The most frequently used reference interest rate is the EURIBOR of varying maturities. Items tied to the EURIBOR account for more than 90% of interest-sensitive assets and liabilities tied to reference interest rates. The 6-month EURIBOR is the most common reference rate used for assets and liabilities.

The second most important reference interest rate is the Swiss franc LIBOR. Various maturities of this reference interest rate account for 8% of interest-sensitive assets and interest-sensitive liabilities tied to reference interest rates. A slight increase in the proportion accounted for by the aforementioned reference interest rate could be discerned for the second consecutive year, as a result of lending in Swiss francs in the first half of 2008.

Banks hold long net positions in key interest rates.

Given the significantly higher proportion of assets tied to reference interest rates than liabilities, banks hold long net positions in all of the most frequently used reference interest rates and interest-rate gaps. Net interest income is therefore sensitive to a fall in the EURIBOR. The position lengthened most in items tied to the 6-month EURIBOR, where banks also hold the longest net position with 15.6% of interest-sensitive assets.

The positions for items tied to the Swiss franc LIBOR and the tolar indexation clause are relatively balanced.

Table 6.40: Structure of interest-sensitive assets and liabilities by reference interest rate

(%)	Interest-sensitive assets				Interest-sensitive liabilities			
	Dec 06	Dec 07	Dec 08	Feb 09	Dec 06	Dec 07	Dec 08	Feb 09
Stock (EUR million)	32,010	40,173	45,440	46,391	30,275	37,919	42,426	43,282
	Structure (%)							
Reference interest rate	43.8	59.6	65.4	62.3	31.6	38.3	39.2	38.7
TOM	4.3	1.4	0.8	0.8	2.1	0.9	0.4	0.3
Other	51.8	39.0	33.8	36.9	66.2	60.8	60.4	60.9
	Proportion of tied items accounted for by individual reference rates (%)							
EURIBOR								
1 month	17.9	19.6	17.4	16.9	7.7	23.2	18.6	17.2
3 months	21.5	23.0	24.0	25.0	46.5	24.7	28.2	29.3
6 months	42.1	45.7	47.0	46.7	36.2	41.1	41.4	42.2
1 year	2.4	2.2	1.9	1.9	1.4	1.3	1.6	1.4
Swiss franc LIBOR								
1 month	0.7	1.1	0.7	0.7	0.0	0.2	0.4	0.4
3 months	1.0	1.8	2.2	2.1	0.9	2.5	3.0	3.1
6 months	2.7	2.5	3.2	3.2	1.5	1.6	3.2	3.2
1 year	1.6	1.5	1.6	1.6	2.0	1.9	1.6	1.6
CB interest rate	4.9	0.1	0.1	0.1	0.0	0.0	0.0	0.0
Other	5.0	2.4	1.9	1.8	3.8	3.5	2.1	1.5

Note: The CB interest rate is the interest rate on 60-day Bank of Slovenia tolar bills, and the ECB's refinancing rate since 2007.
Source: Bank of Slovenia

Table 6.41: Interest-rate gap as percentage of interest-sensitive assets by reference interest rate

	Total net position			Net position by category, Dec 2008			
	Dec 2006	Dec 2007	Dec 2008	Sight	p to 1 year	ver 1 up 5 years	Over 5 years
EURIBOR							
1 month	5.6	3.3	4.6	0.1	4.9	-2.2	1.8
3 months	-4.5	4.8	5.4	0.2	2.6	-0.2	2.8
6 months	7.6	12.4	15.6	0.5	8.2	2.3	4.7
1 year	0.6	0.9	0.7	0.0	-0.3	0.1	0.9
Swiss franc LIBOR							
1 month	0.3	0.6	0.3	0.0	0.1	0.2	0.1
3 months	0.2	0.2	0.3	0.0	0.1	-0.3	0.5
6 months	0.7	0.9	0.9	0.0	-0.1	-0.7	1.7
1 year	0.1	0.2	0.5	0.0	-0.2	-0.1	0.7
TOM	2.3	0.5	0.4	0.1	0.0	0.1	0.3

Source: Bank of Slovenia

A fall in reference interest rates exposes banks to the risk of lower interest income.

One result of the adverse conditions on the financial markets is a fall in reference interest rates. The long positions in the majority of reference interest rates mean that banks are exposed to the risk of lower interest income. This problem will become particularly relevant to banks in 2009.

6.8.4 Option risk

Options in contractual relations between a bank and its clients represent another source of interest-rate risk. This means that a client has the option, but not the obligation, to settle its liabilities to a bank before maturity or in cases when maturity is not defined in advance. An example is the prepayment of a loan. This primarily increases in a period of falling interest rates, when non-banking sectors refinance at lower interest rates. Banks are thus exposed to reinvestment risk.

Prepayment option

The proportion of loans with a prepayment option is increasing.

The proportion of items with a prepayment option on the asset side is increasing as a result of an increase in the loan segment, where the proportion has increased by 1.1 percentage points in the last year. The effect in respect of total assets was even greater, as a result of the simultaneous increase in the proportion of total assets accounted for by loans. On the liability side, where approximately a third of items have a prepayment option, the proportion is significantly smaller and much more stable.

Based on bank survey responses, the proportion of items on which prepayment or early redemption is actually effected is minimal. The highest figure is for deposits at call, where it fluctuates around 0.5%. The proportion is even lower for other items, at less than 0.1%. Based on bank surveys, prepayments accounted for 17% of household loans in 2008.

Table 6.42: Percentage of items with a prepayment option in individual interest-sensitive assets and liabilities

	Assets	Loans	Debt securities*	Liabilities
Dec 2005	46.0	64.3	0.5	32.0
Dec 2006	49.8	65.2	0.5	32.4
Dec 2007	55.2	66.6	0.5	34.6
Dec 2008	57.3	67.7	2.3	32.8
Feb 2009	57.4	67.7	1.6	34.2

Note: Estimate.
Source: Bank of Slovenia

6.9 Currency risk

Currency risk for banks declined sharply when the euro was introduced in 2007. In 2008 too the net open foreign exchange position as a proportion of regulatory capital remained relatively low at -0.2%. Banks opened their positions in Swiss francs more in 2008, but significantly closed their positions in US dollars.

After recording high growth in previous years, lending to non-banking sectors in Swiss francs or with a Swiss franc currency clause declined sharply in 2008 and early 2009.

6.9.1 Currency breakdown of banks' balance sheets

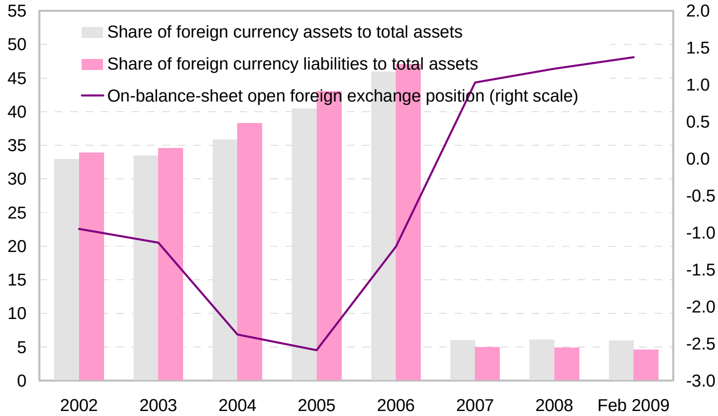
The on-balance-sheet foreign exchange position has remained long since the introduction of the euro.

The proportion of foreign currency items fell sharply with the introduction of the euro. In February 2009 the proportion of foreign currency assets fluctuated at a level of 6%, while foreign currency liabilities accounted for 4.6% of banks' total liabilities. The on-balance-sheet foreign exchange position remained long in February 2009.

Extremely high growth in foreign currency asset and liability items in 2007 was followed by slower growth in 2008.

After the introduction of the euro, foreign currency asset and liability items recorded extremely high year-on-year growth of 60%. Growth in the aforementioned items declined sharply in 2008. Asset items recorded growth of 14%, and liability items growth of 12%. Growth in 2009 is even lower. At the end of February 2009 year-on-year growth in asset items in foreign currency stood at 3.6%, while growth in liability items was actually negative, at -4.5%. The main reasons for the low year-on-year growth is lower bank borrowing in the rest of the world in currencies other than the euro, and a decline in lending in Swiss francs.

Figure 6.50: Ratio of foreign currency assets and liabilities to total assets, and on-balance-sheet open foreign exchange position in percentages



Source: Bank of Slovenia

The Swiss franc sub-balance recorded lower growth in 2008: 20.1% on the asset side, and 15.7% on the liability side. The increase in the proportion of items in Swiss francs came primarily at the expense of a decline in the proportion of items in US dollars and Japanese yen. Year-on-year growth in items in Swiss francs declined further during the first two months of 2009, to stand at 3.49% on the asset side and -4.14% on the liability side.

In the currency breakdown of on-balance-sheet assets, banks are still more exposed to new EU Member States than to the former Yugoslav republics.

Table 6.43: Currency breakdown of assets and liabilities

	December 2007		December 2008		February 2009	
	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
Total foreign curr. excl. euros (EUR million)	2,720	2,267	3,108	2,528	3,053	2,427
Year-on-year growth (%)	63.4	59.9	14.3	11.5	3.6	-4.5
Structure of currencies other than euros			(%)			
Global currencies	97.5	99.1	98.1	99.5	97.3	99.3
Swiss franc	76.3	72.7	80.1	75.6	78.0	74.4
Pound sterling	1.0	1.4	0.7	0.8	0.9	1.1
US dollar	18.4	23.4	16.0	22.0	17.1	22.7
Canadian dollar	0.5	0.6	0.4	0.4	0.4	0.5
Yen	0.8	0.5	0.7	0.1	0.5	0.1
Australian dollar	0.5	0.5	0.2	0.4	0.4	0.5
New EU Member States	1.6	0.0	1.3	0.0	2.0	0.1
Scandinavia	0.3	0.2	0.2	0.3	0.4	0.4
Former Yugoslav republics	0.5	0.4	0.3	0.2	0.3	0.2
Other	0.1	0.3	0.0	0.0	0.0	0.0

Source: Bank of Slovenia

6.9.2 Open foreign exchange position

The net open foreign exchange position was long in the amount of EUR 9.5 million at the end of 2008, or 0.2% of regulatory capital.

The net open foreign exchange position declined in 2008. It was long, and for the banking system as a whole amounted to EUR 9.5 million or 0.2% of regulatory capital at the end of December 2008. This is an indication of the decline in bank exposure to currency risk in 2008. The most open positions held by banks were those in investment fund units. The banking system's position in this item at the end of the year was long in the amount of EUR 38 million. Banks opened their positions in Swiss francs further in 2008. Overall this was short in the amount of EUR 19.2 million at the end of the year. The short net foreign exchange positions in the most important global currencies show banks' exposure to the risk of a rise in the exchange rates of the Swiss franc and the US dollar against the euro, although the small size of the open positions means that the risk is extremely low.

Table 6.44: Open foreign exchange positions by currency in EUR million

	Net position			Grater of the sum of long and short positions		
	Dec 07	Jun 08	Dec 08	Dec 07	Jun 08	Dec 08
Global currencies	-57.4	-20.6	-39.5	-65.0	-33.6	-49.5
US dollar	-48.5	-13.5	-22.9	-50.6	-20.1	-26.8
Swiss franc	-12.1	-8.3	-19.2	-13.3	-10.7	-19.6
Other (GBP, CAD, AUD, JPY)	3.3	1.2	2.6	4.4	4.0	5.7
EEA currencies	1.5	4.5	1.1	5.5	7.0	4.4
Other currencies	9.4	12.7	9.9	14.2	13.0	10.1
CIU	74.9	61.1	38.0	74.9	61.1	38.0
Total	28.5	57.8	9.5	102.2	94.1	62.6
As % of regulatory capital	0.9	1.5	0.2	3.1	2.5	1.5

Note: EEA: European Economic Area, i.e. the EU, Iceland and Norway; CIU: foreign exchange position in investment fund units.
Source: Bank of Slovenia

Table 6.45: Open foreign exchange positions by bank group in EUR million

	Large banks	Small banks	Banks under majority foreign ownership	Total
Global currencies	-33.8	-0.3	-5.4	-39.5
US dollar	-22.0	-0.4	-0.5	-22.9
Swiss franc	-14.0	0.1	-5.3	-19.2
Other (GBP, CAD, AUD, JPY)	2.2	0.0	0.5	2.6
EEA currencies	0.7	0.2	0.2	1.1
Other currencies	4.1	5.4	0.4	9.9
CIU	37.6	0.3	0.1	38.0
Total	8.6	5.6	-4.7	9.5
As % of regulatory capital	0.3	1.5	-0.5	0.2

Note: EEA: European Economic Area, i.e. the EU, Iceland and Norway; CIU: foreign exchange position in investment fund units.
Source: Bank of Slovenia

The open foreign exchange position according to the definition from capital requirements (i.e. the greater of the sum of all long positions and the sum of all short positions by individual currency) almost halved from the end of 2007 to stand at EUR 62.6 million or 1.5% of regulatory capital at the end of 2008.

The domestic banks hold long net positions, while the banks under majority foreign ownership short net positions.

The banking system's overall net open foreign exchange position declined from 0.9% of regulatory capital at the end of 2007 to 0.2% of regulatory capital. While the overall long net position at the large banks declined to 0.3% of regulatory capital and the short net position at the banks under majority foreign ownership declined to 0.5% of regulatory capital, the short net position at the small banks increased to 1.5% of regulatory capital.

6.9.3 Borrowing in Swiss francs

A significant decline in non-banking sectors' borrowing in Swiss francs.

Growth in lending to non-banking sectors in Swiss francs or with a Swiss franc currency clause declined sharply in 2008. The rate was almost negligible in early 2009 at 3.8%.

Table 6.46: Stock and year-on-year growth of loans in Swiss francs or with a Swiss franc currency clause

					Households	
	Non-banking sector	Non-financial corporations	OFIs	Government	All loans	Housing loans
	Stock of loans (EUR)					
2007	1,984.6	783.5	168.2	7.4	1,025.4	769.6
2008	2,403.8	743.6	226.6	7.4	1,426.2	1,125.8
Feb 09	2,317.6	687.2	213.1	8.1	1,409.2	1,119.4
	Year-on-year growth rate (%)					
2007	115.3	152.5	155.5	-7.8	90.7	91.4
2008	21.1	-5.1	34.7	-0.2	39.1	46.3
Feb 09	3.8	-21.4	3.6	-25.5	23.3	29.9

Source: Bank of Slovenia

Table 6.47: Loans tied to the Swiss franc exchange rate by bank group

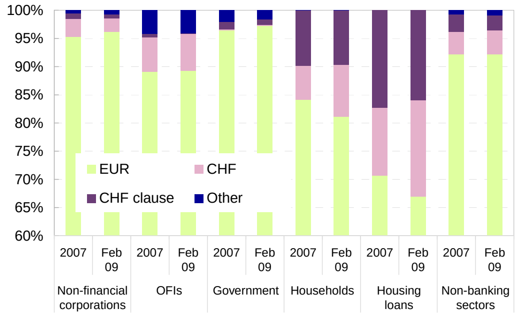
	Year-on-year growth rate (%)		Proportion of all loans to non-banking sectors accounted for by loans tied to Swiss franks (%)		Proportion of loans of the bank group (%)	
	2007	2008	2007	2008	2007	2008
Large banks	102.8	22.8	30.6	31.0	3.9	4.0
Small banks	360.9	-17.7	1.3	0.9	1.0	0.9
Banks under majority foreign ownership	119.0	21.1	68.1	68.1	14.0	13.5
Total	115.3	21.1	100.0	100.0	7.1	7.2

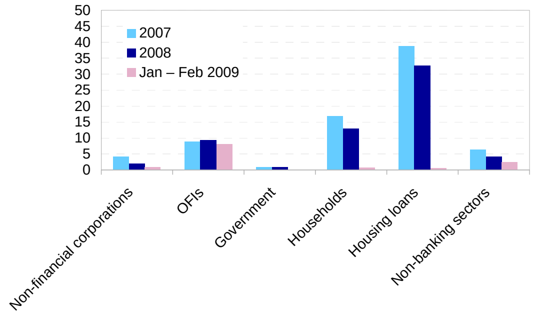
Source: Bank of Slovenia

The proportion of loans to non-banking sectors tied to the Swiss franc exchange rate is around 7%.

In February 2009 the proportion of the total stock of loans to non-banking sectors tied to the Swiss franc exchange rate or with a Swiss franc currency clause was 6.9%, down 0.2 percentage points on the end of 2007. After the Swiss franc appreciated by more than 11% against the euro in 2008, banks ceased to offer loans in foreign currency in late 2008 and early 2009, as they were increasing their clients' exposure to currency risk. During the appreciation in the Swiss franc, banks saw their credit risk rise.

Figure 6.51: Currency breakdown of outstanding loans (left) and new loans tied to the Swiss franc exchange rate (right) by individual institutional sector in percentages

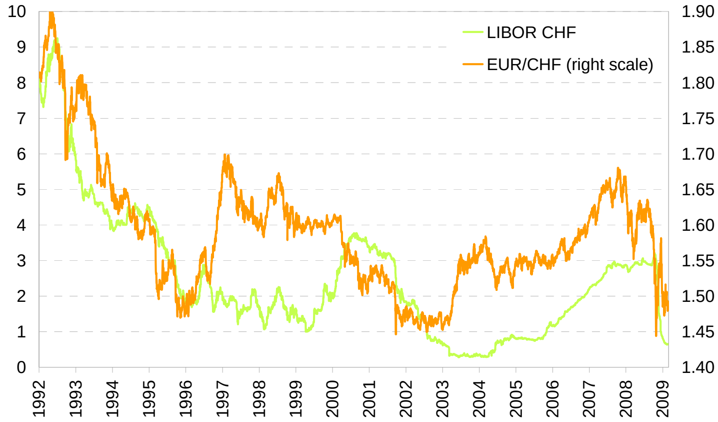




Source: Bank of Slovenia

Despite the appreciation in the Swiss franc, the Swiss franc LIBOR being lower than the EURIBOR acted to reduce the debt repayment burden on borrowers' income. The 6-month Swiss franc LIBOR reference interest rate is still lower than the 6-month EURIBOR, but the spread had narrowed to 1.3 percentage points by the end of February 2009.

Figure 6.52: Changes in the euro/Swiss franc exchange rate and the LIBOR reference interest rate for Swiss francs



Source: Bank of Slovenia

The effect of a change in exchange rate on foreign currency loans is all the more important because, in contrast to a change in interest rate, which only affects the interest repayments, a change in exchange rate affects the amount of the loan principal and thus the entire loan instalment.

6.10 Bank solvency

The banking system's capital adequacy remains satisfactory at 11.7%.

The banking system's capital adequacy fluctuated considerably in the first three quarters of 2008, then increased sharply in the final quarter as a result of the temporary abolition of deductions from original own funds (the so-called prudential filter), to reach its highest level of the last four years. Capital adequacy did not track growth in loans to non-banking sectors at the majority of banks. The higher growth in capital requirements for credit risk than growth in total assets nevertheless indicates that there is still a relatively high level of willingness on the part of banks to assume credit risk. At the end of 2008 the distribution of the capital adequacies of Slovenian banks was concentrated in the interval between 10% and 13%, and had thus become comparable to the average of the EU banking system.

Banks were forced to seek new sources of capital by the continuing growth in capital requirements and the increasing burden placed on capital by the prudential filter. Because the majority of the large domestic banks had already exploited the possibilities of further capital injections by means of subordinated instruments, the numerous and comprehensive capital injections and then the temporary abolition of the prudential filter at the end of 2008 entirely altered the structure of the banking system's capital in favour of original own funds. The improvement in the structure of regulatory capital was very welcome before the reversal of the credit cycle.

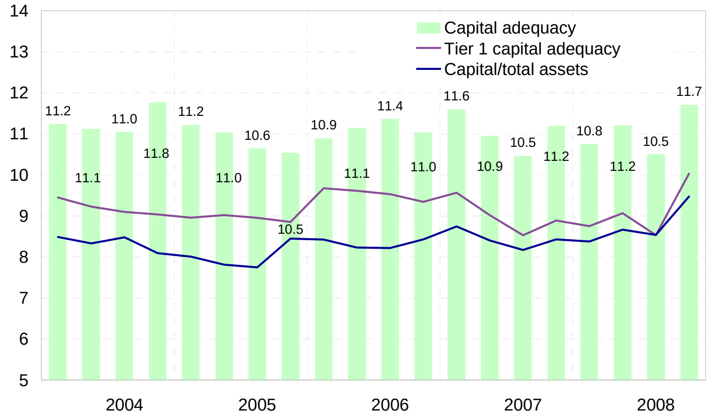
The possibility of increasing capital on the basis of profit is diminishing.

The large domestic banks met the majority of their capital requirements in 2008 by means of share capital and the capital surplus (the share premium account). This was also the case for the domestic banks. By contrast, the banks under majority foreign ownership, which in the past have traditionally had good access to capital injections, made greater use of hybrid instruments and subordinated debt in 2008. The proportion of capital requirements met by profit reserves and retained and revised earnings declined at all the bank groups as a result of lower profitability. This trend will continue in 2009.

The significant increase in original own funds, which was common to all the bank groups, reopened the possibility, for the large domestic banks in particular, of meeting capital requirements to a greater extent by means of subordinated instruments.[45] However, the conditions for issuing such instruments also deteriorated sharply as a result of the financial turmoil. For this reason, and because the possibility of increasing original own funds from retained earnings will diminish even further in the future, during the financial turmoil banks will be forced to rely primarily on first-class sources of capital from capital injections. Above all the capital quality structure will have to convince market participants (depositors, investors, ratings agencies, supervisors) of adequate risk management and long-term sustainability in the individual bank's operations.

6.10.1 Capital adequacy

Figure 6.53: Capital adequacy, Tier 1 capital adequacy and capital to total assets ratio in percentages



Source: Bank of Slovenia

The banking system's capital adequacy stood at 11.7% at the end of 2008, while Tier 1 capital adequacy stood at 10%.

The banking system's capital adequacy stood at 11.7% at the end of 2008, up 0.5 percentage points on the end of 2007. It fluctuated greatly during the year, before increasing sharply in the final quarter as a result of the temporary abolition of the prudential filter. Tier 1 capital adequacy and the capital to total assets ratio tracked the movement of capital adequacy all year, finishing the year at 10.0% and 9.5% respectively, their highest levels of the last five years. The increase of 1.1 percentage points in the two ratios in 2008 was well in excess of the increase in capital adequacy.

The rise in capital adequacy in the second and final quarters of 2008 was in the first instance the result of an increase of 20.5% in capital and capital surplus on the previous quarter, and in the second instance the result of the temporary abolition of the prudential filter, which was reflected in a decline of EUR 308.0 million in undisclosed impairments and provisions on the previous quarter. By temporarily abolishing the prudential filter, the Bank of Slovenia took counter-cyclical action back in October 2008, thereby preventing the occurrence of a credit crunch (the freezing of bank lending because of insufficient regulatory capital). This confirmed the correctness of the Bank of Slovenia's decision during the changeover to the IFRS[46] to prevent, by introducing the prudential filter, impairments and provisions accumulated in the past from being transferred to profit and distributed to shareholders, instead making banks mostly retain them in capital. The decline in capital adequacy in the other two quarters of 2008 was the result of constantly

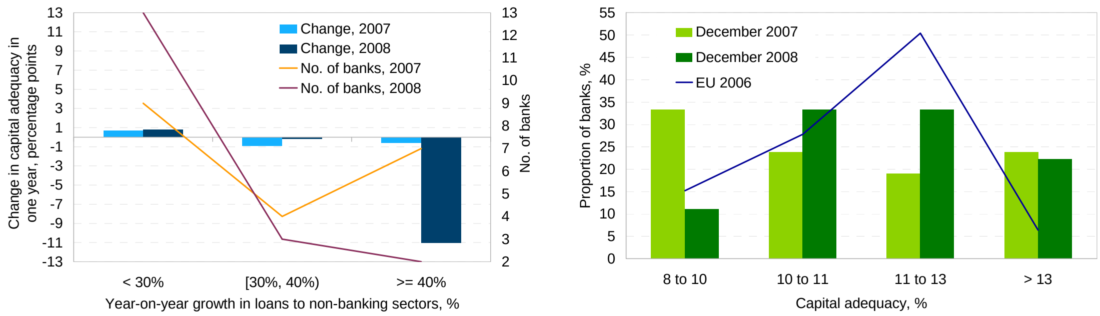
[45] Subordinated instruments include subordinated debt, hybrid instruments and innovative instruments.
[46] International Financial Reporting Standards.

increasing deductions from original own funds, which reached 9.6% of original own funds in September 2008. Other factors in the decline in capital adequacy were the new capital requirement for operational risk in the first quarter, and the significant increase in the capital requirement for credit risk in the third quarter. Growth in capital requirements stood at 22.3% at the end of 2008.

Capital adequacy tracked growth in loans at the majority of banks.

Capital adequacy tracked growth in loans to non-banking sectors at the majority of banks in 2008. The average increase in capital adequacy at 13 banks with growth in loans of up to 30% was 0.8 percentage points. As in 2007, the banks with the highest growth in loans reduced their capital adequacy in 2008, but there were fewer such banks than in the previous year. Capital adequacy was down 11.1 percentage points on average from the previous year at the end of 2008 at banks with growth in loans exceeding 40%, and down 0.2 percentage points at banks with year-on-year growth in loans of between 30% and 40%.

Figure 6.54: Changes in capital adequacy in 2007 and 2008 with regard to year-on-year growth in loans to non-banking sectors, average in percentage points (left), and distribution of capital adequacies of banks (right)

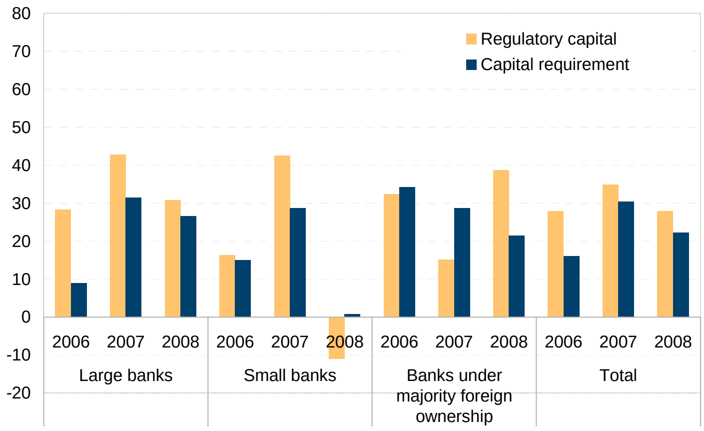


Source: Bank of Slovenia

The distribution of capital adequacies is concentrating in the interval between 10% and 13%.

Upon the temporary abolition of the prudential filter in late 2008, the distribution of the capital adequacies of Slovenian banks concentrated in the middle two brackets of between 10% and 13%, thereby being comparable to the EU average, with the largest number of banks in the capital adequacy bracket of 11% to 13%. From the end of 2007, which was marked by a sharp polarisation in the capital adequacies of banks, there was a continuous increase in the number of banks with a capital adequacy of less than 10%, and a decline in the number of banks with a higher capital adequacy. Six banks had a capital adequacy of less than 9% as at the end of September 2008.

Figure 6.55: Year-on-year growth in regulatory capital and capital requirements by bank group in percentages



Source: Bank of Slovenia

Growth in regulatory capital exceeded growth in capital requirements last year.

Growth in capital during 2008 amounted to 27.8%, 5.6 percentage points higher than growth in capital requirements, which is comparable to 2007, when growth in capital and capital requirements was high as a result of high lending growth. In 2008 there was a decline of 11.0% in regulatory capital at the small banks, a consequence of the takeover of three banks in May 2008, and not a reduction in capital in the bank group. As a consequence of the lower burden on capital resulting from the temporary abolition of the prudential filter, growth in capital at the banks under majority foreign ownership was notably high, at 38.7%.

At the end of 2008, the capital adequacy of the banking system was slightly above the EU average, particularly at the large banks, which are comparable to medium-size EU banks in terms of size. Capital adequacy at the small banks was again well behind the EU average, while the banks under majority foreign ownership significantly reduced the gap by which they trail the EU average.

Capital adequacy is above the EU average. The small banks were well below, while the banks under majority foreign ownership reduced the gap by which they trail.

Table 6.48: Capital adequacy by bank group and comparison with the EU

	2005	2006	2007	2008
Large banks	10.5	11.0	11.9	12.3
Small banks	10.8	10.9	12.1	10.7
Banks under majority foreign ownership	10.5	11.1	9.3	10.6
Slovenian banking sector	10.5	11.0	11.2	11.7
EU banking sector	11.4	11.1	11.5	

Sources: Bank of Slovenia, EU Banking Sector Stability

6.10.2 Capital

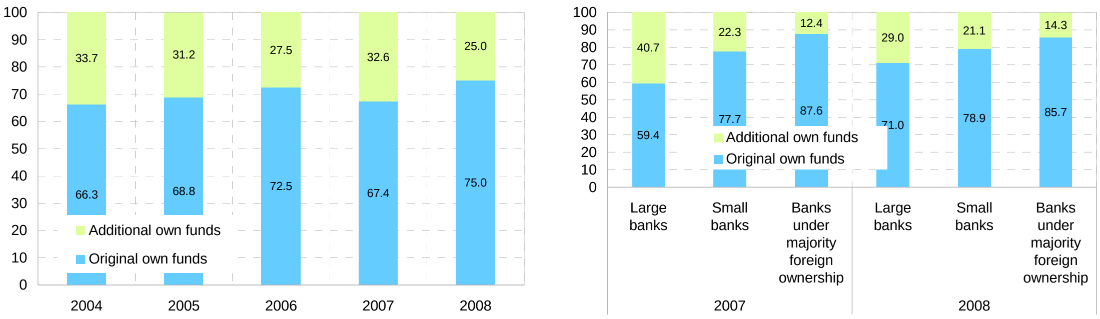
At the end of 2008 the banking sector had EUR 4.45 billion of regulatory capital, up 27.8% or EUR 969.8 million on a year earlier. As a result of the deterioration of conditions on the international financial markets, larger capital requirements and an increase in the capital deductions deriving from the prudential filter, banks again focused a great deal of attention on raising capital in 2008. Capital prior to deductions increased by EUR 983.0 million, exclusively on account of an increase in original own funds, while additional own funds actually declined. The increase of 38% in original own funds and the decline of 5.2% in additional own funds brought a decline of 7.7 percentage points in the proportion of capital prior to deductions accounted for by additional own funds to 25.0%.

An increase in the proportion of capital accounted for by original own funds to 75%.

The banks under majority foreign ownership, which in the past have traditionally had the opportunity to make capital injections, began making greater use of hybrid instruments and subordinated debt in 2008 to meet their capital requirements. As a result the proportion of their capital accounted for by original own funds declined by 1.9 percentage points to 85.7%. By contrast the proportion of capital accounted for by original own funds at the large domestic banks increased significantly to 71%, as a result of new capital injections, the temporary abolition of the prudential filter and great use of innovative instruments included among components of original own funds.

The banks under majority foreign ownership are to a great extent using hybrid instruments and subordinated debt to meet their capital requirements.

Figure 6.56: Structure of capital prior to deductions for the banking system as a whole (left), and by bank group (right) in percentages



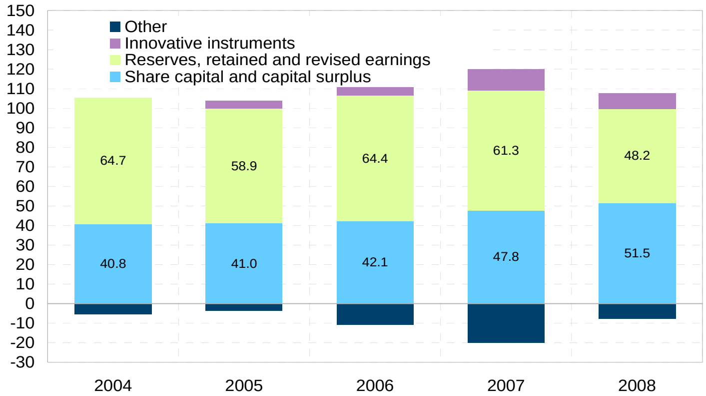
Sources: Bank of Slovenia

Original own funds

At the end of 2008 the original own funds of the banking sector amounted to EUR 3.82 billion. This was up EUR 1,052.3 million or 38.1% on the previous year. Original own funds increased primarily on account of a EUR 645.0 million increase in share capital and capital surplus. Capital injections were carried out by more than half of all banks, including the two largest Slovenian banks and a bank under majority government ownership. Capital injections proceeded throughout 2008. The total amount of capital injected was EUR 666 million, approximately 80% of which went to the large banks, 12% to the banks under majority foreign ownership and the remainder to the small banks.

Original own funds increased by 38.1% in 2008, primarily on account of share capital and capital surplus.

Figure 6.57: Components of original own funds in percentages



Source: Bank of Slovenia

Deductions to original own funds deriving from undisclosed impairments and provisions declined by EUR 218.8 million.

The second most important source of the increase in original own funds was the decline in the item denoted "other", which includes deductions to original own funds,[47] and was down EUR 266.4 million on 2007. The largest factor was a decline of EUR 218.8 million in undisclosed impairments and provisions.[48] These declined by EUR 308.0 million in the final quarter of 2008 alone. The surplus in innovative instruments was down a further EUR 43.3 million on the end of 2007, while other deductions to original own funds remained unchanged.

The increase in original own funds by means of retained earnings is of diminishing importance.

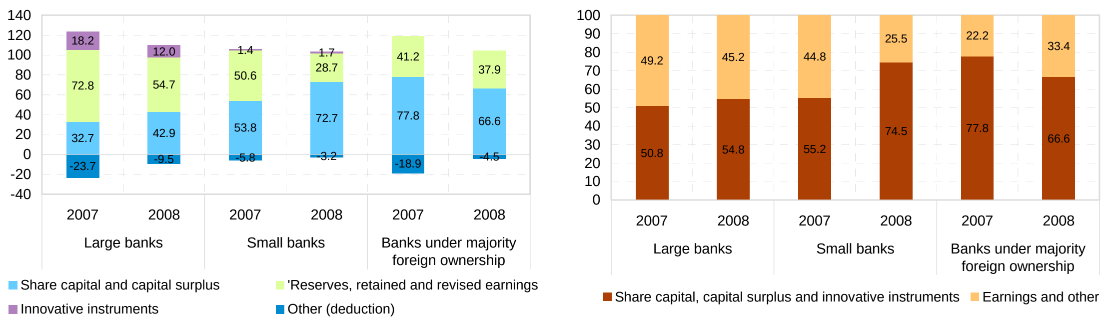
As a result of the significant decline in the banking system's profits in 2008, the increase in original own funds deriving from profit reserves and retained and revised earnings also halved in 2008. The latter were up EUR 147.0 million on 2007. Between 2004 and 2007 profit reserves and retained and revised earnings accounted for an average of 60% of the annual increase in original own funds, and were thus the most important source of increase in banks' regulatory capital during the period of relatively rapid growth. A period of lower bank profitability began in 2008, with correspondingly low profits. This important past source of increase in original own funds will decline sharply in the future.

The stock of innovative instruments remains unchanged.

The stock of innovative instruments, which in 2007 were an important source of increase in original own funds, remained unchanged in 2008 (only their inclusion among original own funds components increased slightly), and consequently their relative importance in the structure of original own funds declined.

A comparison of the structure of original own funds by bank group reveals that thanks to larger capital injections in 2008 the proportion accounted for by share capital and capital surplus at the small banks overtook the figure at the banks under majority foreign ownership, where the proportion actually declined.

Figure 6.58: Components of original own funds by bank group in percentages



Source: Bank of Slovenia

[47] In accordance with the regulation on the calculation of the capital of banks and savings banks, the following items are deducted from original own funds: own shares held in treasury, intangible assets, net loss for the financial year and interim loss, revaluation reserves, surplus in innovative instruments, and undisclosed impairments and provisions.

[48] Undisclosed impairments and provisions are an original own fund deduction item arising from the difference between actual impairments or provisions created for collectively assessed financial assets and assumed commitments from off-balance-sheet items, and legally defined impairments and provisions in accordance with the regulation on the assessment of losses for credit risk. This is the so-called prudential filter, which was temporarily abolished in October 2008.

Share capital and capital surplus accounted for 72.7% of original own funds at the small banks, and 42.9% at the large banks. These figures were up sharply on the previous year at both bank groups, on the basis of additional capital injections, and at the large banks primarily as a result of the inability to continue meeting capital requirements by means of hybrid instruments and subordinated debt owing to limits on Tier 1 additional own funds relative to original own funds. The banks under majority foreign ownership made greater use of hybrid instruments and subordinated debt to meet their capital requirements in 2008, and as a result the proportion of their original own funds accounted for by share capital and capital surplus declined by 11.2 percentage points to 66.6%.

The large and small banks sharply strengthened the proportion of share capital and capital surplus, but the proportion declined at the banks under majority foreign ownership.

Innovative instruments were issued by the small banks for the first time in 2008. Together with numerous capital injections, this meant that the small banks notably had the highest proportion of original own funds accounted for by share capital, capital surplus and innovative instruments.

The largest decline in 2008 in the ratio of "other" (deductions to original own funds) to original own funds was recorded by the banks under majority foreign ownership, as a result of the relatively large burden placed on capital by undisclosed impairments and provisions. Next came the large banks, where a major factor in the decline in the ratio alongside the decline in undisclosed impairments and provisions was the decline in the surplus in innovative instruments. Innovative instruments accounted for an average of just 12% of original own funds at the large banks in 2008 (compared with 18% in 2007).

As a result of lower profits, there was a sharp decline in the proportion of original own funds at the large domestic banks accounted for by profit reserves and retained earnings in 2008, from 72.8% to 54.7%. The same is true of the small banks, where the proportion almost halved, to 28.7%. There was no change in the proportion of original own funds accounted for by this component at the banks under majority foreign ownership (around 40%).

Additional own funds

At the end of 2008 additional own funds included in the calculation of capital adequacy amounted to EUR 1.27 billion. After years of constant growth, additional own funds declined by 5.2% last year. Additional own funds declined on account of a smaller surplus in innovative instruments, a smaller revaluation surplus adjustment in relation to available-for-sale shares and participating interests, and a decline in subordinated debt (an increase of EUR 19.2 million in Tier 1 subordinated debt and a decline of EUR 35.7 million in Tier 2 subordinated debt). The stock of hybrid instruments including cumulative preference shares increased (by EUR 10.6 million), but the increase was more modest than in previous years.

Additional own funds declined by 5.2% as a result of a smaller surplus in innovative instruments, a smaller revaluation surplus adjustment, and a decline in subordinated debt.

The stock of hybrid instruments together with the surplus in innovative instruments and cumulative preference shares stood at EUR 603.3 million at the end of 2008, down EUR 32.7 million or 5.1% on a year earlier. The reason was the decline in the surplus in innovative instruments, more of which could be included in original own funds as a result of the increase in original own funds. The ratio of the stock of hybrid instruments, the surplus in innovative instruments and cumulative preference shares to original own funds at the large banks therefore declined by a significant 14.1 percentage points in 2008. The small banks saw a significant increase in this ratio as a result of issuing additional hybrid instruments.

A modest increase in hybrid instruments.

The stock of Tier 1 subordinated debt stood at EUR 649.5 million at the end of 2008, up 3.1% in year-on-year terms, well behind growth in the previous year. While there was decline in the stock of Tier 1 subordinated debt at the large banks and the small banks, the banks under majority foreign ownership recorded an increase of EUR 63.4 million in Tier 1 subordinated debt. As a result of the significant increase in original own funds, the ratio of Tier 1 subordinated debt to original own funds for the entire banking sector declined by 5.8 percentage points in 2008 to 17.0%. The largest decline in the aforementioned ratio was at the large domestic banks, while the ratio increased at the banks under majority foreign ownership. In 2008 all banks were able to include Tier 1 subordinated debt in full, as no bank exceeded the limit of half of original own funds. Only at one bank did the ratio of Tier 1 subordinated debt to original own funds slightly exceed 40%. Compared with the previous year, banks saw a significant increase in the technical possibility[49] of

Year-on-year growth in Tier 1 subordinated debt stood at 3.1%. The entire increase was at the banks under majority foreign ownership. Tier 1 subordinated debt declined at the other two bank groups.

[49] Regulatory restrictions regarding capital injection by means of Tier 1 subordinated debt and hybrid instruments were abolished while the conditions on the markets on which these instruments are issued were deteriorating.

increasing capital adequacy by means of Tier 1 subordinated debt. Given the current stock of original own funds, and an unchanged ratio, the large domestic banks could increase Tier 1 additional own funds by a further EUR 1.32 billion. However, conditions on the financial markets do not favour the issue of the financial instruments included among subordinated debt. A further decline in bank profitability in the coming years will further diminish the attractiveness of such investments, particularly at banks with a lower-quality structure of regulatory capital.

Figure 6.59: Ratio of hybrid instruments, surplus in innovative instruments and cumulative preference shares to original own funds (left), and ratio of subordinated debt to original own funds (right) in percentages

Source: Bank of Slovenia

Deductions to regulatory capital

Deductions from capital investments were up 2.1% in 2008.

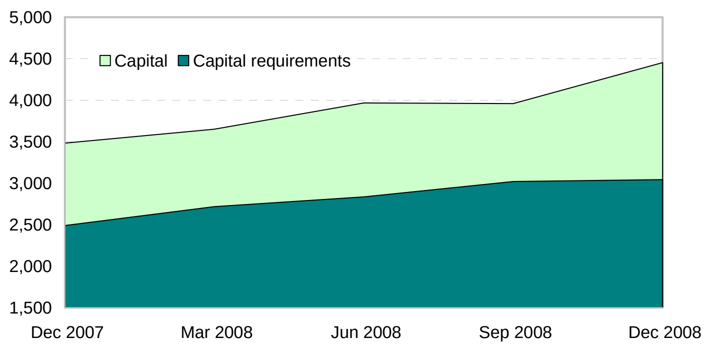
The deductions stemming from capital investments, which reduce the amount of original own funds and additional own funds in the calculation of capital adequacy, amounted to EUR 636.2 million in 2008, up 2.1% on the previous year. The reason for the modest increase lies in the takeover of three subsidiary banks by the largest Slovenian bank in May 2008, for which reason bank investments in other credit institutions and financial institutions that individually exceed 10% of the nominal capital of these institutions first declined sharply in the middle of the year, then rose again during the remainder of the year as turnover was expanded in the former Yugoslavia. However, given the unfavourable conditions for increasing bank capital on the financial markets, the pace of the expansion of capital investments can be expected to decline in the coming years. This is particularly the case for banks that will seek new investors for their capital injections.

6.10.3 Capital requirements

The surplus of capital over capital requirements increased by 41.8% in 2008 to EUR 1,408.9 million.

At the end of 2008 the banking sector had EUR 3.04 billion of total capital requirements, up 22.3% or EUR 554.4 million on a year earlier. Given that the nominal increase in capital in 2008 was double the increase in capital requirements, the surplus of capital over capital requirements also increased sharply. It stood at EUR 1,408.9 million at the end of 2008 (compared with EUR 993.4 million a year earlier).

Figure 6.60: Capital, capital requirements and surplus of capital over capital requirements in EUR million



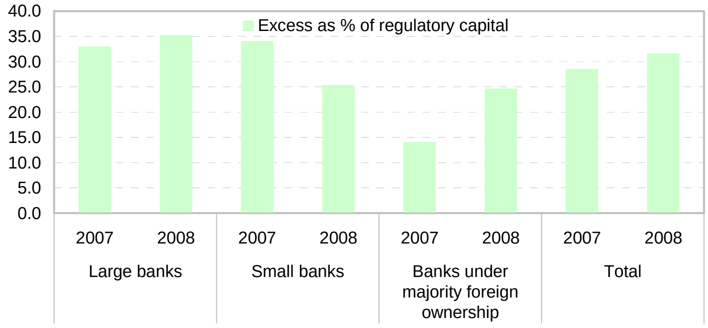
Source: Bank of Slovenia

The large banks have the largest surplus as a percentage of capital.

The banking sector's surplus of capital over capital requirements as measured by a proportion of regulatory capital stood at 31.6% at the end of 2008. Compared with the previous year, it had increased sharply at the banks under majority foreign ownership to 24.7%, thus overtaking the small banks, where the ratio declined significantly in 2008.

The large domestic banks are notable for their above-average surplus of capital over capital requirements as a proportion of regulatory capital, the figure standing at 35.2%.

Figure 6.61: Surplus of regulatory capital over capital requirements by bank group in percentages



Source: Bank of Slovenia

A relatively large willingness on the part of banks to assume credit risk.

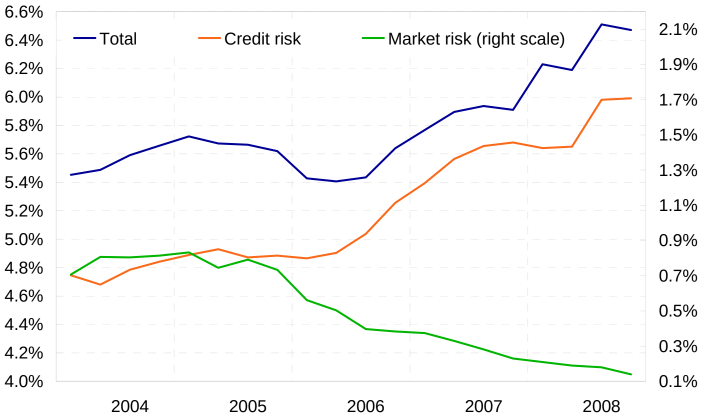
The trend of rapid increase in the ratio of capital requirements for credit risk to total assets seen in previous years slowed slightly in 2008. The ratio rose 0.3 percentage points to stand at 5.99% at the end of 2008. Despite growth in the two aforementioned categories halving from the previous year, that growth in capital requirements for credit risk (17.8%, an increase of EUR 424.8 million) was higher than growth in total assets (11.7%) shows that banks are still relatively willing to assume credit risk.

There was negative growth in capital requirements for market risks for the third consecutive year, which in 2008 was on account of equity instruments.

Growth in capital requirements for market risks (including the capital requirement for settlement risk in the trading book and the capital requirement for exceeding the maximum allowable exposures from trading) was negative for the third consecutive year. After declining by 40% in 2006 and 25% in 2007, capital requirements for market risks declined by EUR 37.2 million or 36.4% in 2008 as a result of falling securities prices, primarily on account of capital requirements for equity instruments.

In accordance with the first pillar of Basel II, in 2008 banks had to secure capital to cover operational risks for the first time, in the amount of EUR 162.8 million.

Figure 6.62: Ratio of capital requirements to total assets in percentages

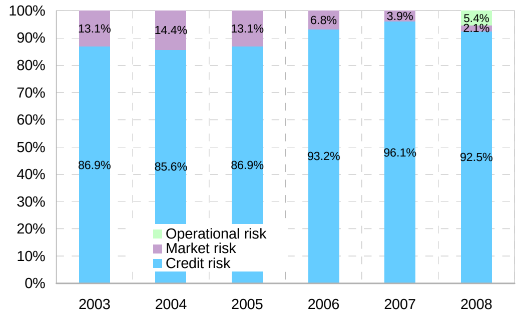


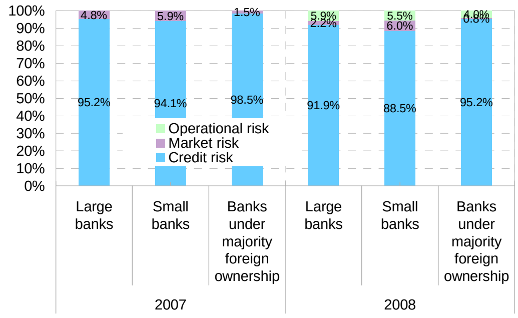
Source: Bank of Slovenia

The proportion of capital requirements accounted for by credit risk declined to 92.5%, partly on account of new capital requirements for operational risk.

Despite the slowdown in credit growth, banks nevertheless increased the proportion of the balance sheet accounted for by loans in 2008, at the expense of the proportion accounted for by securities. Capital requirements for credit risk continue to account for the majority of capital requirements (92.5%). This figure was down 3.6 percentage points on the previous year, partly on account of new capital requirements for operational risk, which accounted for 5.4% of the total. The largest proportion accounted for by capital requirements for credit risk was at the bank under majority foreign ownership (95.2%), while the large domestic banks had the largest proportion accounted for by capital requirements for operational risk.

Figure 6.63: Breakdown of capital requirements of the banking system (left) and bank groups (right) in percentages





Source: Bank of Slovenia

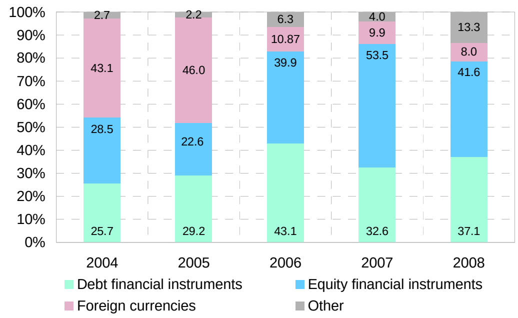
The proportion of capital requirements accounted for by market risks continues to decline. The exception is the small banks, which are notable for having the largest proportion of capital requirements for market risks.

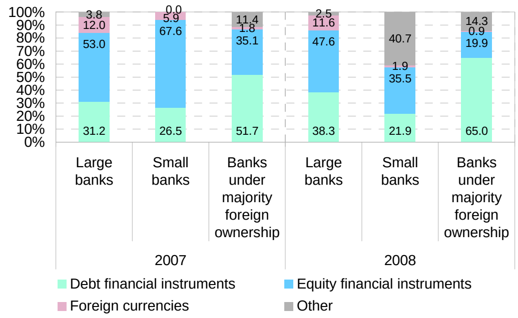
The proportion of the banking sector's capital requirements accounted for by market risks continues to decline slowly (from 3.9% to 2.1%). This trend can be seen at the large banks and the banks under majority foreign ownership. The exception is the small banks, where the proportion of capital requirements accounted for by market risks increased in 2008 to 6.0%, thereby reaching the highest figure among all the bank groups. Capital requirements for market risks amounted to EUR 65.1 million at the end of 2008, the largest proportion of which consisted of capital requirements for equity instruments (41.6%), followed by capital requirements for debt instruments (37.1%).

The relative importance of capital requirements for foreign currencies continued to decline, the proportion of total capital requirements that they account for declining by 0.2 percentage points in 2008 to 0.2%.

Developments on the financial markets in Slovenia and in the rest of the world also had an impact on the breakdown of capital requirements for market risks. Most notably, there was a decline in capital requirements for equity instruments at all bank groups, the small banks and large banks in particular, a decline in the capital requirement for currency risks at the small banks and a large increase in the capital requirement for other market risks (in particular settlement risk in the trading book) at the small banks.

Figure 6.64: Breakdown of capital requirements for market risks of the banking system (left) and bank groups (right) in percentages





Source: Bank of Slovenia

7 NON-BANKING FINANCIAL INSTITUTIONS

7.1 Insurers

7.1.1 Features of insurers' business and comparison with the EU

A decline in concentration in voluntary supplementary pension and health insurance.

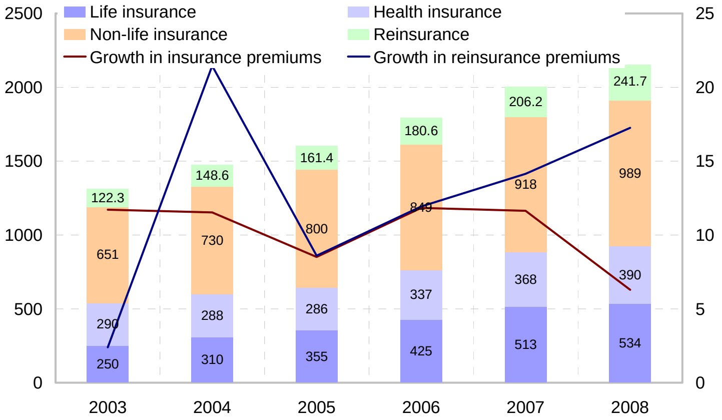
There were 15 insurance companies and two reinsurance companies operating in Slovenia at the end of 2008, of which four were branches of foreign insurers. The insurance market remains strongly concentrated. The only significant declines in concentration were in the areas of voluntary supplementary pension insurance and, to a lesser extent, health insurance. The market share of the largest insurance company in terms of written premium remained unchanged at 39.4%, while the market share of the largest reinsurance company declined by 1.8 percentage points.[50]

A decline in insurers' performance in 2008.

Despite a decline of 5.3 percentage points in growth, insurance companies' gross written premiums in 2008 were satisfactory, increasing to EUR 1,913 million. Net technical provisions increased by 1.1%, primarily on account of the transfer of certain assets and capital of insurers to provisions, while coverage by the assets covering technical provisions reached 135.3%. Insurance companies' performance deteriorated significantly, as evidenced by the decline in ROE,[51] which fell to 0.4%. It was 10.9% at the end of 2007. Median ROE of large insurance companies from euro area countries stood at 12% in the first two quarters of 2008, but declined to 10.1% in the third quarter of 2008.[52]

Reinsurance companies increased their gross written premium by 17.3% in 2008 to EUR 241.7 million. Limited access to funding meant that insurance companies also contributed to this increase, making greater use of traditional reinsurance products with the aim of more efficient risk management. The reinsurance companies' ROE calculated from net profit stood at 3.7% at the end of third quarter of 2008, up 0.2 percentage points on the same period of the previous year. Average ROE of large reinsurance companies from euro area countries stood at 16.2% at the end of 2007, and 7.3% at the end of third quarter of 2008.[53]

Figure 7.1: Gross written premium by type of insurance in EUR million (left scale), and annual growth in percentages (right scale)



Source: ISA

Insurers' written premium in 2008 was up 6.3% on the previous year, growth declining by 5.3 percentage points.

Growth in written premium in 2008 was the lowest in recent years. The main factors in the increase were the growth of 7.2% in gross written premium for non-life insurance, and growth of 5.9% in gross written premium for unit-linked life insurance. The annual decline of 2.5% in gross written premium for traditional life insurance was the result of the lower demand brought by the crisis in the financial sector. The proportion of written

[50] The largest non-life insurance company covers 37.9% of the non-life insurance market, the largest life insurance company has 43.5% of the life insurance market, and the largest health insurance company has 60.3% of the health insurance market.
[51] For insurers and reinsurance corporations, ROE and ROA are calculated from profits after tax.
[52] Source: ECB, provisional figures.
[53] Source: ECB, provisional figures.

premium accounted for by life insurance declined by half a percentage point to 27.9%, while those of health insurance (20.4%) and non-life insurance without health insurance (51.7%) remained unchanged.

Written life insurance premium was down in 2008.

Total written premium amounted to 5.2% of GDP in 2008, or EUR 931 per capita, which is just over a third of the average written premium per person in euro area countries. The proportion of insurers' total written premium accounted for by life insurance, which is just over a third of the proportion in euro area countries, declined slightly in 2008. The decline in written life insurance premium was the result of the spread of the crisis from the real sector to demand for insurance products. Development in the life insurance segment will depend primarily on the speed of economic recovery after the global crisis.

Table 7.1: Total gross written premium and gross written life insurance premium expressed in various categories for Slovenia in 2008 and for selected countries in 2007

	Slovenia	EU15	EU27	Portugal	Austria	Germany	UK
Total premium, EUR billion	1.9	1,114.5	1,142.9	13.9	15.9	162.6	338.3
Per capita, EUR	931	2,676	2,176	1,295	1,912	1,942	5,190
As % of GDP	5.2	9.2	8.8	8.5	5.8	6.6	15.7
Life insurance premiums (EUR billion)	0.53	711.47	723.92	9.45	7.20	74.72	255.17
Per capita, EUR	260	1,734	1,397	883	868	900	4,170
As % of total premium	27.9	63.8	63.3	68.2	45.4	46.0	75.4
As % of GDP	1.4	5.9	5.6	5.8	2.6	3.1	12.6

Sources: ISA, Swiss Re, own calculations

The insurance cycle is related to the economic cycle.

In a period of fierce competition insurers are willing to offer innovative products and to simultaneously reduce premiums to attract new policyholders. This is increasing their turnover, but reducing their profitability. Should the strategy prove ineffective, investment risk will increase, as insurers' profits will depend primarily on the returns on their investments. In euro area countries the insurance sector tracks the business cycle of the economy.[54] The decline in economic activity is reducing household and corporate demand for insurance products. In 2005 and 2006 growth in insurers' premium was higher than growth in GDP, primarily for reason of catching up with the level of development in the life insurance segment. Growth in premium has declined since the end of 2007 in line with the decline in real GDP growth.

Life insurance and contractual ties between insurers and banks

The proportion of life insurance where policyholders assume the investment risk is increasing.

Insurers wrote 27.9% of total gross premium from life insurance. The total assets of life insurance accounted for 50.4% of the total assets of insurers at the end of 2008. The written premium of unit-linked life insurance increased by 5.9% in 2008, despite capital losses. The proportion of total written life insurance premium accounted for by life insurance in which policyholders assume the investment risk increased to 47.1%, contrary to expectations. The proportion of life insurance investments on behalf of policyholders assuming the investment risk declined to 19.3%, compared with a figure of 25.1% in 2007 in the euro area countries.[55]

Table 7.2: Written premium in EUR million and number of policyholders for life insurance and pension insurance provided by insurers

	2005	2006	2007	2008	2005	2006	2007	2008
Life insurance total					Growth rates (%)			
Premium (EUR million)	355	425	513	534	14.7	19.7	20.6	4.1
Number of policyholders	926,306	986,803	1,140,435	1,196,312	8.6	6.5	15.6	4.9
Unit-linked life insurance					Proportion of life insurance (%)			
Premium (EUR million)	80	173	238	252	22.5	40.8	46.3	47.1
Number of policyholders	154,886	216,122	309,009	361,639	16.7	21.9	27.1	30.2
Voluntary supplementary pension insurance								
Premium (EUR million)	15	18	47	60	4.3	4.3	9.1	11.2
Number of policyholders	39,623	42,413	121,611	130,102	4.3	4.3	10.7	10.9

Source: ISA

Banks' ties with insurers in the marketing of insurance products diminished slightly in 2008. There was a decline in the value of transactions concluded, primarily as a result of a

[54] Source: ECB, Financial Stability Review, December 2008.
[55] Source: CEIOPS, Statistical annex 2007.

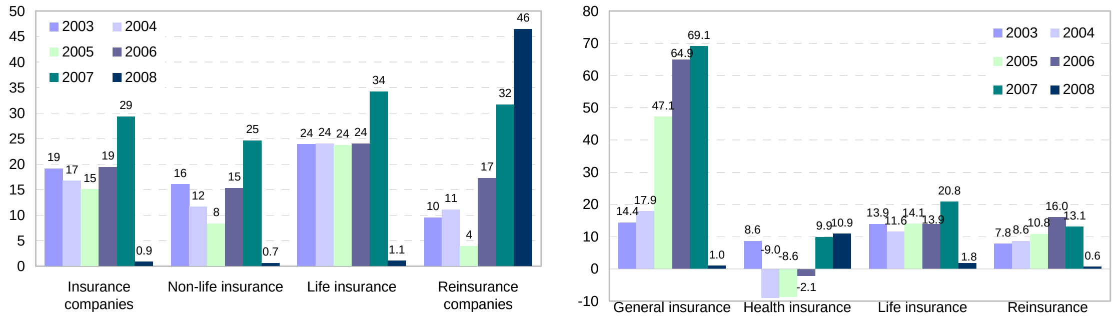
decline of 12% in life insurance transactions to EUR 103.5 million. There was nevertheless an increase of 13% in commission collected via banks, equivalent to 3.3% of the proceeds from the marketing of insurance policies.

Financial statements of insurers

The total assets of insurance companies increased as a result of a new life insurance company and the changeover to the IFRS.

The total assets of insurance companies increased by 0.9% in 2008 to EUR 4.6 billion. In addition to the entry of a new life insurance company to the market, the main factor in the increase was reporting under the new IFRS. According to the new requirements, the reinsurance and co-insurance shares of technical provisions and deferred income from the deduction items in liabilities are transferred to the company's assets. Growth in total assets was reduced by capital losses in investments in securities and investment funds. The quantitative restrictions on insurers' investment policies that entail a higher burden on capital and that will be relaxed upon the implementation of the Solvency II directive proved to be effective during a period of large falls in securities prices.

Figure 7.2: Growth in total assets in percentages (left) and result from ordinary activities in EUR million (right) of insurance companies and reinsurance companies



Note: The figures for reinsurance companies in 2008 relate to the end of the third quarter.
Source: ISA

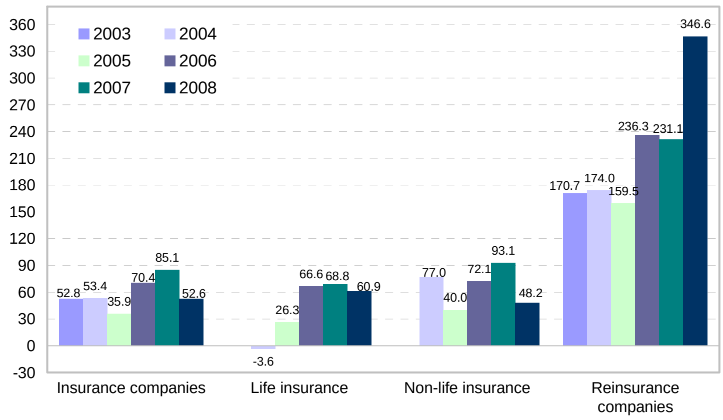
A decline in insurers' net profit.

Insurers' net profit in 2008 amounted to EUR 2.9 million, just 3% of that in the previous year. The large decline in the net profit of the non-life insurance segment was partly the result of a large number of natural disasters. Five non-life insurance companies and six life insurance companies reported a loss at the end of 2008.

A decline in the surplus of insurers' available capital over the required minimum capital.

The surplus of insurers' available capital over the required minimum capital was down just over a third at the end of 2008, to EUR 145 million or 53%. The main factor was the relative decline in the non-life insurance segment, one non-life insurance company failing to maintain capital adequacy.

Figure 7.3: Surplus of available capital over required minimum capital at insurance companies and reinsurance companies in percentages



Note: The figures for reinsurance companies in 2008 relate to the end of the third quarter.
Source: ISA

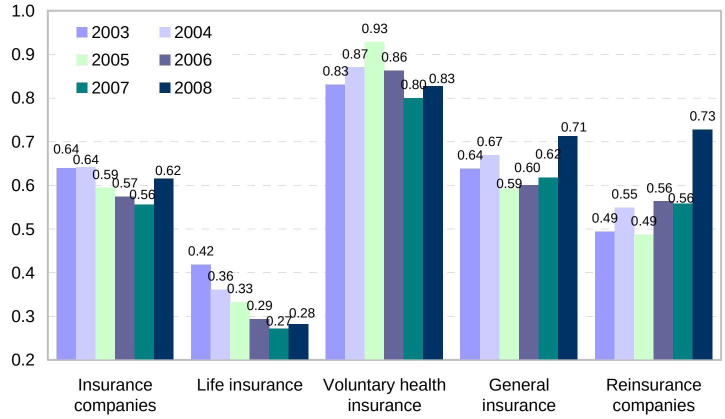
7.1.2 Stability of the insurance sector

Underwriting risk

A deterioration in the claims ratios of insurance companies and reinsurance companies.

The claims ratio at insurance companies as measured by the ratio of gross claims paid to gross written premium deteriorated in 2008. The rise in the ratio was primarily the result of a deterioration in the claims ratio in the non-life insurance segment, as a result of an increase of 19% in claims paid, most notably from claims for fire and natural disaster insurance and motor vehicle insurance. The level of retained risk at insurance companies for non-life insurance increased by 2 percentage points to 84%.

Figure 7.4: Claims ratio for major types of insurance



Source: ISA

Investment risk

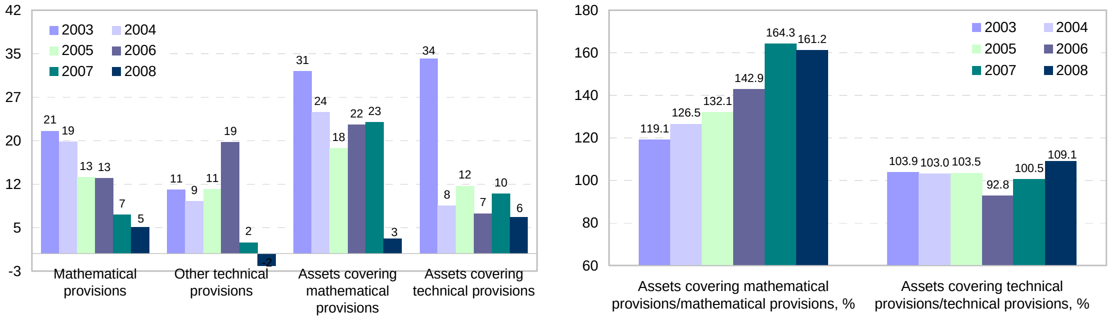
Assets covering technical provisions increased by 4% in 2008, 13.5 percentage points less than in the previous year, to EUR 3,493 million, equivalent to 9.4% of GDP. Growth in life insurance investments in 2008 was outpaced by growth in non-life insurance investments. Nevertheless, the low growth in total assets covering technical provisions meant that the ratio of assets covering mathematical provisions to assets covering technical provisions remained at 1.5 to 1.

The coverage of technical provisions by assets covering technical provisions increased.

The coverage of net technical provisions by assets covering technical provisions increased to 135.3%, up 3.8 percentage points on the end of 2007. The increase of 8.6 percentage points in the coverage of other technical provisions by assets covering technical provisions to 109.1% was entirely responsible for this increase, the coverage of mathematical provisions by assets covering mathematical provisions declining by 3.1 percentage points to 161.2%. According to this indicator, insurers' investment risk declined in non-life insurance.

The conservative investment policy for assets covering mathematical provisions meant that the capital loss resulting from the fall in prices of equities and investment fund units in 2008 was low. The assets covering technical provisions other than those covering mathematical provisions typically have shorter maturities, which allows greater flexibility in investment restructuring. However, insurers ensured an adequate level of technical provisions in 2008 by also using coverage from their capital. In 2009 the possibilities of internally covering potential investment losses will have been exhausted, and the urgency of recapitalization of insurers is rising, given the potential deterioration in business conditions.

Figure 7.5: Growth in net technical provisions and assets for life insurance and non-life insurance (left), and coverage of technical provisions by assets covering technical provisions (right) in percentages



Sources: ISA, own calculations

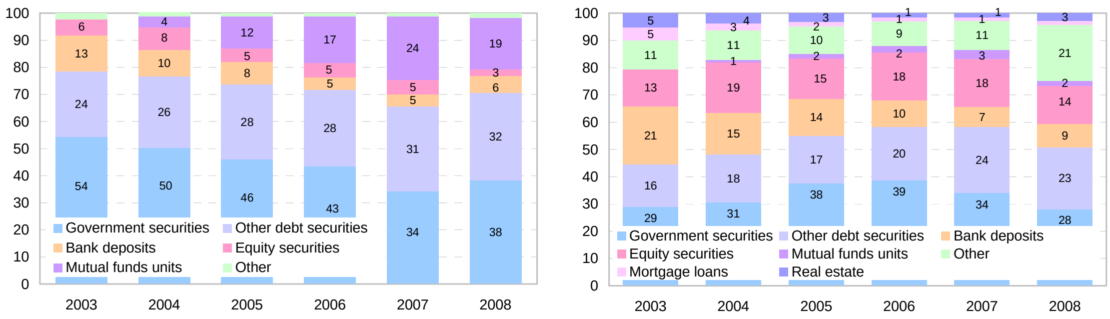
In 2008 insurers increased the proportion of their assets invested in the most conservative forms of deposits, government securities and other debt securities, which now account for 69.8% of all investments. The largest increase was in the proportion accounted for by bank deposits, which rose to 7.2%. Investment risk rose towards the end of 2008 as a result of the fall in interest rates on the money market. The proportion of investments in mutual fund units declined by 4 percentage points, and the proportion of investments in equities by 3 percentage points, partly as a result of capital revaluations in 2008.

The proportion of insurers with an ultra-conservative investment policy increased as a result of developments on capital markets.

The investment policy of Slovenian insurers remains more conservative than euro area insurers. In 2007, when there were high returns on the capital markets, euro area insurers adjusted their investment portfolio so that the safest forms accounted for just 28.4% of the total.[56] This is 40 percentage points less than the equivalent figure in the domestic insurance sector, which means that foreign insurers are more competitive than Slovenian insurers during times of favourable climate. It is forecast that the proportion of conservative investments will rise in the euro area in 2008, but it is thought that the figure will still be lower than in Slovenia, and foreign insurers could therefore suffer greater losses as a result of price falls on the capital markets.

The proportion of life insurance investments accounted for by mutual fund units declined by a fifth in 2008, despite the increase in written premium for life insurance in which policyholders assume the investment risk. This was a result of capital revaluations. The proportion accounted for by equity investments declined by a half. The proportion of assets covering mathematical provisions accounted for by the safest forms of investment increased by 6.7 percentage points to 77%.

Figure 7.6: Structure of insurers' assets covering mathematical provisions (left) and assets covering technical provisions other than mathematical provisions (right) in percentages



Source: ISA

The proportion of assets covering technical provisions other than mathematical provisions accounted for by the safest forms of investment declined by 6.3 percentage points in 2008, primarily as a result of the decline in the proportion accounted for by government securities. Claims against associates and undertakings in the group also increased. Non-life insurance companies balanced their risks at other insurance companies and reinsurance companies. This created greater security in the insurance system in the event of annual claims deviating from the average. Insurance companies face increasing

An increase in the proportion of non-life insurance investments accounted for by debtors arising out of reinsurance operations.

[56] CEIOPS, Statistical annex 2007.

exposure to credit risk where the reinsurance company does not have sufficient assets to pay out the reinsurance claim.[57]

The proportion of assets covering mathematical provisions accounted for by foreign securities is increasing, and reached 42.8% at the end of 2008. The proportion of assets covering technical provisions other than mathematical provisions accounted for by foreign securities declined by 1.3 percentage points to 16.6%.

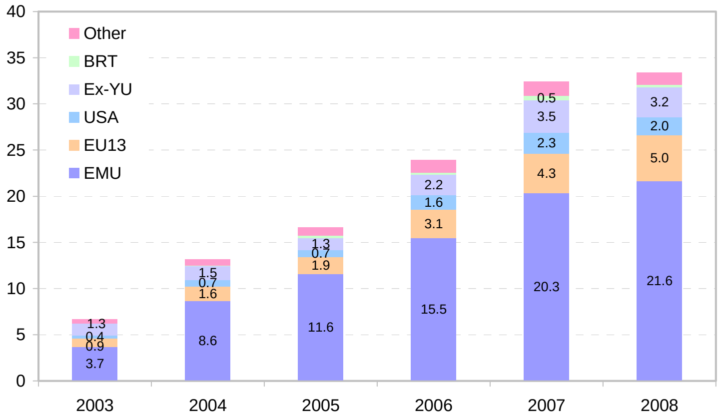
The proportion of the insurance sector's investments placed in securities of foreign issuers increased to 33.4% in 2008.

The entire insurance sector increased its investments in the rest of the world in 2008 by 6.8% to EUR 1,805 million, the proportion of total insurance sector investments accounted for by investments in the rest of the world increasing by 1 percentage point to 33.4%. However, debt securities gained in importance compared with the previous year, accounting for three-quarters of all investments. The proportion accounted for by investments in euro area countries increased, while the proportion accounted for by investments in emerging markets declined, the latter's economic instability presenting higher risk. The capital markets of the former Yugoslav republics account for a relatively high 32.6% of all investments in foreign equities, because of equity holdings in insurance companies. The largest proportion is accounted for by equity investments in euro area countries. Despite advantages such as the shortfall of market development and the lack of competition, expansion into the former Yugoslav republics also entails the risk of uncertain economic conditions and currency risk.

The insurance sector's exposure to emerging economies declined.

According to Insurance Supervision Agency figures, insurers held EUR 200.6 million of investments in structured securities at the end of 2008, which is 6% of their total investments. They created EUR 83 million of impairments for all investments in 2008. EU insurers' exposure to the structured credit instruments of banking sector issuers accounts for 10% of total investments. Given the difficulties of banks issuing structured securities, EU insurers created impairments of 7%.[58]

Figure 7.7: Proportion of the insurance sector's investments in the rest of the world in percentages



Source: ISA

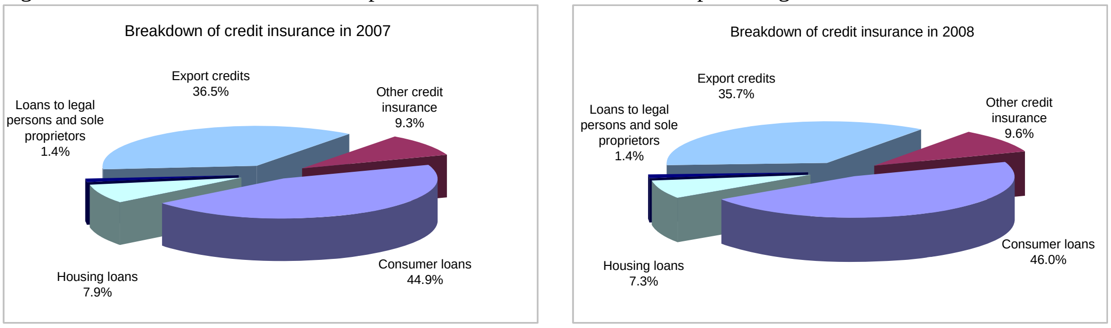
7.1.3 Influence of insurers on the stability of the banking sector via credit insurance

Credit insurance accounted for 2.1% of insurers' total written premium in 2008, while its growth was outpaced by growth in premium by 3.5 percentage points. The proportion of Slovenian credit insurance to loans to non-banking sectors stood at 30.6% (equivalent to EUR 6.2 billion). The proportion of credit insurance to the stock of housing and consumer loans and loans to sole proprietors remained at 9.1%, equivalent to EUR 676 million. The insured sum for all these loans increased by 15.5% in 2008.

[57] The adverse financial conditions and increase in claims payments meant that non-life and life insurance companies made higher tax prepayments during the year. This means that profits generated in real terms were smaller than the taxed profits, and as a result there was an increase in deferred tax assets, which will entail tax refunds in the future.

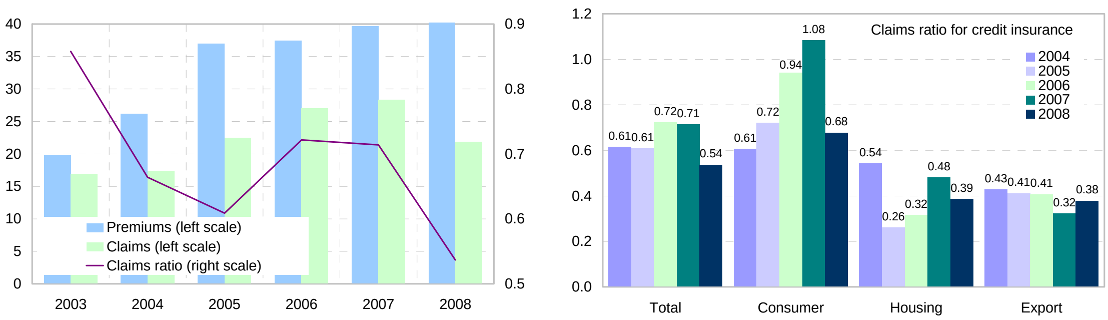
[58] Source: CEIOPS, 2008 Report on Market Developments, November 2008.

Figure 7.8: Breakdown of written premium from credit insurance in percentages



Source: ISA

Figure 7.9: Written premium and paid claims in EUR million, and claims ratios for credit insurance



Source: ISA

The claims ratio for credit insurance overall improved in 2008. Its decline to 0.54 was primarily the result of an improvement in the claims ratio for consumer loans and housing loans, and for loans to sole proprietors. However, the claims ratio for loans to legal persons deteriorated from 0.10 to 0.98, although this did not have a significant impact on insurers, as they account for an extremely low proportion of the total. The relative importance of credit insurance for consumer loans increased slightly again, gross written premium rising by 5.4% in 2008. Claims paid declined by 34.1%, which brought an improvement in the claims ratio to 0.68. Gross written premium for housing loans declined by 5.6%, as a result of the decline in new housing loans, and the decline of 24.4% in gross claims paid was reflected in the claims ratio falling to 0.39. The risk to insurers remains negligible because of the diminishing importance of loans insured at insurers, but the claims ratio can be expected to deteriorate this year as a result of the continuing economic crisis.

An improvement in the claims ratio for consumer and housing loans.

7.2 Voluntary supplementary pension insurance

The number of policyholders covered by voluntary supplementary pension insurance increased by 5.2% in 2008 to 512,000. Written premium was up 9% on 2007 at EUR 240 million, while assets were up 26.9% at EUR 1,212 million, equivalent to 3.3% of GDP. Although returns in 2008 were still uncompetitive or even negative, written premium increased as a result of the anticipated decline in the relative level of the pension provided by compulsory pension insurance and intensive advertising of the personal income tax relief available.

Written premium increased by 9% in 2008.

Table 7.3: Voluntary supplementary pension insurance providers: number of policyholders, written premium and assets

	2004	2005	2006	2007	2008
Number of policyholdes	404,885	427,645	459,764	486,816	512,343
Structure (%)					
Mutual pension funds	50.7	49.3	48.0	47.4	46.6
Insurers	9.5	9.3	9.2	23.3	24.1
Pension companies	39.8	41.4	42.8	29.3	29.3
Earned premium (EUR million)	179	182	204	220	240
Structure (%)					
Mutual pension funds	51.6	46.3	44.1	43.2	42.6
Insurers	8.3	8.3	9.0	21.2	23.7
Pension companies	40.1	45.3	46.9	35.6	33.7
Assets (EUR million)	398	592	783	956	1,212
Structure (%)					
Mutual pension funds	38.0	40.6	43.0	45.9	39.9
Insurers	13.1	11.5	10.9	12.3	22.1
Pension companies	48.9	47.8	46.1	41.8	38.0

Sources: ISA, SMA

The pressure on the compulsory pension and disability insurance treasury declined slightly in 2008, the ratio of policyholders at the PDII to the number of pensioners increasing to 1.64. However, at 8.3%, growth in the average pension was half a percentage point higher than growth in net wages. The average age of new pension recipients remained the same as in 2007 at 59.2. The trend of an aging population is continuing, which is having an adverse impact on the sustainability of the pension system.

Low return for insurers and pension companies, and negative annual return on mutual pension funds.

The average annual return achieved by insurers and pension companies on voluntary supplementary pension insurance investments was 0.1% at the end of 2008, while the annual change in mutual pension fund unit value was -9.5%. Saving in pension funds was of little attraction in recent years because of the low returns compared with the capital markets. Given the large fall in equities prices, losses were recorded by mutual pension funds, despite their mandated conservative investment policy. In OECD countries the negative annual return on pension funds was -23%.[59]

Table 7.4: Pension fund assets in EUR billion and structure in selected European countries in percentages at the end of 2008/2006

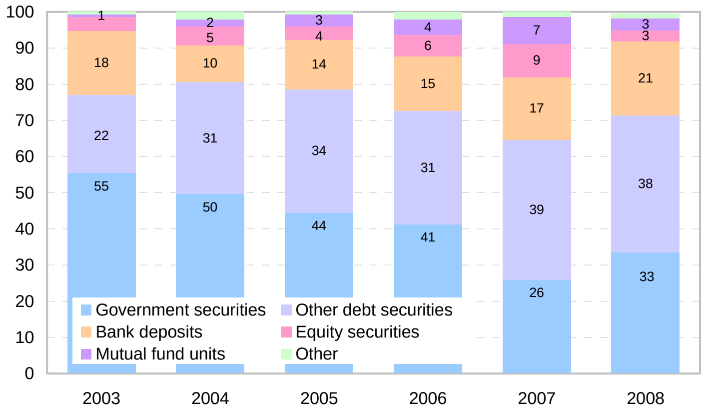
	Slovenia[1]	EMU[2]	Portugal	Germany	UK
Pension fund investments (EUR billion)	1	1,176	21	98	1,460
As % of GDP	3.3		13.6	4.2	77.1
Structure (%)					
Cash and deposits	21	3	5	3	2
Debt securities	71	37	34	32	19
Share	3	46	30	34	39
Mutual funds units	3	3	22	0	20
Loans	1	6	0	26	0
Other	1	5	9	6	19

Notes: [1] Figures for Slovenia are for 2008, figures for EMU countries are for 2006, while figures for the UK are for 2005.
[2] Excludes France, Luxembourg, Greece and Ireland.
Sources: ISA, SMA, OECD Pension Markets in Focus, November 2007, Issue 4

Voluntary supplementary pension insurance providers reacted to the volatility of the capital markets by increasing the safest forms of investment by 10 percentage points. As expected, they reduced the proportion of investments in equities and mutual fund units by the same amount.

[59] Source: OECD. Despite the crisis, private pensions are needed more than ever before, OECD says, February 2009. Provisional figure.

Figure 7.10: Structure of voluntary supplementary pension insurance providers' investments in percentages



Sources: ISA, SMA

A search for higher-return alternatives to voluntary supplementary pension insurance with guaranteed return.

Voluntary supplementary pension insurance with guaranteed return is in difficulties because of the negative returns on equities, low interest rates and rising life expectancy. In some European countries providers offer pension plans without a guaranteed return. This would reduce the risk of capital market volatility faced by fund managers, and would also entail the transfer of certain risks, such as investment decisions, to policyholders. The OECD's assessment is that should pension plans without guaranteed return not be implemented, income payments in the third age could be lower than the guaranteed return.[60] The suggested solution is a combination of guaranteed return with a portion with an open investment policy, which would depend on the policyholder's age and aversion to risk.

7.3 Investment funds

Investment funds' assets declined to EUR 1.9 billion at the end of 2008.

Investment funds accounted for 5.1% of Slovenian households' financial assets at the end of 2008, a similar figure to that seen in the first quarter of 2004, and down 4.1 percentage points on 2007. It was 3.2 percentage points less than the equivalent figure of 8.3% in the euro area at the end of the third quarter of 2008. The ratio of Slovenian investment funds' assets to GDP was 10.8 percentage points less than that of the euro area at 5%. Slovenian investment funds' assets declined by 54% in 2008 to EUR 1.9 billion. The decline was the result of capital losses, and also of outflows from mutual funds. The Ljubljana Stock Exchange's PIX fell by 23.1% last year, while the weighted unit value of mutual funds fell by 43%. The conversion of investment companies means that the proportion of investment funds' assets accounted for by mutual funds continues to increase, reaching 79%.

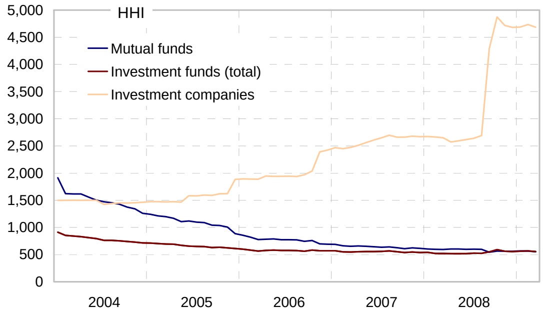
[60] Source: OECD, 2008 Report on Market Developments, November 2008.

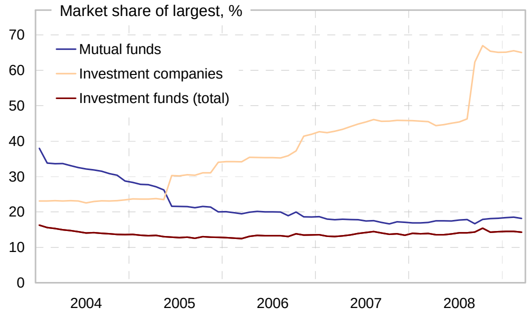
Table 7.5: Overview of investment funds

	2001	2003	2005	2007	2008	Mar 09
	Assets (EUR million)					
Investment funds	2,349	1,833	2,220	4,138	1,912	1,804
Mutual funds	61	389	1,385	2,924	1,513	1,420
Net annual inflows	6	108	138	470	-304	-22
Investment companies	-	894	835	1,213	398	384
Authorised investment companies (IDs)	2,287	550	-	-	-	-
Annual turnover	221	254	149	124	61	3
	Structure (%)					
Mutual funds	3	21	62	71	79	79
Investment companies	-	49	38	29	21	21
Authorised investment companies (IDs)	97	30	-	-	-	-
	Growth rate (%)					
Investment funds	-3.7	-15.3	6.4	45.4	-53.8	-46.7
Mutual funds	37.6	66.9	57.9	51.6	-48.2	-39.6
Investment companies	-	54.7	-30.9	32.4	-67.2	-62.9
VEP	23.1	17.1	7.2	28.0	-42.8	-35.3
PIX	4.4	23.5	-12.2	45.0	-23.4	-

Note: Annual change in the PIX in 2008 relates to 31 July 2008.
Sources: SMA, LJSE, own calculations

Figure 7.11: Market concentration of investment funds





Note: Management company mutual funds: market concentration of management companies in terms of mutual fund assets under management.
Source: SMA

The low proportion of investment companies means that the market concentration of mutual funds is approaching the market concentration of investment funds.

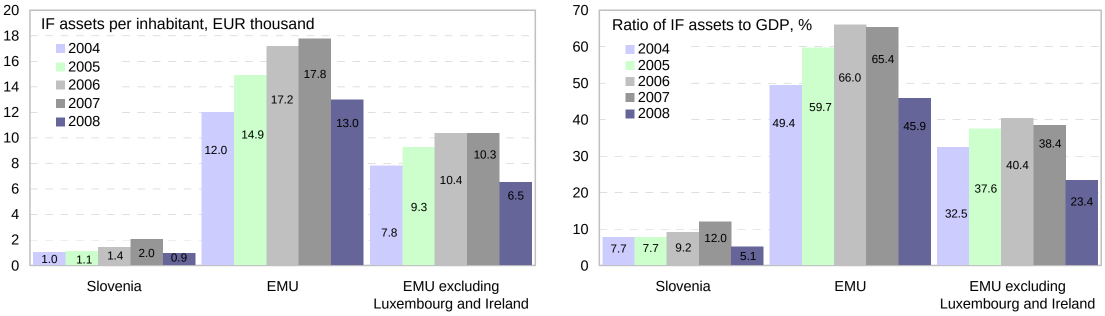
The decline of two-thirds in investment companies' assets was the result of high investment dependence on the domestic capital market, whose value fell strongly because of excessive growth in 2007. Mutual funds' assets recorded a relatively smaller decline, as a result of higher diversification. Foreign funds represent direct competition to domestic mutual funds, attracting assets from domestic investors equivalent to 30% of the assets of domestic mutual funds. This was up 2 percentage points on the previous year. Taking solely those foreign funds marketed officially in Slovenia into consideration,[61] their assets are equivalent to 9% of total domestic mutual fund assets. There were 17 new domestic mutual funds established in 2008, of which 15 were equity funds. A total of 127 mutual funds were being marketed at the end of the year. Equity funds predominate, accounting for 76% of the total. About 34 foreign funds commenced official marketing in 2008 and January 2009. There were close to 318 funds and sub-funds being officially marketed in Slovenia in January 2009.

The total assets of domestic investment funds per capita had declined to EUR 931 by the end of 2008, down more than a half on a year earlier. The gap with the average in the euro area,[62] where the figure was EUR 6,537, widened further.

[61] Only those investments in foreign mutual funds made via domestic stock brokers (brokerage houses and banks) are included. For funds that are officially marketed in Slovenia, figures are selected with regard to the available ISIN of these funds, where a portion of assets could be invested outside the official market. All foreign funds are selected from foreign securities with regard to the CFI code EU (E-equities, U-units).

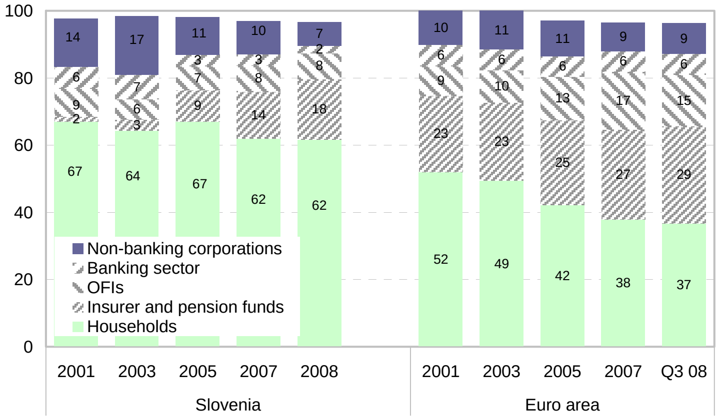
[62] This figure does not include Luxembourg or Ireland, which have many registered funds marketed outside the euro area.

Figure 7.12: Comparison between Slovenia and the euro area in per capita investment fund assets in EUR thousand (left) and assets as a percentage of GDP (right)



Sources: ECB, SMA, Eurostat, SORS, IMF

Figure 7.13: Breakdown of ownership of investment fund units/shares in percentages



Note: The units/shares of all investment funds (investment companies and mutual funds), both domestic and foreign, are taken into account. These were equivalent to 7% of GDP in Slovenia at the end of 2008, compared with just over 41% of GDP in euro area countries at the end of September 2008.
Sources: Bank of Slovenia, ECB

Equity funds continue to account for a large proportion of mutual funds' assets.

There was no decline in the proportion of mutual funds' assets accounted for by equity funds either during the escalation of the financial turmoil or when share prices were falling more sharply than prices of debt securities. Slovenian investment funds thus continue to have a higher proportion of the more risky funds than those of euro area countries.

European Commission proposals to reduce investment funds' operating costs, and to ensure that investors receive clear information.

The European Commission has put forward a proposal to the European Parliament to eliminate bottlenecks in the UCITS Directive. In order to achieve greater efficiency at investment funds and to ensure greater competition for investors, the simplification of the process of issuing marketing authorizations for funds in EU Member States has been proposed, whereby a simple document with key information for investors, presented clearly and understandably, would replace the summary of the prospectus. Mergers of investment funds would be allowed, to reduce fund management costs. A more integrated market would increase competition between European fund management companies.[63]

Interaction of investment funds and the banking sector

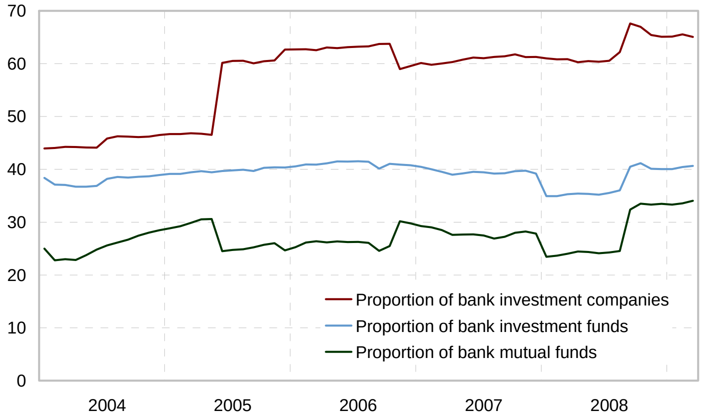
Slovenian banks have a smaller role in the marketing of investment funds than do banks in euro area countries. Last year banks had no need to establish ties with management companies because of rising interest margins, while at the same time bank deposits were more attractive than investing in investment funds for reason of safety. In the context of difficulties in accessing foreign funding, banks showed greater interest in alternative sources of funding. At the same time some mutual fund management companies last year found themselves in financial difficulties because of the adverse movements on the capital markets and the increase in net outflows from mutual funds. This raises the possibility of closer ties between the two sectors this year, or mergers between management companies and banks.

[63] European Commission: Recast of Directive 85/611/EEC (16 July 2008).

The direct debt of management companies with the domestic banks amounted to EUR 129 million at the end of 2008, up 18.8% on a year earlier, and accounted for 0.4% of total bank loans to non-banking sectors. Total bank exposure to management companies amounted to EUR 304 million, of which three-quarters was exposure to companies under majority bank ownership.

The volume of trading in coupons via banks in 2008 was down two-thirds on the previous year. The commission earned from this source recorded the same decline. When the global economy stabilises, investing in investment funds will again be competitive with other bank products. The domestic banks' equity participation in management companies remains low at 36%. Savers are therefore unable to make comprehensive decisions about their investment plans, and fail to allocate their assets optimally in respect of risk, maturity and return.

Figure 7.14: Percentage of assets of investment funds, and separately for investment companies and mutual funds operated by management companies under majority bank ownership

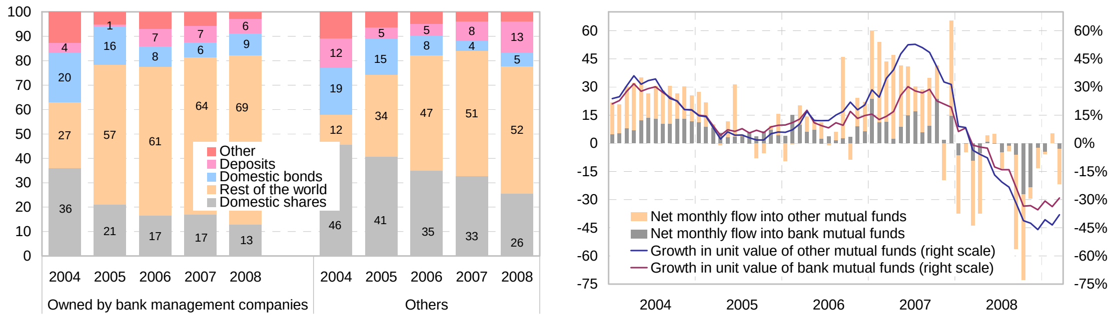


Source: SMA

Proportion of assets managed by management companies under majority bank ownership.

Management companies with significant bank ownership manage about 41% of the total assets of domestic investment funds. The higher proportion accounted for by mutual funds is the result not just of the establishment of mutual funds but also of the conversion of two investment companies under majority bank ownership into mutual funds. Mutual funds under majority bank ownership recorded net outflows of EUR 86 million in 2008, 28% of total net outflows from mutual funds. The number of Balkan mutual funds on the market rose to seven, just two of which are owned by management companies under majority bank ownership. In the context of negative returns in 2008, the weighted annual loss of bank-owned mutual funds was at all times lower than that of other funds. The largest gap was in December 2008, when the annual loss of bank-owned funds of 35.4% was 10.6 percentage points lower than that of others. The two types of fund also differ in terms of investment structure. One feature of bank-owned funds is that they have a smaller proportion of assets invested in domestic shares, and a larger proportion invested in securities of foreign issuers.

Figure 7.15: Comparison of mutual funds operated by management companies under majority bank ownership and others: investment structure in percentages (left), and annual growth in unit value in percentages and net monthly inflows in EUR million (right)



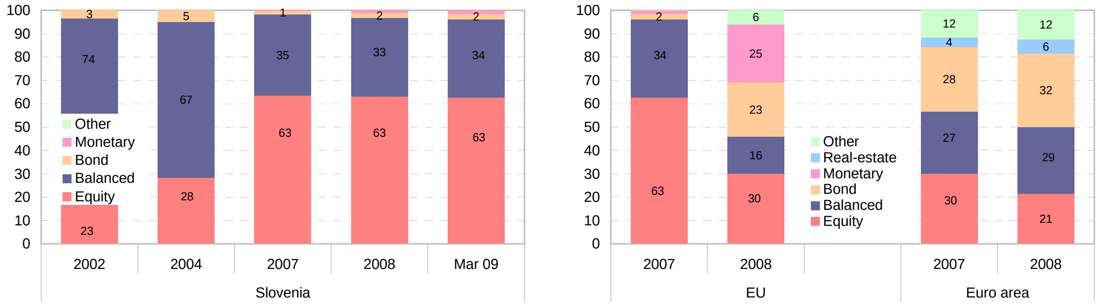
Sources: SMA, own calculations

7.3.2 Mutual funds

Mutual funds' assets declined by 48.2% in 2008 to EUR 1,513 million.

The crisis conditions on the capital markets had an impact on the pace of Slovenian investors' saving in mutual funds. The decline in assets in 2008 was the result of falls in securities prices on the domestic and foreign capital markets, the movements of exchange rates and net outflows from mutual funds. Assets declined by 48.2% in 2008,[64] and then by a further 6.2% to stand at EUR 1,420 million at the end of March 2009. The ratio of mutual fund assets to GDP stood at 4.1% at the end of 2008, and had declined to 3.8% by the end of March 2009.

Figure 7.16: Breakdown of funds by type, in terms of assets, in Slovenia, the EU and the euro area in percentages



Note: The ECB classifies monetary mutual funds as monetary financial institutions, and their assets are therefore not included in the euro area analysis.
Sources: SMA, EFAMA, ECB

No change in savers' aversion to investment risk.

Until August 2008 Slovenian investors made virtually no response to the adverse global developments. Their belated response to the fall in the unit value of mutual funds was relatively small compared with the rest of the world. The anticipated migration of assets between individual funds depending on risk had not even happened by early 2009. Less-informed investors need more time to react, and to incorporate the conditions on the market and the performance of individual mutual funds in the allocation of their investments. Another important role is that of the management companies, which during a time of negative returns should provide up-to-date information to potential and existing investors, thereby compensating for the deficient experience of Slovenian investors, who are relatively inclined towards risk.

Slovenia has one of the highest proportions of equity funds in Europe.

A faster response was evident elsewhere in Europe, with the partial migration of funds from high-risk areas to areas of less risky investments. Thus in 2008 there was a pronounced increase in assets in money-market and bond funds at the expense of a decline of more than a half in assets in equity and balanced funds. Investors from euro area countries reduced their investments in equity funds by 9 percentage points compared with the previous year. Slovenia is ranked third in Europe after the UK and Sweden in terms of the proportion of equity funds and second after Poland in terms of the proportion of balanced funds.[65] Consequently, mutual funds' assets contracted more in Slovenia than in other European countries as a result of the fall in share prices.

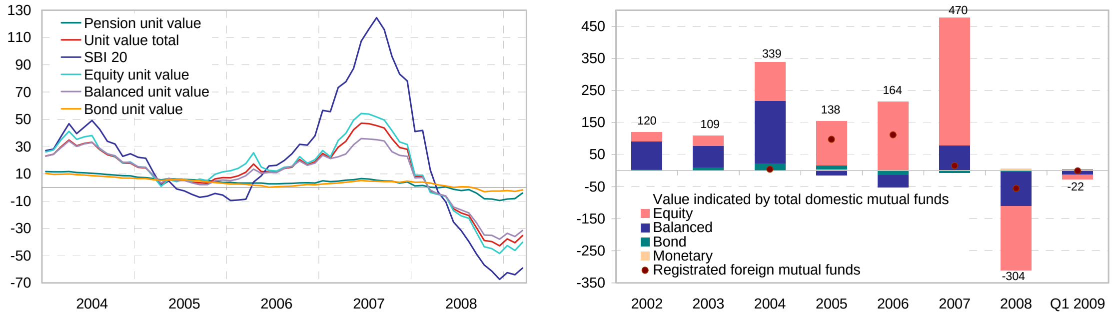
According to ECB figures, at the end of 2008 real estate funds accounted for 6% of the total in the euro area countries. Although they are lower-risk investments, in Slovenia there is not yet the legal basis to allow the establishment of real estate funds. The establishment of accurate and systemically integrated real estate registers and records is a prerequisite for their operation.

An annual fall of 42.8% in the unit value of mutual funds.

The overall unit value of mutual funds fell by 42.8% in 2008. The negative annual change in the unit value of equity funds was 48.4%, 19 percentage points less than the annual fall in the index SBI 20. The correlation coefficient of 0.68 indicates the high correlation between the monthly weighted change in the unit value of mutual funds and the monthly net inflows into individual types of mutual fund.

[64] According to EFAMA figures, assets declined by even more than in Slovenia in Portugal (49.8%), Poland (58.7%), Greece (57.3%) and Bulgaria (62.8%), and by slightly less in other European countries: 31.0% in the Czech Republic, 19.9% in Ireland, 28.4% in Austria, 15.4% in France, 30.5% in Germany and 33.6% in Italy.
[65] EFAMA: The State of the European Investment Fund Industry at End September 2008.

Figure 7.17: Annual change in the unit value of mutual funds and the SBI 20 in percentages (left) and amount of annual net inflows into mutual funds in EUR million (right)

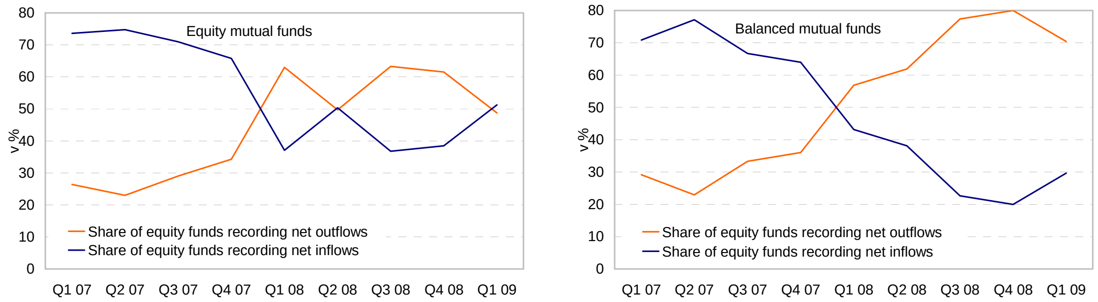


Sources: SMA, LJSE, Bank of Slovenia

There were EUR 303.7 million of net outflows in 2008, equivalent to 25% of total net inflows over the previous five years.

Last year saw fund units being redeemed, in particular those suffering high negative annual returns, although the outflows were lower than expected. Net outflows totalled EUR 303.7 million, while mutual funds' assets declined by EUR 1,411 million. All funds recorded net outflows, other than money-market funds, which received net inflows of EUR 6.5 million.

Figure 7.18: Proportion of mutual funds receiving net inflows and proportion of mutual funds recording net outflows, for equity funds (left) and balanced funds (right)



Source: SMA

A sharp contraction in equity funds' assets.

There were net outflows of EUR 200 million from equity funds in 2008, 14.4% of which came from mutual funds with an investment strategy focusing on the Balkans. Given the negative year-on-year return on the Balkan funds, which by the end of the year had increased to 64.0%, the outflow of 30% of their net inflows in the previous five years was relatively small. Equity funds also saw the largest relative contractions.

Table 7.6: Changes in mutual funds' assets as a result of net inflows and other factors in EUR million

	Bond	Balanced	Equity – "Non-Balkan"	Equity – "Balkan"	Equity – total	Monetary	Total
			2007				
Net payments in 2007	-6	75	338	60	398	3	470
Capital gain in 2007	3	176	329	17	346	1	526
Assets as at 31 Dec 2007	40	1,019	1,725	130	1,855	11	2,924
			2008				
Net payments in 2008	-5	-105	-171	-29	-200	6	-304
Capital loss in 2008	-3	-407	-671	-27	-698	0	-1,107
Assets as at 31 Dec 2008	32	507	883	74	957	18	1,513

Sources: SMA, own calculations

Only 21.5% of the decline in mutual funds' assets in 2008 was the result of net outflows, the remainder coming from capital losses caused by falls in unit value of mutual funds and foreign exchange differences. Net outflows accounted for 44% of the decline in asset under management in Austria, 23% in Germany, 22% in France, 76% in Portugal, 59% in the Czech Republic, and just 7% in Poland.[66] The banking sector has competed fiercely

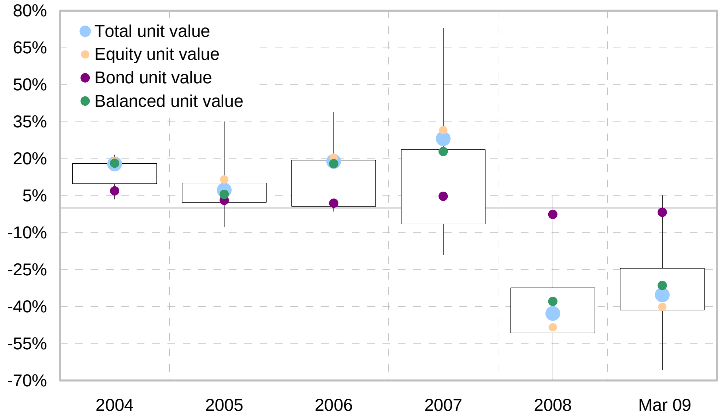
[66] Net outflows from European investment funds totalled EUR 284 billion, 40% of the total coming in October 2008 alone, primarily as a result of the collapse of Lehman Brothers.

with mutual funds in the last year. Banks offered favourable interest rates on deposits, while the government guarantee for all bank deposits also influenced savers.

The differences in the annual returns of individual funds increased.

Sectoral and regional diversification meant that a large variation in the returns of mutual funds was seen even in 2007. The standard deviation in the annual returns of all mutual funds has been rising from year to year, and reached 17.74 at the end of 2008. The existing two money-market funds and four bond funds were the only funds to generate a positive return in 2008. Of the 13 mutual funds that recorded a loss of more than 60%, two-thirds were funds with investments in the Balkans and other eastern European countries.

Figure 7.19: Classification of mutual funds in terms of annual return at year end in percentages

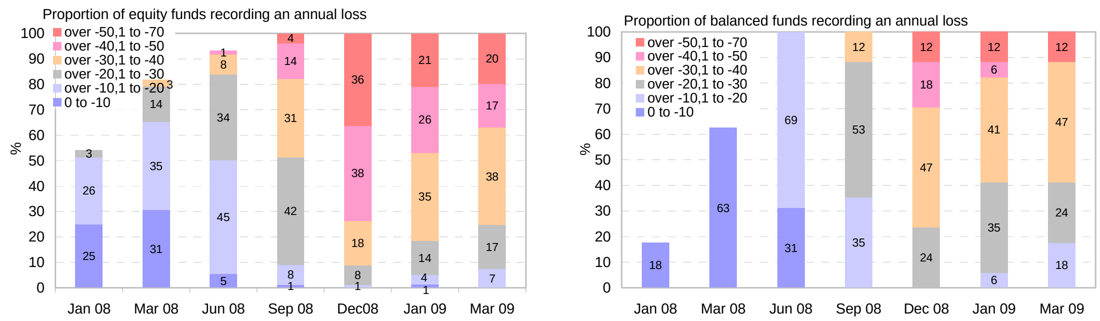


Note: As the funds have been classified according to annual return at the end of the year, only those funds in existence for at least one year are included. The figure shows the variation in annual returns between funds, and the relative standing of particular types of fund compared with mutual funds overall. The rectangles represent the 50% of mutual funds whose annual returns are higher than the bottom quartile of the funds, and lower than the top quartile.

Sources: SMA, own calculations

The proportion of mutual funds recording a negative return increased during the year: all balanced funds were operating at a loss by May, and all equity funds by August. The relative proportion of those with an annual loss of 50% to 70% reached its peak in December 2008.

Figure 7.20: Relative distribution of domestic equity funds (left) and domestic balanced funds (right) in terms of negative annual change in unit value of mutual funds in percentages

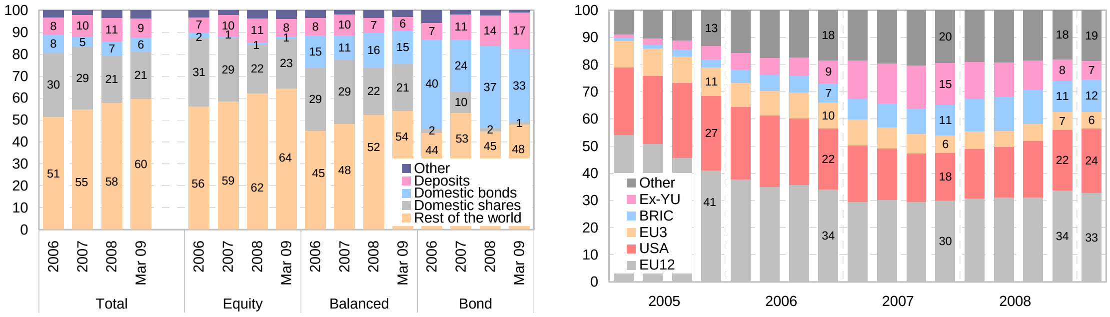


Source: SMA

Change in the regional breakdown of domestic mutual funds' investments.

Domestic mutual funds increased their proportion of investments in the rest of the world in 2008. The proportion invested in domestic shares declined by 7.2 percentage points, which alongside actual sales was also the result of revaluations. The proportion of investments in domestic bonds increased by 2 percentage points. The other financial intermediaries sector redirected some regional investments in shares in 2008 because of adverse capital movements. There was a notable decline of 7.5 percentage points in the proportion of investments accounted for by the former Yugoslav republics, whose markets are less liquid, are economically and politically instable, and carry currency risk. The largest increase of 4.7 percentage points was recorded by investments in shares in the US, which increased risk exposure to the US economy and the movement of the US dollar.

Figure 7.21: Breakdown of mutual fund investments (left) and regional breakdown of investments in foreign shares by the entire other financial intermediaries sector (right) in percentages



Note: EU3: UK, Denmark, Sweden; BRIC: Brazil, Russia, India, China; Ex-YU: former Yugoslav republics.
Source: SMA

The proportion of liquid assets was maintained, despite net outflows.

The increased redemption of fund units also gave management companies a greater need to secure liquid assets. Liquid assets accounted for 12.8% of mutual funds' assets at the end of 2008, up 1.4 percentage points on a year earlier.

Table 7.7: Liquid assets as a proportion of mutual funds' total assets at the end of the month

(%)	Bond	Balanced	Equity	Money-market	Total	Balkan
Mar 08	30.2	11.7	9.2	99.5	11.1	13.4
Jun 08	36.8	10.7	8.9	99.2	10.5	16.2
Sep 08	39.9	10.4	9.7	99.7	11.2	16.9
Dec 08	37.1	11.4	11.1	99.5	12.8	14.2
Mar 09	38.5	11.3	8.3	99.6	11.4	11.3

Note: Liquid assets include cash, deposits, money-market instruments and government bonds.
Source: SMA

Establishment of umbrella funds.

Since the Rules on the traceability of switching between sub-funds of the same umbrella fund began to be applied on 25 October 2008, it has been possible to swap investment coupons in one sub-fund for investment coupons in other sub-funds operated by the same umbrella fund without incurring tax. Free switching between sub-funds is a huge advantage for investors who change their aversion to risk during the investment period. At the same time the formation of umbrella funds has a beneficial impact in reducing outflows from mutual funds. By the end of March 2009, 11 umbrella funds had been established. The reallocation of assets between sub-funds with regard to investors' altered financial position, aversion to risk and saving targets could have, in the case of companies investing primarily in Slovenian shares, an adverse impact on prices on the Ljubljana Stock Exchange.

Four new mutual funds commenced trading on the Ljubljana Stock Exchange in 2008. Units in listed funds can be purchased or sold on the stock exchange, or directly with the management company. Trading suspensions on the Russian, Romanian and Ukrainian stock exchanges meant that payments into and out of four foreign mutual funds marketed in Slovenia have been suspended in the last year.

Mutual funds with an investment strategy focusing on the Balkans

Funds with an investment strategy focusing primarily on the markets of former Yugoslav republics accounted for just under 5% of all the assets under management of domestic mutual funds at the end of 2008.

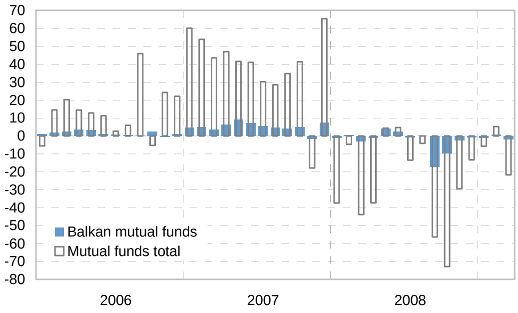
Stock markets in the former Yugoslav republics suffered considerable falls in 2008: the Croatian market index lost 67.1%, the Macedonian 72.9% and the Serbian 75.6%. The interdependence of the capital markets of the former Yugoslav republics is increasing.[67]

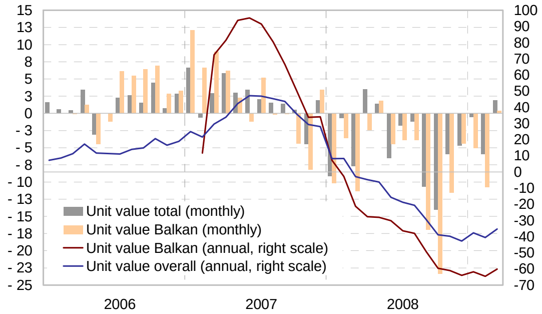
67 Table: Correlation coefficients of monthly returns in 2008

	Serbia	Croatia	Macedonia	Slovenia	Eastern Europe
Serbia	1.00				
Croatia	0.72	1.00			
Macedonia	0.46	0.72	1.00		
Slovenia	0.65	0.66	0.73	1.00	
Eastern Europe	0.82	0.74	0.59	0.70	1.00

Sources: LJSE, Bloomberg, websites of stock exchanges of the former Yugoslav republics

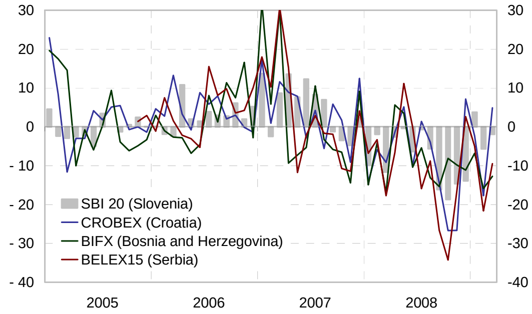
Figure 7.22: Comparison of Balkan funds with all domestic mutual funds in terms of net flows in EUR million (left) and annual and monthly returns on unit value of mutual funds (right) in percentages

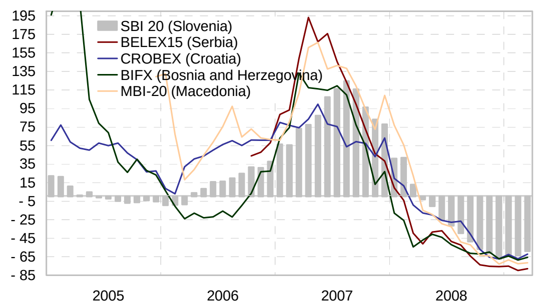




Note: The figures for the Balkan mutual funds differ from last year's because of a change in reporting method allowing for more accurate monitoring.
Sources: SMA, own calculations

Figure 7.23: Monthly (left) and annual (right) growth rates of selected stock exchange indices in the countries of the former Yugoslavia

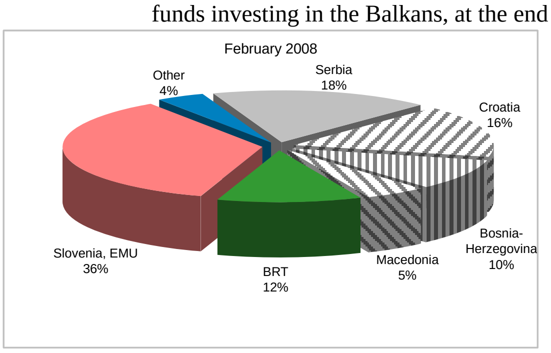


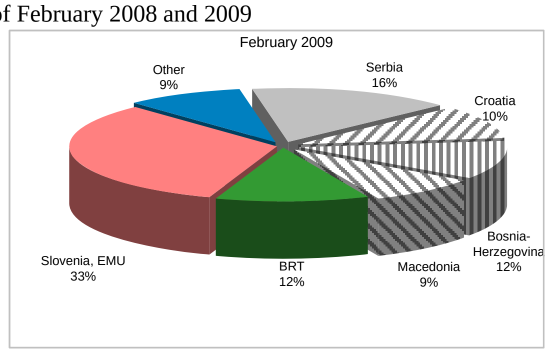


Sources: LJSE, Bloomberg, websites of stock exchanges of the countries of the former Yugoslavia

The markets of the former Yugoslav republics have proved to be very risky in the last year as a result of their low depth and liquidity. The Balkan mutual funds increased their regional focus, with its reduced exposure to euro area countries, even further by increasing their relative investments in Macedonia and in Bosnia and Herzegovina in particular. At the end of February 2009, the proportions of market capitalisation on the individual capital markets of the former Yugoslav republics accounted for by the assets of the Balkan funds were low, and did not exceed 0.2%. No mutual fund announced a suspension of outward payments because of liquidity difficulties. It can be concluded that the pressure for outward payments from investors was not concentrated.

Figure 7.24: Estimated regional breakdown of the investments of the seven mutual funds investing in the Balkans, at the end of February 2008 and 2009



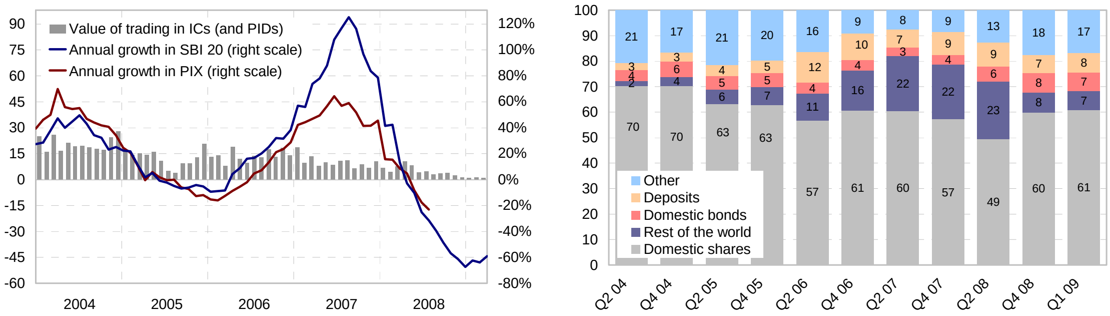


Note: BRT: Bulgaria, Romania, Turkey.
Sources: SMA, management company websites, own calculations

7.3.3 Investment companies

The market capitalisation of the four investment companies stood at EUR 224 million at the end of 2008, equivalent to 56.2% of investment companies assets. Their market returns were significantly lower than their book yields. Two investment companies converted into mutual funds in 2008, one in balanced fund and one in equity fund, for which reason calculation of the investment fund index, the PIX, ceased in July 2008. The proportion of investments accounted for by Slovenian shares increased again, which entails lower regional diversification and greater dependence on the domestic market. Conversion must be undertaken by 2011, but competing with other mutual funds will require restructuring of the investment portfolio.

Figure 7.25: Monthly volume of trading in investment companies in EUR million, and annual growth in the PIX and SBI 20 in percentages (left), and breakdown of investment companies' investments in percentages (right)



Sources: SMA, LJSE

7.4 Leasing companies

The volume of leasing business increased by 20.7% in 2008, equivalent to 15.3% of loans to non-banking sectors by banks.

Slovenian leasing companies accounted for 20.7% of the annual increase in the volume of leasing business in 2008, their volume amounting to EUR 3.3 billion. Client demand for leasing remained buoyant, despite the unstable climate, primarily thanks to the tightened terms for obtaining bank loans. The stock of leasing business (principal) stood at EUR 5.1 billion at the end of 2008, equivalent to 15.3% of loans to non-banking sectors by banks. The domestic leasing market consists of leasing companies that are universal service-providers, and leasing companies owned by vehicle dealers, whose business is primarily for the sale of vehicles. Of the 11 leasing companies included in the leasing committee at the Bank Association of Slovenia, the largest increased its market share in terms of business transacted in 2008 by 1.6 percentage points to 37.5%.

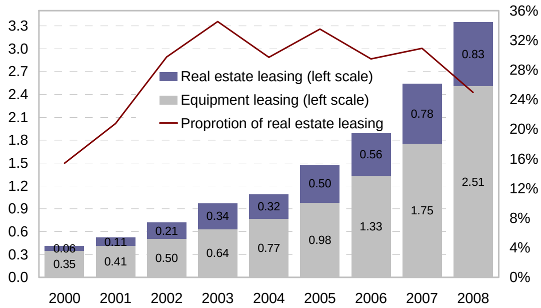
Real estate leasing accounts for a quarter of all leasing business, and recorded annual growth of 6.4%.

Real estate leasing business amounted to EUR 834.6 million in 2008, up 6.4%. The proportion of total leasing business that it accounts for declined by 5.9 percentage points to 25%, as a result of the decline in the number of transactions on the real estate market. Leasing business accounted for 34.2% of the estimated volume of the secondary real estate market transacted by households and legal persons in 2008. The figure was 5.3 percentage points lower in the previous year. Commercial buildings are prevalent, accounting for 47.3% of real estate leasing business. There was also a 10% increase in the volume of leasing business in residential buildings, which accounted for 23.6% of total real estate leasing. The increase matches bank loan requirements in clients' high level of participation in the purchase of housing. After three years of growth, leasing business in production plant and equipment fell by 63% in 2008. During crisis times real estate leasing is primarily a solution for undertakings that wish to improve their liquidity. The advantages of leasing over bank loans are the flexibility of the period for which the lease is concluded, and also that the instalments can be adjusted to the profits of the lessee's business activities.

The proportion of leasing business accounted for by consumer leasing is increasing.

The leasing of vehicles is predominant in equipment leasing. Car leasing is the most important, accounting for 54% of the total in 2008, up 8.5 percentage points, followed by leasing of commercial vehicles, which accounted for 19.1%. Consumer leasing increased slightly, the proportion that it accounts for standing at 21% in 2008.

Figure 7.26: Approved leasing business in EUR billion and the proportion accounted for by real estate leasing (left), and annual growth in leasing business in percentages (right)



Sources: SLA, BAS

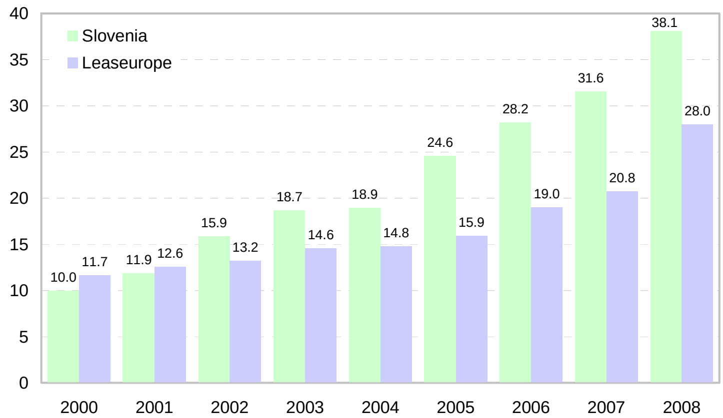
The requirement for the lessee's own participation averaged 14.9% of transaction value at the system level. Leasing companies decide on the deposit on an individual basis, depending on the client's creditworthiness.

The European leasing market expanded in 2007, but contracted in 2008.

The European leasing market[68] increased the role of financing in equipment leasing in particular, the volume of business expanding by 12.4% in 2007. Real estate leasing accounts for 13.7% of the European market, significantly less than in Slovenia. The highest growth in new leasing loans, 32.5%, was again recorded by the countries of central and eastern Europe, primarily as a result of capital investments by wealthier countries and the process of catching up with the economic development of western European countries.

Provisional figures for 2008 show an annual decline in new loans in Europe of approximately 7%. The large depreciation in the currencies of certain rapidly developing eastern European countries meant that the volume of new loans declined more than it would otherwise have done.

Figure 7.27: Ratio of leasing business to gross investment in percentages



Note: The Leaseurope figures include all European Union Member States with the exception of Luxemburg, Ireland and Greece, plus Norway, Switzerland, Romania, Bosnia and Herzegovina, Russia and Serbia. Gross investment includes capital expenditure but excludes investments in residential buildings for reason of comparability with the Leaseurope figures. The Leaseurope figure for 2008 is provisional, and has been calculated on the basis of the available figures for the 21 member-states of the association.
Sources: SLA, BAS, SORS, Leaseurope

The Slovenian leasing market performed in line with expectations in the first half of 2008. When the financial turmoil spread to the real sector in the second half of the year, there was also an adverse impact on leasing. Leasing was profoundly affected last year by the turmoil in the financial sector and the real sector. The importance of leasing to the Slovenian economy has increased, particularly since 2005, the leasing penetration rate reaching 38.1% in 2008. Although the leasing penetration rate in Europe has declined,

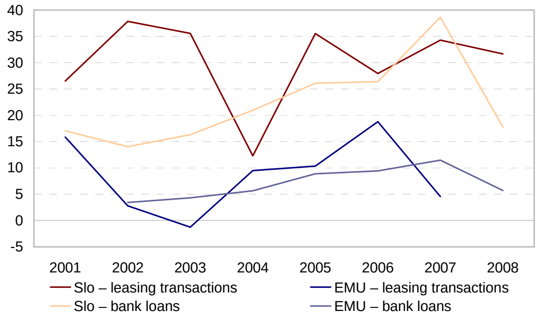
[68] The figures for the European leasing market were obtained by Leaseurope, the European leasing association. Leaseurope was estimated to account for 93% of the European leasing market in 2007.

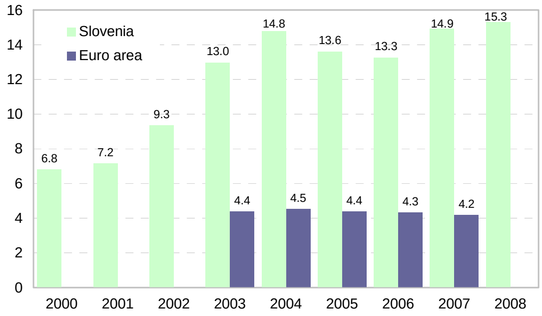
according to provisional figures leasing was used to finance approximately 28% of European investment.

Leasing is expanding as an alternative to more expensive bank loans.

Growth in new leasing business declined towards the end of last year. The weak economy brought reduced demand. The volume of leasing business nevertheless annually increased, primarily as an alternative to more expensive bank loans. The terms given to clients when having leasing loans approved are more flexible and less demanding than those for bank loans. Because household and corporate indebtedness is increasing, financing without thorough analysis of the lessee could lead to defaults. This could lead to an excess supply of contractual subjects on the market, which could consequently reduce their market value. The recoverable value of the subject would then not suffice to cover the debt. The burden of the defaults would then be transferred indirectly via leasing companies to the banking sector, as bank loans represent 70% of the funding for leasing companies.

Figure 7.28: Annual growth in the volume of leasing business concluded and bank loans granted to non-banking sectors (left) and ratio of leasing loans to bank loans (right) in percentages





Note: The figures for the volume of leasing business in the euro area do not include Luxembourg, Ireland or Greece.

Sources: SLA, BAS, Bank of Slovenia, Leaseurope, ECB

Leasing companies under the majority ownership of banks from the rest of the world had easier access to funding in 2008.

Given the domestic banks' difficulties with regard to long-term funding on the foreign financial markets, leasing companies owned by banks from the rest of the world were in a better position in the second half of 2008. They are able to exploit their competitive advantage in securing the necessary liquidity via credit lines at their bank owners. Interest-rate risk was realised at those undertakings that suffered losses because of mismatching between interest rate movements on the funding side and the interest rates concluded on investments.

Leasing is expected to decline, given the uncertainty over future economic growth. In the event of greater demand arising from insufficient willingness to lend to corporates on the part of banks, leasing will be restricted by leasing companies' difficulties in obtaining and rolling over funding.

Performance of Slovenian leasing companies

Growth in profit is declining.

Competition within the sector and from banks reduced growth in profit for the second consecutive year. Leasing companies are competing through greater flexibility in loan approval and lower lending rates, but are limited in this respect. Growth in the total assets of leasing companies increased again in 2007, more than in the previous year, the ratio to bank assets increasing to 12.6%. Leasing companies' liabilities to the rest of the world are declining. This is closing the ratio of net liabilities to the rest of the world to total assets, which stood at 66.7% at the end of 2007.

Table 7.8: Performance of leasing companies and sources of funding

						Growth rates (%)				
	2003	2004	2005	2006	2007	2003	2004	2005	2006	2007
Total assets (EUR million)	1,766	2,328	3,171	4,047	5,348	24.9	31.8	36.2	27.6	32.1
Capital (EUR million)	121	157	224	296	329	11.0	29.8	42.4	32.3	11.1
Total profit/loss (EUR million)	32	37	49	55	62	122.1	14.0	33.7	13.1	11.5
ROA (%)	2.0	1.8	1.8	1.5	1.3					
ROE (%)	27.8	26.2	25.6	21.2	19.7					
Financial and operating liabilities (EUR million)	1,622	2,147	2,931	3,724	4,985	27.4	32.4	36.5	27.1	33.8
Liabilities to banks and group companies (%)	83	85	83	93	94	39.6	35.7	32.7	43.3	35.6
Liabilities to the rest of the world (%)	79	82	78	74	72	35.3	38.0	29.9	20.8	29.2
Open foreign exchange position/assets (%)	-72.1	-75.5	-72.0	-68.2	-66.7					

Note: The figures from financial statements include all companies included under K64.91 (Financial leasing) in the SKD 2008 classification (J65.21 in the SKD 2002). Since 2006 the final accounts of companies have been compiled in accordance with the new Slovenian Accounting Standards (SAS 2006).

Source: AJPES

Leasing companies are increasingly funding themselves at domestic commercial banks.

Leasing companies received 93% of their funding from banks and undertakings in the group in 2007. At EUR 2.2 billion, domestic bank loans to leasing companies represented approximately 41% of leasing companies' liabilities at the end of 2007. The increase in this form of funding is also transferring a portion of credit risk to the banking sector. Loans to leasing companies accounted for approximately 7.7% of total domestic bank loans to non-banking sectors, comparable to 2006. There is no discernible sign of higher growth in this proportion, as a result of the banking sector's high lending activity. Financial risk as measured by the debt-to-equity ratio increased slightly in 2007.

8 FINANCIAL INFRASTRUCTURE

Payment systems and systems for the clearing and settlement of financial instruments ensure the transfer of money and financial instruments and the settlement of claims and liabilities arising in transactions in the real sector and on the financial markets. The financial infrastructure thus contributes to the normal functioning of the financial system, but at the same time can transmit or cause systemic shocks in the system.

8.1 Payment systems

Transactions via the TARGET2-Slovenija payment system were 11 times in excess of GDP in 2008.

Given its large transacted value, the TARGET2-Slovenija payment system has the greatest impact on financial stability in Slovenia. The large number of payments processed daily means that the Giro Clearing payment system designed for low-value credit payments is also important. The total transacted values in the TARGET2-Slovenija and Giro Clearing systems were 11.1 and 1.3 times in excess of Slovenia's GDP in 2008 respectively.

The TARGET2-Slovenija system is operated by the Bank of Slovenia as a component of the TARGET2 system. TARGET2 is the pan-European payment system for euro payments, and is operated by the Eurosystem based on a standard technological platform. In legal terms it is established as multiple national systems with harmonised general terms and conditions of business. Settlement of payments is effected individually and in real time, provided that the sender has sufficient assets for settlement and that there is no block on the sender's settlement account. Oversight of the TARGET2 system, the aim of which is to ensure that it functions securely and effectively, is conducted by the ECB and the participating national central banks of the Eurosystem. A comprehensive review of the operation of the TARGET2 system was conducted in 2008, and it proved to be functioning without disruption during the financial turmoil.

TARGET2-Slovenija and Giro Clearing were functioning without disruption during the financial turmoil.

Giro Clearing is a multilateral net payment system in which the Bank of Slovenia is a clearing and settlement agent. The system is designed for processing low-value credit payments of up to EUR 50,000. It includes the calculation of the net claims or net liabilities of individual members vis-à-vis the clearing group as a whole, and the settlement of the calculated net positions via members' accounts in the TARGET2-Slovenija system. In order to manage financial risk, the Giro Clearing system is supported by the Settlement Guarantee Scheme (SGS), which is based on a cash fund created by all system members other than the Bank of Slovenia. Even since the outbreak of the financial turmoil in 2007, there has been no need to activate the SGS.

Last year saw a slowdown in growth in transacted value and a decline in the number of transactions in the TARGET2-Slovenija system, while the Giro Clearing system recorded moderate growth. A major change in 2007 was brought by the increase in the maximum payment in the Giro Clearing system from EUR 8,346 to EUR 50,000.

Table 8.1: Value and number of transactions in the RTGS/TARGET/TARGET2[69] and Giro Clearing systems

					Year-on-year growth (%)			
	2005	2006	2007	2008	2005	2006	2007	2008
RTGS/TARGET/TARGET2[1]								
Value (EUR billion)	261.62	317.64	364.68	410.4	28.0	21.4	14.8	12.5
No. of transactions (mio)	1.40	1.57	0.73	0.70	2.40	11.60	-53.50	-9.60
Giro Clearing								
Value (EUR billion)	20.98	22.93	45.71	49.1	3.8	9.3	99.3	7.5
No. of transactions (mio)	49.42	52.11	53.62	55.9	1.7	5.4	2.9	4.3

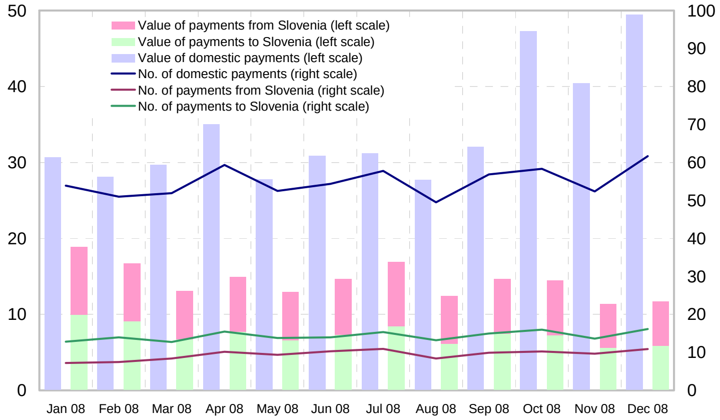
Note: [1]Transactions between members of the TARGET2-Slovenija system (domestic payments).
Source: Bank of Slovenia

The TARGET2-Slovenija system mediates transactions between members of the system, and their transactions with other members of the TARGET2 system outside Slovenia. The

[69] With the introduction of the euro on 1 January 2007, the Bank of Slovenia's real-time gross settlement (RTGS) system for high-value tolar payments was replaced by the TARGET system designed for the interbank transfer of funds in euros in real time. The changeover to the TARGET2 system, an upgrade of TARGET, was made in November 2007.

latter payments segment is smaller in terms of numbers and value, which limits the possibility of any cross-border transfer of risk. A monthly average of almost 55,000 transactions with a total value of EUR 34.2 billion were settled between members of the TARGET2-Slovenija system (i.e. in Slovenia) in 2008. Members of the TARGET2-Slovenija system received a monthly average of 14,000 cross-border payments with a total value of EUR 7.3 billion from other members of the TARGET2 system, and sent a monthly average of 9,000 payments with a total value of EUR 7.1 billion. The value of domestic payments in the final quarter of 2008 was up one-half on the third quarter as a result of payments into the deposit facility at the Eurosystem and the consequent repayments of principal. The undisrupted functioning of the TARGET2-Slovenija system thus ensured that Slovenian banks were able to use the instrument made available by the Eurosystem to mitigate the effects of the escalation of the crisis, but also sharply increased the banking system's exposure to its operational risk. Should it be realised, the functioning of the Eurosystem would be disrupted, which would increase banks' liquidity risk.

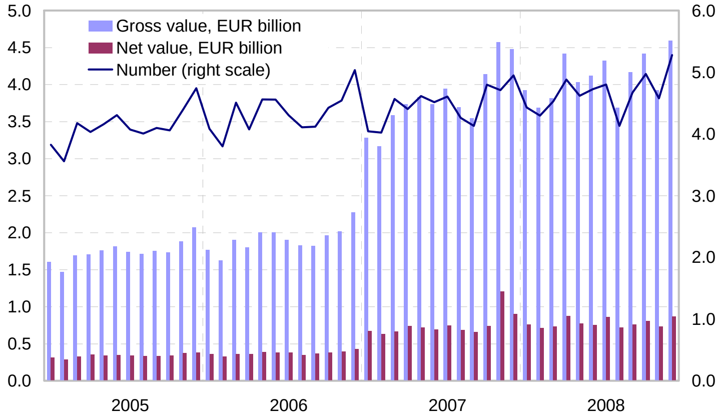
Figure 8.1: TARGET2-Slovenija (domestic payments) and cross-border payments: value in EUR billion (left scale) and number in thousand (right scale)



Source: Bank of Slovenia

There was an average of 4.66 million transactions worth EUR 4.1 billion settled each month in the Giro Clearing system in 2008. The average monthly net value of settled transactions was EUR 0.8 billion.

Figure 8.2: Monthly value (in EUR billion; left scale) and number of transactions (in million; right scale) in the Giro Clearing system



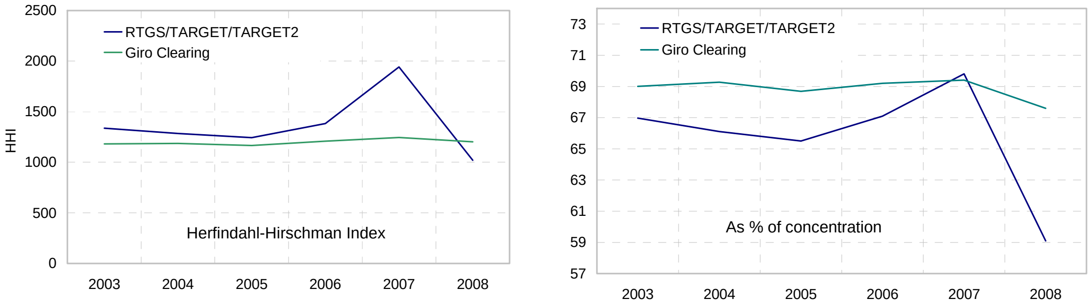
Source: Bank of Slovenia

Great focus in the operation of the two systems is devoted to the management of operational risk, which is reflected in the figures for system availability. The TARGET2-Slovenija system achieved 99.95% operability in 2008, and the Giro Clearing system 99.92% operability.

The reduced concentration in the number of transactions means that TARGET2-Slovenija's exposure to systemic risk is lower.

The concentration in the number of transactions by participant as one of the indicators of systemic risk in a payment system is illustrated by the Herfindahl-Hirschman index. Concentration in the TARGET2-Slovenija system was down sharply on 2007, to reach its lowest level for five years. The proportion accounted for by the five largest system participants in terms of number of transactions was down significantly on 2007, by 10.8 percentage points. There was no significant change in concentration in the Giro Clearing system, the proportion accounted for by the five largest participants declining by 1.8 percentage points from 2007.

Figure 8.3: Concentration of the number of transactions in the RTGS/TARGET/TARGET2 and Giro Clearing systems (Herfindahl-Hirschman Index; left) and proportion of total number of transactions accounted for by the five largest participants (excluding Bank of Slovenia; right)



Source: Bank of Slovenia

8.2 Systems for clearing and settlement of financial instruments

The importance of risk management in the clearing and settlement system is rising as a result of the increased use of eligible collateral for Eurosystem operations.

The Central Securities Clearing Corporation (CSCC) is the sole institution in Slovenia to provide the services of the clearing and settlement of financial instruments and securities. The Bank of Slovenia uses its securities settlement system for the needs of collateralising monetary instrument operations under the principle of securities settlement without simultaneous cash payment. On the basis of the statute of the European System of Central Banks, all Eurosystem central bank credit operations must be fully collateralised by means of eligible securities registered in securities settlement systems, which must comply with Eurosystem requirements. In order to ensure adequate risk management, in 2008 the Bank of Slovenia and the ECB conducted an assessment of the CSCC's suitability for use in central banking operations, as part of a reassessment of the suitability of all securities settlement systems in the euro area and the links between them. The suitability of the CSCC's two existing links with foreign securities settlement systems, Clearstream Banking Frankfurt and Clearstream Banking Luxembourg, was assessed at the same time.

Risk management grew in importance in 2008 as a result of the increasing use of eligible securities registered at the CSCC as collateral for Eurosystem central bank credit operations. Slovenian banks together posted an average of EUR 1,143 million worth of eligible domestic securities as collateral each month in 2008, up 13.4% on 2007. A significant increase in the use of domestic securities was only discernible in the final quarter of 2008, when the average monthly value of collateral amounted to EUR 1,368 million. At the same time the use of the correspondent central banking model (which provides for the use of cross-border financial assets as collateral for Eurosystem credit operations) increased foreign banks' interest in using securities registered at the CSCC. While the average monthly value of domestic securities used as collateral for the credit operations of other Eurosystem banks stood at EUR 5 million in 2007, it increased to EUR 68 million in 2008.

STATISTICAL APPENDIX

1. Inter-sector financial claims and liabilities

Tabela 1.1 Inter-sector financial claims and liabilities of the institutional sectors of the Slovenian economy at the end of the third quarter of 2008 as a percentage of GDP

(% of GDP)	Claims						
	Domestic sector					Rest of	Total
Liabilities	Corporates	Financial sector	Government	Households	Total	the world	liabilities
Corporates	72.8	73.5	24.2	30.3	200.8	42.2	243.0
Cash and deposits	0.0	0.0	0.0	0.0	0.0	0.0	
Securities except shares	0.3	1.1	0.1	0.1	1.6	0.2	
Loans	9.0	63.3	0.8	2.2	75.3	12.4	
Equity	39.0	7.8	18.9	23.5	89.1	16.1	
Technical provisions	0.0	0.0	0.0	0.0	0.0	0.0	
Other	24.5	1.3	4.4	4.5	34.8	13.5	
Financial sector	18.9	26.4	12.6	53.1	111.0	77.2	188.1
Cash and deposits	10.4	7.2	6.6	35.9	60.2	29.8	
Securities except shares	0.5	2.8	0.3	0.2	3.7	1.4	
Loans	0.7	10.1	0.0	0.1	11.0	39.8	
Equity	5.2	5.3	4.4	7.4	22.3	5.5	
Technical provisions	1.1	0.6	0.0	9.0	10.7	0.2	
Other	1.0	0.4	1.3	0.5	3.0	0.4	
Government	6.0	10.8	14.1	2.0	32.9	11.5	44.4
Cash and deposits	0.0	0.0	0.0	0.1	0.1	0.0	
Securities except shares	0.3	8.9	0.4	0.8	10.4	9.7	
Loans	0.5	1.5	4.0	0.0	6.0	0.4	
Equity	0.0	0.0	7.3	0.0	7.3	0.0	
Technical provisions	0.0	0.0	0.0	0.0	0.0	0.0	
Other	5.3	0.4	2.4	1.0	9.2	1.3	
Households	3.7	25.5	0.8	0.0	30.0	0.0	30.0
Cash and deposits	0.0	0.0	0.0	0.0	0.0	0.0	
Securities except shares	0.0	0.0	0.0	0.0	0.0	0.0	
Loans	1.0	24.6	0.2	0.0	25.8	0.0	
Equity	0.0	0.0	0.0	0.0	0.0	0.0	
Technical provisions	0.0	0.0	0.0	0.0	0.0	0.0	
Other	2.6	0.8	0.7	0.0	4.1	0.0	
Total	101.5	136.3	51.9	85.4	375.0	130.9	505.9
Cash and deposits	10.4	7.2	6.6	36.0	60.3	29.8	
Securities except shares	1.1	12.8	0.7	1.1	15.8	11.3	
Loans	11.2	99.7	5.0	2.3	118.3	52.7	
Equity	44.2	13.1	30.6	30.9	118.7	21.6	
Technical provisions	1.1	0.6	0.0	9.0	10.7	0.2	
Other	33.4	2.9	8.8	6.0	51.2	15.2	
Rest of the world	28.1	54.8	2.1	16.0	101.1		101.1
Cash and deposits	0.5	9.2	0.6	14.3	24.7		
Securities except shares	0.2	28.5	0.6	0.1	29.4		
Loans	3.9	9.2	0.0	0.0	13.1		
Equity	7.8	6.6	0.6	1.3	16.3		
Technical provisions	0.0	0.1	0.0	0.2	0.4		
Other	15.8	1.1	0.4	0.0	17.3		
Total claims	129.6	191.1	54.0	101.4	476.1	130.9	606.9

Note: The table is based on financial accounts compiled by the Bank of Slovenia. The unconsolidated figures have been restructured into the form of a matrix with the aim of illustrating the underlying mutual financial ties between domestic institutional sectors and the rest of the world. The household sector (S.14) complies with the financial accounts methodology.

Source: Bank of Slovenia

Tabela 1.2 Inter-sector financial claims and liabilities of the institutional sectors of the Slovenian economy at the end of 2007 as a percentage of GDP

(% of GDP)	Claims						
	Domestic sector					Rest of	Total
Liabilities	Corporates	Financial sector	Government	Households	Total	the world	liabilities
Corporates	76.5	72.2	31.5	33.0	213.2	41.9	255.0
Cash and deposits	0.0	0.0	0.0	0.0	0.0	0.0	
Securities except shares	0.3	1.1	0.1	0.1	1.6	0.1	
Loans	7.5	57.9	0.8	2.3	68.5	10.3	
Equity	43.8	11.8	25.6	26.3	107.4	18.6	
Technical provisions	0.0	0.0	0.0	0.0	0.0	0.0	
Other	24.9	1.4	5.0	4.3	35.6	12.8	
Financial sector	19.9	26.2	13.1	56.6	115.8	73.3	189.1
Cash and deposits	10.8	7.1	5.7	36.1	59.7	28.3	
Securities except shares	0.6	3.0	0.4	0.1	4.2	1.2	
Loans	0.6	8.7	0.0	0.1	9.5	38.0	
Equity	5.8	6.6	5.5	10.8	28.7	5.4	
Technical provisions	1.1	0.5	0.1	8.9	10.6	0.2	
Other	1.0	0.3	1.4	0.5	3.1	0.3	
Government	5.6	12.7	17.1	1.9	37.4	9.6	46.9
Cash and deposits	0.0	0.0	0.0	0.1	0.1	0.0	
Securities except shares	0.3	10.6	0.5	0.9	12.3	8.2	
Loans	0.5	1.6	3.5	0.0	5.7	0.6	
Equity	0.0	0.0	10.3	0.0	10.3	0.0	
Technical provisions	0.0	0.0	0.0	0.0	0.0	0.0	
Other	4.7	0.5	2.8	0.9	8.9	0.8	
Households	3.7	24.4	0.7	0.0	28.8	0.0	28.8
Cash and deposits	0.0	0.0	0.0	0.0	0.0	0.0	
Securities except shares	0.0	0.0	0.0	0.0	0.0	0.0	
Loans	1.1	23.5	0.2	0.0	24.8	0.0	
Equity	0.0	0.0	0.0	0.0	0.0	0.0	
Technical provisions	0.0	0.0	0.0	0.0	0.0	0.0	
Other	2.6	0.9	0.6	0.0	4.1	0.0	
Total	105.8	135.7	62.5	91.5	395.5	124.8	520.2
Cash and deposits	10.8	7.1	5.7	36.2	59.8	28.3	
Securities except shares	1.3	14.8	1.0	1.1	18.1	9.5	
Loans	9.7	91.9	4.6	2.4	108.7	48.9	
Equity	49.6	18.4	41.4	37.1	146.5	24.0	
Technical provisions	1.1	0.5	0.1	8.9	10.6	0.2	
Other	33.3	3.0	9.8	5.7	51.8	13.9	
Rest of the world	26.0	59.3	1.6	15.7	102.5		102.5
Cash and deposits	0.5	13.9	0.0	12.5	26.9		
Securities except shares	0.2	27.1	0.5	0.2	28.0		
Loans	3.0	8.1	0.0	0.0	11.2		
Equity	8.3	8.9	0.7	2.7	20.5		
Technical provisions	0.0	0.1	0.0	0.3	0.3		
Other	14.0	1.2	0.4	0.0	15.6		
Total claims	131.8	195.0	64.1	107.2	498.0	124.8	622.8

Note: The table is based on financial accounts compiled by the Bank of Slovenia. The unconsolidated figures have been restructured into the form of a matrix with the aim of illustrating the underlying mutual financial ties between domestic institutional sectors and the rest of the world. The household sector (S.14) complies with the financial accounts methodology.

Source: Bank of Slovenia

Tabela 1.3 Inter-sector financial claims and liabilities of the institutional sectors of the Slovenian economy at the end of 2006 as a percentage of GDP

(% of GDP)	Claims						
	Domestic sector					Rest of	Total
Liabilities	Corporates	Financial sector	Government	Households	Total	the world	liabilities
Corporates	68.8	60.4	28.8	30.8	188.9	40.7	229.6
Cash and deposits	0.0	0.0	0.0	0.0	0.0	0.0	
Securities except shares	0.3	1.1	0.1	0.1	1.6	0.1	
Loans	6.7	47.5	0.9	2.5	57.6	9.8	
Equity	38.7	10.4	23.3	23.9	96.4	18.1	
Technical provisions	0.0	0.0	0.0	0.0	0.0	0.0	
Other	23.2	1.4	4.5	4.3	33.4	12.7	
Financial sector	18.8	32.1	12.1	54.5	117.5	52.0	169.5
Cash and deposits	10.9	10.8	5.1	37.4	64.3	12.5	
Securities except shares	0.8	9.0	0.4	0.1	10.3	1.3	
Loans	0.3	6.6	0.0	0.1	7.0	32.9	
Equity	4.9	4.6	5.1	7.9	22.5	4.5	
Technical provisions	1.1	0.7	0.1	8.6	10.4	0.3	
Other	0.9	0.2	1.4	0.4	2.9	0.4	
Government	5.6	17.5	11.9	2.0	37.1	8.4	45.5
Cash and deposits	0.0	0.0	0.0	0.0	0.0	0.0	
Securities except shares	0.7	15.0	0.8	1.2	17.7	6.9	
Loans	0.4	2.1	1.5	0.0	4.0	0.8	
Equity	0.0	0.0	7.6	0.0	7.6	0.0	
Technical provisions	0.0	0.0	0.0	0.0	0.0	0.0	
Other	4.6	0.4	1.9	0.8	7.7	0.8	
Households	3.8	21.2	0.6	0.0	25.6	0.2	25.8
Cash and deposits	0.0	0.0	0.0	0.0	0.0	0.0	
Securities except shares	0.0	0.0	0.0	0.0	0.0	0.0	
Loans	1.1	20.2	0.2	0.0	21.5	0.2	
Equity	0.0	0.0	0.0	0.0	0.0	0.0	
Technical provisions	0.0	0.0	0.0	0.0	0.0	0.0	
Other	2.7	0.9	0.5	0.0	4.1	0.1	
Total	97.1	131.3	53.5	87.4	369.3	101.4	470.7
Cash and deposits	10.9	10.8	5.1	37.5	64.3	12.5	
Securities except shares	1.7	25.1	1.3	1.4	29.6	8.3	
Loans	8.4	76.6	2.6	2.6	90.3	43.8	
Equity	43.6	15.0	36.1	31.9	126.5	22.6	
Technical provisions	1.1	0.7	0.1	8.6	10.4	0.3	
Other	31.5	3.0	8.3	5.5	48.2	14.0	
Rest of the world	24.5	43.0	1.3	14.4	83.2		83.2
Cash and deposits	0.3	8.8	0.0	11.7	20.9		
Securities except shares	0.1	23.1	0.3	0.1	23.6		
Loans	1.9	4.2	0.0	0.0	6.1		
Equity	7.0	5.9	0.5	2.1	15.5		
Technical provisions	0.0	0.1	0.0	0.3	0.4		
Other	15.2	0.8	0.4	0.3	16.8		
Total claims	121.6	174.3	54.8	101.8	452.5	101.4	553.9

Note: The table is based on financial accounts compiled by the Bank of Slovenia. The unconsolidated figures have been restructured into the form of a matrix with the aim of illustrating the underlying mutual financial ties between domestic institutional sectors and the rest of the world. The household sector (S.14) complies with the financial accounts methodology.

Source: Bank of Slovenia

2. Financial system

Tabela 2.1 Structure of the financial system

	Total assets (EUR million)		Structure (%)		As % of GDP		No. of institutions	
	2007	2008	2007	2008	2007	2008	2007	2008
Monetary financial institutions[1]	42,598	47,820	72.2	76.9	123.6	128.8	27	21
Banks	42,343	47,501	71.8	76.4	122.8	127.9	24	18
Banks under private ownership	34,467	38,380	58.4	61.7	100.0	103.4	-	-
Domestic	16,853	18,858	28.6	30.3	48.9	50.8	-	-
Foreign	17,615	19,523	29.9	31.4	51.1	52.6	-	-
Banks under gov. ownership	7,876	9,120	13.4	14.7	22.8	24.6	-	-
Saving banks	255	320	0.4	0.5	0.7	0.9	3	3
Non-monetary financial institutions	16,388	14,354	27.8	23.1	47.5	38.7	-	-
Insurers[2]	5,035	5,189	8.5	8.3	14.6	14.0	16	17
Pension funds[3]	1,001	1,039	1.7	1.7	2.9	2.8	10	10
Investment funds	4,138	1,912	7.0	3.1	12.0	5.1	116	131
Leasing companies[4, 5]	5,348	5,348	9.1	8.6	15.5	14.4	20	22
BHs, MCs and others[5]	867	867	1.5	1.4	2.5	2.3	-	-
Total	58,986	62,174	100.0	100.0	171.1	167.5	-	-

Notes: Figures for financial institutions that are not banks, insurers, pension companies or pension and investment funds are obtained from the AJPES database of annual accounts based on the 2008 Standard Classification of Activities.
[1] Monetary financial institutions do not include the central bank. 2 Figures for total assets of reinsurance companies are for the end of the third quarter of 2008. 3 Includes the First Pension Fund. 4 The figures for the number of leasing companies comprise the number of active members of the SLA in 2007, and the number of leasing companies being monitored by the BAS's leasing committee in 2008. 5 Total assets according to figures for the end of 2007.
Sources: Bank of Slovenia, ISA, SMA, SLA, AJPES, BAS

Tabela 2.2 Market concentration of individual types of financial institution

		Banks		Insurers		Pension funds		Investment funds		Leasing companies	
		2007	2008	2007	2008	2007	2008	2007	2008	2007	2008
HHI	All companies	1,301	1,265	2,587	2,389	2,068	2,052	537	555	1,701	1,903
	Five largest	1,167	1,121	2,534	2,329	2,058	2,042	435	464	1,566	1,801
Share (%)	Five largest	60	59	78	77	94	94	42	42	68	72
	Largest	31	30	48	45	29	29	13	14	36	39

Note: The Herfindahl-Hirschman Index (HHI) is calculated in terms of total assets, with the exception of leasing companies, for which it is calculated in terms of volume of business. The figures for pension funds do not include the First Pension Fund, which is a closed pension fund that does not envisage further inflows.
Sources: Bank of Slovenia, ISA, SMA, SLA, AJPES

Tabela 2.3 Financial indicators for individual types of financial institution

	2004	2005	2006	2007	2008
			Pre-tax profit (EUR million)		
Banks	234.2	261.2	393.7	514.2	305.4
Insurers and reinsurance companies[1]	22.7	47.2	67.8	117.5	10.0
Leasing companies	37.0	49.0	55.0	61.5	
Management companies	17.0	18.0	17.0	34.6	
			ROA (%)		
Banks	1.10	1.00	1.30	1.36	0.67
Insurers and reinsurance companies[1]	0.79	1.45	1.74	2.33	0.19
Leasing companies	1.82	1.79	1.53	1.31	
Management companies	13.12	14.01	11.64	12.76	
			ROE (%)		
Banks	12.70	12.70	15.10	16.29	8.12
Insurers and reinsurance companies[1]	4.53	8.66	9.69	10.47	0.75
Leasing companies	26.44	25.57	21.24	19.70	
Management companies	20.79	20.24	16.74	18.34	

Note: [1] Net profit for the financial year (profit after tax) is taken into account for insurance companies and reinsurance companies. The figures for reinsurance companies are for the first three quarters of 2008.
Sources: Bank of Slovenia, ISA, AJPES

Tabela 2.4 Direct ownership structure of the Slovenian financial system (shares valued at market price or book value) in percentages

HOLDERS \ ISSUERS	Banks	Other financial intermediaries	Insurers and pension funds	Corporates	Total
			Ownership structure (%)		
2004					
Non-financial corporations	25	23	12	26	25
Banks	10	7	7	2	4
Other financial intermediaries	5	12	16	20	17
Insurers and pension funds	3	7	10	2	3
Government	23	0	44	17	17
Households	2	43	1	18	18
Non-residents	30	3	8	10	12
Other	1	4	1	5	5
Total	100	100	100	100	100
2005					
Non-financial corporations	24	30	14	31	29
Banks	8	8	7	3	4
Other financial intermediaries	2	9	1	11	10
Insurers and pension funds	3	8	10	1	2
Government	23	8	54	23	23
Households	2	34	1	17	16
Non-residents	36	2	10	11	13
Other	2	2	0	3	2
Total	100	100	100	100	100
2006					
Non-financial corporations	24	29	16	29	28
Banks	8	10	5	3	5
Other financial intermediaries	2	15	1	9	8
Insurers and pension funds	3	6	9	2	3
Government	20	7	56	25	24
Households	2	30	4	18	16
Non-residents	39	1	8	11	15
Other	1	2	1	3	2
Total	100	100	100	100	100
2007					
Non-financial corporations	17	33	22	32	30
Banks	7	8	6	2	3
Other financial intermediaries	5	16	1	10	9
Insurers and pension funds	3	7	9	2	2
Government	26	1	47	24	23
Households	8	32	6	19	18
Non-residents	34	2	9	11	13
Other	1	2	1	1	1
Total	100	100	100	100	100
2008					
Non-financial corporations	23	31	19	39	35
Banks	5	4	11	3	4
Other financial intermediaries	5	19	4	8	8
Insurers and pension funds	5	4	15	1	3
Government	21	1	31	20	19
Households	3	25	5	15	13
Non-residents	37	13	15	13	17
Other	1	3	1	2	1
Total	100	100	100	100	100

Note: The figures for the proportion of issued shares held by the government for 2004 and 2005 are not comparable, as in October 2005 Kapitalska družba was reclassified from the sector of other financial intermediaries (S.123) to the government sector (S.13).

Sources: CSCC, own calculations

3. Banking sector

Tabela 3.1 Banking sector's balance sheet: amounts in EUR million and growth rates in percentages

	(EUR million)					Growth rate (%)				
	2004	2005	2006	2007	2008	2004	2005	2006	2007	2008
ASSETS	23,691	29,287	33,868	42,343	47,498	12.3	23.6	15.6	25.0	12.2
1) Cash	589	599	1,057	604	1,243	-0.3	1.9	76.3	-42.9	105.9
2) Loans to banks (including BoS)	2,118	2,872	3,067	4,072	4,023	47.0	35.6	6.8	32.8	-1.2
3) Loans to non-banking sectors	12,810	16,149	20,414	28,302	33,313	21.0	26.1	26.4	38.6	17.7
3.1 Currency breakdown										
Domestic currency	8,349	8,757	9,095	26,669	31,290	10.6	4.9	3.9	193.2	17.3
Foreign currency	4,461	7,392	11,320	1,633	2,023	46.5	65.7	53.1	-85.6	23.9
3.2 Maturity breakdown										
Short-term	4,369	5,219	6,821	9,893	12,321	14.5	19.5	30.7	45.0	24.5
Long-term	8,441	10,931	13,593	18,409	20,992	24.6	29.5	24.4	35.4	14.0
3.3 Sector breakdown										
Non-financial corporations	8,087	9,908	12,364	17,039	20,034	21.4	22.5	24.8	37.8	17.6
Household	3,186	4,078	5,060	6,429	7,386	21.4	28.0	24.1	27.1	14.9
Government	596	665	574	465	506	0.7	11.6	-13.8	-18.9	8.9
Others	940	1,498	2,417	4,369	5,386	32.4	59.4	61.3	80.7	23.3
4) Financial assets/securities	6,904	8,243	7,719	7,459	7,093	-4.4	19.4	-6.4	-3.4	-4.9
4.1 Currency breakdown										
Domestic currency	3,964	5,406	5,014	6,506	6,232	-5.5	36.4	-7.2	29.7	-4.2
Foreign currency	2,545	2,254	2,006	56	21	-5.0	-11.5	-11.0	-97.2	-63.0
4.2 Maturity breakdown										
Short-term	3,336	3,595	2,101	1,192	1,107	-24.1	7.8	-41.6	-43.3	-7.2
Long-term	3,173	4,064	4,919	5,369	5,146	28.0	28.1	21.1	9.1	-4.2
4.3 Sector breakdown										
Government	2,508	2,706	2,718	4,283	4,079	21.7	7.9	0.5	57.5	-4.8
Bank of Slovenia	3,198	3,501	1,789	0	0	-25.4	9.5	-48.9	….	…
Others	1,198	2,037	3,211	3,176	3,014	36.6	70.0	57.7	-1.1	-5.1
5) Capital investments	319	356	427	615	627	8.3	11.6	19.9	43.9	2.0
6) Other	952	931	1,006	1,031	1,013	-0.6	-2.2	8.0	2.5	-1.7
LIABILITIES	23,691	29,287	33,868	42,343	47,498	12.3	23.6	15.6	25.0	12.2
1) Liabilities to banks (including BoS)	4,664	8,397	10,797	16,086	19,263	33.7	80.0	28.6	49.0	19.8
Foreign banks	4,235	7,892	10,112	14,410	16,002	43.6	86.4	28.1	42.5	11.1
2) Deposits to non-banking sectors	14,716	16,018	17,507	19,381	20,597	7.0	8.8	9.3	10.7	6.3
2.1 Currency breakdown										
Domestic currency	9,623	10,716	11,653	18,848	20,112	4.9	11.4	8.7	61.7	6.7
Foreign currency	5,092	5,300	5,853	532	485	11.3	4.1	10.4	-90.9	-8.9
2.2 Maturity breakdown										
Short-term	12,644	14,017	15,341	17,626	18,136	11.6	10.9	9.4	14.9	2.9
Long-term	2,071	1,999	2,165	1,754	2,461	-14.2	-3.5	8.3	-19.0	40.3
2.3 Sector breakdown										
Non-financial corp. & OFI	3,888	4,340	4,787	4,819	4,755	5.8	11.6	10.3	0.7	-1.3
Household	9,946	10,545	11,322	12,370	13,513	9.5	6.0	7.4	9.3	9.2
Government	565	867	1,114	1,510	1,857	-14.3	53.4	28.5	35.6	22.9
Others	316	266	285	681	472	-3.8	-15.6	6.9	139.0	-30.7
3) Securities	939	992	976	963	1,259	4.0	5.7	-1.6	-1.3	30.6
3.1 Currency breakdown										
Domestic currency	923	973	969	962	1,259	4.6	5.5	-0.4	-0.7	30.8
Foreign currency	16	19	7	1	0	-22.8	17.6	-63.9	-85.1	-95.1
3.2 Maturity breakdown										
Short-term	77	21	8	11	108	-10.7	-73.3	-63.0	49.4	845.6
Long-term	861	971	968	952	1,151	5.5	12.8	-0.3	-1.7	20.9
4) Provisions	502	180	184	208	174	18.8	-64.1	2.2	12.6	-16.0
5) Subordinated debt	599	709	993	1,470	1,597	49.7	18.4	40.0	48.1	8.6
6) Capital	1,918	2,486	2,841	3,556	3,996	9.7	29.6	14.3	25.2	12.4
7) Other	354	505	570	680	612	-8.9	42.7	12.8	19.3	-9.9

Notes: Converted to euros at the conversion rate.
The 2006, 2007 and 2008 figures are those reported under the IFRS, while those for previous years are based on estimated values in accordance with the IFRS.

Source: Bank of Slovenia

Tabela 3.2 Banking sector's balance sheet: as a proportion of total assets, and as a proportion of GDP in percentages

	Proportion of total assets (%)					As % of GDP				
	2004	2005	2006	2007	2008	2004	2005	2006	2007	2008
ASSETS	100.0	100.0	100.0	100.0	100.0	87.5	102.0	109.2	122.8	127.9
1) Cash	2.5	2.0	3.1	1.4	2.6	2.2	2.1	3.4	1.8	3.3
2) Loans to banks (including BoS)	8.9	9.8	9.1	9.6	8.5	7.8	10.0	9.9	11.8	10.8
3) Loans to non-banking sectors	54.1	55.1	60.3	66.8	70.1	47.3	56.3	65.8	82.1	89.7
3.1 Currency breakdown										
Domestic currency	35.2	29.9	26.9	63.0	65.9	30.8	30.5	29.3	77.4	84.3
Foreign currency	18.8	25.2	33.4	3.9	4.3	16.5	25.8	36.5	4.7	5.4
3.2 Maturity breakdown						0.0	0.0	0.0	0.0	0.0
Short-term	18.4	17.8	20.1	23.4	25.9	16.1	18.2	22.0	28.7	33.2
Long-term	35.6	37.3	40.1	43.5	44.2	31.2	38.1	43.8	53.4	56.5
3.3 Sector breakdown										
Non-financial corporations	34.1	33.8	36.5	40.2	42.2	29.9	34.5	39.9	49.4	54.0
Household	13.5	13.9	14.9	15.2	15.6	11.8	14.2	16.3	18.7	19.9
Government	2.5	2.3	1.7	1.1	1.1	2.2	2.3	1.9	1.3	1.4
Others	4.0	5.1	7.1	10.3	11.3	3.5	5.2	7.8	12.7	14.5
4) Financial assets/securities	29.1	28.1	22.8	17.6	14.9	25.5	28.7	24.9	21.6	19.1
4.1 Currency breakdown										
Domestic currency	16.7	18.5	14.8	15.4	13.1	14.6	18.8	16.2	18.9	16.8
Foreign currency	10.7	7.7	5.9	0.1	0.0	9.4	7.9	6.5	0.2	0.1
4.2 Maturity breakdown						0.0	0.0	0.0	0.0	0.0
Short-term	14.1	12.3	6.2	2.8	2.3	12.3	12.5	6.8	3.5	3.0
Long-term	13.4	13.9	14.5	12.7	10.8	11.7	14.2	15.9	15.6	13.9
4.3 Sector breakdown										
Government	10.6	9.2	8.0	10.1	8.6	9.3	9.4	8.8	12.4	11.0
Bank of Slovenia	13.5	12.0	5.3	0.0	0.0	11.8	12.2	5.8	0.0	0.0
Others	5.1	7.0	9.5	7.5	6.3	4.4	7.1	10.4	9.2	8.1
5) Capital investments	1.3	1.2	1.3	1.5	1.3	1.2	1.2	1.4	1.8	1.7
6) Other	4.0	3.2	3.0	2.4	2.1	3.5	3.2	3.2	3.0	2.7
LIABILITIES	100	100	100	100	100	87.5	102.0	109.2	122.8	127.9
1) Liabilities to banks (including BoS)	19.7	28.7	31.9	38.0	40.6	17.2	29.3	34.8	46.7	51.9
Foreign banks	17.9	26.9	29.9	34.0	33.7	15.6	27.5	32.6	41.8	43.1
2) Deposits to non-banking sectors	62.1	54.7	51.7	45.8	43.4	54.4	55.8	56.5	56.2	55.5
2.1 Currency breakdown										
Domestic currency	40.6	36.6	34.4	44.5	42.3	35.5	37.3	37.6	54.7	54.2
Foreign currency	21.5	18.1	17.3	1.3	1.0	18.8	18.5	18.9	1.5	1.3
2.2 Maturity breakdown						0.0	0.0	0.0	0.0	0.0
Short-term	53.4	47.9	45.3	41.6	38.2	46.7	48.8	49.5	51.1	48.8
Long-term	8.7	6.8	6.4	4.1	5.2	7.7	7.0	7.0	5.1	6.6
2.3 Sector breakdown										
Non-financial corp. & OFI	16.4	14.8	14.1	11.4	10.0	14.4	15.1	15.4	14.0	12.8
Household	42.0	36.0	33.4	29.2	28.4	36.7	36.7	36.5	35.9	36.4
Government	2.4	3.0	3.3	3.6	3.9	2.1	3.0	3.6	4.4	5.0
Others	1.3	0.9	0.8	1.6	1.0	1.2	0.9	0.9	2.0	1.3
3) Securities	4.0	3.4	2.9	2.3	2.6	3.5	3.5	3.1	2.8	3.4
3.1 Currency breakdown										
Domestic currency	3.9	3.3	2.9	2.3	2.6	3.4	3.4	3.1	2.8	3.4
Foreign currency	0.1	0.1	0.0	0.0	0.0	0.1	0.1	0.0	0.0	0.0
3.2 Maturity breakdown										
Short-term	0.3	0.1	0.0	0.0	0.2	0.3	0.1	0.0	0.0	0.3
Long-term	3.6	3.3	2.9	2.2	2.4	3.2	3.4	3.1	2.8	3.1
4) Provisions	2.1	0.6	0.5	0.5	0.4	1.9	0.6	0.6	0.6	0.5
5) Subordinated debt	2.5	2.4	2.9	3.5	3.4	2.2	2.5	3.2	4.3	4.3
6) Capital	8.1	8.5	8.4	8.4	8.4	7.1	8.7	9.2	10.3	10.8
7) Other	1.5	1.7	1.7	1.6	1.3	1.3	1.8	1.8	2.0	1.6

Source: Bank of Slovenia

Tabela 3.3 Banking sector's income statement: amounts in EUR million and growth rates in percentages

	(EUR million)					Growth rate (%)				
	2004	2005	2006	2007	2008	2004	2005	2006	2007	2008
1. Net interest income	599	631	690	811	939	-1.4	5.4	9.2	17.5	15.8
1.1 Interest income	1,194	1,198	1,421	1,943	2,604	-13.6	0.3	18.6	36.7	34.0
1.2 Interest expenses	595	567	731	1,133	1,665	-23.1	-4.8	29.0	54.9	47.0
2. Net non-interest income	383	417	526	617	415	17.3	9.0	26.0	17.3	-32.8
2.1 Net fees and commissions	258	282	309	335	339	12.7	9.1	9.5	8.7	1.0
2.2 Net financial operations	84	71	97	136	-115	25.9	-15.7	37.2	39.7	-184.4
2.3 Net other	40	65	120	146	190	33.5	60.0	85.7	21.5	30.7
3. Gross income (1+2)	982	1,049	1,216	1,428	1,354	5.2	6.8	15.9	17.4	-5.2
4. Operating costs	612	647	702	753	773	3.6	5.8	8.5	7.2	2.7
Labour costs	326	342	367	400	410	7.4	5.0	7.3	8.8	2.6
5. Net income (3-4)	370	401	513	675	581	7.9	8.5	28.0	31.5	-13.9
6. Net provisions	136	140	120	161	277	-5.4	3.2	-14.5	34.6	71.8
7. Total costs (4+6)	748	787	822	914	1,050	1.8	5.3	4.4	11.2	14.8
8. Pre-tax profit (3-7)	234	261	394	514	304	17.5	11.5	50.7	30.5	-40.8
9. Taxes	81	52	91	102	54	17.9	-35.9	75.5	11.9	-46.6
10 Net profit (8-9)	153	209	303	412	250	17.3	36.5	44.6	36.1	-39.4

Notes: Converted to euros at the conversion rate.
The 2006, 2007 and 2008 figures are those reported under the IFRS, while those for previous years are based on estimated values in accordance with the IFRS.

Source: Bank of Slovenia

Tabela 3.4 Banking sector's income statement: as a proportion of gross income and as a proportion of total assets in percentages

	Proportion of gross income (%)					Ratio to total assets (%)				
	2004	2005	2006	2007	2008	2004	2005	2006	2007	2008
1. Net interest income	61	60	57	57	69	2.5	2.2	2.0	1.9	2.0
1.1 Interest income	122	114	117	136	192	5.0	4.1	4.2	4.6	5.5
1.2 Interest expenses	61	54	60	79	123	2.5	1.9	2.2	2.7	3.5
2. Net non-interest income	39.0	39.8	43.3	43.2	30.6	1.6	1.4	1.6	1.5	0.9
2.1 Net fees and commissions	26	27	25	23	25	1.1	1.0	0.9	0.8	0.7
2.2 Net financial operations	9	7	8	10	-8	0.4	0.2	0.3	0.3	-0.2
2.3 Net other	4	6	10	10	14	0.2	0.2	0.4	0.3	0.4
3. Gross income (1+2)	100	100	100	100	100	4.1	3.6	3.6	3.4	2.8
4. Operating costs	62	62	58	53	57	2.6	2.2	2.1	1.8	1.6
Labour costs	33	33	30	28	30	1.4	1.2	1.1	0.9	0.9
5. Net income (3-4)	38	38	42	47	43	1.6	1.4	1.5	1.6	1.2
6. Net provisions	14	13	10	11	20	0.6	0.5	0.4	0.4	0.6
7. Total costs (4+6)	76	75	68	64	78	3.2	2.7	2.4	2.2	2.2
8. Pre-tax profit (3-7)	24	25	32	36	22	1.0	0.9	1.2	1.2	0.6
9. Taxes	8	5	7	7	4	0.3	0.2	0.3	0.2	0.1
10 Net profit (8-9)	16	20	25	29	18	0.6	0.7	0.9	1.0	0.5

Source: Bank of Slovenia

Tabela 3.5 Selected performance indicators for the banking sector

	2004	2005	2006	2007	2008
1) Profitability and margins (%)					
ROA	1.1	1.0	1.3	1.4	0.7
ROE	12.7	12.7	15.1	16.3	8.1
CIR	62.3	61.7	57.8	52.7	57.1
Financial intermediation margin	4.4	4.0	3.9	3.8	3.0
Interest margin (per total assets)	2.7	2.4	2.2	2.2	2.1
Non-interest margin (per total assets)	1.7	1.6	1.7	1.6	0.9
Net interest margin (per interest-bearing assets)	2.9	2.6	2.4	2.3	2.2
Interest spread[1]	4.3	3.8	3.8	2.3	2.3
2) Structure of assets and liabilities (%)					
2.1 Maturity breakdown of loans to non-banking sectors					
Short-term loans/loans	34.1	32.3	33.4	35.0	37.0
Long-term loans/loans	65.9	67.7	66.6	65.0	63.0
2.2 Maturity breakdown of deposits by non-banking sectors					
Short-term deposits/deposits	85.9	87.5	87.6	90.9	88.1
Long-term deposits/deposits	14.1	12.5	12.4	9.1	11.9
2.3 Regional breakdown of loans					
Residents	96.1	95.4	94.4	92.2	92.5
Non-residents	3.9	4.6	5.6	7.8	7.5
2.4 Foreign currency sub-balance					
Foreign currency assets/total assets	35.9	40.5	45.9	6.0	6.1
Foreign currency liabilities/total assets	38.1	42.9	46.8	5.0	4.9
Difference	-2.3	-2.4	-0.8	1.1	1.2
Foreign currency loans/loans	38.6	48.7	55.9	6.4	6.4
Foreign currency deposits/deposits	44.5	49.4	53.3	5.9	6.0
Foreign currency loans/loans (non-banking sectors)	34.8	45.8	55.4	5.8	6.1
Foreign currency deposits/deposits (non-banking sectors)	34.6	33.1	33.4	2.7	2.4
2.5 Securities					
Securities/loans to non-banking sectors	53.5	50.4	37.3	26.1	21.1
2.6 Breakdown by sector					
Corporate					
Corporate loans/loans to non-banking sectors	66.5	65.9	66.7	67.7	68.6
Foreign currency corporate loans/corporate loans	44.9	57.0	65.4	3.7	3.4
Households					
Household loans/loans to non-banking sectors	25.0	25.3	24.9	22.9	22.3
Foreign currency household loans/household loans	3.0	11.8	23.2	10.2	12.9
Government					
Loans to government/loans to non-banking sectors	4.7	4.1	2.8	1.6	1.5
Non-residents					
Liabilities to foreign banks/total assets	17.9	26.9	29.9	34.0	33.7
3) Asset quality					
Impairments (EUR million)	1,064.5	1,168.7	1,233.8	1,311.1	1,399.4
Classified claims (EUR million)	20,428.1	25,209.1	31,581.0	40,541.6	46,380.1
Impairments/classified claims (%)	5.2	4.6	3.9	3.2	3.0
Non-performing claims/classified claims (%)	3.0	2.5	2.5	1.8	1.8
Impairments for non-performing claims/non-performing claims (%)	80.1	80.6	84.3	86.4	79.2
Non-performing claims/regulatory capital (%)	33.8	30.8	31.0	20.8	19.1
Non-performing claims minus impairments/capital (%)	6.7	6.0	4.9	2.8	4.0
Sum of large exposures/capital (%)	196.2	226.2	222.9	217.4	127.6
4) Interest rate risk					
Diff. between proportions of interest bearing assets and liabilities (percentage points)	3.7	3.7	3.7	5.0	4.8
Interest-bearing assets/assets (%)	90.1	90.2	91.3	95.1	94.2
Interest-bearing liabilities/liabilities (%)	86.4	86.5	87.6	90.1	89.4
5) Exchange-rate risk (%)					
Open foreign exchange position/regulatory capital	23.4	21.7	25.8	0.9	0.2
6) Liquidity					
Average liquid assets/average short.term deposits by non-banking sectors (%)	9.7	9.5	9.7	8.37	7.41
Average liquid assets/average total assets (%)	5.3	4.8	4.5	3.6	2.97
Category 1 liquidity ratio	1.11	1.12	1.13	1.21	1.24
Category 2 liquidity ratio	1.10	1.11	1.15	1.13	1.14
Proportion of debt securities in total assets (%)	27.5	26.2	20.8	16.02	13.51
7) Solvency and capital structure (%)					
Capital adequacy	11.8	10.5	11.1	11.2	11.7
Original own funds adequacy	9.0	8.9	9.3	8.9	10.0
Additional own funds/original own funds	50.9	45.3	38.0	48.5	33.3

Notes: [1] Spread between the average effective tolar interest rate on loans to and deposits by non-banking sectors in the final quarter.
[2] The 2006, 2007 and 2008 figures are those reported under the IFRS, while those for previous years are based on estimated values in accordance with the IFRS.

Source: Bank of Slovenia

4. Insurers

Tabela 4.1 Total assets and operating results of insurance companies and reinsurance companies

	2004	2005	2006	2007	2008	2005	2006	2007	2008
	(EUR million)					Growth rate (%)			
	Insurers								
Total assets	2,560	2,946	3,519	4,550	4,590	15.1	19.4	29.3	0.9
Non-life insurance	1,444	1,565	1,806	2,251	2,265	8.4	15.4	24.6	0.7
Life insurance	1,116	1,381	1,713	2,299	2,325	23.8	24.0	34.2	1.1
Results									
Result from non-life insurance excluding health insurance	17.9	47.1	64.9	69.1	1.0	162.8	37.6	6.5	-98.6
Results from health insurance[1]	-9.0	-8.6	-2.1	9.9	10.9	-4.0	-75.7	-573.4	9.9
Results from life insurance[1]	11.6	14.1	13.9	20.8	1.8	21.7	-1.2	49.5	-91.5
Income from investments	87.9	78.0	74.6	118.7	104.0	-11.2	-4.4	59.1	-12.4
Expensesfrom investments	17.0	18.6	13.1	21.2	86.9	9.8	-29.7	62.0	309.3
Net profit[2]	13.7	37.6	51.5	95.1	2.9	217.3	37.2	84.7	-97.0
ROE (%)	3.29	8.39	8.74	10.09	0.39				
ROA (%)	0.54	1.27	1.46	2.09	0.06				
	Reinsurance companies[3]								
Total assets	308	314	368	485	598	4.0	17.3	11.0	46.5
Results									
Result from non-life insurance excluding health insurance	8.6	10.8	16.0	11.3	0.6	34.9	47.8	-18.2	-95.1
Income from investments	14.4	14.4	15.6	31.3	22.4	-24.1	8.2	0.0	44.1
Expensesfrom investments	2.5	2.7	2.4	6.9	9.0	-22.7	-11.4	109.1	78.0
Net profit	9.0	9.7	16.3	22.4	7.1	19.2	68.4	-68.3	38.2
ROE (%)	10.60	9.87	4.42	12.47	3.70				
ROA (%)	2.92	3.08	14.82	4.62	1.19				

Notes: [1] Result from ordinary operations.
[2] Net profit for the accounting period is calculated after taxes.
[3] The figures for reinsurance companies in 2008 relate to the end of the third quarter.
Sources: ISA, own calculations

Tabela 4.2 Capital adequacy of insurance companies and reinsurance companies

						Growth rate (%)			
	2004	2005	2006	2007	2008	2005	2006	2007	2008
	Insurers – total								
Minimum capital requirement (EUR million)	181.8	200.7	220.1	261.0	275.2	10.4	9.7	18.6	5.5
Surplus (EUR million)	97.1	72.0	155.0	222.2	144.8	-25.8	115.3	43.4	-34.8
Surplus/minimum capital requirement (%)	53.4	35.9	70.4	85.1	52.6	-32.8	96.3	20.9	-38.2
	Life insurance								
Surplus/minimum capital requirement (%)	-3.6	26.3	66.6	68.8	60.9				
Original own funds/net technical provisions (%)	5.3	7.8	10.0	14.5	7.1				
	Non-life insurance including health insurance								
Surplus/minimum capital requirement (%)	77.0	40.0	72.1	93.1	48.2				
Original own funds/net technical provisions (%)	22.2	19.6	26.2	67.9	54.9				
	Reinsurance companies[1]								
Minimum capital requirement (EUR million)	18.2	19.3	21.9	26.1	25.7	2.8	7.4	18.9	2.1
Surplus (EUR million)	31.7	30.8	51.8	60.2	89.1	-6.6	102.1	16.3	42.5
Surplus/minimum capital requirement (%)	174.0	159.5	236.3	231.1	346.6	-9.1	88.2	-2.2	39.6
Original own funds/net technical provisions (%)	81.4	82.6	73.8	107.0	149.5				

Note: [1] The figures for reinsurance companies in 2008 relate to the end of the third quarter.
Sources: ISA, own calculations

Tabela 4.3 Claims ratios for major types of insurance

	2004	2005	2006	2007	2008
			Insurers		
Total	0.64	0.59	0.57	0.56	0.62
Life insurance	0.36	0.33	0.29	0.27	0.28
Voluntary health insurance	0.87	0.93	0.86	0.80	0.83
Non-life insurance excluding health insurance	0.67	0.59	0.60	0.62	0.71
Liability insurance for motor vehicle	0.64	0.56	0.54	0.55	0.55
Motor vehicle insurance	0.83	0.71	0.76	0.77	0.87
Accident insurance	0.62	0.52	0.44	0.39	0.39
Insurance of other damage to property	0.72	0.70	0.64	0.76	1.04
Fire and natural disaster insurance	0.52	0.43	0.45	0.60	1.14
Credit insurance	0.66	0.61	0.72	0.71	0.54
Other non-life insurance	0.65	0.63	0.77	0.57	0.61
			Reinsurance companies		
Total	0.55	0.49	0.56	0.56	0.73

Source: ISA

Tabela 4.4 Coverage of technical provisions by assets covering technical provisions

	2004	2005	2006	2007	2008
Technical provisions (EUR million)	1,879	2,107	2,314	2,551	2,581
Growth rate (%)	14	12	10	10	1
Assets covering technical provisions (EUR million)	2,150	2,476	2,856	3,357	3,493
Growth rate (%)	16	15	15	18	4
Assets covering technical provisions/technical provisions (%)	114.4	117.5	123.4	131.6	135.3
Assets covering technical provisions as % GDP	8.2	9.0	9.6	10.0	9.4
Mathematical provisions (EUR million)	910	1,031	1,165	1,243	1,300
Growth rate (%)	19	13	13	7	5
Assets covering mathematical provisions (EUR million)	1,152	1,361	1,665	2,042	2,095
Growth rate (%)	24	18	22	23	3
Assets covering mathematical provisions/mathematical provisions (EUR million)	126.5	132.1	142.9	164.3	161.2
Assets covering mathematical provisions as % of GDP	4.4	5.0	3.9	6.1	5.6
Other technical provisions (EUR million)	969	1,077	1,284	1,308	1,281
Growth rate (%)	9	11	19	2	-2
Assets covering technical provisions less assets covering mathematical provisions (EUR million)	998	1,114	1,192	1,315	1,398
Growth rate (%)	8	12	7	10	6
Assets covering technical provisions less assets covering mathematical provisions/other technical provisions (%)	103.0	103.5	92.8	100.5	109.1
Assets covering technical provisions less assets covering mathematical provisions as % of GDP	3.8	4.1	4.3	3.9	3.8

Sources: ISA, SORS, own calculations

Tabela 4.5 Selected indicators for compulsory and voluntary supplementary pension insurance

	2004	2005	2006	2007	2008	Growth rate (%) 2004	2005	2006	2007	2008
	Compulsory pension insurance									
Average no. of policyholders at the PDII	836,668	845,643	857,922	879,090	904,084	0.3	1.1	1.5	2.5	2.8
Average no. of pensioners[1]	523,854	531,075	536,887	543,473	551,258	1.2	1.4	1.1	1.2	1.4
Ratio	1.60	1.59	1.60	1.62	1.64	-0.9	-0.4	0.5	1.2	1.4
Average pension (EUR)[2]	447	461	484	512	554	4.5	3.1	4.9	5.7	8.3
Average net wage(EUR)	693	736	773	835	900	4.5	6.2	5.1	7.9	7.8
Ratio	0.65	0.63	0.63	0.61	0.62	0.0	-2.8	-0.2	-2.0	0.5
Average age of new pension recipients	58.6	58.8	58.9	59.2	59.2	1.6	0.4	0.2	0.5	0.0
Men	60.6	60.4	60.3	60.7	60.8	1.1	-0.3	-0.1	0.6	0.1
Women	56.6	57.1	57.2	57.4	57.5	1.6	0.9	0.1	0.4	0.2
	Voluntary supplementary pension insurance									
No. of voluntary supplementary pension insurance policyholders	404,885	427,645	459,764	486,816	512,343	90.9	5.6	7.5	5.9	5.2
Persons in employment	807,490	813,558	833,016	864,361	880,252	0.8	0.7	1.4	3.8	1.8
Ratio	0.50	0.53	0.55	0.56	0.58	89.5	4.9	6.0	2.0	3.3
Assets (EUR million)	398	592	783	956	1,212	95.2	48.7	32.3	22.0	25.8
Assets as % of GDP	1.5	2.2	2.6	2.8	3.3	81.5	41.7	21.7	8.2	13.7
Assets as % of the financial assets of households	1.7	2.4	2.5	2.6	3.2	74.7	36.1	13.3	6.5	23.0
Collected premium (EUR million)	179	182	204	220	240	90.4	2.0	11.9	7.9	9.0
Premium as % of PDII tax revenues	7.4	7.2	7.5	7.5	7.4	77.7	-3.9	5.5	-0.7	-1.6

Notes: [1] Includes recipients of all types of pension: old-age, disability, family, widow’s, military, farmer’s, state.
[2] Includes old-age, disability, family and widow's pensions, less tax prepayment.

Sources: PDII, ISA, SMA, SORS, Bank of Slovenia

5. Investment funds

Tabela 5.1 Overview of investment funds: assets and net inflows of mutual funds in EUR million and year-on-year returns in percentages

	Mutual funds				(Authorised) investments companies					Total inv. funds	
					Assets						
	Net inflows	Assets		UP - MF	Auth. inv. comp.		Inv. companies		PIX[1]	Assets	
	(mio EUR)	(mio EUR)	Growth	Growth	(mio EUR)	Growth	(mio EUR)	Growth	Growth	(mio EUR)	Growth
2000	5	45	22%	4%	2,393	-4%	-	-	3%	2,438	-
2001	7	61	37%	23%	2,287	-4%	-	-	4%	2,348	-4%
2002	122	231	277%	54%	1,352	-41%	578	-	72%	2,161	-8%
2003	107	389	68%	17%	550	-59%	894	55%	24%	1,833	-15%
2004	339	877	126%	18%	-	-	1,209	35%	39%	2,086	14%
2005	138	1,385	58%	7%	-	-	835	-31%	-12%	2,220	6%
2006	163	1,929	39%	19%	-	-	916	10%	28%	2,845	28%
2007	470	2,924	52%	28%	-	-	1,213	32%	45%	4,138	45%
2008	-304	1,513	-48%	-43%	-	-	398	-67%	-23%	1,912	-54%
2006Q1	29	1,463	56%	11%	-	-	843	-30%	-13%	2,306	8%
2006Q2	38	1,504	26%	11%	-	-	909	3%	-2%	2,413	16%
2006Q3	55	1,697	35%	15%	-	-	970	9%	13%	2,666	25%
2006Q4	41	1,929	39%	19%	-	-	916	10%	28%	2,845	28%
2007Q1	158	2,281	56%	30%	-	-	1,003	19%	46%	3,284	42%
2007Q2	129	2,692	79%	47%	-	-	1,215	34%	64%	3,907	62%
2007Q3	94	2,914	72%	44%	-	-	1,299	34%	51%	4,213	58%
2007Q4	89	2,924	52%	28%	-	-	1,213	32%	45%	4,138	45%
2008Q1	-86	2,350	3%	-3%	-	-	1,034	3%	8%	3,384	3%
2008Q2	-28	2,268	-16%	-16%	-	-	999	-18%	-18%	3,267	-16%
2008Q3	-74	2,100	-28%	-30%	-	-	628	-52%	-23%	2,728	-35%
2008Q4	-116	1,513	-48%	-43%	-	-	398	-67%	-	1,912	-54%

Note: Annual change in the PIX in 2008 relates to 31 July, as a result of calculation of the index being abolished.
Sources: AMC, SMA, LJSE, own calculations

Tabela 5.2 Assets of Slovenian and euro area investment funds in EUR billion and in percentages

		Asset value	Annual	Structure with regards to asset type (%)				
		(EUR billion)	growth (%)	Equity	Bond	Balanced	Real estate	Other
Euro area	2002	3,043	-10.1	20.8	37.3	24.7	5.1	12.1
	2003	3,421	12.4	21.9	34.1	25.0	5.4	13.6
	2004	3,832	12.0	21.9	32.3	24.6	5.1	16.1
	2005	4,791	25.0	27.9	32.1	23.2	4.5	12.3
	2006	5,551	15.9	30.3	29.8	24.8	4.2	10.9
	2007	5,781	4.1	30.0	27.6	26.6	4.2	11.6
	2008	4,243	-26.6	21.4	31.6	28.5	6.0	12.5
Slovenia	2002	0.2	278.9	76.3	0.8	22.8		
	2003	0.4	66.9	74.9	1.5	23.6		
	2004	0.9	125.7	67.6	2.2	30.2		
	2005	1.4	57.9	65.7	2.6	31.7		
	2006	1.9	39.3	68.4	1.5	30.1		
	2007	2.9	51.6	71.3	0.9	27.8		
	2008	1.5	-48.2	63.2	2.1	33.5		

Sources: Bank of Slovenia, ECB

Tabela 5.3 Mutual funds: number, assets and net inflows in EUR million and returns in percentages

	2000	2001	2002	2003	2004	2005	2006	2007	2008	Growth rate (%) 2001	2002	2003	2004	2005	2006	2007	2008
Number																	
Total	18	18	18	20	33	50	99	109	127	0.0	0.0	11.1	65.0	51.5	98.0	10.1	16.5
Equity	4	4	4	6	12	26	72	80	96	0.0	0.0	50.0	100.0	116.7	176.9	11.1	20.0
Bond	3	3	3	3	7	9	9	10	10	0.0	0.0	0.0	133.3	28.6	0.0	11.1	0.0
Balanced	11	11	11	11	14	14	16	17	18	0.0	0.0	0.0	27.3	0.0	14.3	6.3	5.9
Money-market	-	-	-	-	-	1	2	2	2	-	-	-	-	-	-	0.0	0.0
Other	-	-	-	-	-	-	-	-	1	-	-	-	-	-	-	-	-
Assets																	
Domestic MF (EUR million)	45	61	233	389	877	1,385	1,929	2,924	1,513	37.6	278.9	66.9	125.7	57.9	39.3	51.6	-48.2
Equity (%)	21	20	23	25	28	53	58	68	63	-2.8	12.2	9.5	14.8	85.4	9.6	17.7	-6.8
Bond (%)	4	6	3	5	5	4	2	1	2	70.8	-43.4	45.5	2.0	-18.6	-45.3	-47.4	78.6
Balanced (%)	76	74	74	70	67	43	40	31	33	-2.5	0.2	-5.0	-5.3	-35.5	-7.4	-23.0	9.4
Bank (%)	25	26	28	25	28	25	30	28	33	5.1	5.8	-8.5	13.2	-13.4	20.8	-6.5	20.1
Non-bank (%)	75	74	72	75	72	75	70	72	67	-1.7	-2.0	3.2	-4.4	5.3	-6.8	2.7	-7.8
Foreign MF (EUR million)	-	-	-	-	7	137	308	367	130	-	-	-	-	-	119.8	19.4	-64.7
Net annual inflows																	
Domestic MF (EUR million)	7	6	120	108	339	138	163	470	-304	-	-	-9.8	212.2	-59.1	18.1	187.3	-164.6
Equity (%)	50	18	24	29	36	100	130	84	-200								
Bond (%)	2	27	3	9	7	8	-9	-1	-5								
Balanced (%)	48	55	73	62	58	-11	-23	16	-105								
Bank (%)	9	42	30	20	37	52	44	31	28								
Non-bank (%)	91	58	70	80	63	48	56	69	72								
Foreign MF (EUR million)	-	-	-	-	-	97	127	2	-55								
Annual UP growth rate (%)																	
Total	4	23	54	17	18	7	19	28	-43								
Equity	2	21	57	19	19	11	20	32	-48								
Bond	11	13	18	10	7	3	2	5	-3								
Balanced	4	25	55	17	18	5	18	23	-38								
Bank	11	20	48	16	18	10	15	19	-35								
Non-bank	1	24	57	17	18	6	20	31	-46								

Note: The figures for foreign mutual funds only include those officially marketed in Slovenia.
Sources: SMA, own calculations

Tabela 5.4 Breakdown of investments by type in percentages

(%)	2001	2002	2003	2004	2005	2006	2007	2008
Mutual funds								
Equity	78	63	60	59	46	40	37	29
Bond	13	23	21	12	11	7	4	7
Bank deposits	6	9	5	7	5	9	10	10
Foreign investments	1	1	7	9	27	40	45	47
Other	2	4	6	14	10	5	4	6

Note: A change in methodology has allowed for more detailed analysis of the investment breakdown. The figures therefore differ from those published in 2007.
Source: SMA

6. Leasing companies

Tabela 6.1 Comparison of the Slovenian leasing sector with European leasing companies in percentages

(%)	2003	2004	2005	2006	2007	2008
Slovenian leasing companies			(%)			
Growth rate - business	35.6	12.3	35.5	28.0	34.3	31.7
Leasing business as a proportion of gross investments	18.7	18.9	24.6	28.2	31.6	38.1
Structure of business						
Real estate leasing	34.5	29.7	33.5	29.5	30.9	25.0
Equipment leasing	65.5	70.3	66.4	70.5	69.1	75.0
Activity of leasing takers						
Equipment and real estate leasing by individuals	20.2	22.2	20.9	19.2	19.5	20.9
European leasing companies			(%)			
Growth rate - business	8.3	8.0	11.6	16.9	12.4	-
Leasing business as a proportion of gross investments	14.6	14.8	15.9	19.0	20.8	-
Structure of business						
Real estate leasing	16.6	16.2	17.1	15.8	13.7	-
Equipment leasing	83.4	83.8	82.9	84.5	86.3	-

Note: The Leaseurope figures include all European Union Member States with the exception of Luxemburg, Ireland and Greece, plus Norway, Switzerland, Romania, Bosnia and Herzegovina, and Russia. Gross investment includes capital expenditure but excludes investments in residential buildings for reason of comparability with the Leaseurope figures.

Sources: SLA, BAS, SORS, Leaseurope

7. Capital market

Slovenian capital market

Tabela 7.1 Overview of the regulated securities market in EUR million and in percentages

	Market capitalisation (EUR million)	Market capitalisation (As % of GDP)	Turnover (EUR million)	Turnover (As % of GDP)	Change in value of securities	Growth rate SBI 20 (%)
2000	4,751	25.7	1,125	6.1	0.237	0.1
2001	5,759	27.9	1,454	7.0	0.252	19.0
2002	9,073	39.2	2,007	8.7	0.221	55.2
2003	10,190	40.6	1,420	5.7	0.139	17.7
2004	12,726	47.0	1,655	6.1	0.130	24.7
2005	13,395	46.7	1,840	6.4	0.137	-5.6
2006	18,838	60.8	1,805	5.8	0.096	37.9
2007	26,696	77.4	3,324	9.6	0.125	78.1
2008	15,488	41.7	1,286	3.5	0.083	-67.5

Sources: LJSE, SORS

Tabela 7.2 Number of issuers and issued securities on the LJSE and number of securities registered at the CSCC

	2003	2004	2005	2006	2007	2008	2003	2004	2005	2006	2007	2008
LJSE							Year-on-year change					
Number of issuers	185	173	148	130	119	107	-12	-12	-25	-18	-11	-12
Number of MF issued	254	254	227	205	188	187	-10	0	-27	-22	-17	-1
Equity	136	142	112	102	89	86	-3	6	-30	-10	-13	-3
Bond	92	101	95	93	89	90	0	9	-6	-2	-4	1
Investment companies	26	11	10	7	7	4	-7	-15	-1	-3	0	-3
Number of members	27	27	27	24	24	23	0	0	0	-3	0	-1
CSCC							Proportion of issuers and MF from LJSE in CSCC (%)					
Number of issuers	869	853	827	810	803	764	21	20	18	16	15	14
Number of MF issued	1033	1030	1043	1026	995	943	25	25	22	20	19	20
Equity	886	886	910	889	880	829	15	16	12	11	10	10
Bond	120	133	123	115	112	114	77	76	77	81	79	79
Investment companies	27	11	10	7	7	4	96	100	100	100	100	100

Sources: LJSE, CSCC

Tabela 7.3 Comparison of annual trading volume on the LJSE and annual trading volume outside the regulated market in EUR million and in percentages

	2002	2003	2004	2005	2006	2007	2008	2002	2003	2004	2005	2006	2007	2008
LJSE	(EUR million)							Growth rate (%)						
Total trading volume	1986	1420	1655	1840	1805	3324	1271	38.2	-28.5	16.6	11.1	-1.9	84.2	-61.8
Shares	1164	623	931	941	1451	3035	953	17.7	-46.4	49.4	1.0	54.3	109.1	-68.6
Bonds	461	541	474	749	188	166	257	114.2	17.3	-12.4	58.1	-74.9	-11.8	54.9
Investment companies	358	254	250	149	166	124	61	62.1	-29.0	-1.4	-40.3	10.9	-25.4	-50.5
Short-term securities	3	1	0	0	6	0	-	-	-	-	-	-	-	-
Unregulated securities market	(EUR million)							Proportion of trading volume on stock exchange (%)						
Total trading volume	1071	1684	975	1059	-	-	-	54	119	59	58	-	-	-
Shares	362	343	295	469	-	-	-	31	55	32	50	-	-	-
Bonds	111	133	79	150	-	-	-	24	25	17	20	-	-	-
Investment companies	0	0	0	0	-	-	-	-	-	-	-	-	-	-
Short-term securities	598	1209	602	441	-	-	-	-	-	-	-	-	-	-

Note: The figure for transactions concluded outside the regulated market comprises only transactions concluded by brokerage houses and banks as final purchasers or vendors of non-marketable securities that must be reported to the SMA.

Sources: LJSE, SMA

Investments by residents in the rest of the world

Tabela 7.4 Residents' investments in securities issued in the rest of the world in EUR million and in percentages

	2001	2002	2003	2004	2005	2006	2007	2008	Feb 09
Growth rate of investments in the rest of the world (%)	96.3	27.3	61.7	119.7	130.5	81.5	77.7	-21.6	-22.0
Total investments in the rest of the world (EUR million)	290	370	598	1,313	3,027	5,495	9,767	7,655	7,338
	Strucutre by sectors (%)								
Banks	79	49	38	32	39	41	47	55	56
Other financial intermediaries	2	21	24	22	21	21	19	12	11
Insurers	16	24	26	29	19	18	17	24	24
Households	2	5	8	10	11	12	10	4	4
Corporates	1	1	3	6	5	4	3	1	1
Other	0	0	1	1	5	4	4	4	4

Sources: LJSE, Bank of Slovenia

Investments by non-residents in Slovenia

Tabela 7.5 Non-residents' investments in securities issued in Slovenia by institutional sector in EUR million and in percentages

	2004	2005	2006	2007	2008	Feb 09
Growth rate of investments by non-residents (%)	54.2	24.9	38.6	22	5	8
Total investments by non-residents (EUR million)	2,401	3,000	4,129	5,054	5,295	6,239
	Structure by domestic sectors (%)					
Corporates	64	57	52	55	36	31
Banks	25	25	24	26	29	26
Other financial intermediaries	2	1	0	1	3	2
Insurers	2	2	2	2	2	2
Government	7	16	22	16	30	39

Sources: CSCC, Bank of Slovenia, own calculations