BANKA SLOVENIJE

BANK OF SLOVENIA
EUROSYSTEM

ANNUAL REPORT

YEAR 2007

Published by:

BANK OF SLOVENIA
Slovenska 35
1505 Ljubljana
Tel: +386 1 47 19 000
Fax: +386 1 25 15 516

The Annual Report is based on figures and information available at the end of March 2008.

This publication is also available in Slovene.

ISSN 1318-5284 (print)
ISSN 1518-2103 (electronic)

Table of contents

Tables and figures

Tables:*

*Excludes financial statements

Figures:

Introduction

Slovenia introduced the euro as the national currency on 1 January 2007. The transition to and exchange of currency proceeded smoothly. The adaptation of all systems was carried out efficiently and according to plans. The population and economy adjusted quickly to the new currency. As expected, there were some cases of prices being “rounded up”, particularly in the service and catering sectors. According to most estimates, the introduction of the euro contributed 0.3 percentage points to inflation, partly in December 2006 and the remainder in subsequent months.

The positive effects of Slovenia’s entry to the European Union continued in 2007. A favourable economic climate in Europe and the international environment and the resulting high growth in foreign trade contributed to real aggregate economic growth of 6.1%, the highest level achieved since Slovenia’s independence. High economic growth resulted in a significant increase in overall employment of 2.7%, and a drop in the unemployment rate to 4.6%. Bottlenecks occurred in a number of sectors due to a labour shortage, leading to increased demand for foreign workers.

In addition to exports, high growth in domestic spending also contributed to high growth in GDP and employment. This growth was driven by very high investment growth, particularly in construction works. Following entry to ERM II in July 2004, the effectiveness of the Bank of Slovenia’s monetary control has diminished due to the convergence of domestic interest rates with European rates. This has stimulated strong growth in lending.

The Bank of Slovenia estimates that economic growth in the second half of 2006, and even more so in 2007, exceeded the output potentials which ensure macroeconomic equilibrium. Entry to the European Union resulted in high growth in imports, which was balanced with growth in exports in the first few years. With increased domestic spending, imports began to grow faster than exports, resulting in a significant increase of the external deficit. Rising outflows of interest payments, the payment of earnings to investors and the income and transfers of migrant workers also contributed to the deterioration of the external deficit. The current account deficit stood at 4.9% of GDP in 2007, a clear and serious indication of macroeconomic imbalances.

The first indications of pressures on wage increase were seen already at the end of 2006. Wage growth increased throughout 2007, coinciding with high cyclical growth in productivity, primarily in the export sector of the economy. Inflation, which slowed somewhat in the first months of 2007, began to rise in the middle of the year and even more so towards the end of the year, being well above the euro area average. By the end of the year, the Harmonised Index of Consumer Prices (HICP) had already risen by 5.7%. The majority of this growth was driven by external supply-side shocks, particularly growth in prices of food, commodities and energy. Specific domestic factors, primarily structural problems in the market, also contributed to the above-average increase in Slovenian food prices. The prices of services and infrastructural activities also had an impact on inflation in the second half of the year. High inflation has led to a significant drop in real interest rates, which could have an effect on demand in the current year.

The first signs of a slowdown in high economic growth were seen at the end of 2007. There were several factors in this regard, particularly uncertainties on international financial markets. In addition, there was a slowing in domestic demand. Given the inertia of inflationary pressures, there has been a decrease in real wages in the recent months, triggering wage increase demands. Future competitiveness of the Slovenian economy will depend a great deal on the results of wage negotiations. As we move into 2008, there are significant risks regarding the stability and competitiveness of the economy, despite the gradual closing of the output gap.

Ljubljana, April 2008

Governor of the Bank of Slovenia
Marko Kranjec

1 ECONOMIC AND FINANCIAL DEVELOPMENTS

1.1 International economic and financial developments

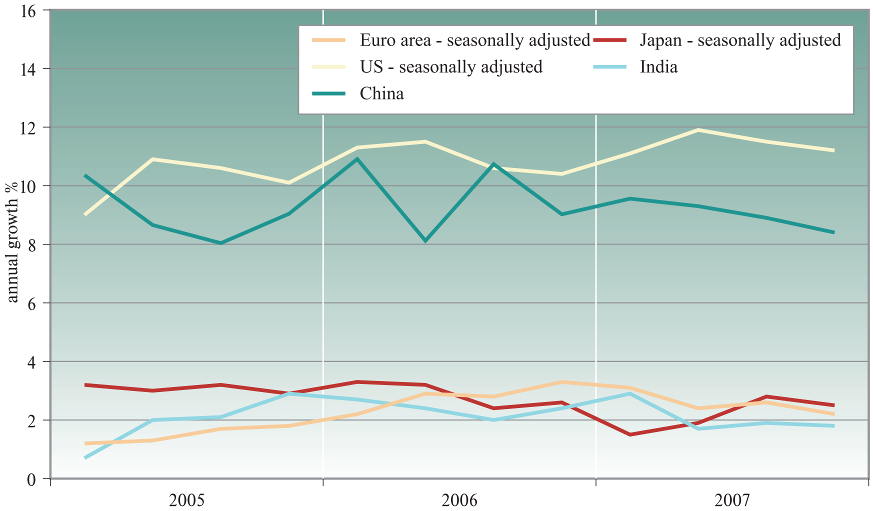
In 2007, the global economy was characterised primarily by structural shifts in respect of relative prices and increasing uncertainty on financial markets from the middle of the year onwards. The aforementioned, in addition to country specific factors, led to a slowdown in economic growth.

The global economy was characterised by structural shifts in respect of relative prices and increasing uncertainty on financial markets in the second half of the year

Global economic growth remained relatively high in 2007 at 4.9%, according to International Monetary Fund estimates. A slowdown in global economic growth was felt in the fourth quarter. Following relatively good results in the first quarter of the year, euro area economic growth slowed during the remainder of the year, reaching 2.6% according to preliminary estimates. Once again, domestic consumption contributed most to economic growth, with investment growth becoming more moderate during the year. Economic growth in the US and Japan also slowed in 2007. Despite a gradual slowdown in certain larger Asian countries, such as India and China, growth remains at a very high level. According to preliminary estimates, economic growth in the US slowed to 2.2% last year, primarily as the result of a cooling of the real estate market.

Global economic growth slowed somewhat, but remained high at 4.9%

Figure 1: **Economic growth in selected major world economies**



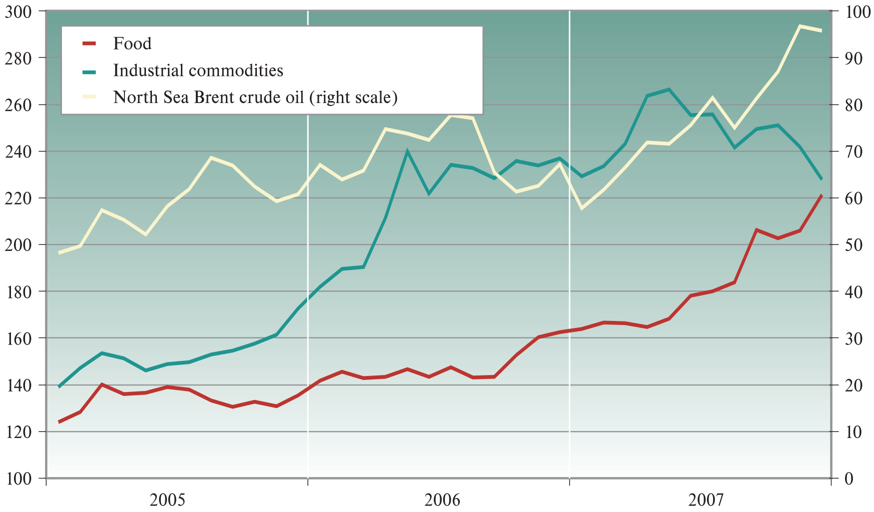
Sources: Eurostat, US Bureau of Economic Analysis, National Bureau of Statistics of China, Reserve Bank of India

The economic activity of Slovenia's main trading partners from the European Union slowed in 2007, with the exception of some new Member States, such as Slovakia and Poland, which achieved higher growth than the previous year. The slowdown in growth was relatively sharp in some larger Member States, such as Germany, France and Italy. Among the most important trading partners outside the European Union, economic activity improved in Russia and in the majority of new countries in the Balkan region, most notably in Croatia and Serbia.

Significant shifts in relative prices were driven by rapid growth in food prices, and oil prices in the second half of the year

Significant shifts in relative prices were driven primarily by continuing rapid growth in food prices on world markets since the end of 2006. Accelerated growth in oil prices accompanied growth in food prices in the second half of 2007. Growth in food prices on the world market reached 26% on average in 2007, compared to average annually growth of 11% in 2006. Growth was affected primarily by demand from some rapidly growing Asian countries, the increasing use of certain products for the production of bio-fuels and unfavourable weather conditions. Oil prices rose gradually throughout the year, although a strong base effect, which resulted in negative year-on-year growth rates, was present in year-on-year indices in the first half of the year. In the last quarter, when year-on-year growth in oil prices rose sharply, reaching approximately 60% on average, the base effect acted in the opposite manner. In 2007, the average price of a barrel of Brent crude was USD 74, up approximately 14% from the previous year. The fundamental reason for the growth in oil prices remains high demand for this commodity which continues to outstrip supply. In addition, geopolitical tensions in oil-rich regions were present, which further impeded supply. During its meetings in 2007, OPEC raised the official quota of oil production just once. This was reflected in slightly higher supply in November, but did not stop continued growth in prices. Increased concern and the resulting higher oil prices were also caused by low oil inventories in the US and the depreciation of the US dollar against other currencies. Among other commodities (excluding oil), growth in metal prices slowed sharply in 2007. Lower growth in metal prices was partly the result of a high basis from 2006, and partly due to a slowdown in the economic growth of major world economies.

Figure 2: **Prices of commodities and oil on the world market**



Note: Index 2000 = 100; oil price is for North Sea Brent in USD per barrel.
Sources: The Economist, London; Bloomberg

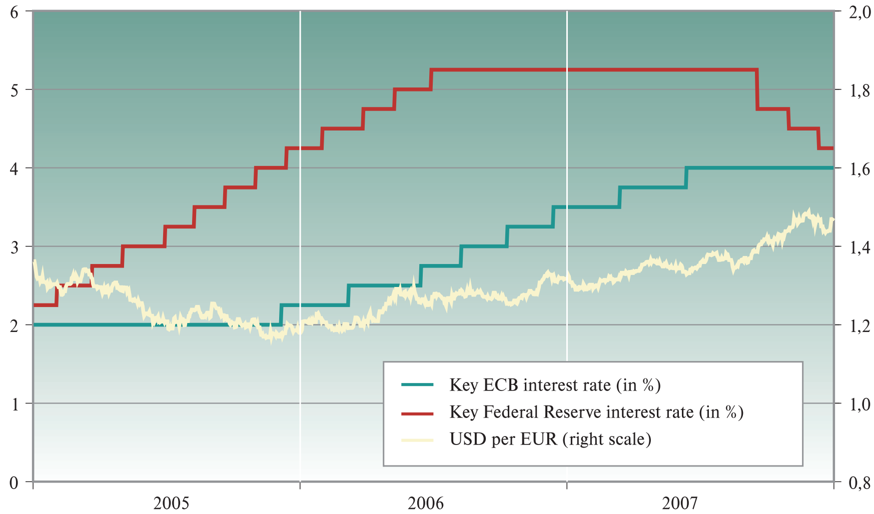
There has been increased uncertainty on world financial markets since the middle of the year

A major turnaround occurred on world financial markets in the middle of the year. In August, there was a significant increase in uncertainty on financial markets, linked to the rapidly growing inability of sub-prime borrowers to repay housing loans in the US and due to markets' lack of confidence in the various derivatives which were secured by these loans. The effects were felt by other derivatives markets as well. Trading in these types of instruments came to a standstill, while the lack of confidence passed through to the interbank market. The result was end to the previous trend of rising stock market indices around the world and liquidity problems for banks, primarily in North America and Europe. The ECB and other central banks responded to these events with a significant injection of liquidity to stabilise the interbank market.

A major turnaround on world financial markets affected central bank activities

The ECB continued with restrictive monetary policy until the middle of the year and increased interest rates by 0.25 percentage points in March and June so that the key central bank interest rate has stood at 4.0% since the middle of the year. Following the tightening of conditions on financial markets, the ECB stopped raising interest rates, and focused its attention on stabilising the interbank market. The Federal Reserve kept its key central bank Federal Funds interest rate at 5.25% until August. Three rate cuts have followed, primarily as the result of the continuation and deepening of the sub-prime mortgage loan crisis and expectations of a slowdown in US economic growth. At the end of the year, the key central bank Federal Funds interest rate stood at 4.25%. In February, the Japanese central bank raised its key interest rate by 0.25 percentage points to 0.5%, where it remained until the end of the year.

Figure 3: **Euro-US dollar exchange rate and key ECB and Federal Reserve interest rates**



Sources: ECB, Federal Reserve

The euro appreciated 9% against the US dollar in 2007

Changes in the US dollar exchange rate were reflected in developments in the US and euro area economies. The euro appreciated significantly against the US dollar, gaining 9.2% during the year, relative to its 2006 average. This appreciation was mainly the result of more encouraging data regarding the euro area economy than the US economy. In addition, euro area interest rates rose, while US interest rates remained unchanged until the end of the summer. Rates then began to fall, lowering the interest rate spread between dollar and euro interest rates.

Inflation in the euro area and US rose sharply towards the end of the year due to rapid growth in food and oil prices

Inflation in the euro area and US remained at a moderate level until the last quarter of the year, followed by a sharp increase. Despite the increase in the last quarter, average inflation in 2007 was slightly lower than the previous year, and stood at 2.1% in the euro area and at 2.9% in the US. The high energy price basis from 2006 resulted in moderate price growth in the euro area until the last quarter. The effect of the energy price basis from 2006 reversed in the last quarter, thus accelerating inflation until the end of 2007 together with continued high growth in oil prices. Furthermore, rapid growth in food prices on world markets was increasingly reflected in euro area inflation. Similarly, inflation in the US rose sharply in the last quarter due to the effect of a low energy price basis in the last quarter of 2006 and due to the effect of rapid growth in food prices. In 2007, average inflation excluding energy and unprocessed food prices in the euro area was slightly higher than the previous year, reaching 2.0% for the year. An increase in the VAT rate in Germany at the beginning of the year was a contributing factor. Inflation excluding food and energy prices in the US fell during 2007, but rose slightly towards the end of the year, reaching 2.3% on average. In Japan, deflation was once again present until the last quarter of the year. High energy prices, given last year's low basis, contributed to positive inflation in the last quarter, with average annual inflation reaching 0.1%.

1.2 Economic and financial developments in Slovenia

1.2.1 Economic Activity and the Labour Market

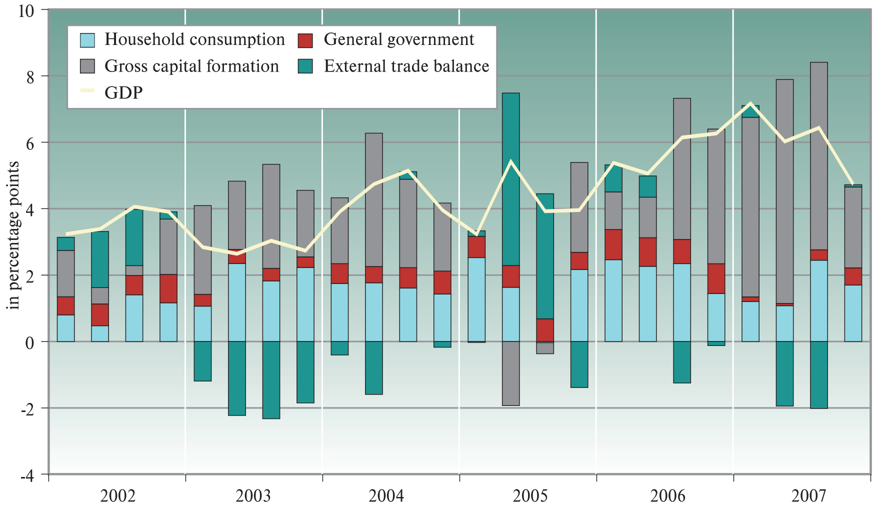
In 2007, economic growth exceeded estimated potential growth, and outstripped euro area growth by 3.5 percentage points

Economic growth in Slovenia continued to rise in 2007, reaching its highest level since independence. Following 5.7% growth in 2006, gross domestic product (GDP) growth rose by 0.4 percentage points last year, reaching 6.1% and exceeding estimated potential GDP growth. In the euro area, economic growth fell from 2.8% in 2006 to 2.6% in 2007. The gap between growth in Slovenia and growth in the euro area rose from 2.9 to 3.5 percentage points. The Slovenian economy's strong growth exceeded expectations and was, for the most part, the result of rapid growth in gross capital formation. The largest increases in value-added were recorded by construction (18.7%), financial intermediation (12.1%), retail (7.6%) and manufacturing (8.3%), where the differences in growth in value-added compared to the euro area are most evident. The structure of economic growth in Slovenia still points to a favourable economic cycle. However, growth which exceeds estimated growth in the economy's supply capacity, or potential growth, fuels inflationary pressures from aggregate demand and leads to macroeconomic imbalance.

Investment spending was the main driver of economic growth in 2007

Domestic demand, which began to pick up at the end of 2005 and continued to increase throughout 2006, contributed significantly to high economic growth in 2007. Year-on-year growth in gross investment, which led to accelerated growth back in the second half of 2006 and achieved average year-on-year growth of 17.8% in 2007, was even more prominent among components of domestic consumption than it was in 2006. In 2007, the acceleration of investment spending was strongest in the construction sector, where investments in housing and non-residential construction were most notable, while investments in transportation equipment also rose sharply. High growth in investments in non-residential construction at the beginning of the year was partially the result of favourable weather conditions which sped up planned motorway construction, and partly due to the construction of facilities intended for trade activities and the construction and renovation of facilities in the scope of preparations for the expansion of the Schengen border. High growth in investments in housing construction in 2007 was partially driven by high demand linked to favourable financing conditions, together with a drop in real interest rates, and partially as the result of increased construction prior to the anticipated end of the transitional period of low VAT for housing construction and renovation. According to expectations from the beginning of 2007, the period of low VAT expired at the end of last year, as there was no subsequent extension of the aforementioned period. Investments in plant and equipment also rose rapidly in 2007, recording growth of 13.3%. Investments in transportation equipment, which rose by 24.7% year-on-year, recorded the fastest growth, which was in part driven by certain one-off transactions, primarily the purchase of aircraft in the second quarter. Household consumption fell slightly on average in 2007, despite improved conditions on the labour market and favourable terms of lending, accompanied by relatively low real interest rates. Compared to the previous year, average year-on-year growth in government spending also slowed in 2007 (by 3 percentage points to 1.4%). Despite solid growth in 2007, year-on-year growth in exports of goods and services lagged behind growth in imports of goods and service, which was stimulated by high growth in domestic demand. This ratio between growth in exports and imports contributed to a negative balance of payments position in 2007, and made a negative contribution to GDP growth last year of 0.9 percentage points.

Figure 4: **Contributions to economic growth (in percentage points) and the expenditure structure**



Sources: SORS, Bank of Slovenia calculations

Table 1: **Contributions to economic growth (in percentage points) and the expenditure structure**

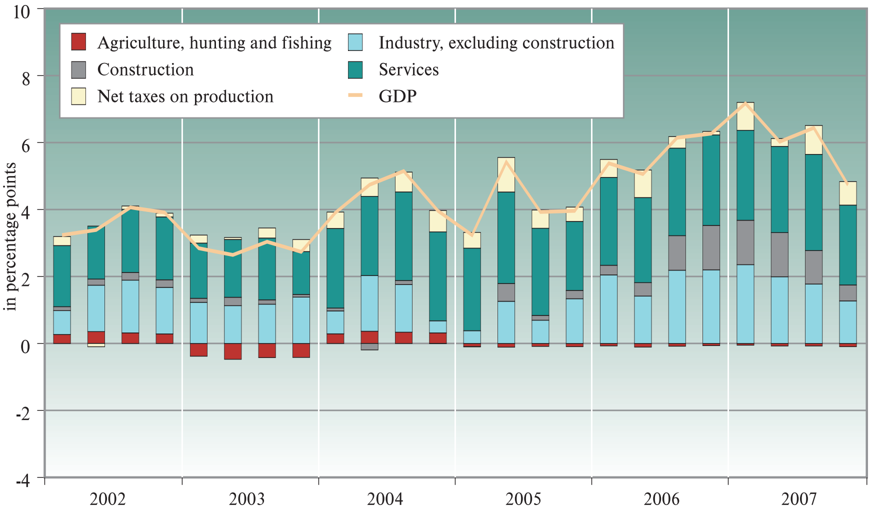
in percentage points	2002	2003	2004	2005	2006	2007
Household consumption	1.0	1.9	1.6	1.6	2.1	1.6
Gross capital formation	1.0	2.5	2.7	0.1	2.7	5.0
General government	0.7	0.4	0.6	0.6	0.8	0.3
External trade balance	1.0	-1.9	-0.5	2.0	0.0	-0.9
Economic growth	3.7	2.8	4.4	4.1	5.7	6.1

Sources: SORS, Bank of Slovenia calculations

Given high economic growth, the sharp increase in inventories was unexpected

In line with the high growth in value-added in manufacturing in 2007 (8.5%), there was also high growth in industrial production (6.9%), which slowed slightly only at the end of the year. The largest increases in industrial production in 2007 were recorded primarily in export-oriented sectors, particularly in the production of chemicals, chemical products and man-made fibres (21.6%), the manufacture of transportation equipment (19.8%), for the most part in the automobile industry, the production of metals and metal products (10.5%) and the manufacture of machinery and equipment (10.5%). Last year, the largest drop in industrial production was recorded in the manufacture of leather and leather products (down 21.0%). The acceleration of industrial production was seen for all types of goods, particularly for capital goods (12.8% year-on-year). The main factors in this increase were high activity in the construction sector and an increase in exports of capital goods to new EU Member States. Growth in industrial sales revenues was also high in 2007 (7.6%), where year-on-year growth in sales revenues on foreign markets (8.8%) outstripped growth on domestic markets (5.3%). The greatest contribution to this growth came from sales revenues from capital goods. Total industrial inventories rose by 8.9% year-on-year in 2007, a significant increase compared to the previous year, with inventories of capital goods and consumer goods rising by 18.7% and 11%, respectively.

Figure 5: **Contributions to economic growth (in percentage points) and the output structure**



Sources: SORS, Bank of Slovenia calculations

Table 2: **Selected economic indicators**

	2002	2003	2004	2005	2006	2007
Real GDP growth[1] (%)	3.7	2.8	4.4	4.1	5.7	6.1
GDP (EUR million)	21,142	23,399	25,814	27,783	29,859	32,295
GDP per capita (EUR)	11,407	12,380	13,355	14,098	15,146	16,569
Composition of GDP (%)						
Agriculture, forestry and fishing	2.7	2.2	2.4	2.1	2.0	1.8
Industry and construction	28.0	27.5	27.0	26.4	27.0	27.5
- Manufacturing	23.1	22.8	22.4	21.7	21.5	21.4
Services	53.9	54.3	54.8	55.6	55.6	55.3
Total value added	87.6	87.0	87.1	87.2	87.7	87.6
Compensation of employees	52.0	51.7	51.9	51.8	51.4	...
Taxes on production and imports less subsidies	14.3	14.2	14.1	14.0	13.4	...
Gross operating surplus and gross mixed income	33.7	34.0	34.0	34.2	35.2	...
- Exports of goods and services	57.9	56.3	59.1	62.3	66.9	71.8
- Imports of goods and services	57.7	57.0	59.7	61.6	67.5	73.6
Net trade	0.2	-0.7	-0.7	0.7	-0.6	-1.8
Household final consumption expenditure	53.9	54.3	53.3	52.6	52.1	50.9
General government final consumption expenditure	19.6	19.3	19.1	19.1	19.1	18.4
Gross capital formations	25.0	25.8	27.0	26.7	28.4	31.5
Labour force (ILO)[2], in thousands	971	961	1,007	1,015	1,022	1,035
Self-employed persons and persons in paid employment by natural persons (ILO)	910	897	943	949	961	985
Unemployed (ILO)	61.3	64.2	63.3	66.1	60.8	49.2
Unemployment rate (ILO)	6.3	6.7	6.3	6.6	6	4.9
Nominal growth in gross wages (%)	9.8	7.6	4.6	4.9	4.8	5.9
Growth in labour productivity (%)	2.1	3.2	4.1	4.0	4.5	3.3

Note: [1] The national accounts figures are expressed in fixed prices from the previous year, with the exception of employee expenditure, taxes on production and imports minus subsidies, and gross operating surplus and miscellaneous earnings, which are given in current prices.
[2] Internationally comparable data compiled according to ILO methodology.

Source: SORS

Conditions on the labour market improved again in 2007 in line with the favourable economic cycle. The labour force was approximately 864.4 thousand at the end of 2007, up 3.5% compared to 2006. There was a sharp increase in employment from the previous year both at companies (3.1%) and in the small business sector (5.1%) including the self-employed and employees of the self-employed. The largest increases in employment in 2007 were again recorded by the sectors of construction (11.4%) and real estate (8.5%), while there were declines in agriculture (3.8%), mining (5.7%). In contrast to the previous four years when declines were recorded, employment in manufacturing rose 1.1% year-on-year in 2007. As in previous years, within the manufacturing sector the largest decline in employment was most notable in labour-intensive sectors, particularly in textiles, foodstuffs and leather, while employment in the manufacture of transportation equipment rose by 10.6% year-on-year, primarily as the result of new capacities in the automobile industry. The number of unemployed in December 2007 was down 9,892 or 16.8% from a year earlier, while the unemployment rate in December stood at 7.3%, down 1.3 percentage points from the previous year. There was also a sharp decline in the survey rate of unemployment (ILO methodology), which fell to a record low in the third quarter of 2007, and was 4.9% on average over the year. According to the Labour Force Survey, the activity rate increased by 0.4 percentage points in 2007 to 59.7% of the population, while the employment rate increased by 1.1 percentage points to 56.9%.

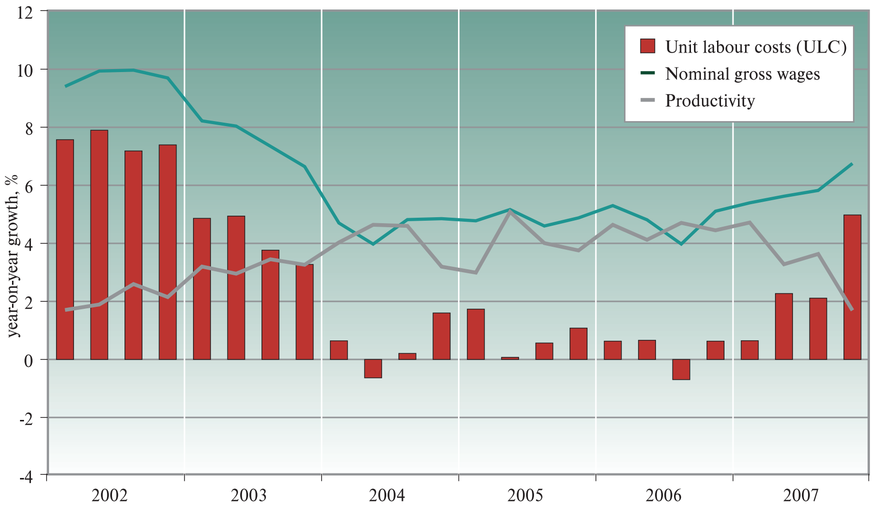
Labour market conditions were favourable throughout 2007. The average unemployment rate stood at 4.9%

Growth in the average nominal gross wage rose by 1.1 percentage points in 2007, reaching 5.9%. Growth in the average nominal gross wage in the private sector was 6.8%, compared to growth of 4.1% in the public sector. The fastest growing wages were in the retail sector (7.6%), the financial sector (7.3%) and the real estate sector (7.1%), while the slowest growth was recorded by public administration (4.0%).

Nominal unit labour costs were slightly higher in 2007 than in the previous three years, and were particularly strong in the last quarter. Although labour costs rose gradually, they fluctuated at a level of approximately 2% until the last quarter, and did not represent inflationary pressures. In the last quarter, year-on-year growth in nominal unit labour costs rose sharply to approximately 5.0%; measured by gross wages, together with other employment earnings (AJPES), they fluctuated at around 4.0%. Other earning grew at a slower rate than gross wages. They thus exceeded the level of growth in labour costs that is consistent with maintaining price stability. Based on these data however, it is not yet clear whether this is a permanent or temporary deviation.

Unit labour costs outstripped growth in productivity in 2007, in line with maintaining price stability

Figure 6: **Productivity, employment and nominal gross wages**



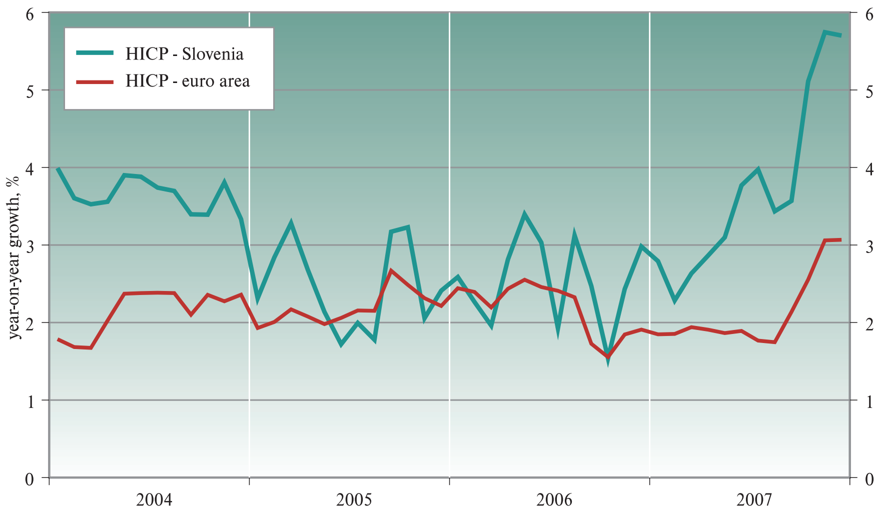
Sources: SORS, Bank of Slovenia calculations

1.2.2 Price Developments

The rise in average annual inflation to 3.8% represents a significant deviation from euro area price developments

Average inflation, measured by the Harmonised Index of Consumer Prices (HICP), was 3.8% in 2007, up 1.3 percentage points from the average rate in 2006. Inflation was even higher at the end of the year, when the year-on-year HICP growth rate reached 5.7%. This relatively high inflation was the result of supply-side shocks that reflect conditions in the world economy (price increases for food, oil and other commodities) and internal macroeconomic factors. Deviations from euro area price developments rose sharply.

Figure 7: **Year-on-year growth in prices in Slovenia and the euro area**

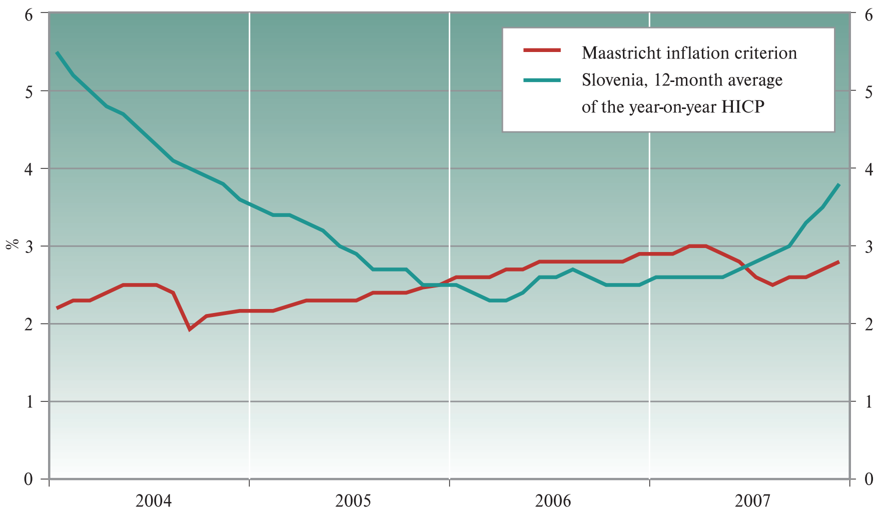


Source: Eurostat

Deviation from the Maastricht criterion had reached 1 percentage point by the end of the year

There were upward deviations from the Maastricht criterion in the middle of 2007. The inflation rate in EU Member States began to rise with a time lag, as did the Maastricht criterion itself, although at a significantly slower pace than in Slovenia. Therefore the upward deviations from this criterion rose sharply. The deviations were already 1.0 percentage point at the end of 2007. The 12-month average growth in prices in Slovenia was 3.8%, while the Maastricht criterion was 2.8%.

Figure 8: **Price stability convergence criterion**



Source: Eurostat

Supply-side shocks from the external environment were primarily reflected in food prices. Growth in the latter was up 4.4 percentage points compared to the previous year to 7.1% on average, significantly exceeding the 2.7% average growth in the euro area. The contribution of growth in food prices to overall inflation began to rise in the second half of 2006, while a particularly sharp rise was seen in 2007. Food prices contributed an average of 1.6 percentage points to inflation in 2007. The first price shock was felt in April in prices of unprocessed food, and in September in prices of processed food. The sharp rise in prices was partially linked to growth in food prices in the international environment, where average year-on-year growth was 26% in 2007. However, the significantly sharper rise in food prices in Slovenia compared to the euro area is also a reflection of internal factors, most notably high growth in disposable income and weak competition in the retail sector.

Sharp growth in food prices was affected by high growth in disposable income and weak competition on the internal markets, as well as external factors

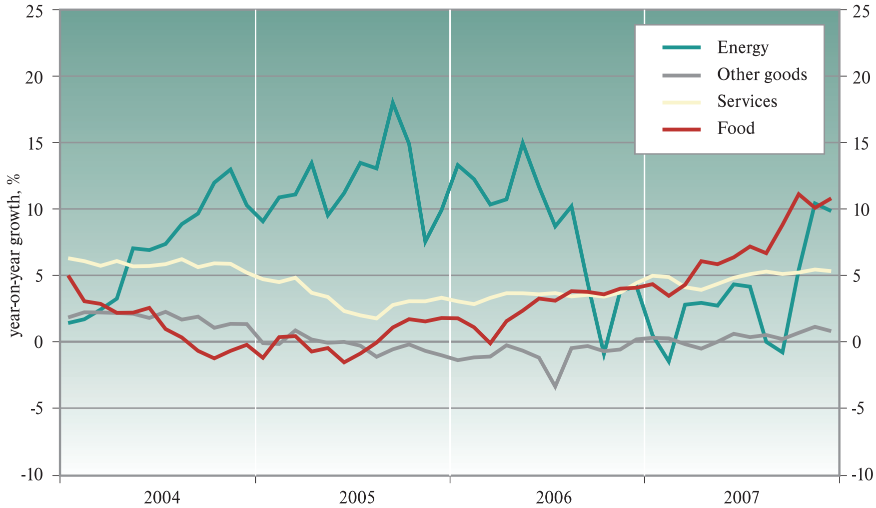
In addition to food prices, energy prices also rose by 3.4% on average. The rise in energy prices was more moderate on average in 2007 compared to a year earlier. The contribution of oil prices to year-on-year inflation was actually negative in February and September. For the year, energy prices contributed 0.4 percentage points to inflation. Average annual growth in energy prices was 3.4% last year, down 5.2 percentage points from 2006. However, energy prices rose sharply again in the last two months of 2007, with oil prices approaching USD 100 per barrel on world markets. In the last quarter of 2007, year-on-year growth in energy prices reached 8.6% in Slovenia and 8.1% in the euro area. The government lowered excise duties on petrol and diesel to the lowest level permitted by the EU directive to mitigate the impact of rising energy prices. In December, these prices contributed 1.3 percentage points to year-on-year inflation.

Energy prices rose sharply in the last months of 2007, with the price of oil more than doubling year-on-year

Average annual growth in the prices of services was up 1.4 percentage points, compared to the previous year, to 4.9%. Since the summer of 2007, year-on-year growth has exceeded 5%. The short-term rise in prices of services at the beginning of 2007 was likely linked to the concentration of price adjustments during the transition to euro prices. A subsequent rise in the prices of services was linked to an environment conducive to domestic demand. As a result, the average contribution of prices of services to inflation rose from 1.2 percentage points in 2006 to 1.6 percentage points in 2007. Following negative growth in 2005 and 2006, prices of non-energy industrial goods also recorded positive growth in 2007. Year-on-year growth was practically zero in the first half of the year, while the 1% growth at the end of the year had already exceeded the euro area average.

Growth in prices of services exceeded 5% in the last months of the year, while prices of non-energy industrial goods recorded positive growth after two years of negative growth

Figure 9: **Year-on-year growth in prices of individual sub-groups of inflation**

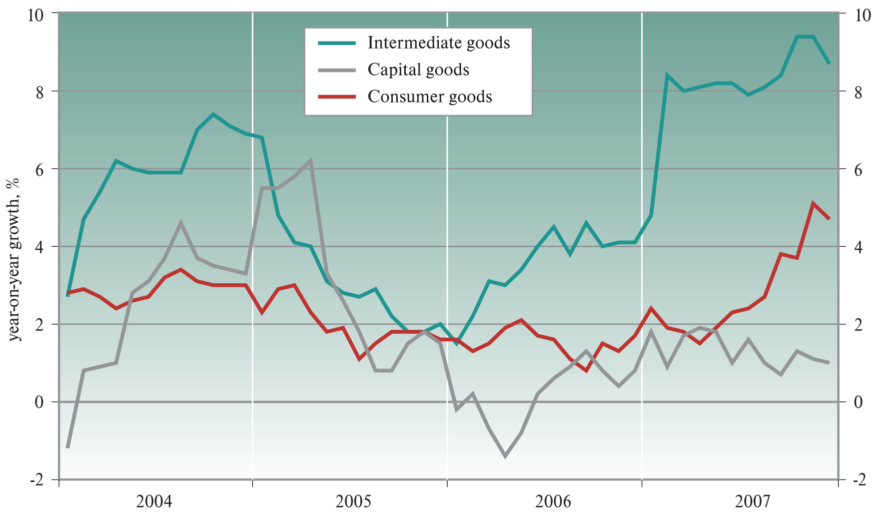


Source: Eurostat

Producer prices of manufactured goods also recorded accelerated growth

Producer prices of manufactured goods on the domestic market rose by 5.4% on average in 2007, 3.1 percentage points more than in 2006 and 2.5 percentage points more than in the euro area. Prices of intermediate goods recorded the highest growth (8.1%), as the result of high prices of energy and other commodities. The primary reason for high growth in food prices was unfavourable weather conditions in some major agricultural commodity exporting countries. High energy prices also contributed to the rise in costs of energy-intensive inputs for agriculture, such as fertiliser, fuel for transportation and machinery. Average growth in prices of capital goods rose from 0.2% in 2006 to 1.3% in 2007, while growth prices of consumer goods rose from 1.5% in 2006 to 2.9% in 2007.

Figure 10: **Year-on-year growth in producer prices of manufactured goods on the domestic market**



Source: Eurostat

The Ministry of the Economy estimates that administered prices, excluding liquid fuels for transport and heating, rose by 1.5%

The Ministry of the Economy estimates[1] that administered prices rose by 1.5% in the first 11 months of 2007, excluding the effects of growth in prices of liquid fuels for transport and heating.[2]. Prices of liquid fuels for transport and heating rose 12.9% in the same period. Furthermore, prices for remote heating rose by 0.3% in the period from January to October 2007 primarily due to changing input energy prices, based on the prescribed mechanism for amending prices for the production and distribution of steam and hot water. In 2007, prices of passenger railway services within Slovenia were formed in accordance with the Plan for Managing Regulated Prices in 2006 and 2007, and rose by 2.3%. Retail electricity prices also rose by 5.4%, in line with the plan, as did prices of municipal services (by 2.3% on average).

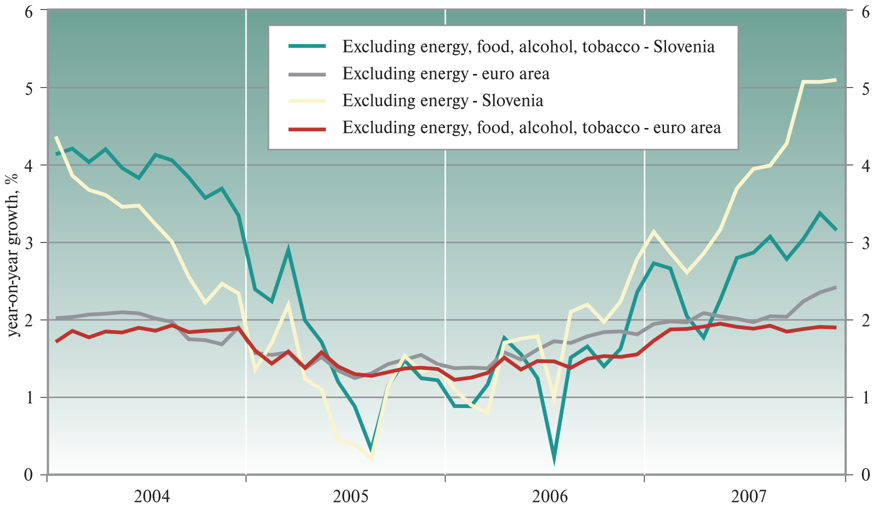
Core inflation indicators point to the sources of inflation in the domestic environment

On average, core inflation indicators rose more sharply than overall inflation during the year, and primarily reflect factors in the domestic macroeconomic environment. The level of average core inflation, expressed as growth in the harmonised index of prices excluding prices of energy, food, alcohol and tobacco (with external supply-side shocks fully excluded), nearly doubled compared to 2006, rising from 1.4% to 2.7% and reaching 3% year-on-year by the end of 2007. This growth is high, particularly compared with the euro area, where average core inflation was 1.9%, an increase of 0.5 percentage points from a year earlier. The largest contribution to this

1 See the Plan for Managing Regulated Prices for 2008 and 2009.
2 The calculation also includes the price of electricity, which rose by 4.9% in April in accordance with the Slovenian Government's decision. Since 1 July 2007, the price of electricity is formed freely.

discrepancy came from prices of services, which grew nearly twice as fast than in the euro area. The difference with regard to the euro area indicates an overheating of economic activity and excess demand in Slovenia, contrary to growth in economic activity in the euro area, which was in line with growth in the supply potential.

Figure 11: **Year-on-year growth in core inflation indicators for Slovenia and the euro area**



Source: Eurostat

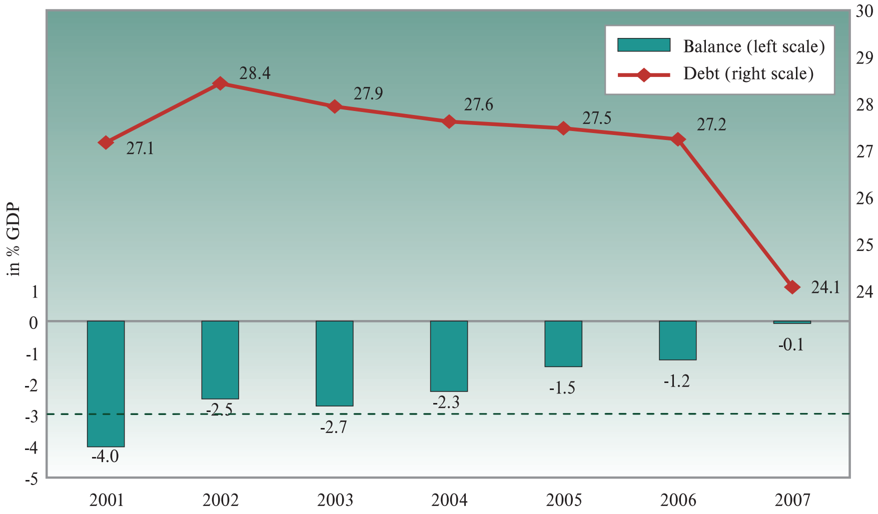
1.2.3 Public finances

The general government deficit in 2007 according to the ESA95[3] methodology stood at 0.1% of GDP. The general government debt stood at 24.1% of GDP, and was lower than at the end of 2006. These figures also form the basis for verifying that the reference values for the deficit and general government debt are met. According to data from the Stability Programme update and given the estimates of the European Commission, Slovenia also met its medium-term goal in 2007, which is defined as a structural deficit in the amount of 1% of GDP.

In 2007, the general government deficit stood at 0.1% of GDP, its debt 24.1% of GDP

3 The 1995 European System of Accounts methodology (ESA 95) ensures that countries follow the same standards and the same definitions of categories and classifications, and the same accounting rules. The ESA95 methodology sets out in detail the criteria for classifying units into institutional sectors and reporting individual transactions. An important element of the methodology is the time when a transaction is recorded. The accrual basis is used, which entails recording transactions when a claim or liability occurs.

Figure 12: **Balance and debt of the government sector according to ESA95 methodology**



Source: SORS

The general government surplus stood at 0.3% of GDP according to the national methodology

Preliminary estimates put the general government surplus, calculated by the national methodology[4], which covers four public treasuries, namely the national budget, municipal budgets and the treasuries of the Pensions and Disability Insurance Institute and the Health Insurance Institute of Slovenia, at EUR 96 million in 2007 or 0.3% of GDP. Given the higher economic growth than in 2006, the general government position improved, as the deficit in the previous year was 0.8% of GDP. The state budget and Health Insurance Institute recorded surpluses in the amounts of EUR 37 million and EUR 65 million, respectively, while municipal budgets recorded a smaller deficit of EUR 7 million. The position of the Pension and Disability Insurance Institute was balanced following a significant transfer from the state budget. According to the national methodology, the consolidated general government deficit was EUR 77 million in the first half of last year, which was similar to the level recorded in the same period the previous year. Comparing year-on-year, there was a significant improvement in this position in the second half of the year (primarily due to developments in the state budget), when a surplus of EUR 172 million was recorded compared to a deficit of EUR 181 million in the second half of 2006.

Growth in revenues outstripped growth in expenditure

Growth in general government revenues in 2007 outstripped growth in public finance expenditure. General government revenues were up 8.1% in 2007 from the previous year, 2.8 percentage points more than the growth in general government expenditure.

High growth in tax revenues, despite income tax reform and a decrease in payroll taxes

General government revenues amounted to EUR 14,010 million in 2007, or 41.8% of GDP. Tax revenues, which account for the majority of general government revenues, rose by 8.5% in 2007. Of the major types of tax revenue, corporate income tax revenues rose 18.1%, while social security contributions increased by 8.7%, despite unchanged contribution rates. Revenues from tax on goods and services were 10.3% higher than last year, with growth in VAT revenues reaching 7.0%, while excise duties rose by approximately 20%. High growth was also recorded for some less significant taxes (e.g. motor vehicle fees). Taxes on international trade rose

---

4 The consolidated balance sheet position is compiled on the cashflow principle in line with IMF methodology. Owing to the methodological differences (mainly in sectorisation and the cashflow principle), these figures differ from those required to verify that the fiscal criterion of the general government deficit is being met, as implemented by the EU.

by 131% last year, and accounted for less than 1% of revenues. The extremely high growth in customs duties was the result of payments of customs duties on imports via the Port of Koper. Revenues from personal income tax rose by 0.6% compared to the previous year. Growth was low due to the implementation of changes on 1 January 2007, including an increase in the general allowance, the abolishment of certain special allowances, the reduction of the number of tax brackets from five to three and less progressive taxation. Last year, revenues from payroll taxes recorded the sharpest drop (11.6%), resulting from the lowering of the aforementioned tax rate on 1 January 2007. The relatively strong growth in all main categories of tax revenues is primarily the result of relatively high economic growth, which stood at 6.1% in 2007, and the associated high growth in employment.

EU budget funds received remained at the same level; the structure of funds changed

Non-tax revenues, which account for approximately 5% of all revenues, rose by 11.8% compared to the previous year, while funds from the EU budget were nearly the same at EUR 348 million. The structure of funds received has changed. There were more funds than the previous year for agricultural policy (151 million) and for internal policy (EUR 94 million). Slovenia was not entitled to lump-sum rebates in 2007.

Investment expenditure stands out among expenditure, while low growth was recorded in most other categories

General government expenditure amounted to EUR 13,914 million in 2007, or 41.5% of GDP. The largest increase among major expenditures last year was recorded by investment expenditure, while payments to the EU budget were also considerably higher, primarily due to higher liabilities from traditional own funds. Growth in investment expenditure was high for the second consecutive year. Reasons include preparations for the EU presidency and entry to the Schengen area, as well as organisational changes in the transport sector. In 2007, fewer funds were earmarked for interest payments than in 2006. The trend of low growth in expenditure for wages and other employee expenditure in the public sector continued last year.

Pensions as a proportion of GDP decreased, while the number of pensioners and the pension adjustment have increased

Transfers to individuals and to households, which remain the largest category on the expenditure side, accounting for more than one-third of all expenditure, were 4.5% higher than in 2006, with pension expenditure rising by 6.3%. Old age pensions were the most important factor in this increase, with the number of old age pensioners increasing by 3.1% in 2007 compared to the previous year. The basic pension was 5.9% higher in 2007 than a year earlier. Fewer payments for unemployment and fewer funds necessary for social security contributed to favourable trends, as the decline in the number of unemployed continued in 2007.

The general government surplus was accompanied by a net repayment

In the context of a surplus in revenues over expenditure of EUR 96 million and a surplus in net loans granted and sales of capital holdings in the amount of EUR 463 million, the government sector made a net repayment of EUR 56 million in 2007, while increasing its bank balances by EUR 502 million. The privatisation of NKBM in December contributed most to the decrease in capital holdings and the increase in bank balances. In its borrowing, the government made a net repayment of EUR 215 million in Slovenia, but recorded net borrowing of EUR 159 million in the rest of the world.

Central government debt stood at 22.0% of GDP at the end of 2007

Central government debt stood at EUR 7,395 million at the end of 2007, or 22.0% of GDP. At the end of 2007, domestic debt accounted for 66% of total government debt, down 13 percentage points from the end of the previous year. A significant portion of the debt consists of government securities, mostly of a long-term nature. Over 90% of the total debt is in the form of securities, and over 90% is long-term debt.

The Ministry of Finance continued to issue short-term and long-term securities in 2007. It released 8 issues of 3-month treasury bills and 3 issues of 6-month treasury bills. The individual issues amounted to approximately EUR 50 billion, with the interest rates ranging from 3.70% to 4.05%. In March 2007, the Ministry of Finance issued 11-years reference bonds abroad in the amount of EUR 1 billion, with a fixed interest rate of 4.00%. The bonds mature in 2018.

Table 3: **General government consolidated position and debt**

	2006			2007			y-o-y
	in EUR mio	(% GDP)	share	in EUR mio	(% GDP)	share	growth
Consolidated general government accounts*							
Revenue	**12,959**	**42.6**	**100.0**	**14,010**	**41.8**	**100.0**	**8.1**
Taxes	11,762	38.6	90.8	12,758	38.0	91.1	8.5
- on goods and services	4,077	13.4	31.5	4,498	13.4	32.1	10.3
- social security contributions	4,231	13.9	32.7	4,598	13.7	32.8	8.7
- on income and profit	2,735	9.0	21.1	2,918	8.7	20.8	6.7
Receipts from the EU budget	348	1.1	2.7	348	1.0	2.5	-0.3
Other	848	2.8	6.5	904	2.7	6.5	6.6
Expenditure	**13,209**	**43.4**	**100.0**	**13,914**	**41.5**	**100.0**	**5.3**
Current expenditure	5,689	18.7	43.1	5,947	17.7	42.7	4.5
Current transfers	5,926	19.5	44.9	6,143	18.3	44.2	3.7
Investment expenses and transfers	1,306	4.3	9.9	1,468	4.4	10.6	12.4
Payments to the EU budget	288	0.9	2.2	356	1.1	2.6	23.6
Balance	**-250**	**-0.8**		**96**	**0.3**		
Central government debt	**7,351**	**24.1**		**7,395**	**22.0**		
General government debt (ESA 95)	**8,289**	**27.2**		**8,071**	**24.1**		

Data in the table are based on national methodolgy, except for the general government's debt, which is based on ESA 95.

* General government comprises the state budget, the Health fund, the Pension fund and the local government budgets.

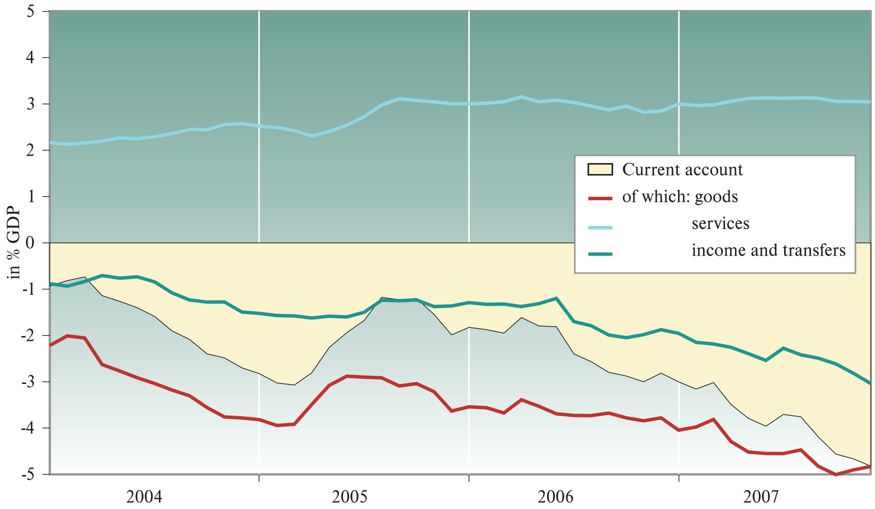
Sources: Ministry of Finance, SORS

1.2.4 Balance of payments and external debt

The current account deficit rose to 4.9% of GDP in 2007

There was a significant increase in the balance of payments current account deficit in 2007. The deficit was EUR 1,641 million or 4.9% of GDP and was two percentage points higher than the 2006 deficit of 2.8% of GDP. The deficit reached its highest level since Slovenia's independence. The biggest contribution to the current account deficit in 2007 came from developments in merchandise trade with the rest of the world, particularly in the second and third quarters when, given increased domestic consumption, there was a significant upturn in the import of goods, which exceeded year-on-year growth in exports by more than 3 percentage points. In addition to the merchandise trade deficit in the amount of EUR 1,664 million, the deficit in the transfer account of EUR 292 million and net outflows of factor income in the amount of EUR 725 million contributed significantly to the current account deficit. The only positive effect on the current account was the surplus in trade in services in the amount of EUR 1,040 million.

Figure 13: **Balance of payments current account**



Sources: SORS, Bank of Slovenia

The trade deficit rose, while the level of coverage of imports by export fell

Slovenia' trade deficit with the rest of the world was EUR 2,102 million in 2007, or 6.3% of GDP, and was slightly more than one percentage point higher than in 2006. It was still however lower than the trade deficit of 7.7% of GDP recorded in 1999. Merchandise trade with the rest of the world rose in 2007, in terms of volume and value.[5] Exports of goods totalled EUR 19.4 billion, up 15.7% from 2006. Imports of goods grew 1.5 percentage points faster than exports, and were up 17.2% from 2006 at EUR 21.5 billion. The coverage of imports by exports fell by just over 1 percentage point to 90.2%.

Export prices rose slower than import prices…

In terms of volume, growth in imports and exports of goods was lower in 2007 than indicated by indices calculated from the value figures expressed in euros. The reason for this difference is that the average import-export value indices (import-export prices) calculated in euros in 2007 increased compared to 2006, with export prices growing somewhat more slowly than import prices. In the first half of 2007, growth in import prices, where intermediate products are predominant, was heavily influenced by growth in prices of industrial metals and food. Developments in energy prices, primarily prices of oil and non-food agricultural products expressed in euros, which actually fell year-on-year in the first half of the year, acted to decrease or limit growth in import prices. Rising prices of industrial metals stalled in the second half of the year, but growth in food and oil prices picked up. Growth in US dollar prices of industrial commodities, energy and food was partially offset by the appreciation of the euro against the US dollar by 9.2% on average in 2007. In 2007, euro oil prices rose 2.1% year-on-year, while industrial metal prices rose 4.4% and food prices recorded the highest growth at 15.2%.

… but terms of trade did not deteriorate significantly compared to 2006

On average, euro export prices rose by 3.2% year-on-year in 2007, and euro import prices by 3.5%. In 2007, terms of trade deteriorated by just 0.3% compared to 2006. This is slightly more than one-quarter of the average annual deterioration in terms of trade in the last three years. Deterioration in terms of trade with the rest of the world contributed EUR 109 million or 0.3% of GDP to the merchandise trade deficit.

5 Since entry to the EU, the so-called »Roterdam« or »Roterdam-Antwerp« effect has likely had impact on the level and the growth in Slovenian foreign trade. The Port of Koper is an important entry and exit point for exports and imports to other member states of EU, which are included in Slovenian foreign trade statistics.

Exports and imports of consumer goods rose fastest

Slovenia's exports of highly processed products rose fastest in 2007. Exports of consumer goods rose 22.9% year-on-year (mostly in the last two quarters, reaching 25% year-on-year), primarily due to an increase in road vehicle exports of 35%. Growth in exports of capital goods was more than one-half lower at 15.1%. The largest increase in this regard was recorded by exports of general industrial and metalworking machinery, while the smallest increase was recorded by exports of intermediate goods (11.4%). Similar to exports, imports of consumer goods recorded the highest growth, reaching 25.9% in 2007, up from 14.9% in 2006. Faster growth in imports of capital goods, which began in 2006, continued in 2007, with the exception of the last quarter. Year-on-year growth in imports of capital goods reached 17.1%. Growth in imports of consumer and capital goods in 2007 was affected by high growth in domestic consumption, primarily investment spending which, in addition to high foreign demand, was the main engine of Slovenian economic growth last year. In addition to domestic factors, external price factors which are seen in growth in prices of consumer goods, particularly in food prices, had an impact on growth in the value of imports. In 2007, the smallest increase (13.7%) was recorded by imports of intermediate goods.

Table 4: **Regional breakdown of merchandise trade**

	EXPORTS			IMPORTS			TRADE BALANCE		
EUR million	2005	2006	2007	2005	2006	2007	2005	2006	2007
European Union (27)	**10,003**	**11,767**	**13,675**	**12,960**	**14,896**	**16,946**	**-2,957**	**-3,129**	**-3,271**
Eurozone	**7,867**	**9,032**	**10,103**	**10,908**	**12,527**	**14,119**	**-3,041**	**-3,495**	**-4,016**
Austria	1,160	1,451	1,509	1,953	2,245	2,684	-793	-794	-1,175
France	1,185	1,135	1,262	1,157	1,129	1,151	28	6	111
Italy	1,819	2,157	2,563	3,014	3,405	3,927	-1,195	-1,248	-1,364
Germany	2,863	3,296	3,654	3,163	3,743	4,176	-300	-447	-522
New member states	**1,476**	**1,923**	**2,676**	**1,619**	**1,841**	**2,248**	**-143**	**82**	**428**
Czech Republic	321	390	489	380	399	506	-59	-9	-17
Hungary	284	385	647	603	671	758	-319	-286	-110
Poland	364	488	616	239	303	356	125	185	260
Slovakia	213	272	311	211	259	284	3	13	28
EFTA	**219**	**196**	**242**	**220**	**267**	**225**	**-1**	**-71**	**18**
Non-European OECD members	**561**	**658**	**619**	**550**	**615**	**1,116**	**11**	**43**	**-497**
United States	294	384	329	145	199	280	149	185	49
Canada	26	36	43	43	33	65	-17	3	-22
South Korea	15	16	18	70	110	480	-54	-94	-462
Countries of former Yugoslavia	**2,476**	**2,736**	**2,990**	**1,034**	**1,350**	**1,584**	**1,442**	**1,386**	**1,406**
Bosnia and Herzegovina	515	485	535	208	313	321	307	172	215
Croatia	1,304	1,464	1,569	609	736	849	695	729	720
Macedonia	134	126	144	29	38	58	105	87	87
Serbia	262	509	670	102	239	352	159	270	318
Countries of former Soviet Union	**686**	**870**	**1,055**	**390**	**436**	**555**	**297**	**435**	**500**
Russian Federation	468	600	692	334	357	490	133	242	202
Other countries	**452**	**530**	**804**	**652**	**775**	**1,061**	**-200**	**-246**	**-257**
China	36	54	61	197	246	346	-161	-192	-285
TOTAL	**14,397**	**16,757**	**19,385**	**15,805**	**18,339**	**21,487**	**-1,408**	**-1,582**	**-2,102**

Note: Export f.o.b. and import c.i.f.
Source: SORS; data for 2007 are preliminary

The proportion of exports to EU Member States rose, while the proportion of imports from EU countries was down

Due to above-average growth in exports to and below-average growth in imports from EU Member States, the regional distribution of Slovenia's merchandise trade with the rest of the world changed in 2007. EU Member States accounted for 70.5% of total exports, up 0.3 percentage points year-on-year, and for 78.9% of imports, down 2.3 percentage points. In this regard, primarily the proportion of trade with the euro area is declining (exports are down 1.8 percentage points to 52.1%, while imports are down 2.6 percentage points to 65.7%), while merchandise trade with countries which joined the EU after May 2004 is rising. Among Slovenia's most important trading partners in the euro area, only exports to Italy recorded above-average growth (of 18.8%), while below average growth in exports was recorded for Germany (10.9%), Austria (11.9%) and France (4.0%). Among new EU Members States, exports increased sharply to Hungary (up 68.1%), and to the Czech Republic and Poland, by more than 25%, while growth in exports to Slovakia (just over 14%) was below the EU average. Among Slovenia's more important partners, imports from France were below average (2.0%), from Germany slightly below average (11.6%), while they were above average from Austria (19.6%) and Italy (15.3%).

Imports from the former Yugoslav republics have grown faster than exports since Slovenia joined the EU. Trade with Serbia recorded the highest growth last year

Since Slovenia joined the EU, imports from the republics of the former Yugoslavia are growing faster than exports. Exports to former Yugoslav republics grew by 9.3% year-on-year, while imports were up 17.3%. Trade with Serbia has risen most in the last two years. Last year, exports and imports were up 31.6% and 47.1%, respectively. Trade with Croatia grew somewhat below the average of trade with the republics of the former Yugoslavia (exports: 7.2%; imports: 15.4%), while exports to Bosnia & Herzegovina rose by 10.5% (imports: 2.6%). Exports to Macedonia were up 14.7%, while imports rose by 50.4%. Growth in merchandise trade with Russia continued in 2007. Growth in exports was somewhat modest at 15.3%, while above-average growth (37.2%) was recorded on the import side.

The deficit in merchandise trade with EU Member States is increasing

Slovenia's deficit in merchandise trade with the EU27 has risen gradually since entry to the European Union. The highest increase, of EUR 1.4 billion, was recorded in 2004. Last year, the deficit rose EUR 0.1 billion, reaching EUR 3.3 billion, or 9.8% of GDP. The trade deficit with euro area countries recorded the most significant increase, as Slovenia achieved a minor surplus with Member States outside the euro area in both 2006 and 2007. Slovenia has achieved a surplus in merchandise trade with non-EU countries, which rose to EUR 1.7 billion in 2004, or slightly more than 6% of GDP, although it has gradually fallen since. It fell most in 2007, relative to the previous year, by EUR 0.38 billion to EUR 1.17 billion, or 3.5% of estimated GDP.

The surplus in trade in services reached 3.1% GDP

Among the subheadings of Slovenia's balance of payments current account with the rest of the world, only trade in services recorded some improvement in 2007. The surplus in the amount of EUR 1,040 million represented 3.1% of GDP. The balance of services has remained at approximately 3% of GDP since the middle of 2005. Growth in trade in services with the rest of the world outstripped growth in merchandise trade by 2 percentage points, on average in 2007. With trade in services growing faster, the proportion of exports of goods and services accounted for by services also rose by 0.3 percentage points to 17.2%, while services as a proportion of imports remained unchanged at 12.5%. Exports of services reached EUR 4.1 billion in 2007, up 19.3% year-on-year, while imports were up 19.0% year-on-year to EUR 3.1 billion.

The surplus in tourism represents 78.5% of the surplus in trade in services

Results in the tourism sector were the largest factor in the services surplus. Revenues from tourism, totalling EUR 1,619 million, were up 13.6% year-on-year which, given growth in the number of arrivals of foreign tourist in Slovenia and the number of overnight stays by foreign visitors by 8%, indicates increased spending by foreign tourists in Slovenia. Despite favourable economic conditions in 2007, expenditure on tourism grew three times slower than revenues from tourism. Expenditure stood at EUR 803 million, an increase of just 4% from 2006. The tourism trade surplus rose EUR 163 million year-on-year to EUR 816 million, representing 78.5% of the overall surplus in trade in services in 2007.

The transport services surplus has risen while other services recorded a deficit

Since Slovenia's entry to the EU, transport services have recorded the most significant improvement, as the transport services surplus doubled between 2003 and 2007. Revenues from transport grew by 18.8% year-on-year in 2007, while expenditure on transport was up 21.6%, taking the surplus up more than one-tenth to EUR 525 million. Other services recorded a net outflow in the amount of EUR 301 million. Trade in construction services (construction and assembly work) recorded the most significant growth among other services in 2007. Growth of 50% was recorded on the export side, while growth on the import side more than doubled reaching EUR 161 million, under the influence of high domestic investment in construction. With this significant increase in the import of construction services, a deficit of EUR 7 million was recorded. In addition to construction services, financial services also recorded high growth (exports: 52%; imports: 37%). Among financial services, financial intermediation services of banks recorded the faster growth, on both the export and import sides. Among other business services, exports and imports of foreign trade intermediation services recorded above average growth, while expenditure on operating leasing abroad rose by more than 50% on the import side.

The net outflow of factor income rose, driven by an increase in the outflow of capital income

Net outflows of factor income have more than doubled in the last five years and, in addition to the deficit in merchandise trade with the rest of the world, is becoming the most significant factor in Slovenia's balance of payments current account deficit with the rest of the world. Net outflows of factor income rose by 82% year-on-year in 2007, reaching EUR 725 million. With increasing employment of foreign labour in Slovenia, net inflows of labour income have been falling for a number of years. In 2007, inflows were more than halved compared to the previous year, and stood at just EUR 55 million. Net outflows from capital income have recorded the most significant increase in recent years under the influence of foreign direct investments, increasing indebtedness abroad and the rise in interest rates on world financial markets. The deficit in capital income was up EUR 265 million on 2006 at EUR 780 million. Until 2005, foreign-owned companies reinvested two-thirds of profits, while transferring one-third abroad. The situation has changed entirely since 2005. Last year, foreign-owned companies reinvested only EUR 52 million of the EUR 478 million in generated profits, while transferring the remainder abroad. With regard to capital income, income and expenses from investments in securities rose by more than 25%. The net inflow from these investments rose by just over EUR 40 million in 2007 to EUR 222 million. On the income side, the largest increase was recoded by banks' income from Bank of Slovenia bonds and notes.

The deficit in current transfers was up more than 67% year-on-year

The deficit of EUR 292 million in current transfers was up more than 67% from 2006, and was a major factor in the deterioration in the balance of payments current account. Private transfers deteriorated by EUR 10 million year-on-year to EUR 76 million. The greatest deterioration was recorded by official transfers as the deficit in official transfers doubled year-on-year to EUR 216 million. The majority of official transfers relate to payments of taxes and contributions to the rest of the word, insurance premiums and other transfers. The net position of the budget of the Republic of Slovenia against the EU budget contributed just EUR 7 million to the deficit in official transfers in 2007.

Table 5: **Balance of payments**

EUR million	2002	2003	2004	2005	2006	2007
A. CURRENT ACCOUNT	**247**	**-196**	**-720**	**-561**	**-857**	**-1,641**
- in % of GDP	***1.0***	***-0.8***	***-2.7***	***-2.0***	***-2.8***	***-4.9***
1. Goods	-265	-543	-1,009	-1,026	-1,151	-1,664
2. Services	620	540	688	849	866	1,040
2.1. Transport	249	260	324	398	456	525
2.2. Travel	508	522	608	672	653	816
- exports	1,143	1,186	1,312	1,380	1,425	1,619
2.3. Other	-137	-243	-245	-221	-243	-301
3. Income	-168	-219	-322	-288	-398	-725
3.1. Labour income	160	135	138	135	117	55
3.2. Investment income	-328	-353	-460	-423	-515	-780
4. Current transfers	60	26	-76	-97	-173	-292
B. CAPITAL ACCOUNT	**-5**	**-1**	**1**	**-114**	**-131**	**-52**
C. FINANCIAL ACCOUNT	***-242***	***197***	***719***	***675***	***988***	***1,693***
1. Private sector	387	-135	942	1,332	-401	-1,965
1.1. Claims	-92	-467	255	-3,452	-4,727	-8,635
Outward FDI	8	-6	-28	-516	-718	-1,154
Portfolio investments	-22	5	1	-1,498	-2,094	-3,698
Trade credits	-9	-235	-320	-227	-435	-426
Loans	-13	-4	-57	-340	-733	-1,807
Cash and deposits	-55	-227	659	-872	-747	-1,551
1.2. Liabilities	479	332	688	4,784	4,326	6,670
Inward FDI	118	138	295	473	512	1,073
Portfolio investments	-0	-2	48	210	176	94
Trade credits	-1	18	11	293	468	520
Loans	333	49	317	2,758	2,179	3,802
Deposits at banks	29	128	18	1,051	991	1,182
2. Government*	117	449	138	-196	382	889
3. Bank of Slovenia	-235	-359	-1,149	-189	1,287	3,639
4. Other	-510	241	787	-272	-280	-869

Note: * The transactions of domestic banks with government bonds are excluded.
Sources: Bank of Slovenia.

In 2007, both the financial outflows and, even more so, financial inflows of the private sector significantly exceeded those of a year earlier, an indication of Slovenia's increasing integration into international financial flows. Financial inflows of the private sector rose from EUR 4.3 billion in 2006 to EUR 6.7 billion in 2007, while financial outflows of the private sector over the same period rose from EUR 4.7 billion to EUR 4.9 billion. [6]

Loans to banks represent the majority of financial inflows

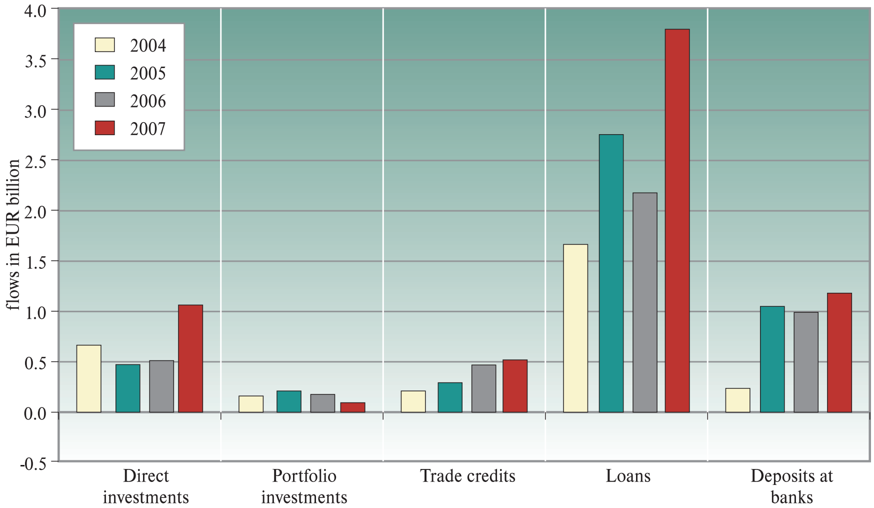
Loans to banks from the rest of the world and bank deposits by non-residents represent the majority of financial inflows of the private sector. Of the total financial inflows into the private sector in the amount of EUR 6.7 billion, loans to banks from the rest of the world accounted for EUR 3.4 billion, while bank deposits by non-residents represented EUR 1.2 billion. Loans to banks from the rest of the world nearly doubled compared to the previous year. Despite uncertainties on financial markets and the associated higher costs of borrowing abroad, financial inflows via loans from the rest of the world and non-residents' deposits strengthened towards the end of the year.

6 Financial flows originated because of the repayment of Bank of Slovenia bills are excluded.

Foreign direct investment doubled

Among other financial inflows of the private sector, foreign direct investments doubled in 2007 compared to the previous year, while corporate borrowing abroad fell significantly. Foreign direct investment rose from EUR 0.5 billion in 2006 to EUR 1.1 billion in 2007. Corporate borrowing abroad fell from EUR 0.7 billion to EUR 0.4 billion which, to a great extent, is the result of a shift from foreign sources of financing to domestic sources. Corporate borrowing abroad as a proportion of total borrowing fell from almost 20% in 2006 to less than 10% in 2007. Inflows from portfolio investments remained negligible in 2007.

Figure 14: **Breakdown of financial flows from the rest of the world**

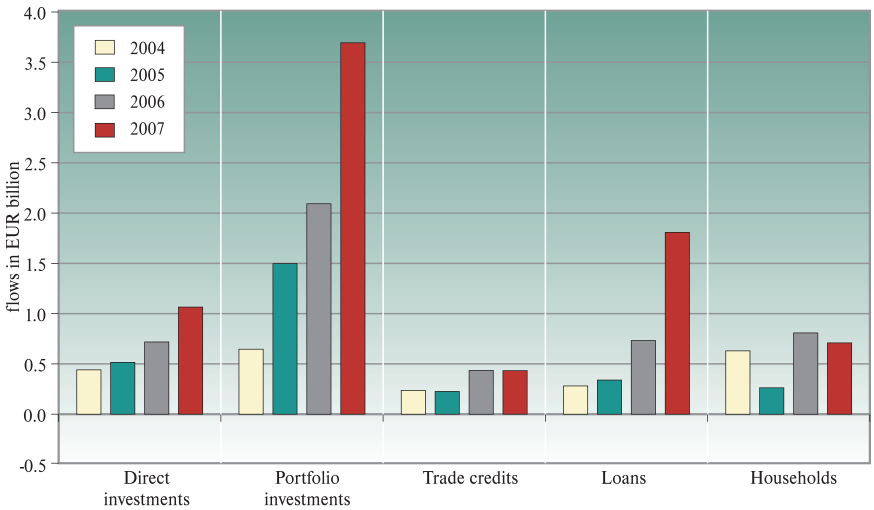


Source: Bank of Slovenia

Loans and deposits were also prevalent among outflows

Among financial outflows in 2007, loans and deposits abroad recorded the highest growth, while higher portfolio investments were primarily the result of the flow of released liquidity from repaid Bank of Slovenia bills into foreign securities. Financing of the rest of the world via loans amounted to EUR 1.8 billion in 2007, almost three times as much as the previous year, with bank lending prevalent. Bank deposits abroad rose by EUR 0.9 billion in 2007, while the outflow was virtually zero in 2006. Portfolio investments, which totalled EUR 3.5 billion in the first half of the year, slowed, as expected, amounting to just EUR 0.2 billion in the second half of the year. Foreign direct investments stood at EUR 1.1 billion and were equal to direct investments in Slovenia by non-residents.

Figure 15: **Breakdown of financial flows to the rest of the world**



Source: Bank of Slovenia

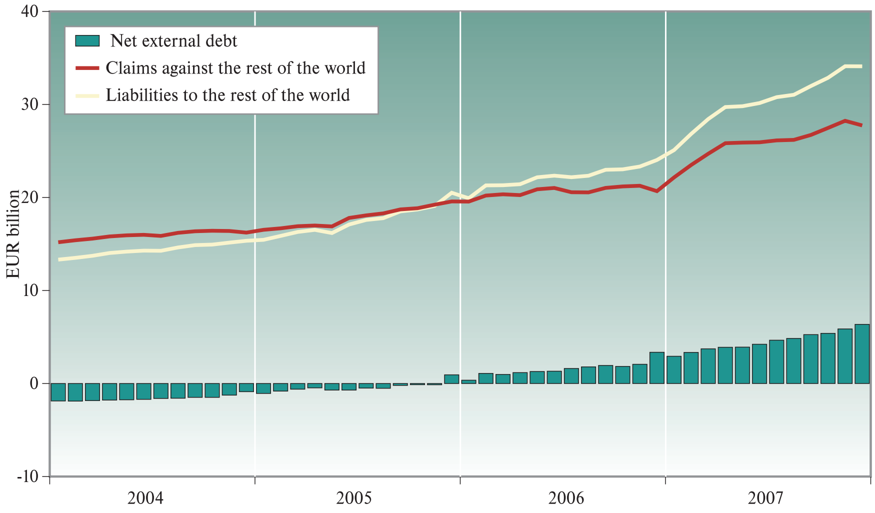
Claims and, particularly liabilities, to the rest of world increased

Increased financial flows with the rest of the world, which were mostly in the form of debt instruments, were seen as an increase in both gross external debt and claims against the rest of the world. Slovenia's gross external debt rose from EUR 24.0 billion at the end of 2006 to EUR 34.1 billion at the end of 2007. In the same period, Slovenia's claims against the rest of the world rose from EUR 20.7 billion to EUR 27.7 billion.

Net external debt stood at EUR 6.4 billion at the end of 2007

The prevailing net financing from the rest of the world via debt instruments is reflected in an increase in net external debt and a deterioration of the balance of payments' current account. Next external debt rose by EUR 1.8 billion in 2005, EUR 2.4 billion in 2006 and EUR 3.0 billion in 2007. The net external debt thus stood at EUR 6.4 billion at the end of the year. An increase in the burden of financing, which adds to the deterioration of the balance of payments current account, was accompanied by rising net external debt.

Figure 16: **External debt**



Source: Bank of Slovenia

In 2007, the Bank of Slovenia debt rose by EUR 3.6 billion in the financial account of the balance of payments. This increase stems from entry to the euro area and the fact that the last tolar monetary policy instruments did not mature until April 2007. Until that time, the Bank of Slovenia repaid its liabilities to banks by the maturities stated on bills. This resulted in a gradual change of the Bank of Slovenia's internal domestic debt to banks to cross-border domestic debt to the Eurosystem on the liability side of its balance sheet. Banks no longer maintained released liquidity on Bank of Slovenia accounts, but invested it in financial instruments on the European financial market or used it for lending. In terms of assets, this change of creditors was entirely neutral. It did however result in a change of the previous relation between residents (e.g. between the Bank of Slovenia and domestic banks) to a relation between a resident and a non-resident (e.g. between the Bank of Slovenia and the Eurosystem).

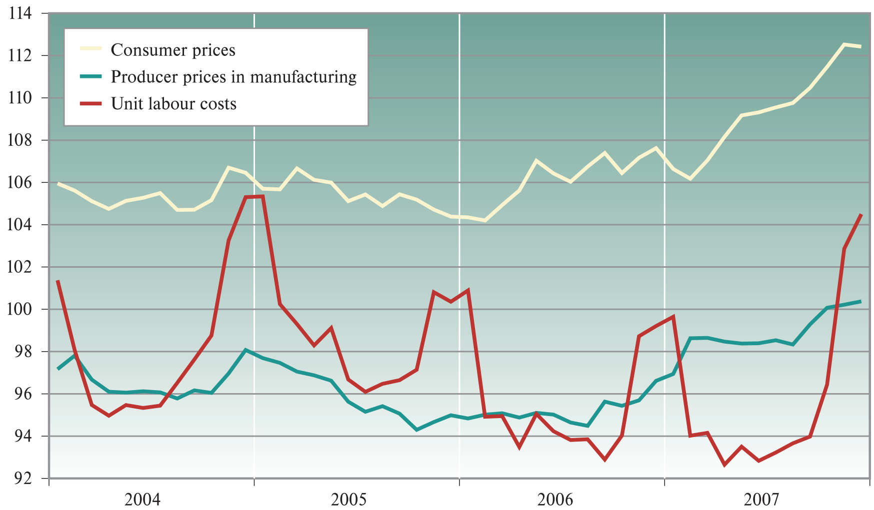
The nominal effective euro exchange rate appreciated by 1.6% in 2007

The real and nominal effective euro exchange rate appreciated in Slovenia in 2007. The nominal effective euro exchange rate as measured against a basket of foreign currencies appreciated by an average of 1.6% year-on-year in 2007. The rise in the value of the domestic currency was affected by external factors which are primarily reflected in the movement of exchange rates on external financial markets, particularly in the appreciation of the euro against the US dollar by 9.2%. In addition to external factors, domestic factors, which are reflected in domestic prices rising faster than the basket of foreign prices, also contributed to the appreciation of the real effective exchange rate. The real effective euro exchange rate, measured by the ratio of the domestic cost of living to the cost of living abroad, appreciated by 3.8%, and by just under one-quarter less (or 3.0%) as measured by producer prices. The real effective euro exchange rate, measured by relative unit labour costs in the manufacturing sector, recorded the lowest appreciation (0.5%) in 2007 among all competitiveness indicators.

Real sales revenues in industry on foreign markets grew faster than sales revenues on the domestic market

Despite the appreciation of competitiveness indicators, foreign demand had a favourable effect on export growth and domestic economic activity in 2007. Real sales revenues in industry rose by 7.6%, with real income from sales on the domestic market rising 5.3% and income from sales on foreign markets rising 8.8%. Growth in real revenues from sales to euro area countries of 7.5% was at the average level for industry, while above-average growth of 10.7% was recorded in 2007 in real revenues from sales outside the euro area, particularly in EU Member States which joined the EU after May 2004. The largest real increases in revenues were recorded in the production of capital goods and consumer goods intended for sale on foreign markets, while the production of intermediate goods recorded the smallest increase, which is also reflected in the dynamics and breakdown of merchandise exports.

Figure 17: **The real effective exchange rate of the domestic currency**



Note: Index 1995 = 100.
Source: Bank of Slovenia

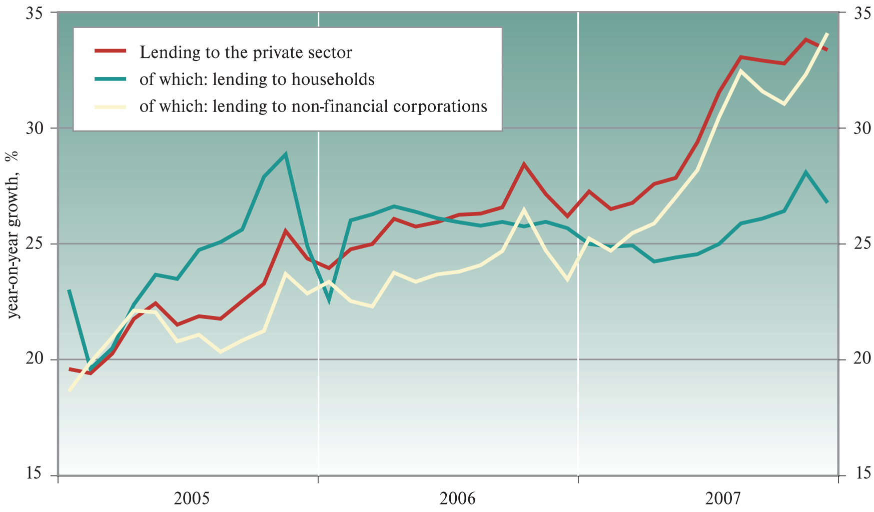
1.2.5 Financing conditions

Financial needs of the private sector were primarily linked to strong economic activity

In 2007, the financial needs of the domestic private sector[7] were primarily linked to high economic growth and investment activity. Real investment growth slowed in the last quarter, coinciding with a slowdown in the lending activities of non-financial corporations. At the same time, the process of financial deepening continued, where the development of the domestic financial sector is catching up with the level of more developed economies.

[7] The domestic private sector includes non-financial corporations, households and non-monetary financial institutions.

Figure 18: **Lending to the domestic private sector**



Source: Bank of Slovenia

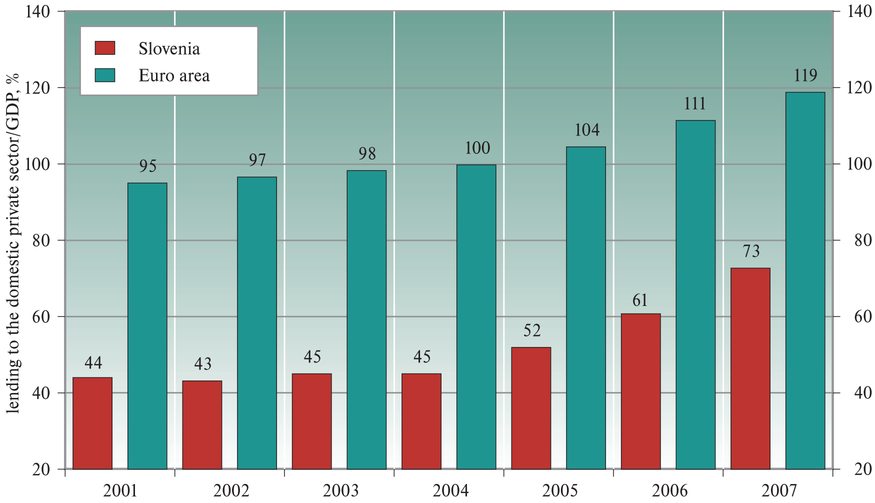
Bank credits to the private sector were up nearly 35% year-on-year

These needs were financed primarily via bank credit channels. Bank credits to the private sector, which had achieved year-on-year growth of nearly 35% by the end on the year, rose almost 10 percentage points over a period of one year. Lending to non-financial corporations began to rise noticeably in the second quarter of 2007, while the first signs of a slowdown were already evident at the end of the year. Lending to households also increased in the second quarter (growth remains just above 25%), but significantly less than lending to non-financial corporations.

Indebtedness of the domestic private sector is also linked to financial deepening

The relatively high growth in the indebtedness of the domestic private sector at banks can, to some degree, be attributed to the process of the deepening of financial intermediation. The high levels of indebtedness are an expected part of the process of real convergence with wealthier EU Member States. This process has become more evident since 2004. It is also reflected in structural changes in the capital account of the balance of payments, which has seen marked growth in gross capital flows in recent years. This increase is the result of needs for financing investment activities, which follow interest for acquiring title, generating income on financial markets and investing in real estate. The depth of financial intermediation, measured by credits to the private sector as a proportion of GDP, has risen at an annual rate of approximately 10% of GDP in recent years in Slovenia, and already exceeds 70% of GDP. Measured as such, the difference of financial deepening between the euro area and Slovenia has fallen from approximately 55% of GDP in 2004 to around 45% of GDP in 2007.

Figure 19: **Financial deepening**

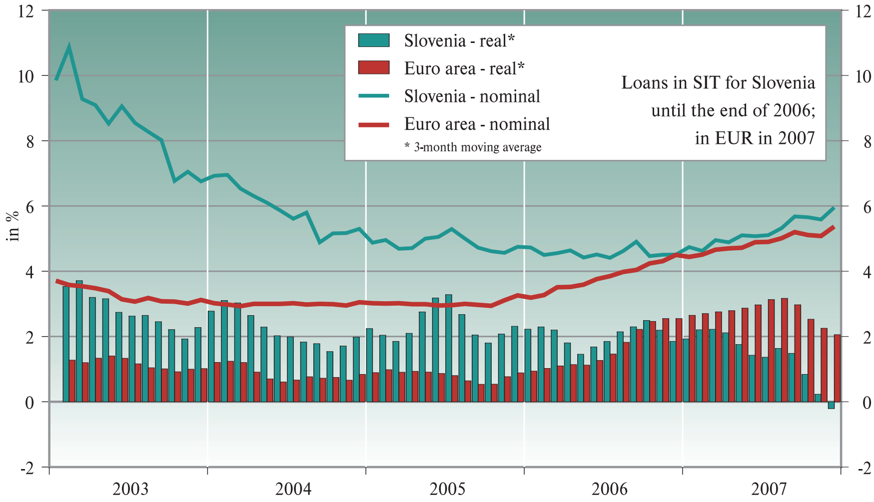


Sources: ECB, Bank of Slovenia

Financing conditions for non-financial corporations remain favourable

Despite the gradual rise in interest rates since the end of 2006, financing conditions for non-financial corporations are still favourable. Nominal lending interest rates for non-financial corporations began to rise in the euro area at the end of 2005 as the result of tightened ECB monetary policy, following the low levels experienced in 2004 and 2005. Since the end of 2006, the trend and level of nominal interest rates for loans to non-financial corporations in Slovenia are comparable to those in the euro area, indicating a high level of integration of Slovenia's financial system with the euro area. Until the middle of 2006, real interest rates in Slovenia were above those of the euro area due to the Bank of Slovenia's appropriately restrictive monetary policy. Since that time, however, they are below euro area interest rates primarily due to somewhat higher inflation. In 2007, borrowing became markedly attractive due to high inflation, as real interest rates for loans to companies were actually negative at the end of the year.

Figure 20: **Interest rates for loans of more than EUR 1 million for non-financial corporations**



Sources: ECB, Bank of Slovenia

Credits are financed by borrowing abroad

Given the deficit in domestic sources, banks also financed the increased demand of the domestic private sector for bank loans by increasing borrowing abroad, thus facilitating the foreign financing of domestic consumption, particularly investments. The flow of loans from the rest of the world to banks and the flow of non-resident deposits was EUR 2.4 billion in 2006 and EUR 4.5 billion in 2007, while the flow of credits to domestic sectors was EUR 4.2 billion in 2006 and EUR 6.8 billion in 2007. This means that in 2006 banks financed more than half the flow of credits to the domestic private sector by borrowing abroad, and approximately two-thirds in 2007. That proportion exceeded 90% in the second half of 2007.

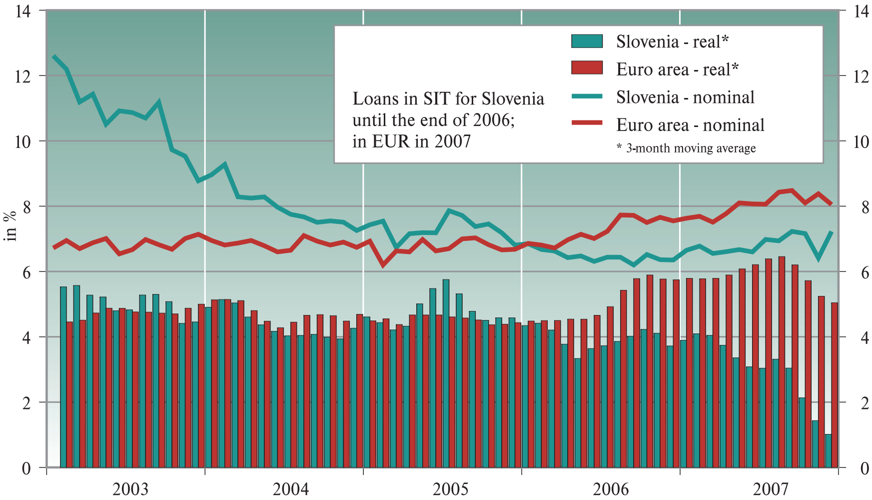
Housing loans drive increased lending to households

The somewhat higher lending to households is primarily the result of a high level of housing loans[8]. It is evident from the structure of household lending that growth in housing loans rose until the end of 2005. Since that time, it has gradually slowed, but still achieved year-on-year growth of nearly 40% in 2007. Growth in housing loans has always exceeded total growth in loans to households, taking into account the fact that high growth in housing loans is also the result of a relatively low basis. This growth can also be in part attributed to high growth in real estate prices. Housing loans, as a proportion of all loans to households, have risen from approximately 25% at the beginning of 2005 to more than 40% at the beginning of 2008. Since the middle of 2007, year-on-year growth in consumer loans has risen from approximately 15% to more than 20% year-on-year at the end of 2007. This is in line with the trend of domestic consumption which rose from 2.2% in the first half of the year to 4.0% in the second half of 2007.

Financing conditions for households are also more favourable

Since the middle of 2006, financing conditions for household consumption are also more favourable in Slovenia than in the euro area. Since the beginning of 2006 nominal, and to a greater extent, real interest rates for consumer loans in Slovenia are lower than in the euro area. Low real interest rates, particularly in the second half of 2007, are probably one reason for the renewed gradual increase in consumer credits. Nominal interest rates for housing loans are still significantly higher in Slovenia than in the euro area.

Figure 21: **Interest rates for consumer loans to households**



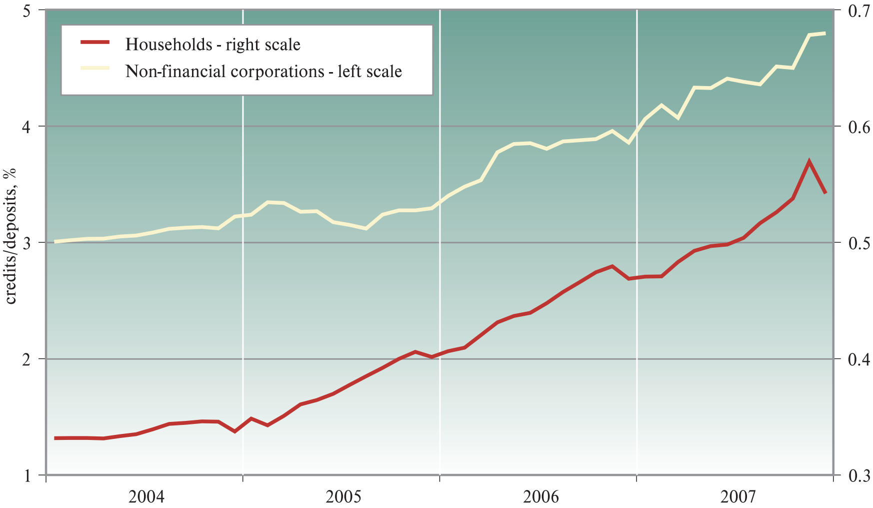
Sources: ECB, Bank of Slovenia

[8] Lending to households in the euro area has slowed since the middle of 2006. The ECB attributes the gradual decline in lending to households in the euro area primarily to a drop in real estate prices and a gradual rise in lending interest rates (ECB, Monthly Bulletin, February 2008).

Net indebtedness at banks is up

The net indebtedness of non-financial corporations and households at domestic banks continues to rise due to the aforementioned factors, particularly low interest rates which have stimulated borrowing and discouraged savings. The net indebtedness of non-financial corporation and households, defined as the ratio of lending stock to the deposits of specific sectors, began to increase noticeably in 2005. Until that time, the ratio for non-financial corporations was slightly more than 3, and just above 0.35 for households. By the end of 2007, that ratio had risen to more than 4.5 for non-financial corporations and to approximately 0.55 for households.

Figure 22: **Net indebtedness at banks**



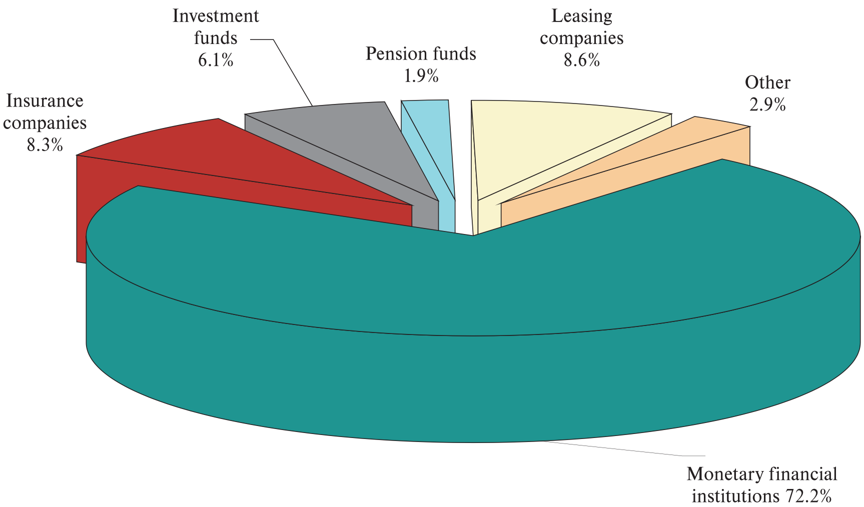
Source: Bank of Slovenia

1.2.6 Financial markets (structure and developments)

The Slovenian financial market is dominated by monetary financial institutions

The Slovenian financial market is dominated by monetary financial institutions, which account for more than 72% of total assets. Leasing companies account for the highest proportion (8.6%) among non-monetary financial intermediaries, followed by insurance companies (8.3%) and investment and pension funds with 6.1%.

Figure 23: **Financial intermediaries by total assets**



Note: Figures for the end of 2006.
Sources: Bank of Slovenia, Insurance Supervision Agency (ISA), Securities Market Agency (SMA), Agency of the Republic of Slovenia for Public Legal Records and Services (AJPES)

Table 6: **Composition of Slovenia's financial system**

Total assets	2004		2005		2006	
	v mio EUR	%	v mio EUR	%	v mio EUR	%
Monetary financial institutions	**23,827**	**70.7**	**29,435**	**72.3**	**33,928**	**72.2**
Non-monetary financial institutions	**9,887**	**29.3**	**11,269**	**27.7**	**13,044**	**27.8**
Insurance companies	2,856	8.5	3,260	8.0	3,895	8.3
Pension funds	476	1.4	670	1.6	893	1.9
Investment funds	2,086	6.2	2,220	5.5	2,845	6.1
Leasing companies	2,681	8.0	3,185	7.8	4,041	8.6
Brokerage houses, management companies and others	1,788	5.3	1,934	4.8	1,370	2.9
Total	**33,714**	**100.0**	**40,703**	**100.0**	**46,972**	**100.0**

Note: Monetary financial institutions include banks and savings banks, but not the central bank.
Sources: Bank of Slovenia, ISA, SMA, AJPES

Investments of insurance and reinsurance companies rose 11.1% in the first nine months of the year, reaching EUR 3.4 billion

Gross premiums written by insurance and reinsurance companies totalled EUR 1.5 billion in the first nine months of 2007, an increase of 10.9% compared to the same period in 2006, while claims paid rose by 9.4% to EUR 803 million. The claims ratio improved to 0.53. The value of investments of insurance and reinsurance companies rose by 11.1% in the first nine months of 2007 to EUR 3.4 billion. Investments in government securities and other debt securities were prevalent. The proportion of government securities fell sharply (by 7.6 percentage points to 34.3%), while the proportion of investments in mutual fund units rose 4.3 percentage points to 15.1%, as the result of the growing significance of life insurance linked to mutual fund units.

The value of voluntary supplementary pension insurance stood at EUR 2,260 per policyholder at the end of September 2007

The number of policy holders covered by voluntary supplementary pension insurance rose by 1.4% in the first three quarters of 2007, reaching nearly 504,000. Premiums of EUR 153 million were collected, an increase of 7% compared to the same period in 2006. The total value of investments held by voluntary supplementary pension insurance policyholders rose by 26.1% in the first nine months of 2007 to EUR 1,137 million. The average value of insurance per policyholder stood at EUR 2,260 in September 2007. The investment policy of voluntary supplementary pension insurance providers has remained quite conservative, despite the drop in the proportion of the safest forms of investments (government and other debt securities and bank deposits) of 4 percentage points to 84%.

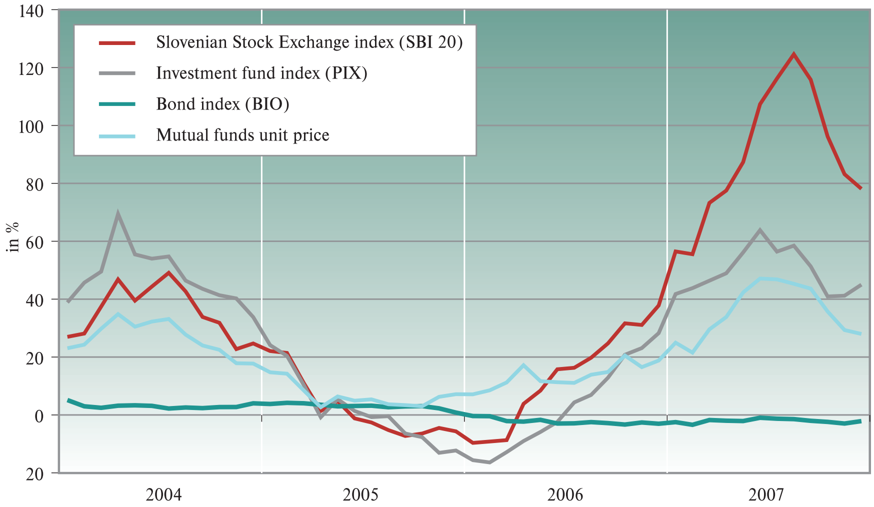
Investment fund assets stood at 12.3% of GDP at the end of 2007

Investment fund assets rose by 45% in 2007 to EUR 4.1 billion, reaching 12.3% of GDP. The major contribution to growth in assets was provided by favourable developments on capital markets in the first half of 2007 and high net inflows into mutual funds (EUR 470 million). Investment companies account for 30% of investment funds assets. The investment company turnover of EUR 113 million achieved in 2007 was similar to that generated the previous year. However, the PIX index achieved considerably higher annual growth (45%). This growth was the result of growth in share prices on capital markets, the listing of Nova kreditna banka Maribor (NKBM) on the stock exchange and its market valuation, as well as the expected transformation of investment companies into mutual funds.

Mutual funds recorded net inflows of EUR 470 million in 2007

Total assets in domestic mutual funds stood at EUR 2.9 billion at the end of 2007 (a year-on-year increase of nearly 28%), driven by net inflows in the amount of EUR 470 million and 28% growth in unit prices. Given the considerable international diversity of assets (more than half of the assets of domestic mutual funds are invested abroad), domestic mutual funds could not avoid the growing uncertainty on world financial markets towards the end of 2007, nor the unstable political situation in certain countries of the former Yugoslavia. Given the significant link between the returns of mutual fund assets and inflows thereof, the negative returns on capital markets towards the end of 2007 affected growth in unit prices and resulted in lower inflows into mutual funds. In the last three months, mutual funds recorded negative growth in unit prices of –2.2% (monthly growth in November was –4.5%) and inflows of EUR 90 million, or 75% of average quarterly inflows. The sale of 49% of the Government's stake in NKBM in December contributed to the rebound of the domestic capital market and also had a positive impact on domestic mutual funds, which have a higher proportion of investments on the domestic capital market.

Figure 24: **Year-on-year of growth of Slovenian stock indices and mutual funds unit price**



Sources: Ljubljana Stock Exchange, Vzajemci.com, ATVP, Bank of Slovenia calculations

The high growth of 78.1% recorded by the SBI20 index was mainly the result of growth until the end of August. This trend subsequently reversed due to uncertainty on world financial markets, high growth is share prices on the Ljubljana Stock Exchange in the past and certain other extraordinary events on the domestic market

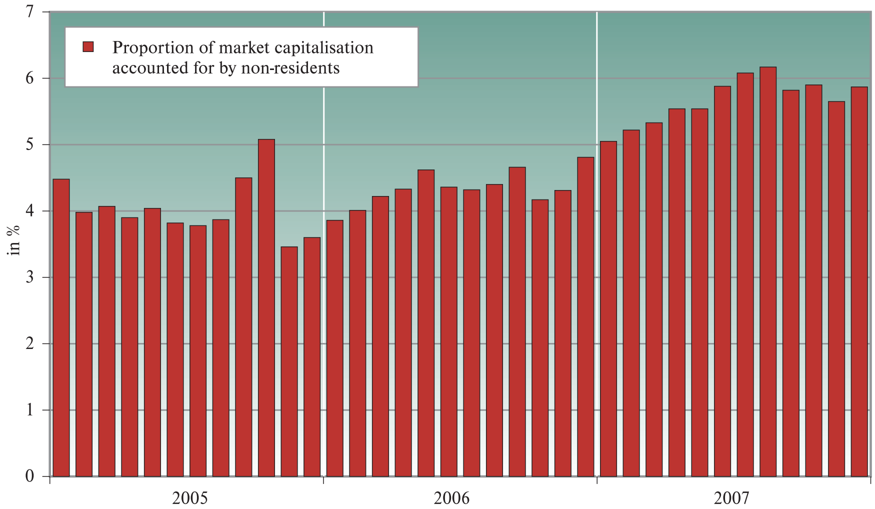
The SBI20 index rose by 78.1% in 2007. At the end of August, it achieved the highest value in its history at 12,242 points. It lost 7% of its value during the rest of the year, ending at 11,370 points. The value of the BIO, the bond index, fell by 2.1% during the year. The operating results of companies were good, but did not justify such high growth in the SBI20 index in the first eight months of 2007. There were other factors that contributed significantly to this growth. One factor was the introduction of the euro, which brought about changes in the psychological limits on share prices due to their quotation in euros. Until the outbreak of the sub-prime mortgage market crisis in the US, increased liquidity in the euro area resulted in increased demand from foreign investors for Slovenian shares. Acquisitions and concentration of ownership linked to the government's gradual withdrawal from the commercial sector and the issue of certificates on Slovenian blue chip shares also had a considerable impact on growth. In addition to high growth in share prices in the past and developments on world capital markets, uncertainty regarding the sale of the government's stake in Telekom Slovenije, Petrol's low takeover bid for Istrabenz and the collection of funds for participation in the privatisation of NKBM also contributed to a drop in share prices on the Ljubljana Stock Exchange in September, October and November 2007. The drop in prices was further accelerated by the certificates, issued on Slovenian blue-chip shares, reaching the knock-out barrier.

At the end of 2007, there were 995 securities registered at the Central Securities Clearing Corporation (CSCC). Equity and debt securities represented 88.4% and 11.6% of this amount, respectively.

Transactions on the Ljubljana Stock Exchange more than doubled in 2007; market capitalisation as a proportion of GDP rose to 76.4%

Of the 188 securities listed on the Ljubljana Stock Exchange at the end of 2007, 96 were shares (of this amount, 7 were shares of investment companies), 89 were bonds, as well as the units of 3 mutual funds. In 2007, the number of shares listed on the stock exchange fell by 25 as the result of the exclusion of four shares of acquired companies (Delo, Droga Kolinska, Emona Obala Koper and Comet) and the listing of NKBM shares at the end of the year. Market capitalisation of shares (excluding investment companies) on the Ljubljana Stock Exchange rose by 70% to EUR 20.8 billion, while market capitalisation of bonds fell by 10.5% to EUR 5.9 billion. Market capitalisation of shares (excluding share of investment companies) and bonds represents 76.4% of GDP. The high growth in the market capitalisation of shares is the result of high growth in securities prices and the listing of NKBM shares, while the drop in market capitalisation of bonds is primarily the result of early repayment of government bonds. The proportion of total market capitalisation accounted for by non-residents rose by 1.1 percentage points to 5.9%. At EUR 2.2 billion, the volume of trading on the Ljubljana Stick Exchange was 118.5% higher than the volume recorded in 2006. The highest volume was in shares (88.3%, excluding investments companies), followed by shares of investment companies (5.2%), bonds (4.1%) and mutual funds units (2.5%). The most heavily traded shares last year were Krka, Petrol, Telekom Slovenije, the Luka Koper and Gorenje.

Figure 25: **Proportion of market capitalisation of shares on the Ljubljana Stock Exchange accounted for by non-residents**



Source: Ljubljana Stock Market

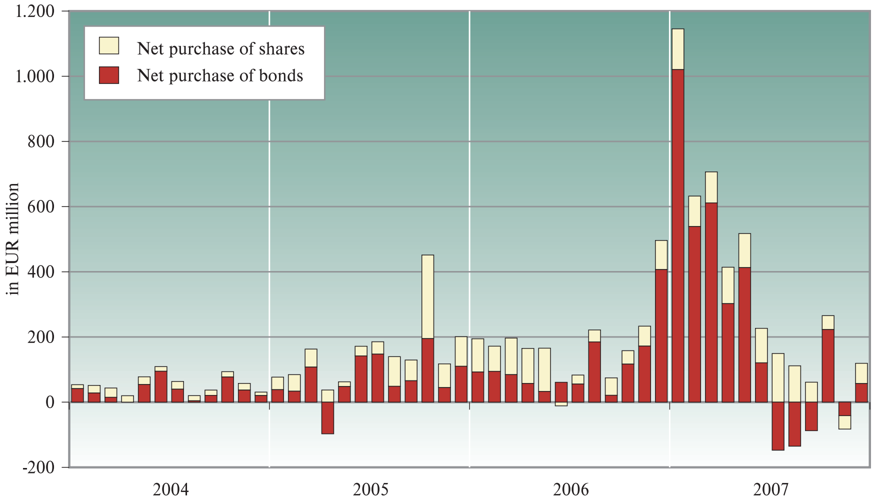
Residents' investments in foreign securities continue to increase

In 2007, the value of investments by residents in foreign securities rose to 29% of GDP (an increase of more than 10 percentage points from the previous year). Residents made net purchases of foreign securities totalling almost EUR 4 billion. Investments of the domestic banking sector in foreign government and bank bonds from the euro area were prevalent (EUR 2.2 billion). This increase was partly the result of the release of funds from Bank of Slovenia bills and the repurchase of domestic government securities. The adoption of the euro means that there is no longer any currency risk for domestic investors who invest in the euro area. Investment funds, direct household investment and the insurance sector contributed to the increase in investments in foreign shares of almost EUR 1 billion. Growth in financial investments in the rest of the world by residents reflects Slovenia's financial deepening in recent years and, given the limited absorption capacity of the domestic market, facilitates greater diversification of assets, as individuals reduce their exposure to a single economy. On the other hand, increasing investment abroad also means an outflow of domestic savings.

Non-residents' investments in Slovenian securities were up marginally

Investments by non-residents in Slovenian securities (15% of GDP) account for more than half of investments by residents in foreign securities. In 2007, these investments rose by barely 1.5 percentage points. Non-residents made net purchases of more than EUR 500 million in Slovenian securities (shares and bonds), with net sales of Slovenian bonds totalling EUR 12 million[9]. The net sale of Slovenian bonds by non-residents is partly the result of the March issue of Republic of Slovenia bonds on the EuroMTS single market, as the Ministry of Finance repurchased certain government bonds in Slovenia due to this issue.

Figure 26: **Net investments by residents in the rest of the world**



Source: Bank of Slovenia

1.3 Banking system

1.3.1 Composition of the banking sector

Banks held a market share of 99.4% at the end of 2007 as measured by total assets (the same as the share recorded at the end of 2006), with savings banks accounting for the remainder.

At the end of 2007 there were 21 banks, 3 savings banks and 3 branches of foreign banks operating in Slovenia

As at 31 December 2007, there were 21 banks operating in Slovenia, eight of which were subsidiaries. In addition, there were three savings banks and three branches of foreign banks (Austrian and French). There was an increase in the number of credit institutions subject to direct Bank of Slovenia supervision during the course of the year, which occurred with the establishment of SID – Slovenska izvozna in razvojna banka d.d., Ljubljana (arising from the transformation from Slovenska izvozna družba d.d. Ljubljana). On 1 January 2007, a third foreign bank branch, the Ljubljana branch of RCI Banque Societe Anonyme, began operating in Slovenia.

On 3 August 2007, the Ljubljana District Court issued a decision regarding the registration of the change of the name of the bank UniCredit Banka Slovenija d.d. On 3 September 2007, the Maribor District Court issued a similar decision for Raiffeisen banka d.d.

9 These figures do not include government bonds of the Republic of Slovenia sold on the EuroMTS single market – MTS Slovenia.

In addition to the eight subsidiary banks and three branches that were under majority foreign ownership as at 31 December 2007, there were five banks under full domestic ownership, and eight banks under majority domestic ownership (of these eight banks, two had less than 2% foreign equity). The proportion of capital held by non-residents as measured by equity was unchanged from 31 December 2006 at 37.7% (of which the proportion held by non-residents holding more than 50% stood at 26.7%, or approximately one percentage point less than a year earlier). The proportion of non-resident owners rose most at one bank under majority foreign ownership and at one bank which was under full domestic ownership prior to the change in ownership. The proportion held by non-residents as measured by total assets was 3.9 percentage points more than the proportion held by non-residents as measured by equity as at 31 December 2007. SID – Slovenska izvozna in razvojna banka d.d., Ljubljana, and Poštna banka Slovenije d.d are under majority state ownership.

The proportion of banks' capital held by non-residents was unchanged in 2007 at 38%

Table 7: **Ownership structure of the banking sector (by equity)**

	12. 31. 2005	12. 31. 2006	12. 31. 2007
Non-residents (more than 50% management rights)	19.4	27.7	26.7
Non-residents (less than 50% management rights)	15.5	10.0	11.0
Central government	18.2	17.9	15.1
Other domestic persons	46.9	44.4	47.2

Sources: Bank of Slovenia

Table 8: **Ownership structure of the banking sector (by total assets)**

	12. 31. 2005	12. 31. 2006	12. 31. 2007
Non-residents (more than 50% management rights)	21.1	27.3	27.9
Non-residents (less than 50% management rights)	17.6	12.8	13.7
Central government	22.7	22.3	18.6
Other domestic persons	38.6	37.6	39.8

Source: Bank of Slovenia

The ratio of total assets of banks and savings banks to GDP is rising from year to year, although it remains considerably below the EU average.

Table 9: **Total assets and GDP**

in EUR million	2005	2006	2007*
Total assets of banks and savings banks	29,445	34,080	42,450
GDP at current prices	27,625	29,736	33,542
Total assets (as % of GDP)	106.6	114.6	126.6

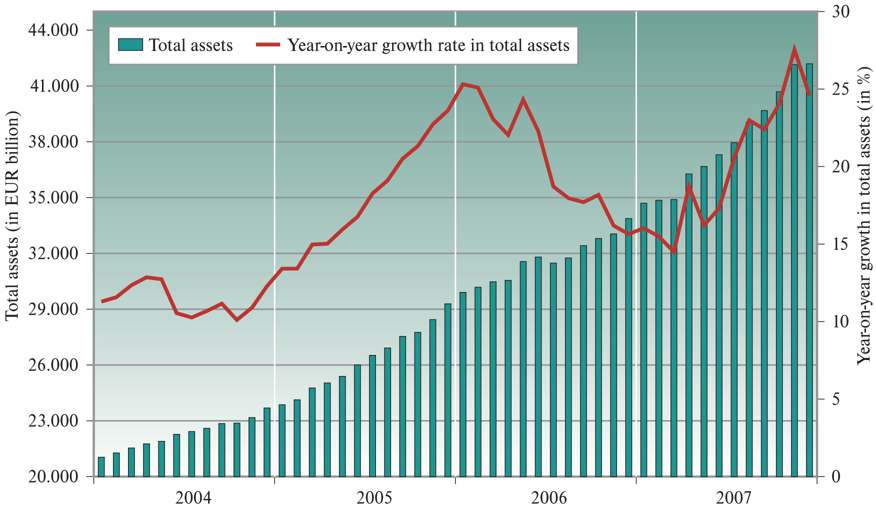
Note: *Figures exclude NLB branch in Italy.
Source: Bank of Slovenia

1.3.2 Balance sheet

Growth in total assets of the banking system strengthened in the second half of the year, more so at banks under domestic ownership than at banks under foreign ownership

Total assets of the banking system[10] at the end of 2007 stood at EUR 42,195 million. Total assets rose by EUR 8,326 million during the year, an increase of nearly 25% in relative terms. In the first half of the year, year-on-year growth in total assets was approximately 16%, maintaining the moderate trend from 2006, followed by a sharp increase in the second half of the year. At 27.5% in November, total assets achieved their highest nominal growth in the last three years. The total assets of six foreign and one domestic bank grew faster than the banking system average, while the total assets of one bank fell. Despite the fact that several foreign banks grew faster than the banking system, the group of foreign banks recorded slightly below average growth of 22.7%, and lagged behind the group of domestic banks whose total assets rose by 25.4%. Following a lengthy period in which the growth of foreign banks was markedly more robust, the growth of domestic and foreign banks was again more comparable in 2007.

Figure 27: **Total assets and year-on-year growth**



Source: Bank of Slovenia

The market shares of domestic and foreign banks are 71% and 29%, respectively

The market shares of domestic and foreign banks remain stable due the even growth in total assets. Thus the market share of domestic banks rose by just 0.5 percentage points, reaching 71.1%. The NLB group maintained its market share at over 33%, while the market share of more specialised domestic banks is strengthening at the expense of larger domestic banks. The market share of foreign banks stands at 28.9%.

Banks covered 85% of the growth in total assets with deposits

Banks primarily obtained resources for their operations in 2007 by accepting deposits by non-banking sectors and by taking bank deposits measured at amortised cost. Deposits covered 84.8% of the growth in total assets.

Banks obtain the majority of resources on the interbank market, primarily at foreign banks

The main source remains borrowing in the banking sector, accounting for EUR 4,732 million or 56.8% of the increase in total assets. Domestic banks were more active in the acquisition of resources on the interbank market. The volume of domestic and foreign bank's resources acquired on the interbank market rose by 56.9% and 29.2%, respectively. Resources acquired at foreign banks represent 82.6% or EUR 3,909 million. Borrowing at domestic banks also strengthened considerably. However, this sources remains less significant. Several years of actively acquiring bank deposits is also reflected in the strengthening of their proportion of total liabilities. Deposits totalling EUR 15,503 million at the end of the year already

10 Banks and branches of Member States.

account for 36.7% of total liabilities, which is almost 5 percentage points higher than the pervious year.

Table 10: Total assets and market shares

Bank	Total assets (in EUR thousand)		Growth (in %)		Market share (in %)	
	12.31.2006	12.31.2007	2006/2005	2007/2006	12.31.2006	12.31.2007
Nova LB d.d. Ljubljana	10,415,794	12,945,034	12.48	24.28	30.8	30.7
Nova KB d.d. Maribor	3,669,158	4,218,792	22.64	14.98	10.8	10.0
Abanka Vipa d.d. Ljubljana	2,861,880	3,439,008	15.18	20.17	8.4	8.2
SKB banka d.d. Ljubljana	2,085,499	2,295,677	8.04	10.08	6.2	5.4
UniCredit Banka d.d. Ljubljana	2,187,291	2,132,695	16.16	-2.50	6.5	5.1
Banka Koper d.d. Koper	1,864,590	2,239,211	2.85	20.09	5.5	5.3
Banka Celje d.d. Celje	1,959,737	2,305,449	13.65	17.64	5.8	5.5
Gorenjska banka d.d. Kranj	1,492,156	1,732,976	7.71	16.14	4.4	4.1
Raiffeisen banka d.d. Maribor	957,734	1,259,559	5.62	31.51	2.8	3.0
Hypo Alpe-Adria-bank d.d. Ljubljana	1,132,655	1,906,206	33.57	68.30	3.3	4.5
Probanka d.d. Maribor	804,692	1,041,857	25.59	29.47	2.4	2.5
Poštna banka Slovenije d.d. Maribor	564,992	626,309	10.19	10.85	1.7	1.5
Deželna banka Slovenije d.d. Ljubljana	609,803	756,905	20.35	24.12	1.8	1.8
Banka Sparkasse d.d. Ljubljana	718,547	886,628	55.04	23.39	2.1	2.1
Volksbank-Ljudska banka d.d. Ljubljana	484,778	618,324	17.29	27.55	1.4	1.5
NLB Banka Domžale d.d.	431,374	451,177	8.92	4.59	1.3	1.1
Factor banka d.d. Ljubljana	525,591	630,760	37.23	20.01	1.6	1.5
NLB Koroška banka d.d.	353,201	364,453	7.69	3.19	1.0	0.9
NLB Banka Zasavje d.d.	254,467	257,012	1.20	1.00	0.8	0.6
BAWAG d.d. Ljubljana	384,896	596,297	246.18	54.92	1.1	1.4
SID banka d.d. Ljubljana		1,248,711	0.00	0.00	0.0	3.0
BKS Bank AG Ban. podružnica Ljubljana	97,917	196,194	94.39	100.37	0.3	0.5
Zveza Bank Ljubljana branch	11,730	22,776	516.07	94.16	0.0	0.1
RCI Banque Societe anonime, Ljubljana branch		22,709	0.00	0.00	0.0	0.1
Total banks and branches	33,868,481	42,194,719	15.64	24.58	100.0	100.0

Source: Bank of Slovenia

Growth in total assets outstripped growth in deposits by non-banking sectors

Growth in deposits by non-banking sectors continued to rise, but at 10.6%, still lags behind growth in total assets. As a result, the proportion of deposits by non-banking sectors, which totalled EUR 19,366 million, continues to fall. At the end of the year, this proportion was just 45.9%, falling below 50% of total assets for the first time. The largest contribution to growth in deposits by non-banking sectors in nominal terms came from household deposits (EUR 1,028 million). Deposits by non-financial corporations, the government and non-residents rose by slightly less than EUR 400 million, while deposits of other non-financial institutions fell by EUR 300 million.

Short-term time deposits recorded the highest growth in 2007 among deposits by non-banking sectors

Following several years of rising sight deposits, there was an increase in short-term time deposits (primarily for a period of 91 days to one year) in 2007. The aforementioned deposits rose by 27.3% or EUR 2,230 million. Long-term deposits, with the exception of the end of 2006 which was marked by the transition to the euro, continue to stagnate. This also had an impact on the structure of deposits by non-bank sectors. Short-term deposits account for 53.7% of deposits, sight deposits 37.2% and long-term deposits just 9.1%. The drop in deposits by non-banking sectors as a proportion of total assets has not had a significantly negative effect on the maturity matching of the balance sheet, as deposits acquired in the banking sector are mostly long-term.

Ten banks opted to issue derivatives in 2007. Three issues however were in lower total amount. Two banks acquired a portion of their resources through repurchase transactions with foreign banks. Nevertheless, the volume of resources acquired with the aforementioned instruments remains modest.

Three banks opted to issue securities in 2007, but their total volume fell slightly as a result of the maturity of individual issues. In order to increase their regulatory capital, several banks opted to issue subordinated liabilities, which thus increased by just over EUR 477 million, or 48.1%.

The book value of capital increased by 25%

The book value of capital stood at EUR 3,557 million as at the final day of the year, an increase of 25.2%. The increase includes that part of profit transferred to profit reserves in accordance with the Companies Act. Nine banks underwent capital injections in 2007.

Table 11: **Principal items in the banking sector balance sheet**

BALANCE SHEET	Amount (in EUR thousand)		Proportion (in %)		Growth (in %)	
Balance in EUR thousand; growth in %	12.31.2006	12.31.2007	12.31.2006	12.31.2007	2006/2005	2007/2006
Assets	**33,868,481**	**42,194,719**	**100.0**	**100.0**	**15.6**	**24.6**
Cash	1,056,796	603,706	3.1	1.4	76.3	-42.9
Lending	23,481,957	32,112,534	69.3	76.1	23.4	36.8
To banks	3,067,496	4,066,288	9.1	9.6	6.8	32.6
To non-banking sectors	20,414,461	28,046,246	60.3	66.5	26.4	37.4
of which non-financial corporations	12,364,059	16,808,545	36.5	39.8	24.8	35.9
...households	5,059,608	6,428,844	14.9	15.2	24.1	27.1
...government	573,710	465,139	1.7	1.1	-13.8	-18.9
...other financial institutions	1,257,489	2,114,261	3.7	5.0	71.2	68.1
...non-residents	1,138,349	2,188,046	3.4	5.2	52.2	92.2
Financial assets held for trading	1,269,361	1,595,835	3.7	3.8	-20.6	25.7
of which government securities	215,364	203,447	0.6	0.5	-50.0	-5.5
.......Bank of Slovenia securities	0	0	0.0	0.0	-100.0	0.0
Financial assets available for sale	5,440,414	4,870,408	16.1	11.5	6.1	-10.5
of which government securities	2,141,829	3,123,736	6.3	7.4	7.4	45.8
.......Bank of Slovenia securities	1,240,615	0	3.7	0.0	-42.2	-100.0
Financial assets held to maturity	1,008,860	992,601	3.0	2.4	-33.5	-1.6
of which government securities	361,209	955,484	1.1	2.3	28.9	164.5
.......Bank of Slovenia securities	548,193	0	1.6	0.0	-52.9	-100.0
Other	1,611,093	2,019,635	4.8	4.8	13.2	25.4
Liabilities	**33,868,481**	**42,194,717**	**100.0**	**100.0**	**15.6**	**24.6**
Fincial liabilities to central bank	0	156,528	0.0	0.4	0.0	0.0
Financial liabilities at amortised cost (deposits)	30,246,001	37,302,517	89.3	88.4	16.4	23.3
a) Liabilities to banks	10,771,035	15,503,445	31.8	36.7	30.3	43.9
of which foreign banks	10,086,170	13,994,905	29.8	33.2	29.9	38.8
b) Liabilities to non-banking sectors (deposits)	17,506,329	19,365,884	51.7	45.9	9.3	10.6
...of which non-financial corporations	3,341,120	3,659,588	9.9	8.7	6.8	9.5
...households	11,077,172	12,104,976	32.7	28.7	7.2	9.3
...government	1,113,602	1,510,337	3.3	3.6	28.5	35.6
...other financial institutions	1,446,168	1,144,582	4.3	2.7	19.4	-20.9
c) Debt securities	975,976	963,464	2.9	2.3	-1.6	-1.3
d) Subordinated liabilities	992,661	1,469,724	2.9	3.5	40.0	48.1
Financial liabilities tied to financial assets without terms for derecognition (repo)	27,135	298,048	0.1	0.7	-79.4	998.4
Capital	2,841,400	3,556,542	8.4	8.4	14.3	25.2
Provisions and other	753,945	881,082	2.2	2.1	10.0	16.9
TOTAL ASSETS	**33,868,481**	**42,194,719**	**100.0**	**100.0**	**15.6**	**24.6**

Source: Bank of Slovenia

In the past, banks diverted a large portion of their assets to Bank of Slovenia bills due to various reasons. The Bank of Slovenia ceased to issue bills following Slovenia's entry to the euro area. All notes issued in 2006 also gradually matured until April 2007. Their maturity released EUR 1,789 million. Banks diverted the majority of money released into lending and other securities (government and other issuers).

Banks diverted money released at the maturity of Bank of Slovenia bills into lending and securities

Taking this into account, banks increased the total stock of loans (measured at amortised cost) by EUR 8,631 million, outstripping growth in total assets by 3.7 percentage points. Lending to the banking sector accounts for a smaller portion of these investments, while lending to non-banking sectors represents the majority.

Almost 92% of the increase in total assets of banks was earmarked for lending to non-banking sectors. The stock of loans rose by EUR 7,632 million or 37.4% (compared to just 26.4% in 2006), and stood at EUR 28,046 million at the end of the year. Given the accelerated growth in credits to non-banking sectors in recent years, the proportion thereof at the end of the year had already reached 66.5% of total assets, an increase of 6.2 percentage points from the end of 2006. In 2007, foreign banks maintained their high relative growth in comparison with domestic banks, outstripping the latter by just under 4 percentage points at 40%.

Almost 92% of the increase in total assets was used in lending to non-banking sector

As in previous years, banks recorded the highest nominal increase in credits to non-financial corporations in 2007. The stock of lending rose by EUR 4,444 million, or 36% in relative terms, or 11 percentage points more than in 2006. At 27%, growth in lending to households marginally exceeded 2006 growth. Lending to non-residents rose sharply (92.2%, or EUR 1,050 million), lagging behind growth in lending to households by just over EUR 300 million in nominal terms. The stock of lending to other financial organisations also rose, while lending to the government declined for the second consecutive year.

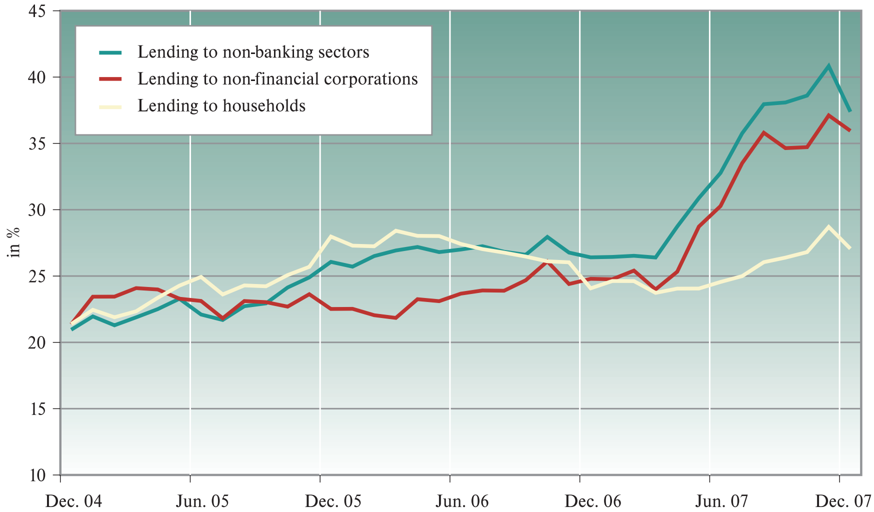
The stock of lending to non-financial corporations recorded the highest increase

In relative terms, growth in short-term lending to non-banking sectors (slightly less than 42%) was higher than growth in long-term lending, although a higher basis meant that long-term lending recorded a larger nominal increase (EUR 4,788 million). This had a marginal impact on the change in the structure of lending to non-bank sectors. At 65.5%, the proportion of long-term lending remains high, declining just 1 percentage point at the expense of short-term lending.

Long-term credits account for the majority of credits to non-banking sectors

Guarantees issued by banks, which stood at EUR 3,307 million at the end of the year, rose by just under 18%, an increase of 6.7 percentage points compared to the previous year.

Figure 28: **Year-on-year growth in lending to non-banking sectors**



Source: Bank of Slovenia

The stock of investments in securities decreased due to the maturity of Bank of Slovenia bills

The stock of bank investments in securities (EUR 7,291 million) declined by 3.5%, primarily due to Slovenia's inclusion in the Eurosystem, and as a result of maturing Bank of Slovenia bills. Banks diverted the money released at maturity into lending and the purchase of government and other debt securities. The stock of government securities[11] increased by nearly 60% and stood at EUR 4,283 million at the end of the year, while investments in other debt securities stood at EUR 2,502 million. Banks increased investments in shares and participating interests by more than 30%, but at just over EUR 500 million, they do not represent a significant proportion.

Banks disclose securities in their balance sheet with regard to the purpose for which they were acquired. Banks classified Bank of Slovenia bills in financial assets available for sale or financial assets held to maturity. Following restructuring, banks maintained the stock of investments in securities held to maturity (EUR 993 million, a decrease of just 1.6%), while the stock of investments in debt securities available for sale declined by nearly 12%, and stood at EUR 4,570 million. Investments in debt securities held for trading increase by more than 20% to EUR 999 million on account of the aforementioned decreases.

Table 12: **Maturity breakdown of deposits by and lending to non-banking sectors**

in %	12.31.2004	30.06.2005	12.31.2005	30.06.2006	12.31.2006	30.06.2007	12.31.2007
Sight deposits of non-banking sector	34.8	36.3	39.6	40.2	41.0	41.5	37.2
Short-term deposits of non-banking sector	51.1	50.0	47.9	47.4	46.7	48.9	53.7
Long-term deposits of non-banking sector	14.1	13.6	12.5	12.4	12.4	9.6	9.1
Total deposits of non-banking sector	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Short-term loans to non-banking sector	34.1	33.7	32.3	33.2	33.4	34.4	34.5
Long-term loans to non-banking sector	65.9	66.3	67.7	66.7	66.6	65.6	65.5
Claims arising from guarantees	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Total lending to non-banking sector	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: Bank of Slovenia

Structure of liabilities and investments

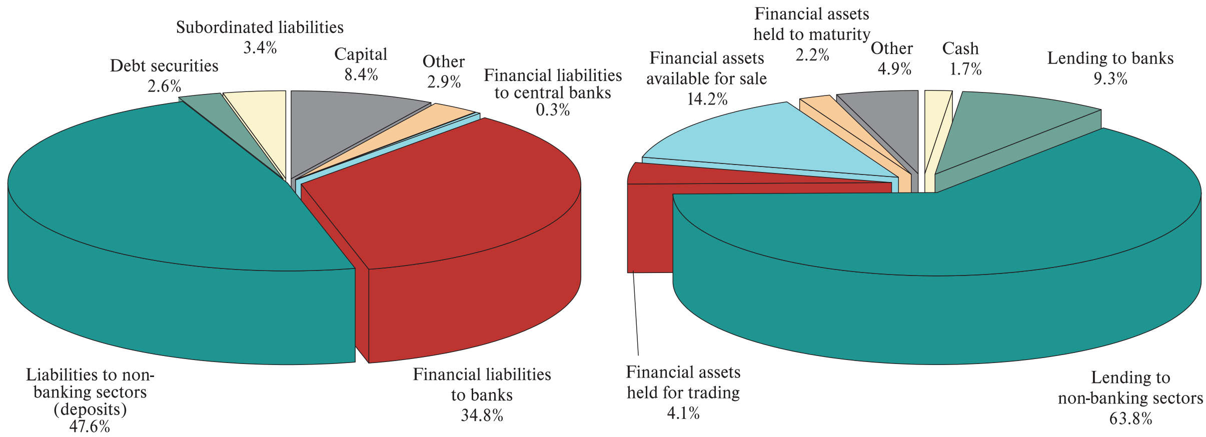
All of the aforementioned changes also affected the average structure of liabilities and investments.

The proportion of liabilities to banks rose again due to the active borrowing of banks in the banking sector

For several years, the active borrowing of banks at other banks has led to an increase in the proportion of liabilities to banks, which represented almost 35% of all sources in 2007. In the last year alone, this proportion has risen by 4.7 percentage points, which is less than in previous years when increases fluctuated at around 6 percentage points. The shift towards liabilities to banks came almost entirely at the expense of liabilities to non-banking sectors, the proportion of which declined again by more than 5 percentage points and no longer exceeds 50% of liabilities.

[11] Securities of the Republic of Slovenia and other countries.

Figure 29: **Average structure of liabilities and investments in 2007**



Source: Bank of Slovenia

The maturity on Bank of Slovenia bills and the resulting sharp decrease in the proportion of investment in debt securities (from 24.7% to 18.5%) primarily brought about a decrease in structural proportions of investments in financial assets available for sale and held to maturity and further stimulated already lively lending to non-banking sectors. This is also reflected in the above-average 6.4% growth in the proportion of lending to non-banking sectors in the average structure of investments, which already accounts for nearly two-thirds of all bank investments, while the proportion of other items was almost unchanged from the previous year.

The above-average growth in lending to non-banking sectors in 2007 was the partly the result of maturing Bank of Slovenia bills

Currency breakdown of liabilities and investments

The currency breakdown of balance sheets is entirely different due to the transition to the euro. The increase in liabilities and investments in the domestic currency reflects the fact that a high volume of past transaction were carried out in euros. Liabilities in the domestic currency account for 95% of all liabilities, while the proportion of investments is similar at 94%.

95% of liabilities and 94% of investments are in domestic currency

Liabilities in foreign currency consist almost entirely of the bank deposits and just a small proportion of deposits of non-banking sector. On the investment side, that proportion is represented primarily by lending to non-banking sectors. The aforementioned is mainly a reflection of lending to non-banking sectors in Swiss francs, which drove banks to adjust sources obtained in the banking sector due to currency matching.

Table 13: **Maturity breakdown of deposits by and lending to non-banking sectors**

in %	Proportion as at 31 Dec. 2006		Proportion as at 31 Dec. 2007	
	domestic currency	foreign currency	domestic currency	foreign currency
Cash	2.9	0.2	1.4	0.0
Lending	30.6	38.8	71.2	4.9
- to banks	3.7	5.3	8.6	1.1
- to non-banking sectors	26.9	33.4	62.7	3.8
Financial assets held for trading	2.6	1.2	3.6	0.2
Financial assets available for sale	11.5	4.6	11.4	0.1
Financial assets held to maturity	2.6	0.4	2.4	0.0
Other assets	4.0	0.8	4.0	0.8
Total assets	**54.1**	**45.9**	**94.0**	**6.0**
Financial liabilities to central bank	0.0	0.0	0.4	0.0
Financial liabilities at amortised cost (deposits)	42.6	46.7	83.4	5.0
- deposits by banks	4.6	27.3	33.1	3.7
- deposits by non-banking sectors	34.4	17.3	44.6	1.3
- debt securities	2.9	0.0	2.3	0.0
- subordinated liabilities	0.8	2.2	3.4	0.0
Financial liabilities tied to financial assets				
without terms for derecognition	0.0	0.1	0.7	0.0
Other liabilities and provisions	1.7	0.3	2.1	0.0
Capital	8.4		8.4	
Total liabilities	**52.7**	**47.1**	**95.0**	**5.0**

Note: FA indicates financial assets, FO indicates financial liabilities.
Source: Bank of Slovenia

1.3.3 Income Statement

The profit of banks and branches of foreign banks rose by 31% in 2007, which is significantly less than the previous year, while…

The operating result recorded by banks and branches of foreign banks in 2007 amounted to EUR 514 million (pre-tax profit). This was EUR 120 million or 30.5% up on the banking system's profit in the previous year. This is significantly less than the growth recorded in 2006 (50.7%), which was characterised by the transition to accounting in accordance with the International Financial Reporting Standards.

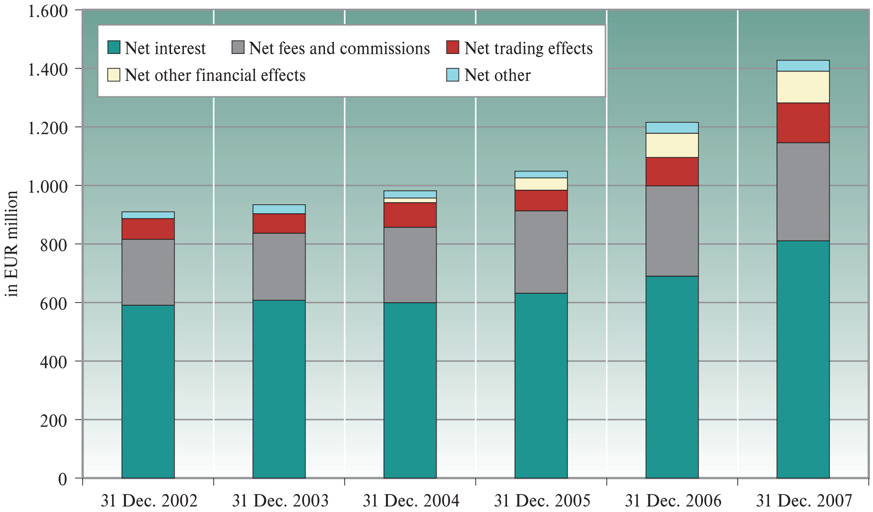
…gross income was up 17%

The banking system's gross income amounted to EUR 1,428 million in 2007, up EUR 212 million, an increase of 17.4% compared to 15.9% a year earlier. The biggest contribution to growth in gross income came from net interest (an increase of EUR 121 million or 17.5%), followed by net trading (an increase of 39.7% or EUR 39 million), net other financial effects (an increase of EUR 26 million or 31.0%, primarily as the result of an increase in dividend income) and net fees and commissions, which were up 8.7% or EUR 27 million.

Growth in net interest was high…

The growth rate of net interest increased significantly again in 2007 (by 8.3 percentage points). The high growth rate of net trading (growth in 2007 exceeded the growth recorded in 2006 by 2.5 percentage points) still stands out, despite the decline in securities prices. The growth rate of net fees and commission lagged slightly behind last year's growth (by 0.8 percentage points).

Figure 30: **Breakdown of gross income**

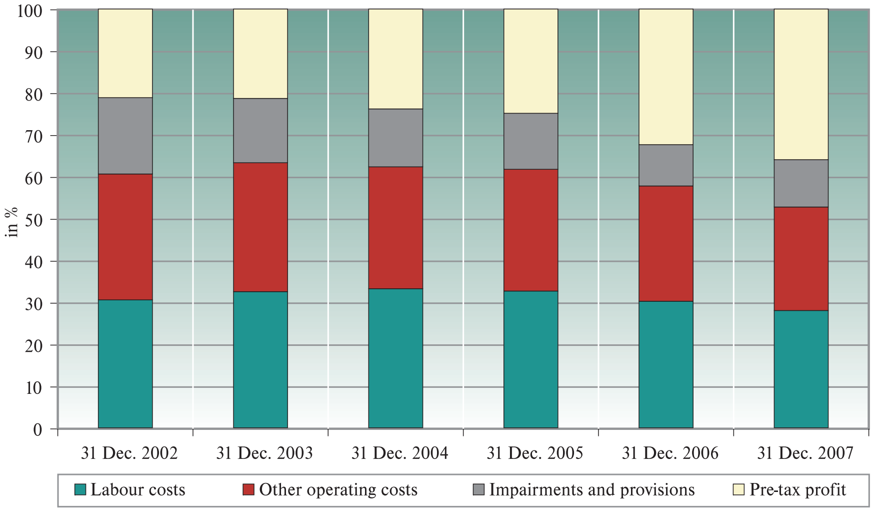


Source: Bank of Slovenia

… representing the largest proportion of gross income

Net interest still accounts for the largest proportion of gross income. Following six consecutive years of declines, the proportion of net interest remained at the previous year's level (56.8%). The proportion of net fees and commissions continues to decline (from 25.4% to 23.5%), resulting in an increase of the proportion of net income from financial assets and liabilities held for trading from 8.0% to 9,5%.

Figure 31: **Disposal of gross income**



Source: Bank of Slovenia

The proportion of gross income accounted for by operating costs fell

The proportion of gross income accounted for by operating costs fell sharply, from 57.8% to 52.7%, as the result of controlled growth in 2007. Growth in operating costs, at 7.2%, lagged behind the growth recorded in 2006 (8.5%). Pre-tax profit already accounts for nearly 36% of gross income (32.4% in 2006). The proportion of gross income used by banks for impairments and provisioning also increased from the previous year (from 9.8% to 11.3%).

Table 14: **Principal items of adjusted income statement**

	Amount (in EUR thousand)		Proportion (in %)		Growth (in %)	
	2006	2007	2006	2007	2006/2005	2007/2006
Net interest	689,847	810,674	56.7	56.8	9.2	17.5
Net fees and commissions	308,537	335,433	25.4	23.5	9.5	8.7
Net trading	97,190	135,815	8.0	9.5	37.2	39.7
Net other financial effects	82,710	108,336	6.8	7.6	98.2	31.0
Net other	37,321	37,389	3.1	2.6	62.9	0.2
Gross income	**1,215,605**	**1,427,647**	**100.0**	**100.0**	**15.9**	**17.4**
Operating costs	702,130	752,663	57.8	52.7	8.5	7.2
- of which labour costs	367,434	399,864	30.2	28.0	7.3	8.8
Net income	**513,475**	**674,984**	**42.2**	**47.3**	**28.0**	**31.5**
Impairments and provisions	-119,798	-161,237	-9.9	-11.3	-14.5	34.6
- Net impairments of financial assets at amortised cost and provisions	-115,886	-130,373	-9.5	-9.1	-27.7	12.5
Pre-tax profit	**393,677**	**513,747**	**32.4**	**36.0**	**50.7**	**30.5**
Net profit	**302,827**	**412,064**	**24.9**	**28.9**	**44.6**	**36.1**

Source: Bank of Slovenia

Net interest income

Net interest rose 17.5% year-on-year

Net interest was EUR 121 million or 17.5% higher in 2007 than in 2006, when a 9.2% increase was recorded. Similar to the previous year, both interest categories increased in 2007. Interest expenses recorded relatively higher growth (54.9%), but in the context of an expanded basis, interest income recorded higher nominal growth.

The interest income of banks rose…

Interest income amounted to EUR 1,943 million in 2007, up EUR 522 million on the previous year. The largest contribution to the increase in interest income came from interest income from lending and deposits, which recorded an increase of EUR 507 million, as the result of high growth in lending and the continuing rise in lending interest rates. Interest income from central bank securities fell by EUR 98 million due to the maturity of bills in April 2007.

… as did interest expenses

Banks recorded interest expenses of EUR 1,133 million in 2007, up EUR 401 million from the previous year. Growth in borrowing at foreign banks continued to rise in 2007, once again significantly exceeding growth in deposits by non-banking sectors. This and the considerable rise in interest rates on financial markets in the rest of the world contributed most to the increase in interest expenses.

Net non-interest income

Growth in net fees and commissions was 8.7% in 2007

Earnings from **net fees and commission** totalled EUR 335 million in 2007, an increase of EUR 27 million, or 8.7%, compared to the increase of 9.2% recorded in 2006. Similar to the previous year, fees and commissions received increased primarily as a result of higher fees for administrative services and commissions on domestic payments, while commissions from securities transactions for clients also increased. Banks generate the majority (70%) of income from fees and commissions from the aforementioned transactions. In contrast to the previous year, fees for guarantees also increased as the result of a higher volume of guarantees issued.

Net income from financial assets and liabilities held for trading totalled EUR 136 million in 2007, an increase of EUR 39 million, or 39.7%, compared to the increase of 37.2% recorded in 2006. Net income from the trading of shares (EUR 150 million) represented the entire amount of net income from trading generated by banks, while trading in debt securities resulted in a loss. Banks recorded high month-on-month increases in net trading until July, followed a slowdown in month-on-month growth due to a drop in securities prices. In November, banks generated a loss in the amount of EUR 9 million.

Income from trading in securities was higher in the first half of the year, driven by trading in shares

Earnings from net other financial effects totalled EUR 108 million in 2007, an increase of EUR 26 million, or 31.0%. Banks generated the majority of the aforementioned effects through **dividend income** in the amount of EUR 75.0 million, an increase of EUR 34 million or 81.1% from the previous year, when negative growth was recorded. The largest portion of the increase in dividend income derives from dividends from capital investments in group companies. The **realised effects from financial assets and liabilities not measured at fair value through profit or loss** (EUR 46 million) represent a significant category within net other financial effects. Banks generated a minor loss in the amount of EUR 6 million **from financial assets and liabilities recognised at fair value through profit or loss** in 2007. This relates to the investments of a small number of banks in structured securities, which lost value due to the turbulence on world financial markets.

Operating costs

Operating costs, which have increased for the third consecutive year, stood at EUR 753 million at the end of 2007. The growth rate of 7.2% was lower than that recorded the previous year (8.5%). Growth in labour costs increased somewhat compared to the previous year (from 7.3% to 8.8%), while growth in general and administrative costs was halved, from 12.6% to 6.0%. The latter were outstripped primarily due to a minor increase in the costs for services of others, lower costs for advisory services and lower commercial property rental expenses.

Operating costs were higher; however their growth has slowed

Growth in costs was again outstripped by growth in gross income in 2007, with the difference rising from 7.4 percentage points in 2006 to 10.2 percentage points. As a consequence, operating costs as a proportion of gross income fell sharply (from 57.8% to 52.7%). Due to the moderate growth in operating costs compared to growth in net non-interest income, banks are able to cover 82% of costs with the latter, compared to 75% in 2006. With faster growth in total assets, the trend of a declining ratio of costs to average assets continued, reaching 2.0% (2.2% at the end of 2006).

Banks cover 82% of costs with non-interest income

Net provisioning

Banks recorded net impairments and provisions of EUR 161 million in 2007, an increase of 34.6% or EUR 41 million from 2006, nearly reaching the level of impairments and provisions (approximately 166 million) recorded by banks in the years prior to the changeover to the IFRS[12]. The amount of net impairments and provisions recorded by banks for financial assets measured at amortised cost was more modest (EUR 130 million), and was up 12.5% or EUR 15 million from the previous year. The difference between the increase in total impairments and provisions and the increase in impairments and provisions for financial assets at amortised cost can be attributed to the considerable increase in expenses for other provisions and the decrease in income from the release of provisions for unsettled lawsuits. The year 2007 was characterised by the fact that banks increased the

Banks recorded an increase in net impairments and provisions, nearly reaching the level from the years prior to the changeover to the IFRS

12 International Financial Reporting Standards.

monthly amount of impairments and provisions relatively uniformly and that no significant fluctuation could be discerned.

Bank performance indicators

Average ROA increased to 1.4%...

In 2007, growth in profit outstripped growth in total assets by 10.7 percentage points. This was reflected in average ROA, which increased by 0.1 percentage points to 1.4%. Seven banks recorded above-average indicators, while four saw declines in their indicators from the previous year.

… while average ROE also increased

ROE also improved in 2007 (by 1.2 percentage points to 16.3%), as the result of growth in profit outstripping growth in the book value of capital. The number of banks with an above-average value for this indicator rose significantly compared to the previous year (from 8 to 13).

Gross income per average total assets continues to decrease, while the interest margin remains unchanged

Gross income per average total assets (3.8%) continued to display a declining trend, while the interest margin remained at last year's level of 2.2%. The modest decline in the value of gross income per total average assets, similar to past years, and the unchanged interest margin are due to the fact that growth in average total assets marginally outstrips growth in gross income and net interest. The non-interest margin declined compared to the previous year (from 1.67% to 1.64%) due to the modest increase in net fees and commissions and net trading.

Table 15: **Selected bank performance indicators**

in %	2002	2003	2004	2005	2006	2007
Gross income per average assets	5.3	4.7	4.4	4.0	3.9	3.8
Average return on assets	1.1	1.0	1.1	1.0	1.3	1.4
Average return on equity	12.6	11.9	12.7	12.7	15.1	16.3
Interest margin	3.4	3.1	2.7	2.4	2.2	2.2
Non-interest margin	1.83	1.64	1.72	1.60	1.67	1.64
Operating costs per average assets	3.2	3.0	2.8	2.5	2.2	2.0

Source: Bank of Slovenia

The cost efficiency indicator (the ratio of operating costs to average assets) continues to improve (from 2.2% to 2.0%). Growth in operating costs continues to lag significantly behind (just under 13 percentage points) growth in average assets, which had a favourable impact on this indicator.

1.3.4 Interest rates and interest rate spread

Banks deposits as a proportion of interest-bearing liabilities increased, while the proportion of deposits by non-banking sectors declined

No decrease in borrowing at foreign banks meant that the proportion of average interest-bearing liabilities accounted for by bank deposits continued to increase in 2007 at the expense of the proportion accounted for by deposits by non-banking sectors. The proportion of average interest-bearing liabilities accounted for by deposits by non-banking sectors fell from 59.5% at the end of 2006 to 53.8%, while the proportion accounted for by bank deposits rose by 5.5 percentage points to 39.3%. The already modest proportion of debt securities (2.9%) declined further compared to the previous year, while the proportion of interest-bearing liabilities accounted for by subordinated liabilities is rising (3.8%).

The proportion of interest-bearing assets accounted for by debt securities fell sharply (from 26.6% to 19.9%) due to the maturity of Bank of Slovenia bills. That and the continuing increase in the lending activity of banks contributed to the sharp increase in lending to non-banking sectors as a proportion of interest-bearing assets by 6.7 percentage points to 68.6%.

Debt securities as a proportion of interest-bearing assets fell sharply due to maturing Bank of Slovenia bills

Table 16: **Effective lending and deposit interest rates**

in % p. a.	Dec. 05	Dec. 06	Mar. 07	Jun. 07	Sep. 07	Dec. 07
Average lending rate	4.83	5.27	5.37	5.53	5.81	5.95
Average deposit rate	2.23	2.63	2.83	3.03	3.35	3.66
Interest rate spread	2.60	2.64	2.54	2.50	2.46	2.29

Source: Bank of Slovenia

Lending and deposit rates continued to rise in 2007. The rise in interest rates was higher than recorded in 2006, with average lending rates rising by 0.68 percentage points and average deposit rates by 1.03 percentage points. With deposit rates rising faster than lending rates, the result is a considerable drop in the interest rate spread, from 2.46 to 2.29 percentage points.

Lending and deposit rates continued to rise, with deposit rate rising more than lending rates

The largest rise among lending rates was recorded by rates on long-term lending (0.76 percentage points), with rates on short-term lending recording a slightly smaller increase (0.57 percentage points). With regard to long-term lending, the largest rise in interest rates was recorded for lending to banks, non-residents and non-financial corporations, while interest rates for lending to the government and for interbank lending rose most in the short-term segment.

The largest rise among lending rates was recorded by rates on long-term loans…

The largest rise in deposits rates was recorded by interest rates for short-term deposits of more than 30 days (by 1.30 percentage points, with rates on deposits by the government, non-financial corporations and households recording the highest increase), while the rise in these interest rates in 2006 was merely symbolic (0.15 percentage points). Interest rates on long-term deposits recorded a similar increase as the previous year (0.99 percentage points).

…and on deposit rates by those on deposits for more than 30 days

In terms of currency, a continuing rise in euro interest rates was evident on both the lending and deposits sides. Short-term lending rates rose by 1.33 percentage points to 5.78%, while long-term lending rates rose by 1.24 percentage points to 6.16%. Deposit rates, particularly on short-term deposits of more than 30 days, rose more sharply (by 1.42 percentage points to 4.37%).

In terms of currency, euro interest rates continued to rise…

The rise in Swiss franc interest rates was slightly lower than in the previous year, particularly with regard to lending rates, where interest rates for short-term loans in Swiss francs rose by 0.87 percentage points to 3.52%, and by 0.64 percentage points to 4.47% for long-term loans.

… while the increase in Swiss franc interest rates was slightly lower than in 2006

1.3.5 Liquidity position

To ensure an adequate liquidity position that is in line with the provisions of the regulation on the minimum requirements for ensuring an adequate liquidity position, banks must ensure an adequate level of liquid investments for all liabilities maturing within 30 days[13] . This means that the ratio of investments to liabilities for category 1 (from 0 to 30 days) must always be at least 1.

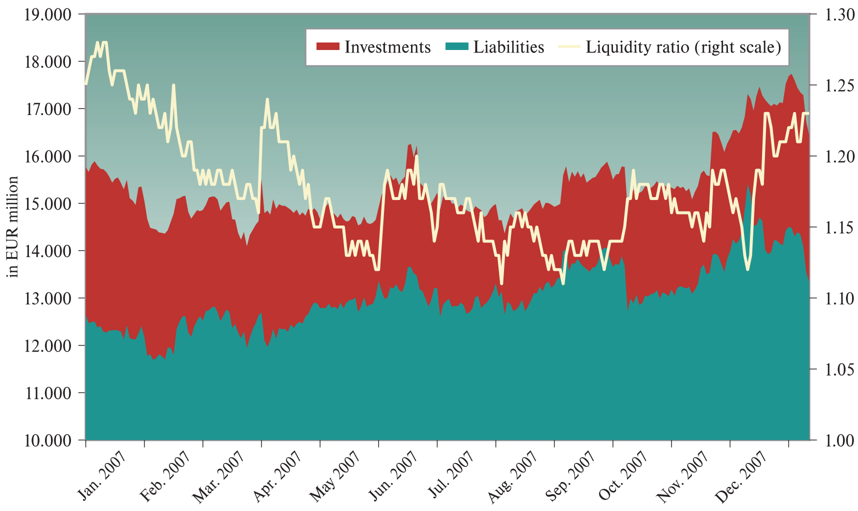
In 2007, the liquidity ratio exceeded the prescribed value at all times

In 2007, the stock of investments exceeded the balance of liabilities at all times, ranging from EUR 1,504 million to EUR 3,429 million. With average liabilities in the amount EUR 13,046 million and average investments in the amount of EUR 15,349, investments exceeded liabilities by at least 11%. As a result, the liquidity ratio also exceeded the prescribed value at all times, fluctuating between 1.11 and 1.28. Individual banks also exceeded the prescribed ratio of investments to liabilities at all times.

The somewhat lower liquidity ratio values in the middle of the year were the result of increased uncertainties on world financial markets

The liquidity ratio gradually decreased from its initial value of 1.25 during the course of the year. Two sharp increases in the first half of the year were the result of new foreign borrowing by banks. The lower liquidity ratio values, recorded by banks during the summer and early autumn were the result of turmoil on the US mortgage loan market. Despite the fact that Slovenian banks were not directly affected by the turmoil, it was partly reflected in the liquidity ladder. Since August, it has been increasingly difficult for banks to obtain sources with a longer-term maturity due to conditions on financial markets. This has led to an increase in the amount of liabilities with a maturity of up to 30 days. With an unchanged investment structure, the aforementioned has affected the level of the liquidity ratio, which recently reached its lowest level. The decrease and subsequent increase in late autumn are a reflection of changes in cash flows during the sale of one bank.

Figure 32: **Investments and liabilities and the liquidity ratio**



Source: Bank of Slovenia

13 In this section, banks, branches of EU Member States and savings banks are included in the banking system.

1.3.6 Asset Quality

The maximum exposure limit was not exceeded

The two vital elements of credit risk management are the monitoring of the credit rating structure of claims, and the prevention of concentrations of credit exposure. As at 31 December 2007, no bank had exceeded the limits on the maximum allowable exposure to individual clients (25% of capital), to groups of related clients (25% of capital), to other persons in the group (20% of capital) or to persons with a special relationship with the bank (20% of capital).

Table 17: **Bank exposure in relation to capital**

	2003	2004	2005	2006	2007
Ration of sum of large exposures to capital (%)	214	196	228	223	217
Number of large exposures	296	253	305	333	350
Number of banks with large exposures of more than 300% of capital	4	3	5	4	8

Source: Bank of Slovenia

The sum of large exposures declined

By the end of 2007 the sum of large exposures in the banking system had been reduced to 217% of capital. The total number of large exposures was up 17 from the end of 2006. The number of banks which recorded a sum of large exposure of more than 300% of their capital increased from 4 to 8.

Table 18: **Credit rating structure and level of coverage of classified assets by impairments and provisions**

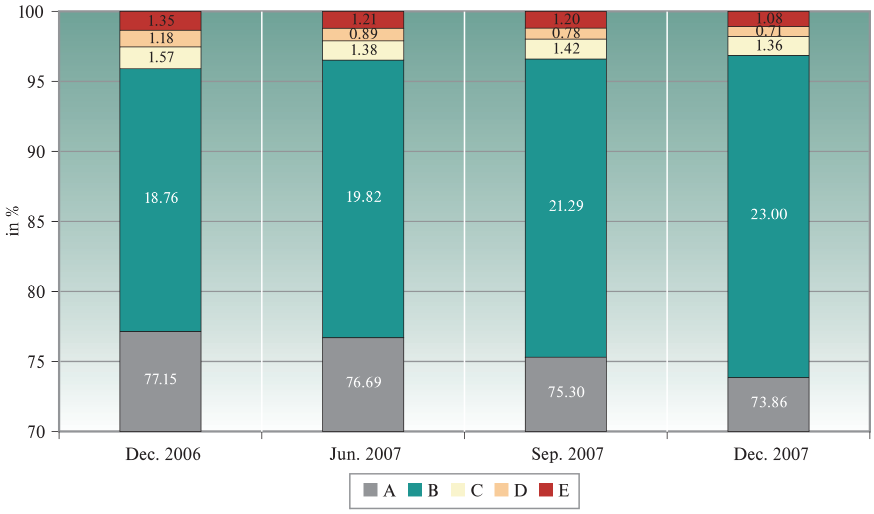
Credit rating	Dec. 06				Dec. 07			
	Classified assets in EUR thousand	Classified assets in (%)	Impairments and provisions in EUR thousand	Level of coverage in %	Classified assets in EUR thousand	Classified assets in (%)	Impairments and provisions in EUR thousand	Level of coverage in %
A	24,364,110	77.1	88,044	0.4	29,942,739	73.9	111,971	0.4
B	5,923,146	18.8	352,842	6.0	9,324,671	23.0	442,065	4.7
C	494,267	1.6	118,869	24.0	550,088	1.4	131,260	23.9
D	373,072	1.2	247,660	66.4	286,353	0.7	188,087	65.7
E	426,423	1.4	426,423	100.0	437,731	1.1	437,747	100.0
Total	31,581,018	100.0	1,233,838	3.9	40,541,582	100.0	1,311,130	3.2

Source: Bank of Slovenia

Total exposure increased

Total exposure in the banking system had increased by 22.7% by the end of 2007, and stood at EUR 49,401 million, with balance sheet claims and off-balance sheet claims representing 83.0% and 17.0%, respectively. The amount of classified assets increased by 28.4%, to account for 82.1% of total exposure at the end of 2007.

Figure 33: **Structure of banking system's credit portfolio**



Source: Bank of Slovenia

The credit rating structure of claims deteriorated

By the end of 2007, the credit rating structure of classified assets had deteriorated owing to an increase in the proportion of B-classified assets (up 4.24 percentage points), at the expense of a decline in A-classified assets (down 3.29 percentage points). There was also a decrease in the proportions of C-classified assets (down 0.21 percentage points), D-classified assets (down 0.47 percentage points) and E-classified assets (down 0.27 percentage points). The highest-quality credit portfolios were maintained by banks under majority foreign ownership, with 84.8% of their claims being A-rated, or 16.1 percentage points more than at domestic banks.

Table 19: **Credit rating structure of banking system's credit portfolio (in % and EUR thousand)**

Credit rating	Classified assets	Proportion in %	Average impairment under IFRS
1 (from 0.00% to 1.00%).	29,942,739	73.9	0.4
2 (from 1.01% to 5.00%)	5,509,663	13.6	2.4
3 (from 5.01% to 8.00%)	2,352,104	5.8	6.4
4 (from 8.01% to 15.00%)	1,462,904	3.6	10.8
5 (from 15.01% to 25.00%)	386,456	1.0	19.8
6 (from 25.01% to 40.00%)	163,632	0.4	33.5
7 (from 40.01% to 75.00%)	189,898	0.5	53.8
8 (from 75.01% to 99.00%)	96,455	0.2	89.1
9 (from 99.01% to 100%)	437,731	1.1	100.0
OVERALL	40,541,582	100.0	3.2

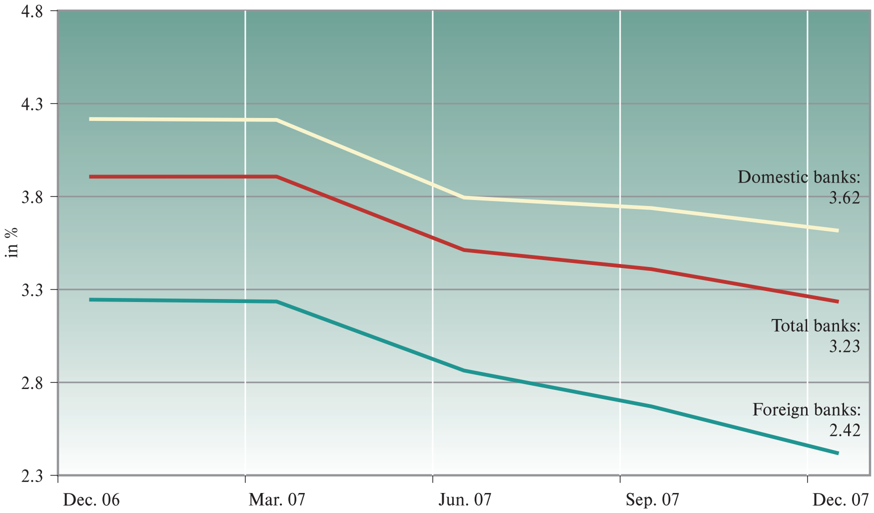
Source: Bank of Slovenia

The majority of claims were classified in credit rating category 1

In the credit rating structure of classified assets, which contains nine categories[14], the 1-rating accounts for the largest proportion (73.9%) at the end of 2007, followed by the 2-rating and 3-rating (13.6% and 5.8% respectively). The remaining six credit ratings account for 6.8% of classified assets, of which 1.8% are classed as non-performing (rated 7, 8 and 9).

[14] A-classified assets include credit rating 1, B-classified assets include credit ratings 2, 3 and 4, C-classified assets include credit ratings 5 and 6, D-classified assets include credit ratings 7 and 8 and E-classified assets include credit rating 9.

Figure 34: **Average risk of claims in banking system overall and in individual groups**

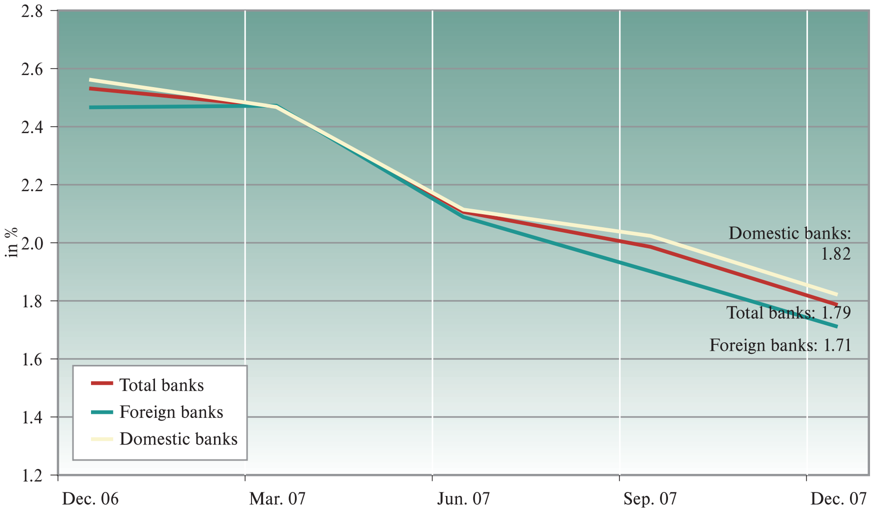


Source: Bank of Slovenia

Average risk of claims declined at both foreign and domestic banks

Both groups of banks are demonstrating a decline in the average risk of claims[15], with foreign banks recording a sharper decline (by 1.13 percentage points) than domestic banks (0.71 percentage points). Banks created impairments and provisions of 3.23% overall under the IFRS in 2007. The impairments and provisions created by domestic banks (3.62%) under the IFRS were 1.2 percentage point higher than those created by banks under majority foreign ownership (2.42%). The level of coverage of classified assets by provisions stood at 3.91% for the banking system overall at the end of 2006 (4.22% at domestic banks, and 3.25% at banks under majority foreign ownership).

Figure 35: **Proportion of D- and E-classified assets, by groups of banks and for banking system**



Source: Bank of Slovenia

The proportion on non-performing claims declined

At the end of 2007, the proportion of non-performing claims in the banking system (categories D and E or credit ratings 7, 8 and 9) was down 0.75 percentage points

15 The average risk of claims is equal to the level of coverage, calculated as the ratio of total impairments and provisions to rated claims.

from the end of 2006. A comparison between the two groups of banks shows that this proportion decreased slightly more at banks under majority foreign ownership (-0.76 percentage points compared with -0.74 percentage points) to stand at 1.71% at the end of 2007, 0.11 percentage points less than at the domestic banks (1.82%).

Table 20: **Breakdown of classified assets by institutional sector, and average credit rating of sectors**

	31 Dec. 06		**30 Jun. 07**		**30 Sep. 07**		**31 Dec. 07**	
	Proportion in %	Average risk (in %)	Proportion in %	Average risk (in %)	Proportion in %	Average risk (in %)	Proportion in %	Average risk (in %)
A. Industry	**20.9**	**5.5**	**19.3**	**5.1**	**19.2**	**5.0**	**19.3**	**4.8**
- metals and machinery	4.0	4.2	4.2	3.5	4.0	3.5	3.9	3.8
- chemicals	2.5	6.1	2.5	4.5	2.5	4.2	2.7	2.9
- food and beverages	2.2	5.6	2.2	4.9	2.1	5.3	2.1	5.4
- construction	6.3	3.4	4.8	4.0	4.8	3.9	4.9	4.1
- energy supply	0.9	1.2	0.9	1.1	1.0	1.2	0.9	1.3
B. Services	**50.5**	**3.0**	**44.4**	**2.9**	**44.9**	**2.9**	**43.8**	**2.8**
- trade, motor vehcile repair	9.9	5.3	9.8	4.7	9.4	4.8	9.5	4.3
- transport, warehousing	3.1	2.8	5.2	1.8	5.3	1.6	5.1	1.6
- financial intermediation	15.9	0.8	8.6	1.5	9.3	1.5	8.7	1.4
- Bank of Slovenia	8.0		0.2		0.2		0.2	
- real estate, leasing	10.4	3.5	12.3	2.8	12.8	2.8	12.7	2.7
- public administration, defence social security	8.4	0.4	5.8	0.3	5.4	0.3	5.1	0.3
C. Households	**14.1**	**4.4**	**14.3**	**4.1**	**14.4**	**4.0**	**14.5**	**3.8**
D. Non-residents	**14.5**	**3.2**	**22.1**	**2.2**	**21.6**	**2.1**	**22.5**	**1.8**
Total	**100.0**	**3.9**	**100.0**	**3.5**	**100.0**	**3.4**	**100.0**	**3.2**

Source: Bank of Slovenia

Banks remain most exposed to clients in the service sector, although their proportion has declined compared to the end of 2006

As at 31 December 2007 banks were most exposed to clients in the service sector, their proportion declining 6.7 percentage points from the end of 2006 to 43.8%. The main factors in the decline were the decline in the proportion accounted for by Bank of Slovenia securities (down 7.7 percentage points) and the decline arising from social insurance (down 3.3 percentage points), while there was an increase in exposure to the real estate sector (up 2.3 percentage points) and in transport and warehousing (up 1.9 percentage points). The level of risk in the service sector declined by 0.3 percentage points, primarily as a result of lower risk in transport and warehousing sector (down 1.2 percentage points), trade and motor vehicle repair (down 1.0 percentage points), and real estate (down 0.7 percentage points).

The proportion of debt accounted for by the highest risk sectors of industry declined on account of a decline in the proportion of debt of the construction sector

The proportion of debt accounted for the highest risk sectors of industry had declined 1.6 percentage points to 19.3% by the end of 2007, primarily on account of the construction sector (down 1.3 percentage points). The largest decrease in the level of risk of the industrial sector was recorded by the chemicals industry (down 3.2 percentage points) and also by the metal and machinery industry (down 0.4 percentage points), while the level of risk in the construction sector increased by 0.7 percentage points. Exposure to households also increased slightly (by 0.4 percentage points), its level of risk down 0.6 percentage points, while exposure to non-residents increased more significantly (by 8.0 percentage points) in the context of a decline of 1.4 percentage points in risk.

Table 21: **Exposure to particular groups of countries**

in EUR thousand, %	31 Dec. 04 Amount	31 Dec. 04 Propor.	31 Dec. 05 Amount	31 Dec. 05 Propor.	31 Dec. 06 Amount	31 Dec. 06 Propor.	31 Dec. 07 Amount	31 Dec. 07 Propor.
EU	1,871,082	69.3	2,707,315	63.5	3,472,926	59.1	7,112,554	63.8
EFTA	117,464	4.3	235,641	5.5	281,255	4.8	353,605	3.2
Former Yugoslav republics	415,273	15.4	816,554	19.2	1,326,748	22.6	2,721,443	24.4
Other	296,744	11.0	504,006	11.8	796,273	13.5	964,125	8.6
Total	**2,700,563**	100.0	**4,263,516**	100.0	**5,877,203**	100.0	**11,151,727**	100.0
Proportion of classified assets accounted for by non-residents	9.6%		12.4%		14.5%		22.6%	

Source: Bank of Slovenia

The trend of increasing exposure to the former Yugoslav republics continues

The proportion of exposure accounted for by EU Member States recorded the highest increase from the end of 2006. The latter still prevails in the breakdown of exposure to particular groups of countries, accounting for 63.8% of the total at the end of 2007. The trend of increasing exposure to the former Yugoslav republics continued, with the proportion of the total that they account for reaching 24.4 by the end of 2007 (up 1.8 percentage points), primarily at the expense of the proportion accounted for by EFTA countries (down 1.6 percentage points). The proportion of exposure to other countries declined 4.9 percentage points to 8.6%, the major countries within that group being the US (32.5%) and Russia (27.5%).

1.3.7 Capital and capital adequacy

Growth in capital outstrips growth in capital requirements

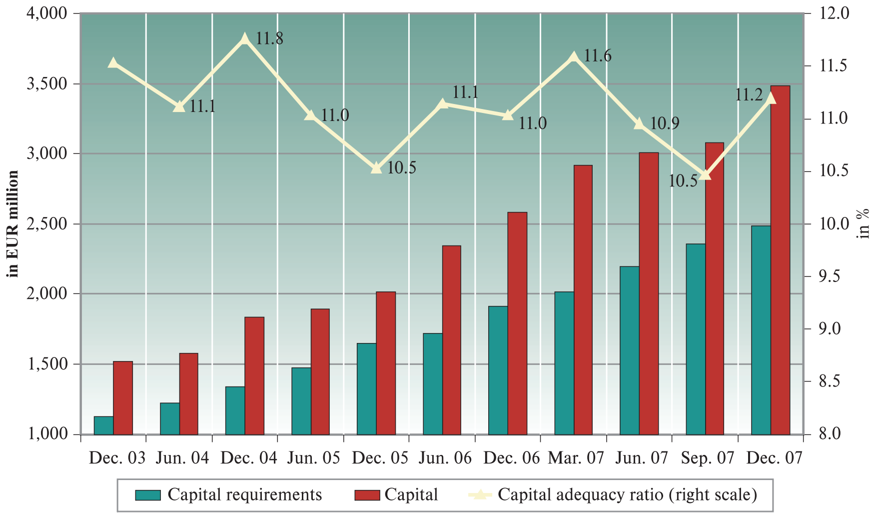
Following a decrease in the first three quarters of 2007, capital adequacy rose sharply in the last quarter, with the ratio exceeding the level from the end of 2006. This growth was primarily the result of a capital injection of the largest Slovenian bank and the entry of a new bank at the beginning of the year. At the end of 2007, capital was up 34.9% from the end of 2006, and was 4.6 percentage points higher than the growth in capital requirements of the banking system. The capital adequacy of the Slovenian banking system stood at 11.19% as at 31 December 2007, compared to 11.03% as at 31 December 2006.

The increase in capital in 2007 was the result of increases in both original and additional capital

The increase in the banking system's capital in 2007 was the result of increases in both original and additional capital. The banking system's capital stood at EUR 3,483 million at the end of 2007, up EUR 902 million from the previous year. Original capital increased by EUR 588 million, with largest increases recorded by share capital and capital reserves (EUR 403 million) and profit reserves and retained earnings (EUR 292 million). The volume of innovative instruments was up EUR 81 million from the end of 2006. On the other side, original capital deduction items also increased in the amount of EUR 208 million (of this amount EUR 130 million is represented by the surplus of innovative instruments, which is included in original capital deduction items as of 2007).[16] The proportion of original capital accounted for by innovative instruments increased by 2.0 percentage points to 6.3%.

16 Among the latter, the largest increase was recorded by deduction items arising from the difference between the disclosed impairments and provisions for financial assets and commitments and contingent liabilities under off-balance sheet items in accordance with the IFRS and the amount of impairments determined or provisions calculated based on the Bank of Slovenia's prescribed methodology. The proportion of the aforementioned original capital deduction items was 7.9% in 2006, compared to 6.6% at the end of 2006.

Figure 36: **Capital adequacy, capital and capital requirements of the banking system**



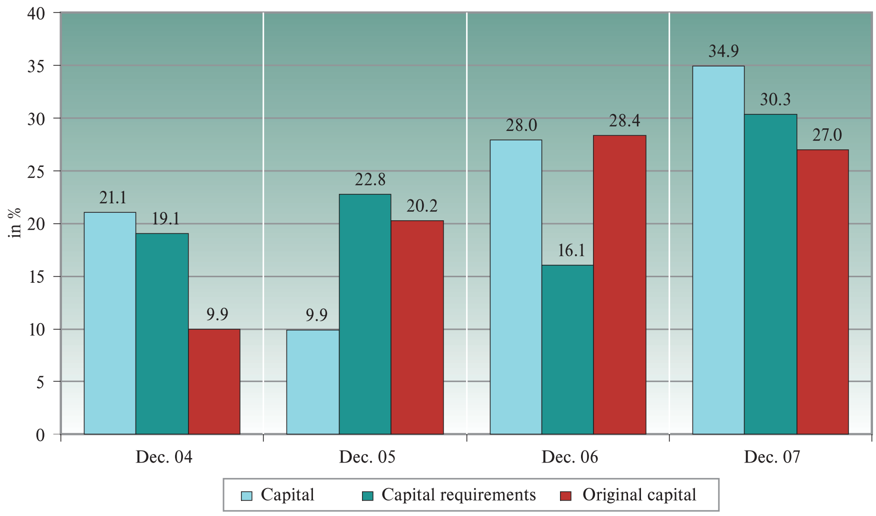
Source: Bank of Slovenia

The proportion of capital accounted for by original capital declined by 5.1 percentage points to 67.4% in 2007, in favour of additional capital (32.6%). The banking system recorded an increase in additional capital in the amount of EUR 516 million, primarily through hybrid instruments (EUR 318 million) and subordinated debt (EUR 181 million). Within the banking system, subordinated debt represents 23.9% of original capital, however exceeds 40% of original capital at five banks. Capital deduction items were up EUR 199 million from the end of 2006, primarily on account of capital investments in other credit or financial institutions (up EUR 132 million).

Capital requirements for credit risk have increased on account of rapid growth in lending and a decrease in capital requirements for currency and market risks

Capital requirements for credit risk, which represent 96.1% of capital requirements, continue to increase due to strong lending activity and decreasing capital requirements for currency and market risks. At the end of 2007, growth in lending to non-banking sectors (37.4%) was slightly higher than growth in capital requirements for credit risk (34.4%).

Figure 37: **Year-on-year growth in capital, original capital and capital requirements**



Source: Bank of Slovenia

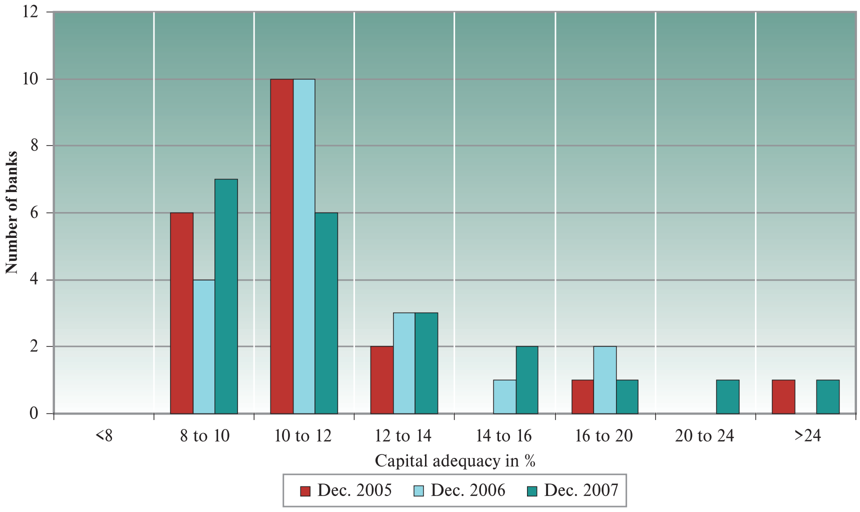
Capital requirements for market risks continue to decrease…

Capital requirements for market risks (including currency risk) in the structure of capital requirements continue to decline gradually. Capital requirements for market risks stood at EUR 98 million at the end of 2007. Capital requirements for equity instruments represent the highest proportion (53%), followed by capital requirements for debt instruments (33%), capital requirements for foreign currencies (10%) and capital requirements for exceeding the maximum allowable exposure from trading (4%).

…within them also capital requirements for currency risk

The level of capital requirements for currency risk, which are now an integral part of capital requirements for market risks, has decreased since the end of 2005, largely due to methodological changes. In 2007, the proportion of capital requirements for currency risk continued to decrease (down 0.3 percentage points).

Figure 38: **Proportion of D- and E-classified assets, by groups of banks and for banking system**



Source: Bank of Slovenia

Most banks are in the capital adequacy interval of 8% to 10%

All the banks met the minimum capital adequacy requirement as at 31 December 2007. Compared to the end of 2006, the number of banks in the capital adequacy interval of 8% and 10% rose (from 4 to 7) at the expense of the number of banks in the capital adequacy interval of 10% and 12% (from 10 to 6). While one half of all banks were in the interval of 10% to 12% at the end of 2006, the majority of banks were in the interval of 8% to 10% at the end of 2007. One bank was in the interval of 20% to 24% and one in capital adequacy interval of more than 24% at the end of 2007.

2 BANK OF SLOVENIA ACTIVITIES

2.1 Implementation of ECB monetary policy

The Bank of Slovenia ceased to independently implement monetary policy as at 31 December 2006. With entry to the Eurosystem on 1 January 2007, it began implementing the single monetary policy of the Eurosystem in Slovenia in accordance with the decentralisation of the Eurosystem's monetary policy implementation. In this regard, the Bank of Slovenia harmonised its monetary policy instruments with the operational framework of the Eurosystem's monetary policy.

The Bank of Slovenia ceased to independently implement monetary policy as of 2007

2.1.1 Changes in the Bank of Slovenia's balance sheet in the context of entry to the Eurosystem

With its entry to the Eurosystem, the Bank of Slovenia's balance sheet changed due to the transition to a new monetary policy operational framework. Immediately at the beginning of 2007, the overnight deposits made by banks on 29 December 2006 matured, while short-term and long-term deposits at the Bank of Slovenia gradually matured until the end of March. Tolar and euro denominated bills matured until the end of April. In this way, banks were able to gradually restructure investments abroad. A change in the structure of external debt resulted, as the Bank of Slovenia's liabilities to domestic banks based on monetary policy instruments were replaced by the Bank of Slovenia's liabilities within the Eurosystem, which are disclosed as liabilities to the rest of the world. The Bank of Slovenia's net claims to the rest of the world decreased by EUR 3.1 billion as a result.

Entry to the euro area resulted in an increase in the Bank of Slovenia's liabilities to the rest of the world

Due to the introduction of the euro, the Bank of Slovenia approved an interest free secured loan of euro cash for banks and savings banks totalling EUR 855 million at the end of 2006 to facilitate the changeover from tolars to euros at the beginning of 2007. The last instalment of this loan fell due at the end of January 2007.

2.1.2 Use of Eurosystem monetary policy instruments in 2007

The Eurosystem's monetary policy is implemented with three groups of instruments: open market operations, standing facilities and minimum reserve requirements.[17] Open market operations are basic instruments for managing the liquidity of the banking sector. The Eurosystem may conduct open market operations at its own discretion, but most are implemented according to a pre-specified calendar in the form of tenders. Standing facilities, i.e. marginal deposit and lending facilities, represent additional possibilities to manage liquidity which counterparties may use at their own discretion.

For stabilising interest rates close to ECB key interest rate, Eurosystem uses three groups of instruments: open market operations, standing facilities and minimum reserve requirements

In monetary policy operations, counterparties may be credit institutions which are also subject to the Eurosystem's minimum reserve requirements. In Slovenia, these are banks and savings banks, as defined by the Bank of Slovenia Act, which meet the operational criteria set out in the Regulation on General Rules for Monetary Policy Implementation adopted by the Governing Board of the Bank of Slovenia. In 2007,

In monetary policy operations, counterparties are credit institutions; in Slovenia these are banks and savings banks

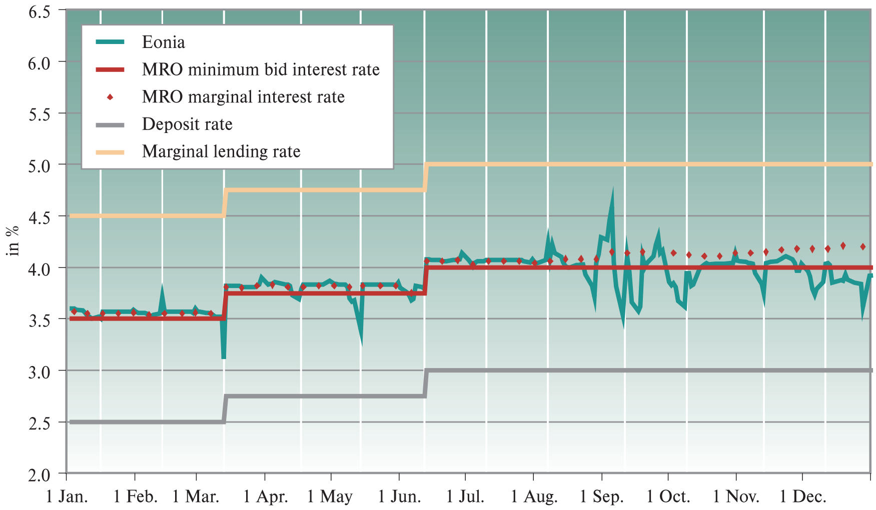
[17] For a more detailed description see, the General Documentation on Eurosystem Monetary Policy Instruments and Procedures, http://www.ecb.int/pub/pdf/other/gendoc2006sl.pdf

a total of 27 Slovenian institutions subject to the minimum reserve requirements had access to monetary policy instruments which are implemented in the form of standard tenders (e.g. main refinancing operations and longer-term refinancing operations) and access to standing facilities.

Slovenian counterparties participated in 51 main refinancing operations, realising 67% of bids…

The Eurosystem signals the stance of monetary policy by changing the minimum bid rate on *main refinancing operations (MRO).* These are liquidity-providing reverse transactions with a weekly frequency and a maturity of normally one week, which are executed according to a pre-specified calendar. In 2007, there were 52 such operations in the average amount of EUR 257.0 billion. Until the beginning of August, this amount was higher, averaging EUR 292.2 billion, but subsequently fell due to the turmoil on financial markets. Slovenian counterparties participated in 51 MROs, submitting bids of EUR 3.1 billion and receiving EUR 2.0 billion in liquidity, or 67% of the desired amount.

Figure 39: **Eurosystem interest rates and Eonia**

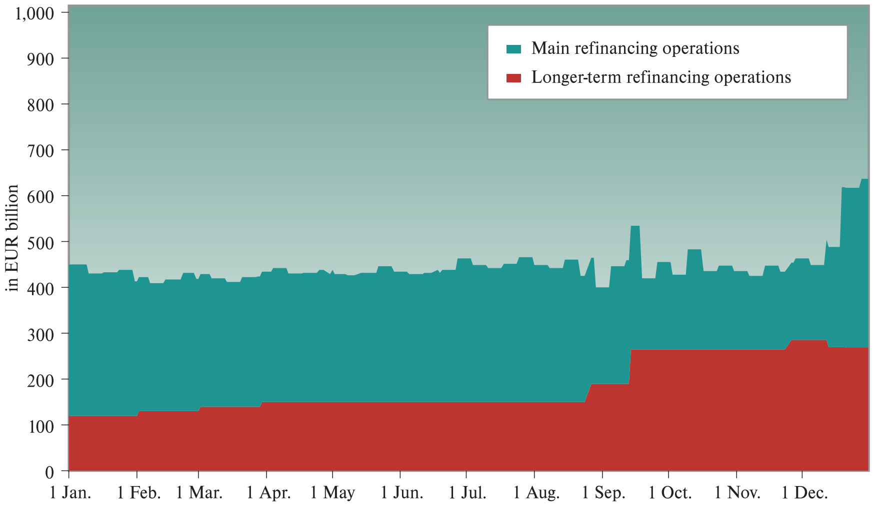


Note: Vertical lines represent the end of a reserve maintenance period.
Source: ECB

…and in 14 longer-term refinancing operations where they realised 60% of bids

Longer-term refinancing operations are aimed at providing banks (e.g. counterparties) additional longer-term refinancing. These are liquidity-providing reverse transactions with a monthly frequency and a maturity of normally three months, which are executed according to a pre-specified calendar. Because of the turmoil on financial markets in the second half of 2007, which resulted in greater volatility in money market interest rates, the Eurosystem decided to execute additional operations which were renewed each time the operations matured. The Eurosystem compensated for the increased amount of these operations by decreasing the amount of main refinancing operations. As a result, longer-term refinancing operations, measured as their proportion in covering the Eurosystem's liquidity needs, became the main source for providing liquidity in the euro area towards the end of 2007. In 2007, 16 longer-term refinancing operations were executed: one regular operation at the end of each month and four supplementary operations from August onwards. The Eurosystem allocated EUR 50 billion in liquidity in each regular operation and between EUR 40 billion and EUR 75 billion in supplementary operations. Slovenian counterparties participated in 14 longer-term refinancing operations, submitting bids of EUR 0.5 billion and receiving EUR 0.3 billion in liquidity, or 60 % of the desired amount.

Figure 40: **Main and longer-term refinancing operations of the Eurosystem**



Source: ECB

Slovenian counterparties also participated in fine tuning operations

Fine tuning operations are executed on an ad hoc basis with the aim of managing liquidity imbalances in the market and stabilising interest rates. In 2007, these operations were executed as liquidity-providing reverse transactions or as the collection of fixed-term deposits, each time as a quick tender. A total of 24 tenders were executed, 7 to provide liquidity and 17 to absorb liquidity. Six operations (two to provide and four to absorb liquidity) were executed until August, always on the last day of the reserve maintenance period. Operations were later carried out due to turmoil on the money market and due to increased liquidity management needs during the reserve maintenance period. Slovenian counterparties also participated in these tenders.

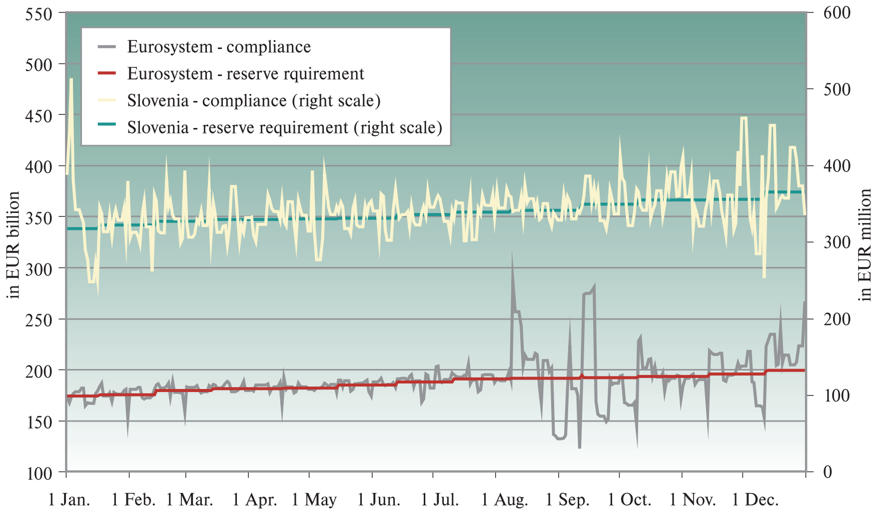
The use of standing facilities is typically higher at the end of the reserve maintenance period, also in Slovenia

The use of *standing facilities* is limited to the closing of unexpected supply gaps of credit institutions with liquidity and is typically higher at the end of a reserve maintenance period when the possibility to balance gaps via average minimum reserve holdings or regular open market operations is reduced. The average daily balance of a deposit facility in the Eurosystem was EUR 0.5 billion, while the average daily balance of the marginal lending facility reached EUR 0.2 billion.

Liabilities arising from the minimum reserve requirement rose by 14.2% in the euro area and 15.1% in Slovenia

The Eurosystem's *minimum reserve requirement* of each credit institution is determined in relation to specific items from the liability side of its balance sheet. On average, the reserve maintenance period is approximately one-month, which typically starts on the Wednesday following the meeting of the Governing Council of the ECB, when the latter makes monetary policy decisions. Slovenian credit institutions began the year with a shorter interim period (from 1 to 16 January 2007), and transitioned to normal periods as determined by the calendar of reserve maintenance periods. Liabilities arising from the reserve requirement rose gradually during the year (by 14.2% in the euro area, and 15.1% in Slovenia). The average annual balance on accounts included in the reserve requirement in the euro area was EUR 189.0 billion. Slovenian institutions subject to the reserve requirement accounted for EUR 0.3 billion or 0.18% of this amount. Slovenian banks violated the reserve requirement four times, all during the first half of the year.

Figure 41: **Minimum reserve requirement and compliance**



Sources: Bank of Slovenia, ECB

2.1.3 Securing Eurosystem credit operations

A single list of assets for securing Eurosystem credit operations was introduced in 2007

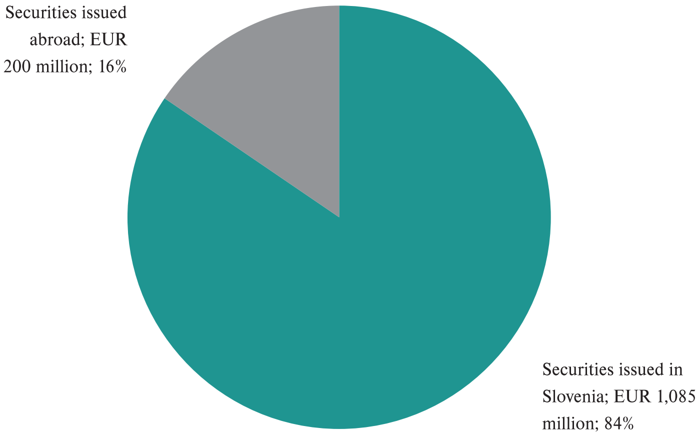
In accordance with the Statute of the ESCB and ECB, all Eurosystem credit operations must be secured with adequate collateral. Assets used to secure monetary policy operations and overnight Eurosystem loans includes a broad range of financial instruments, the most important of which are euro-denominated debt securities. The introduction of a single list of eligible assets on 1 January 2007 further expanded the range of assets with the inclusion of non-marketable assets (i.e. credit claims and non-marketable retail mortgage-backed debt instruments) throughout the entire euro area.[18]

Transactions are secured via a pool of underlying assets at the Bank of Slovenia

In order to make the transition for Slovenian credit institutions as easy as possible, the Bank of Slovenia carried out the majority of adaptations to the new collateral framework in the middle of 2006. On 1 January 2007, the possibility of using non-marketable assets and assets issued abroad was introduced. In 2007, Bank of Slovenia debt instruments (bills and deposits at the Bank of Slovenia) lost their status as eligible collateral for Eurosystem credit operations. Slovenian counterparties use eligible assets by transferring them to the pool of underlying assets at the Bank of Slovenia, either through the Central Securities Clearing Corporation (KDD) for assets issued thereby, or through the Correspondent Central Banking Model for asset issued abroad. During 2007, the size of the pool did not limit counterparties in the use of Eurosystem credit operations, as the size of the pool was considerably larger than the use of credit operations at all times. The value of the pool as at 31 December 2007 stood at EUR 1.3 billion, comprising securities issued in Slovenia in the amount of EUR 1.1 billion and securities issued in the rest of the world totalling EUR 0.2 billion. Slovenian counterparties did not use bank credit claims or other non-marketable assets to secure Bank of Slovenia claims in 2007.

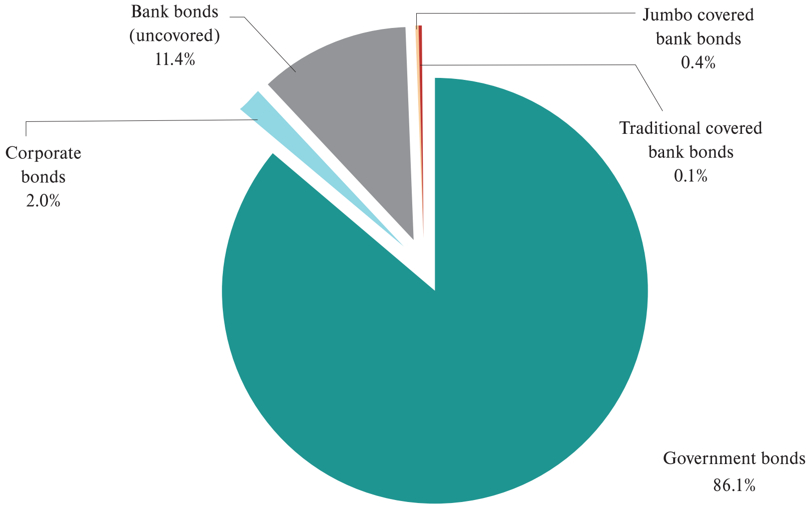
[18] Eligible assets are described in Chapter 6 of the General Documentation on Eurosystem Monetary Policy Instruments and Procedures, http://www.ecb.int/pub/pdf/other/gendoc2006sl.pdf

Figure 42: **Pool of underlying assets at the Bank of Slovenia as at 31 December 2007 – breakdown by place of issue**



Source: Bank of Slovenia

Figure 43: **Pool of underlying assets at the Bank of Slovenia as at 31 December 2007 – breakdown by type of asset**



Source: Bank of Slovenia

Providing liquidity after August 2007

At the beginning of August 2007, tensions arose on financial markets due to the turmoil on the US sub-prime mortgage market. Owing to increased doubts regarding the dispersion of risks linked to sub-prime mortgage loans among market participants, activity on the interbank market dropped off, particularly in the segment of unsecured deposits, where deposits with a maturity of more than one month were especially affected. This led to a sharp rise in market interest rates. Volatility was passed through to interest rates via increased demand for Eurosystem operations. In order to bring about a normalised functioning of the money market in a period of increased uncertainty, the Eurosystem opted for a policy of providing increased liquidity early in the reserve maintenance period, initially with fine tuning operations in August, and later through regular main refinancing operations. The Eurosystem attempted to satisfy demand for three-month liquidity through supplementary longer-term refinancing operations.

Additional liquidity measures were necessary at the end of the year, when bank activity on the money market typically decreases. Due to turmoil in 2007, there could have been an even sharper increase in interest rates, given this seasonal effect, than would otherwise be the case. Therefore the Eurosystem extended the maturity of the penultimate main refinancing operation from one week to 16 days, so that it matured after the new year. Banks received the entire allotted amount of bids which they submitted at an interest rate that was the same or higher than the average interest rate from the previous tender (4.21%). The allotted amount was EUR 348.6 billion. During the last main refinancing operation in 2007, credit institutions were allotted an additional EUR 20 billion with a maturity extending into the new year to meet the demand which arose during these two operations. In the days prior to 31 December 2007, the Eurosystem used a series of liquidity absorbing fine tuning operations with a maturity of up to several days to prevent the overnight interest rate from slipping well below the key interest rate.

In December in a coordinated action with the central banks of the US, Canada UK and Switzerland, the Eurosystem provided its counterparties with US dollar liquidity. This coordinated action, based on mutual agreement and supported by several other larger central banks, resulted in a partial easing of tensions and an improved global liquidity situation. Eurosystem counterparties were allotted USD 10 billion in each of two operations with maturities of 28 and 35 days. The interest rate of the operations was the same as the marginal interest rate at the Term Auction Facility, executed simultaneously by the US Federal Reserve. The operations were renewed in January 2008.

The participation of Slovenian credit institutions in open market operations, their use of the deposit facility and marginal lending facility and their activities on the interbank money market in the period following August did not change significantly from the period prior to August.

2.1.4 Co-management of international monetary reserves

On 1 January 2007, the Bank of Slovenia transferred its share of international monetary reserves in US dollars and gold to the ECB in an amount equivalent to EUR 192 million. All euro area central banks contributed that share which they manage jointly with the ECB to the ECB's monetary reserves. Since 1 January 2007, the Bank of Slovenia and the Central Bank of Luxembourg jointly manage their share of the ECB's international monetary reserves. In addition to the international monetary reserves transferred, the Bank of Slovenia also holds foreign currency investments due to the possible further call for monetary reserves by the ECB, in accordance with Article 30 of the Protocol on the Statute of the European System of Central Banks and The European Central Bank.

2.2. Bank of Slovenia as "lender of last resort"

Article 4 of the Bank of Slovenia Act states that one of the Bank of Slovenia's objectives is to strive to ensure financial stability. Based on the provisions of Point 14 of the first paragraph of Article 12 of the aforementioned act, which defines the Bank of Slovenia's lending for needs not related to the implementation of monetary policy, the Bank of Slovenia may act as a lender of last resort.

One of the ways the Bank of Slovenia functions in this role is by granting a *special liquidity loan with participation*. The purpose of the liquidity loan with participation is to prevent systemic risk caused by unforeseen liquidity problems at otherwise solvent banks and savings banks. At the end of 2006, the Bank of Slovenia concluded an agreement on willingness to participate in liquidity loans with 17 banks and savings banks. The agreement runs from January 2007 to January 2008, and is the eleventh successive agreement. The banks' participation mechanism was not triggered while the agreement was in force, as has been the case since the agreement has existed.

2.3 Banking supervision and ensuring financial stability

2.3.1 Licensing

Licensing credit institutions is one of the Bank of Slovenia's most important tasks. In addition to issuing authorisations for the provision of banking services and the provision of mutually recognised and additional financial services, the Bank of Slovenia also issued authorisations to obtain a qualifying holding in the capital of a bank, authorisation to conclude a shareholders agreement and authorisation to hold office as a member of a bank's management board. The decision to issue or reject authorisation is taken by the members of the Governing Board of the Bank of Slovenia based on the opinions of the License Commission and the Commission of the Governing Board of the Bank of Slovenia for the Preparation of Opinions for the Issue of Authorisation to Hold Office as a Member of a Bank's Management Board.

The Bank of Slovenia issued 15 authorisations in 2007 for the provision of various type of financial services

In 2007, the Bank of Slovenia issued a total of 15 authorisations for various types of mutually recognised and additional financial services, for qualifying holdings, for concluding shareholders agreements, and for holding office as a member of the management board. No requests were rejected. The majority of authorisations in 2007 were issued to hold office as a member of the management board of a bank or savings bank and to obtain a qualifying holding in a bank (five of each type) and two authorisations to conclude a shareholders agreement. The number of authorisations issued to provide mutually recognised and additional financial services (three) was lower than in 2006. Authorisations were issued for the following: issuing electronic money, participation in the issuance of securities, and ancillary investment services and administrative services for investment funds.

In 2007, the Bank of Slovenia received 69 notifications of the direct provision of banking and other financial services by banks from other EU Member States in Slovenia

Pursuant to Directive 2006/48/EC (previously: Directive 2000/12/EC) and Annex I (List of activities subject to mutual recognition), a bank of a Member State that is entitled to provide banking services and other financial or mutually recognised services may also provide these services in Slovenia. It may provide them via a branch (in the case of permanent pursuit of business) or directly (in the case of occasional provision of services without elements of a permanent presence in Slovenia) without authorisation from the Bank of Slovenia. However, the Bank of Slovenia must be notified by the relevant supervisory authority in the home Member State. In 2007, the Bank of Slovenia received 69 notifications of the direct provision of services, and no notifications of the provision of services via a branch. A list of banks of EU Member States that have carried out the notification procedure for the provision of banking services and other financial services in Slovenia via their home banking supervisors is available on the Bank of Slovenia's website. Different arrangements apply to banks of third countries (previously: foreign banks). Banks of third countries may only provide banking and other (mutually recognised) financial services via a branch, a Bank of Slovenia authorisation being required to establish the branch. The Bank of Slovenia may request that the bank of a third country deposit a specific sum of cash or other eligible collateral in Slovenia, or provide other appropriate collateral as a guarantee for the settlement of liabilities from transactions concluded in Slovenia.

2.3.2 Examinations of banks and savings banks

Examinations of specific areas were prevalent among examinations conducted

In 2007, the Banking Supervision Department continued to conduct its examinations of banks and savings banks according to its internal risk assessment methodology, which is based on assessing the risks and quality of the control environment. Examinations of specific areas were prevalent among the examinations conducted, practice having shown that shorter and thus more frequent and more detailed examinations of specific areas are more significant and more needed than comprehensive examinations (examinations of all areas of operations). Follow-ups of the implementation of requirements from orders and recommendations were frequent, as it was not always clear from the documentation submitted whether the banks had rectified the irregularities.

Examinations relating to the introduction of the new Basel II capital framework were important

In 2007, examiners from the Banking Supervision Department placed particular attention during examinations on the readiness of banks and savings banks for the introduction of the new European capital framework, Basel II, which entered into force on 1 January 2008 (except capital requirements for markets risks which have been in force since the beginning of 2007). Examinations were conducted in two, two-month cycles, in the spring and autumn.

The Bank of Slovenia received applications for authorisation to use advance approaches from two banks under foreign ownership

In 2007, the Bank of Slovenia received two applications from banks under foreign ownership for authorisation to use advance approaches to calculate capital requirements for credit (IRB)[19] and operational (AMA)[20] risk. One bank is expected to use advanced approaches to a limited extent already in 2008.

In addition to the aforementioned activities, the following areas were subject to the most frequent examinations: credit risk, market risks with an emphasis on interest rate and liquidity risk, ensuring an adequate level of capital (capital adequacy), stable deposits, structured products, etc. Examinations to determine the risk profiles of banks and savings banks also continued in accordance with risk assessment methodology.

83 examinations were conducted in 2007

In 2007, there were 83 examinations conducted based on authorisations by the Governor of the Bank of Slovenia, among which were 42 examinations of the preparations of banks and savings banks for Basel II, several follow-ups of the implementation of measures and a range of one-day examinations or the monitoring of operations of a specific area. Based on the findings of examinations at banks and savings banks, the Bank of Slovenia may issue recommendations, warnings or orders. In 2007, the Bank of Slovenia issued four orders to rectify breaches, several orders and resolutions extending deadlines from orders, rejecting appeals and terminating proceedings against banks, and several letters to the management and supervisory boards of banks and savings banks with a range of warnings and recommendations for improving operations. In 2007, the Banking Supervision Department participated in three misdemeanour proceedings in which the Bank of Slovenia issued two misdemeanour decisions. The proceedings have not yet been concluded. All of the aforementioned material was discussed and approved by the Governing Board of the Bank of Slovenia.

---

19 Internal Ratings-Based Approach (IRB)
20 Advanced Measurement Approach (AMA)

In 2007, the Bank of Slovenia issued 12 authorisations to banks and savings banks for the inclusion of individual instruments in the calculation of capital, most frequently for the inclusion of hybrid instruments and subordinated debt in Tier 1 additional capital.

12 authorisations for the inclusion of individual instruments in the calculation of capital were issued

In line with the Core Principles for Effective Banking Supervision, the Banking Supervision Department of the Bank of Slovenia maintains regular contact with the management of banks and savings banks through channels including regular annual meetings held at the completion of an examination or separately. These meetings are primarily intended to assess the operating results and position of the bank or savings bank in question and to become familiar with its strategy for future development. The exchange of opinions and information between supervisors and the management of banks or savings banks is also a prerequisite for timely and appropriate action in the event of operating difficulties. The Banking Supervision Department continued this practice in 2007, and conducted a number of interviews with the management of banks and savings banks.

The Banking Supervision Department participated in six examinations of banks abroad

In 2007, the Banking Supervision Department continued to examine banks and other financial organisations abroad that are owned by Slovenian banks. On the basis of memoranda of understanding (the Bank of Slovenia has a total of 12 memoranda of understanding concluded with foreign supervisory institutions), the Banking Supervision Department participated in six examinations of the operations of banks abroad under the majority ownership of Nova Ljubljanska Banka (two of these examinations were conducted independently, i.e. without the cooperation of host supervisors). Four annual discussions with foreign supervisors were conducted at the Bank of Slovenia (with De Nederlandsche Bank – DNB, Central Banking Authority of Kosovo – CBAK, Finanzmarktaufsicht – FMA and Oesterreichische Nationalbank – OeNB) and at the registered office of a foreign supervisory institution (Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin).

Examinations of banks and other financial institutions in the rest of the world owned by Slovenian banks

Cooperation with the other two Slovenian supervisory institutions (the Securities Market Agency and the Insurance Supervision Agency) took the form of an exchange of information between the institutions. The rules on mutual cooperation between supervisory bodies regulate the cooperation between the Bank of Slovenia, the Securities Market Agency and the Insurance Supervision Agency. Supervisory institutions are required to inform the relevant supervisory institution if they identify any infringements that fall under the auspices of other institutions.

The Bank of Slovenia continues to work with two other supervisory institutions

2.3.3 Bank activities related to the introduction of the new European capital framework (Basel II)

In 2007, the Bank of Slovenia began the systematic monitoring of the preparations of banks and savings banks for the introduction of the new European capital framework. An internal methodology was drawn up before the examinations of banks and savings banks were conducted.

Monitoring the preparations of banks and savings banks for Basel II

The activities of the Banking Supervision Department in the first round of examinations, carried out in April and May 2007, were focused on examining the introduction of the new European capital framework in the area of credit, market and operational risks. It was determined that banks and savings banks appropriately organised activities for the introduction of the new European capital framework requirements and that project leaders received adequate support from the management boards of banks and savings banks. In most cases, its was evident that preparations were mainly focused on the implementation of regulations on the

The first round of examinations revealed that leaders of the project to introduce the new European capital framework received adequate support from the management of banks and savings banks

calculation and reporting of capital requirements for specific risks, while banks and savings banks did not devote sufficient attention to the second and third pillars of the new European capital framework. It was recommended that banks begin carrying out the necessary activities for the timely and effective implementation of Internal Capital Adequacy Assessment Process (ICAAP). Activities relating to the calculation and reporting of capital requirements were assessed to be the most complex part of the project in terms of the extent of work, the content of requirements, the interdependence of tasks, the creation of software solutions and the requisite quality of data. Based on the information provided by banks regarding staff limitations and a high level of dependence on external suppliers in this area, the Bank of Slovenia evaluated project risk exposure and issued recommendations for its mitigation. Banks did not encounter significant difficulties while implementing the calculation and reporting of capital requirements for market risks. However, the first calculations and reports were performed manually. It was therefore recommended that banks ensure the appropriate information support for this process. In addition to activities for implementing the calculation and reporting of capital requirements for operational risk, preparations in this area were sufficiently dynamic, and banks gradually established additional conditions for improving the operational risk management process. The Bank of Slovenia issued the appropriate recommendations to banks with the additional responsibility of implementing requirements on a consolidated basis.

In addition to providing feedback to individual banks, banks were also sent a report on collective findings following the first round of examinations. The Bank of Slovenia also issued a requirement for the submission of a brief report by the internal audit department regarding the project's status and the implementation of recommendations, and a requirement for the simulated calculation of capital requirements using a selected approach for the situation as at 30 June 2006.

The second round of examinations included an examination of the second and third pillars of the new capital framework

The second round of examinations was carried out in October and November 2007. In addition to an evaluation of the general progress of activities for the implementation of the new European capital framework and verification of the implementation of previous recommendations, the status of activities of banks and savings banks regarding the first pillar of the new European capital framework (calculation of the minimum capital requirement) was rechecked. Additional attention was given to verifying the status of activities in the second pillar (Internal Capital Adequacy Assessment Process) and the third pillar (disclosure). Following examinations, banks were provided feedback in the form of a letter, which included the Bank of Slovenia's key findings and recommendations.

Banks and savings banks implemented the calculation of capital requirements for credit and operational risks

The examinations of banks and savings indicated that the implementation of the calculation of capital requirements for credit risk using the standardised approach and reporting on new forms was completed. The calculation of capital requirements and reporting for operational risk was also implemented. Sufficient progress was evident in the process of establishing a new operational risk management system at banks. During this time, activities for the implementation of the second and third pillars, which were mostly in line with internal plans, were carried out at most banks.

Several banks under majority foreign ownership have decided to begin using advanced approaches (IRB and/or AMA) in the near future for the calculation of capital requirements. These banks are included in a joint decision-making process and are a part of a joint application, which the parent bank submits to its supervisor. In such cases, the Bank of Slovenia is included in the process of issuing a joint decision as host supervisor.

Active monitoring of banking operations will continue in 2008 with the verification of the correctness of implementation of capital requirements (accuracy of the calculation of requirements, appropriateness of the management system and the internal capital adequacy assessment process the under the second pillar).

Activities will continue in 2008

2.3.4 Financial stability

Striving to ensure financial stability is one of the Bank of Slovenia's legally prescribed objectives. Its importance has risen in recent years due to the increasing integration of the Slovenian financial system in foreign financial markets. In 2007, the Bank of Slovenia prepared three comprehensive assessments of financial stability: the Financial Stability Report, the Report on Banking Operations and Developments on Capital Markets and the analysis Macro Stress Tests for the Slovenian Banking System. The aforementioned documents are published on the Bank of Slovenia's website[21], summaries of the their key findings are presented below.

Assessments of financial stability conducted in 2007 indicate that the financial system is relatively stable, while some risks have increased, including liquidity risk

The Financial Stability Report, with an emphasis on risk assessment and risk management methods, includes the banking sector and non-banking financial institutions, the corporate sector and households and the financial infrastructure. The financial system was assessed as relatively stable, with a reduced direct exposure to risks following the adoption of the euro. The interest rate risk of banks, and particularly the risk of exchange rate fluctuations, has been reduced. At the same time, it has been determined that the indirect exposure to risk arising from growing debt and the introduction of new financial instruments is increasing rapidly. The indebtedness of households has increased relatively rapidly, also in the form of housing loans with the repayment of principal at maturity, loans linked to investment products and loans tied to the changes in the Swiss franc exchange rate. The corporate sector has been subject to increased borrowing by institutional sectors with a relatively high level of financial gearing and the potential underestimation of credit risks. The November Report on Banking Operations and Developments on Capital Markets reflected the first possible assessments of the consequences of shocks in markets due to turmoil on the US sub-prime mortgage market. Risks in the Slovenian financial system have risen in four ways. First, liquidity risk has risen primarily due to the confidence crisis on financial markets, reflected in the deterioration of liquidity ladder coefficients, the coverage of loans by deposits of non-banking sectors and other long-term liquidity indicators. Second, the proportion of loans with a variable interest rate has increased and been transferred for the most part from banks to companies. Households are increasingly exposed to exchange rate risk due to borrowing in Swiss francs. Third, elements of increased credit risk, in part due to the increased exposure of banks to sectors with above-average levels of debt such as construction and real estate, and an increasing proportion of loans secured by securities in a period of overheating prices on the domestic capital market, have been exposed. The latter, in particular, represents the fourth area of increasing risk. The first step in the assessment, Macro Stress Tests for the Slovenian Banking Sector, was the analytical breakdown of the most likely scenario for the development of the Slovenian banking system. This was followed by an assessment of the banking system's sensitivity to possible, but unlikely shocks to which it could be exposed. It was determined that banks are especially exposed to the risk of a simulated liquidity shock and the risk of rising interest rates, while the vulnerability of banks to a shock of decreasing economic growth is less significant.

[21] http://www.bsi.si/publikacije-in-raziskave.asp?MapaId=285

At the Bank of Slovenia, financial stability is also closely tied to the established operational analysis of the banking system's operations and developments on financial markets. An assessment of the rapid growth in lending, in terms of maintaining financial stability, led the Bank of Slovenia to take steps in December 2007. In November, data regarding banking sector operations indicated that the relatively high growth in lending had increased further, in part due to the rising indebtedness of borrowers in foreign currencies. This coincided with the increasing likelihood of a drop in security prices on the Ljubljana Stock Exchange and with volatility on financial markets. Therefore, the Bank of Slovenia warned banks and savings banks in writing regarding the importance of and obligation to adequately inform borrowers about the risk to which they are exposed, and expressed its expectations that banks begin taking a more conservative approach (which was also described therein) to approving loans in foreign currencies. The Bank of Slovenia tightened capital requirements for approving higher-risk loans, and in a letter to banks set out the categories subject to these requirements, and recommended that banks use a larger portion of profits for the creation of reserves.

2.4 Management of the Bank of Slovenia's financial investments

A new role for the Bank of Slovenia's financial assets following the introduction of euro

The role of the bank of Slovenia's financial assets changed following the adoption of the new currency. The majority of assets became investments in the domestic currency. Therefore there is a new definition of the composition of these assets. The Bank of Slovenia's financial investments include all of its financial assets. They comprise financial investments denominated in domestic and foreign currencies. The Bank of Slovenia transferred a portion of foreign currency assets to the international monetary reserves of the European Central Bank (ECB) with the adoption of the euro.

The value of the Bank of Slovenia's financial investments as at 31 December 2007 stood at EUR 5,548 million. Of this amount, investments in financial instruments, which are either claims on euro area residents or claims on non-euro area residents denominated in euros, totalled EUR 4,820 million. These include EUR 2,520 million of investments in capital market instruments, EUR 682 million in money market instruments and EUR 1,618 in cash and deposits. In addition, EUR 728 million was investment in financial instruments that meet the criteria of international monetary reserves.

According to the International Monetary Fund's definition, cash in foreign currency and foreign exchange holdings abroad, gilt-edged securities, monetary gold, holdings of SDRs and the reserve tranche at the International Monetary Fund are considered international monetary reserves. After 1 January 2007, Slovenia takes into account the concept used by other euro area Member States in the statistical treatment of international monetary reserves. With the euro as its national currency, Slovenia only shows the portion of international monetary reserves not denominated in euros and placed in countries outside the euro area, in addition to monetary gold, the reserve tranche and SDRs. The methodology is explained in detail in the article, Statistical Treatment of International Monetary Reserves Following Slovenia's Entry to the Euro Area (Surveys and Analysis, May 2007)[22].

[22] See: http://www.bsi.si/iskalniki/raziskave.asp?MapaId=234

Table 22: **Balance of the Bank of Slovenia's financial investments**

in EUR million	Financial investments of the Bank of Slovenia		
	Investments in euros and all investments in instruments of euro area issuers	International monetary reserves	Total
2007	4,820.0	727.9	5,547.9

Note: Balance as at 31 December 2007
Source: Bank of Slovenia

A three-level decision making process is employed for managing financial assets

The changed role of financial assets managed by the Bank of Slovenia coincided with the introduction of a three-level decision making process regarding the management of financial assets. The Governing Board of the Bank of Slovenia sets out the Guidelines for Managing the Bank of Slovenia's Financial Investments (Guidelines), which represent the long-term policy for the management of the Bank of Slovenia's financial investments and defines management objectives. The second level of the management process is represented by the Investment Committee, which prescribes the criteria for managing the Bank of Slovenia's financial investments, separately for each type of risk. At the third level, portfolio managers carry out the operational aspect, within specific tolerances.

The investment policy is defined in management criteria

Under the current criteria for managing credit risk, financial investments may be invested in financial instruments with supranational, sovereign and banking risks, for which there exists a list of counterparties with allowable banking risk and limits on individual counterparties with regard to their credit ratings. The currency structure and the limits on permitted deviations are precisely set out in the criterion for managing foreign currency risk. The criterion for managing interest-rate risk specifies the modified duration of financial investments and lays down the maximum allowable deviation from the target modified duration. The criterion for managing liquidity risk specifies a minimum amount of liquid assets. The criteria for managing the Bank of Slovenia's financial investments also set out the terms for securities lending and other activities.

During the year, the Bank of Slovenia's financial investments were managed within these criteria and in line with developments and expectations on international financial markets. More detailed information on the structure of the international monetary reserves as at 31 December 2007 is given in the section on the financial statements.

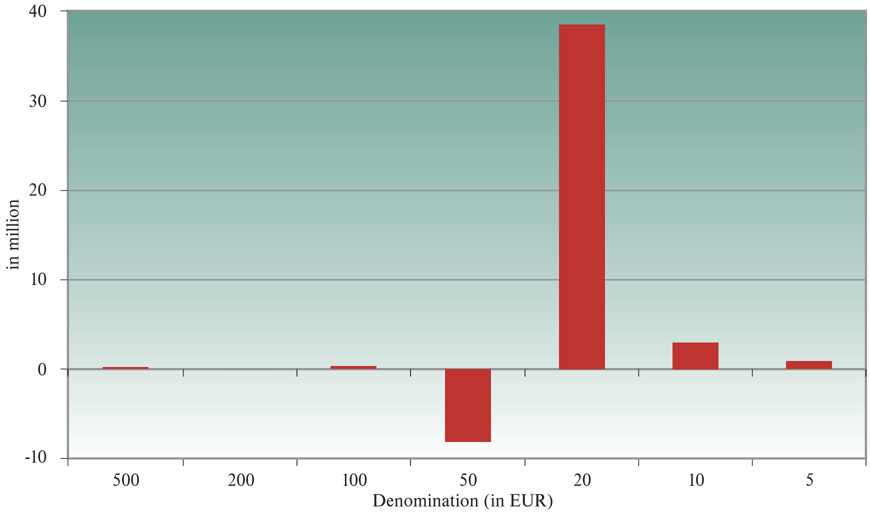
2.5 Cash Operations

EUR 563 million in euro cash was released into circulation in 2007

By 31 December 2007, the Bank of Slovenia had released EUR 563.0 million of euro cash into circulation (taking into account cash at banks). Of this amount, EUR 523.4 million was in banknotes (34.5 million banknotes) and EUR 39.6 million was in coins (142 million coins). Of the aforementioned, the most common denomination of euro banknotes, in terms of quantity, was EUR 20 (38.4 million banknotes), followed by EUR 10 (2.9 million banknotes) and EUR 5 (0.8 million banknotes). In terms of quantity, the most common denominations of coins released into circulation by the Bank of Slovenia are 1 euro cent (28.3 million coins) and 2 euro cents (26.9 million coins). The EUR 2 coin represents the smallest proportion in terms of quantity (9 million coins).

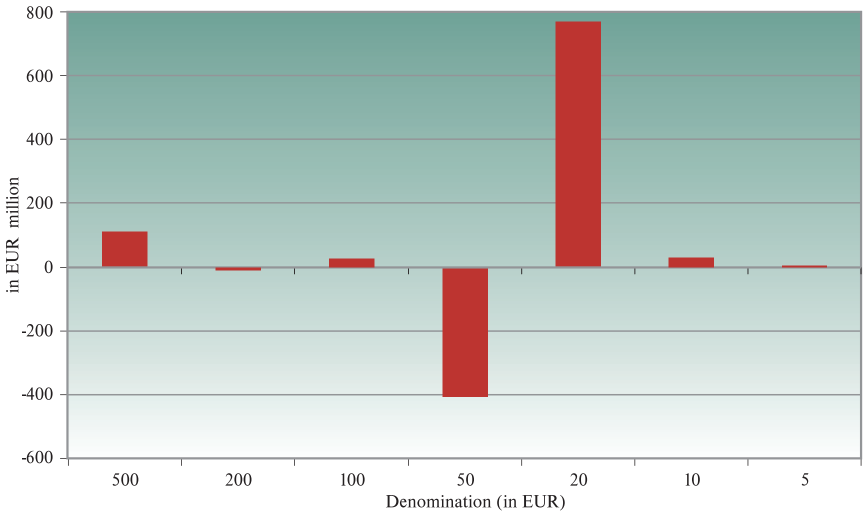
The Bank of Slovenia organised the issue, distribution and storage of general circulation and commemorative coins.

Figure 44: **Banknotes released into circulation by volume**



Source: Bank of Slovenia

Figure 45: **Banknotes released into circulation by value**



Source: Bank of Slovenia

The Bank of Slovenia issued into circulation 400,000 copies of the first euro bimetallic circulation-standard commemorative EUR 2 coin to mark the 50th anniversary of the signing of the Treaty of Rome. The common European side is the same as the EUR 2 circulation-standard coin.

Coins issued by the Republic of Slovenia bear the design of the common side in use since 1 January 2007. The Republic of Slovenia is the first euro area country to introduce a design for the new common side of coins.

As at 31 December 2007, there were still 47.8 million tolar banknotes, 20.9 million tolar coins and 449,8 million vouchers in circulation.

Tolar banknotes are exchangeable at the Bank of Slovenia without any time limit

Tolar banknotes and vouchers, which were released into circulation at the expiration of the Brioni moratorium in October 1991, are exchangeable at the Bank of Slovenia without any time limit. Tolar coins are exchangeable until 31 December 2016.

A total of 7,186 treasury receipts and outlays of euro cash and 7,282 incoming and outgoing payments of cash for the needs of government bodies were made.

The money counting unit counted 106.5 million banknotes and coins

The Bank of Slovenia money counting unit counted 106.5 million banknotes and coins (62.6 million in 2006), comprising 97.1 million banknotes and 9.3 million coins (56.0 million banknotes and 6.6 million coins in 2006). A total of 4.7 million euro banknotes (compared with 54.8 million tolar banknotes in 2006) were taken out of circulation and destroyed in order to maintain an appropriate quality of banknotes in circulation.

The government is supplied with euro cash via depots at banks

Euro cash was supplied to the government through the Bank of Slovenia's banknote depots at five commercial banks, for which the Bank of Slovenia set a quarterly treasury maximum and checked operations on a daily basis. Last year, examinations were carried out at all five depots, where it was determined that the banks have the appropriate organisational, personnel and technical conditions for operations.

The value of euro counterfeits has decreased

According to data from the NAC and CNAC, 1,826 counterfeit euro banknotes and 1,803 euro coins were discovered in 2007 (compared to 2,629 euro banknotes and 999 euro coins in 2006). Compared with 2006, 2007 saw a decrease in the number of counterfeit euro banknotes (down 30.5%) and a sharp increase in the number of counterfeit euro coins (up 80.5%). In 2007, the value of euro counterfeits was EUR 282,300.00 compared to EUR 652,449.50 in 2006, a decrease of 56.7%. The majority of counterfeit euro banknotes, both in terms of quantity and value, is represented by the four highest denominations (EUR 100, 50, 200 and 500), while EUR 2 coins represent the majority of counterfeit euro coins. The counterfeiting of euro cash has yet to present a major problem in Slovenia. However, attention should be given to the damage incurred by natural and legal persons in this respect.

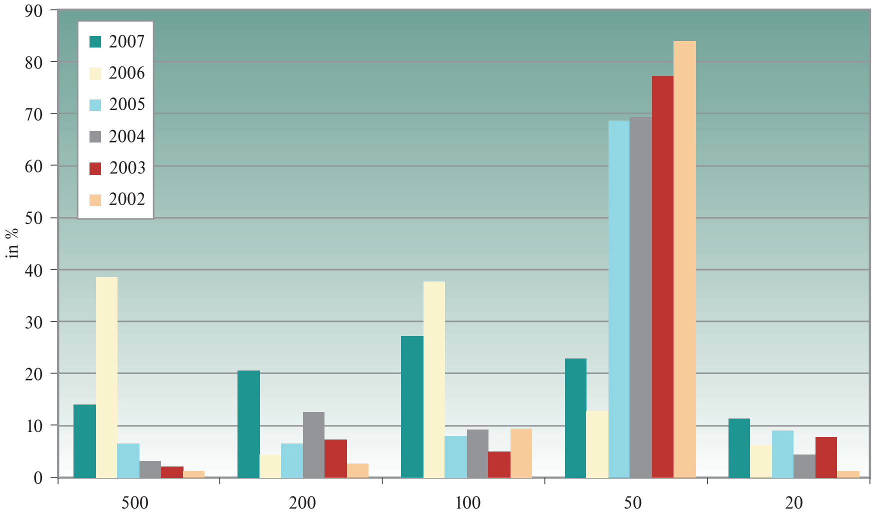
Other foreign currency counterfeits were also discovered

In 2007, 1,890 foreign currency counterfeits (US dollars, Swiss francs and pound sterling) were discovered, compared to 218 counterfeits in 2006. The quality of foreign currency counterfeits has improved over time, making it more difficult for users to identify them, particularly US dollar counterfeits.

Supervision of the authenticity of euro cash was organised

Pursuant to Regulation EC 1338/01, the National Analysis Centre (hereinafter: the NAC) and the Coin National Analysis Centre (hereinafter: the CNAC) are responsible for issuing expert opinions regarding the authenticity of euro cash. These centres work in connection with the Forensic Investigation Centre at the Ministry of the Interior. Supervision of the activities of the aforementioned centres, in connection with the work of the Counterfeit Monitoring System at the ECB, is carried out by the National Counterfeit Centre (hereinafter: the NCC). The Governing Board of the Bank of Slovenia established the NCC on 30 October 2003, within the Cash Operations Department. Without any significant organisational, personnel or technical difficulties, the NCC is actively involved in a system of data and information exchange with the European Central Bank's Counterfeit Analysis Centre, other national counterfeit centres and the European Technical and Scientific Centre for the analysis of euro banknotes.

Figure 46: **Breakdown of counterfeit euro banknotes discovered in Slovenia**



Source: Bank of Slovenia

2.6 Statistical system

The Bank of Slovenia provides statistical functions as a member of the ESCB based on the Statute of the ESCB and ECB as well as one of the authorised providers of national statistics, implementing the Slovenian statistical research programme in accordance with the national statistics act, and on the basis of other authorisations.

Main statistical areas include monetary, financial and international economic relations statistics

The Bank of Slovenia's main statistics work covers the wider areas of monetary, financial and international relations statistics. It is increasingly involved in statistical processes in the field of general economic and public finance statistics.

The statistical activities of the Bank of Slovenia in 2007 served the purpose of informing the domestic and foreign public about financial and macroeconomic trends in Slovenia. These activities also include data support for the monetary policy of the ESCB and national economic policy, and statistical cooperation with international organisations and institutions. In addition to the ECB, these institutions include the IMF (International Monetary Fund), Eurostat (European statistical office within the European Commission) and the BIS (Bank for International Settlements).

Participation in the Statistics Committee and working groups of the ESCB

Bank of Slovenia representatives, together with representatives of EU Member States (and with the core group of central banks of euro area Member States), attend meetings of the ESCB's Statistics Committee and working groups for: international relations statistics, general economic statistics and government finance statistics, monetary, financial institutions and markets statistics, monetary union financial accounts and for statistical information systems. The same is true for developmental working groups of the ESCB, for example in the area of financial market statistics and development of a central database of securities at the ECB. Prior to entry to the euro area, the internal organisation of the Financial Statistics Department was adapted to the needs of cooperation within the ESCB. In addition to regular meetings in working groups and at seminars of Eurostat and the ECB, Bank of Slovenia representatives also attend plenary sessions of the Committee on Monetary, Financial and Balance of Payments Statistics (CMFB), the main body for coordinating strategic issues concerning European macroeconomic statistics.

Successful statistical inclusion in the euro area

Following Slovenia's entry to the euro area in 2007, transition to recording and reporting statistical amounts in euros was successfully carried out. Prior to this, all key statistics were methodologically harmonised as a prerequisite for inclusion in the euro area and the special section of the convergence report.

The updated Memorandum of Understanding in the area of macroeconomic and financial statistics with the MoF and the SORS is an important element of statistical reporting in the EMU

The fulfilment of statistical requirements for membership in the EU and the EMU has in recent years been aided considerably by successful cooperation with the Ministry of Finance and the Statistical Office of the Republic of Slovenia (SORS) on the basis of the Memorandum of Understanding in the area of macroeconomic and financial statistics, signed in 2004. The conclusion of a MoU, based on and following the example between the ECB and Eurostat, was required for the purpose of harmonising competences and responsibilities due to the increasing burden of statistical requirements and interdependence between individual statistics.

The memorandum set out the responsibilities of individual signatories and the manner of cooperation between them in the submission of Slovenian macroeconomic and financial statistics to the European Commission, Eurostat and the ECB. The subject of the memorandum includes cooperation in maintaining standard classifications of institutional sectors, as particularly important statistical infrastructures in the provision of macroeconomic and financial statistics. The official sector classification is managed by the Agency for Public Legal Records and Related Services (AJPES) as part of the Business Register of Slovenia. Following entry to the euro area, the memorandum was updated in the spring of 2007 with the exclusion of previously completed tasks and supplemented with new statistical requirements which have arisen in this area.

The Bank of Slovenia is responsible for producing a complex set of statistics: financial accounts, monetary, financial and international relations statistics. These statistics are primarily based on figures from direct and indirect reports by banks and companies. Figures regarding merchandise trade compiled (based on customs declaration and Intrastat statistics following entry to the EU) by the Statistical Office of the Republic of Slovenia (SORS), in cooperation with the Customs Administration of the Republic of Slovenia (CARS), are also important. The Bank of Slovenia also collects, compiles and/or publishes statistics on modern payment instruments and financial markets, as well general government and general economic statistics.

The primary source for compiling financial account statistics are the quarterly reports collected by AJPES

The primary source for compiling financial accounts are the quarterly reports of individual institutional units (non-financial corporations, financial corporations and government units) intended for financial account statistics, which are collected by the AJPES for the Bank of Slovenia.

The direct reporting of quarterly data for financial accounts through the AJPES continues with great success. In 2007, the Bank of Slovenia compiled financial account data for the fourth quarter of 2006 and the first three quarters of 2007, as well as the annual financial account data for 2006 (based on quarterly data).

Financial account statistics are submitted to the ECB and Eurostat in accordance with prescribed requirements

Quarterly financial account data were submitted to the ECB pursuant to the requirements of Monetary Union Financial Accounts (MUFA), and in accordance with the Guideline of the ECB of 15 November 2007 amending Guideline ECB/2002/7 on the statistical requirements of the European Central Bank in the field of quarterly financial accounts (ECB/2007/13). Data must be submitted to the ECB within 110 days following the end of the quarter for which data is being reported.
Annual financial account data were submitted to Eurostat in June 2007, in accordance with Regulation (EC) No. 501/2004. This regulation requires that

annual data be submitted within 9 months following the end of the year for which data is being reported.

In November 2007, the Financial Accounts of Slovenia 2001-2006 was published. The publication includes an analysis of financial account data by individual sectors. Tables of financial positions, transaction and value changes follow the scheme of the financial accounts model: first, unconsolidated and consolidated tables are compiled for all years, followed by unconsolidated and consolidated tables by individual sectors for the last year. The methodology and process used to compile the financial accounts are presented in the conclusion of the publication.

Reduction in the burden on non-financial corporations for the reporting of financial accounts and an extended deadline for reporting fourth quarter data

In December 2007, a new regulation on the reporting of data for the purpose of financial accounts statistics and guidelines for implementing the regulation on the reporting of data for the purpose of financial accounts statistics (Official Gazette of the Republic of Slovenia No. 113/2007) were adopted. The regulation introduced a reporting threshold for institutional units of the financial corporations sector (S.12) and a new threshold for reporting in euros for the institutional units of other sectors (S.11 – non-financial corporations – and S.13 – general government). In addition to the lower reporting threshold for non-financial corporations, the extended reporting deadline for the last quarter reduces the reporting burden on reporting entities.

The quarterly MUFA accounts also assist the ECB in the compilation of euro area accounts. In addition to MUFA data, the ECB also uses other statistical data such as data from monetary financial institutions, balance of payment data or statistical data regarding securities. The ECB's aim is to obtain data for the compilation of all euro area accounts, including quarterly non-financial accounts. The ECB's strategy also includes the gradual shortening of the deadline for submission of quarterly MUFA data of Member States.

In 2007, the Bank of Slovenia also prepared for expanded MUFA requirements in the field of financial accounts. As of April 2008, the ECB requires the submission of data by foreign counterpart sectors for loans and deposits data series from the first quarter of 2004 onwards.

1 January 2007 marked the start of reporting in euros and a transition from own monetary aggregate statistics to statistics regarding the contribution to the monetary aggregates of the euro area

In the statistics of financial (including monetary) institutions and markets, reporting by other monetary financial institutions was adjusted to the introduction of the IFRS in the spring of 2006 in accordance with Regulations ECB/2001/13 and ECB/2001/18. In this respect, the reporting currency was changed from the tolar to the euro. Due to its inclusion in the wider euro area, Slovenia no longer has its own monetary aggregates. Instead, the Bank of Slovenia calculates and publishes statistics, known as its contribution to the monetary aggregates of the euro area, since the beginning of 2007.

New Regulation ECB/2007/8 about harmonised data of investment funds and recast of Guideline ECB/2007/9

In the scope of activities of the European System of Central Banks in the area of monetary, financial institutions and markets statistics, the preparation of harmonised statistics of non-monetary financial intermediaries stands out, in addition to the amendment of Directives ECB/2001/13 and ECB/2001/18, which will be completed in 2008. The first to be issued was Regulation (EC) No. 958/2007 of the ECB of 27 July 2007 concerning statistics on the assets and liabilities of investment funds (ECB/2007/8), which requires harmonised data of investment funds from the last quarter of 2008 onwards. In addition, the previous Guideline ECB/2003/2 was updated and recast as Guideline of the ECB of 1 August 2007 on monetary, financial institutions and markets statistics (ECB/2007/9).

In the area of statistics of economic relations with the rest of the world, the Bank of Slovenia met all requirements for the reporting of statistical data at the end of 2006. As a new member of the Economic and Monetary Union, the Bank of Slovenia was obliged to prepare these data for the ECB for the period prior to the introduction of the euro (from 1999 to 2006). In 2007, data required of members of the Economic and Monetary Union were sent on a regular basis to the ECB.

The concept of international monetary reserves changed due to entry to the euro area

The introduction of the euro resulted in a change in statistical definition of international monetary reserves. After 1 January 2007, Slovenia only shows the portion of foreign currency reserves not denominated in euros and placed in countries outside the euro area, in addition to monetary gold, the reserve tranche and SDRs. Other euro area Member States have a similar concept of international monetary reserves.

Change to the methodology for disclosing cash transactions due to a change in the capturing of transaction with non-residents

Entry to the euro area also meant it was necessary to change the methodology of capturing and assessing data regarding cash transactions with non-residents included in current account items, as capital account data sources no longer include these transaction as of 2007 due to the introduction of the single currency. Household currency is now estimated as the difference between cash inflows and outflows from travel (total travel less non-cash transactions, i.e. credit cards and travel organised by travel agencies) and cash inflows and outflows from labour income.

New direct data sources for statistics on international economic relations

Due to the requirements of Regulation EC 2560/2001 on cross-border payments in euros, three sets of direct reports were established in 2007 in the process of migrating data sources for balance of payment and international investment position statistics from the indirect collection of data from commercial banks to the direct collection of data from economic agents which operate with non-residents. These sets of reports are as follows:

- credits received and granted and deposits with non-residents for all sectors, except banks (KRD),
- purchased/sold foreign debt securities bypassing domestic brokers (DVP), and
- trade in services and a portion of merchandise trade and current/capital transfers with non-residents (BST).

In addition, instructions for the monthly reporting on capital investments between residents and non-residents – transactions (SN-T), which are valid as of January 2008, were published, as well as amended instructions and reports on capital investments between residents and non-residents, which are valid for the reporting period from and including 31 December 2007. These changes will make it possible to distinguish between listed and unlisted shares and to monitor the book and market values of shares. Attributes were also added, which are necessary for “external” FATS[23] statistics and which are also a condition for fulfilling the grant agreement signed by the Bank of Slovenia and the European Commission in July 2007.

Monitoring and promoting the quality of statistics

The Bank of Slovenia must also submit to the ECB certain other information, especially in the areas of general government and general economic statistics, which, in addition to information about the Maastricht economic criteria, i.e. information about long-term interest rates and the general government balance, government debt and the harmonised consumer price index, also includes other information from national account statistics, labour statistics, information about procedures with regard to an excessive government deficit, etc. This information is compiled by the SORS and/or the Ministry of Finance in accordance with an agreement between these institutions. In this respect, the Bank of Slovenia is tasked with monitoring and promoting the quality of data submitted to the ECB based on the Guideline

[23] Foreign Affiliates Trade in Services.

of the ECB of 17 February 2005 on the statistical reporting requirements of the European Central Bank and the procedures for exchanging statistical information within the European System of Central Banks in the field of government finance statistics (ECB/2005/5).

The Bank of Slovenia has also successfully completed its technological inclusion in the ESCB statistical information system. The overall exchange of statistical data with the ECB takes place on the basis of the GESMES/TS technical standards.

Slovenia fully meets the requirements of the SDDS

The Bank of Slovenia releases data on its website in accordance with the IMF's special Statistical Data Dissemination Standards (SDDS) for Slovenia, prepared together with the SORS and the Ministry of Finance. The SDDS require the regular publication of methodologically sound, key macroeconomic data according to an advance release calendar. Slovenia fully meets the requirements of the IMF's special data publication standards.

Key financial and economic data for Slovenia are published in a monthly bulletin and in annual publications regarding direct investments and financial accounts. All publications, along with information on the extended data series of from the bulletin and certain other important data, are also published on the Bank of Slovenia website.

2.7 Payment Systems

Connection to the new pan-European real-time gross settlement system

With the adoption of the euro, the Bank of Slovenia became a full participating member of the TARGET system…

With the adoption of the euro, several activities were successfully completed in the field of payment and settlement systems, among them connection to the TARGET system[24]. The Bank of Slovenia has been connected to the TARGET system as a direct participant since 2004 (the majority of Slovenian banks since 2005) through remote participation in the German RTGS^{plus}[25] system . Only with the adoption of the euro on 1 January 2007, did the Bank of Slovenia become a full participating member in the TARGET system, again using the temporary technical solution of connection via the German RTGS^{plus} system. Since 1 January 2007, the Bank of Slovenia ensures the operating conditions for Slovenian participants and offers them Eurosystem monetary policy instruments. At the same time, the real-time gross settlement system (BPRČ), which was established at the Bank of Slovenia in April 1998 and facilitated the real-time processing of high-value domestic (tolar) and urgent payments until the end of 2006, ceased to operate.

… which was an interim step to connection to TARGET2

Full participation in the TARGET system, which was obligatory due to the adoption of the euro and which facilitated the processing of domestic and cross-border euro payments, was actually an interim step to the connection of the Bank of Slovenia and Slovenian banks to the TARGET2 system.

The TARGET2 system eliminates some of the deficiencies of the TARGET system

The TARGET2 system represents a new pan-European real-time gross settlement system established for the purpose of eliminating the deficiencies of the TARGET system, replacing it and ensuring increased harmonisation of services, cost efficiency and rapid system adaptation. TARGET2 is managed by the Eurosystem and operates on a single technical platform. It began operating on 19 November 2007 and provides participants harmonised settlement services in central bank money. In contrast to the TARGET system, the TARGET2 system's technical

24 Trans-European Automated Real-time Gross Settlement Express Transfer system (TARGET).

25 Real-Time Gross Settlement (RTGS^{plus}).

infrastructure is centralised, while it remains a decentralised system in a legal sense, comprising national components. Thus individual central banks manage their own real-time gross settlement systems in the TARGET2 environment, using a single technical platform. The name of the Slovenian component is TARGET2-Slovenija, and is managed by the Bank of Slovenia in the national environment. All TARGET2 system participants have open settlement account within the single technical platform on which they make overnight liquidity deposits and execute payment transactions.

In 2007, various activities relating to the TARGET2 system were carried out…

Activities relating to the connection to the TARGET2 system began back in 2005, when the ESCB decided that the Bank of Slovenia and Slovenian banks would be included in the first migration group, i.e., immediately following the establishment of the system. Activities in 2007 linked to connection to the TARGET2 system were mainly linked to the preparation of a legal basis, the updating of procedures, technological support and several months of testing.

… including the preparation of a legal basis…

With regard to the preparation of the legal basis, the Bank of Slovenia cooperated with ESCB working bodies at the beginning of 2007 during the preparation of TARGET2 Guideline, which represent the fundamental legal act of the TARGET2 system. Based on this Guideline, adopted by the Governing Council of the ECB in April 2007, the Bank of Slovenia prepared the legal basis which governs the relationships between the Bank of Slovenia and Slovenian banks (system participants) and consists of the General Conditions for Participation in TARGET2-Slovenija and standard agreements between the Bank of Slovenia and participants. Compliance of the aforementioned legal basis with the TARGET2 Guideline was confirmed by the Governing Council of the ECB in November 2007.

… and testing for connection to TARGET2

Organisational and technological preparations at the Bank of Slovenia and Slovenian banks were completed for the most part in April 2007, in accordance with the deadline set out by the ECB. Comprehensive testing began in May. Testing was carried out in four specific groups between May and October 2007. Given that, in the context of its relationship with the ECB, the Bank of Slovenia was responsible for ensuring the readiness of Slovenian banks for connection to the TARGET2 system, it monitored the progress of testing at Slovenian banks in addition to its own testing. All testing, carried out in accordance with ECB guidelines, at the Bank of Slovenia and Slovenian banks was completed successfully.

TARGET2 began operating in November

The TARGET2 system began operating on 19 November when the Bank of Slovenia, Slovenian banks and the central banks and credit institutions of seven other countries were included. Migration of the TARGET system to the TARGET2 single shared platform is being carried out gradually in three migration groups, with three groups of countries. Migration will be complete on 18 May 2008. The next migration groups, comprising the remaining 12 countries, are expected to be included in TARGET2 on 18 February and 18 May 2008.

Settlement of securities transactions in the Eurosystem

TARGET2-Securities (T2S), intended for the settlement of securities transactions, is being developed

In July 2006, the ECB's Governing Council decided to explore, together with other European central securities depositories and market participants, the possibilities of creating a new, centralised European securities settlement infrastructure under the name TARGET2-Securities (T2S). T2S is expected to provide a single technical platform for settling securities transactions, meaning that the settlement function would be shifted from all European central securities depositories and centralised on a single platform. The primary aim of T2S is to consolidate securities settlement infrastructures in the EU, which are currently fragmented and locally limited, thus increasing the effectiveness and security of securities settlements, and ultimately facilitating the integration of securities markets.

The preparation of T2S user requirements…

The Eurosystem, in cooperation with market participants, began preparing a T2S feasibility study in the last quarter of 2006, which includes a legal, economic, operational and technical feasibility analysis. In March 2007, the Governing Council of the ECB discussed the study and took the decision that T2S is feasible and that the next phase of the project may begin, e.g. the definition of T2S user requirements.

… was carried out in Slovenia as well

For the purpose of preparing user requirements, the Governing Council of the ECB confirmed the basic principles and proposed functionality of the system in April 2007, and defined the project's governance structure. This structure includes the following three levels: a) the Governing Council of the ECB as the highest decision-making body; b) an Advisory Group composed of the national central banks of the Eurosystem, the ECB, central securities depositories, and securities settlement systems users; c) technical groups (in the same composition as the Advisory Group), which are responsible for preparing specific aspects of the user requirements. For the purpose of establishing cooperation with national environments, all national central banks have also established national users groups who work with the Advisory Group in the preparation of user requirements. Representatives of the Bank of Slovenia and the Central Securities Clearing Corporation represent Slovenia as permanent members of the Advisory Group.

Work was carried out on the user requirements until December 2007, when they were submitted for three months public consultation. During the public consultation, activities will also be carried out at the beginning of 2008 relating to the analysis of legal issues, the estimate of the project's economic effects and the definition of the governance structure in the next phase of the project, which will include defining the functional specifications of the system. Based on the public consultation on user requirements and following the receipt of responses from individual central securities depositories regarding their intentions for connection to T2S, the Governing Council of the ECB will make its final decision regarding the implementation of T2S in the summer of 2008.

The national user group examines the possibility of connection to T2S

In August 2007, the Bank of Slovenia established a national user group, whose focus is to examine the possibility of connecting the Slovenian environment to T2S. The group includes representatives of the Bank Association of Slovenia, individual banks, the Association of Members of the Securities Exchange, the Central Securities Clearing Corporation, the Ministry of Finance, the Securities Market Agency and the Bank of Slovenia. Information and opinions regarding T2S are exchanged within the group. Its role also includes the analysis of the impact of T2S on the Slovenian environment and the identification of necessary adaptations, as well as an analysis of the user requirements and the preparation of comments with regard to the needs of the Slovenian environment. The aforementioned group has actively monitored the progress of the project and the preparation of user requirements, and prepared responses and initiatives regarding the definition of user requirements. The group will continue detailed discussions of user requirements in 2008 and prepare a single response from the Slovenian market in the scope of public consultation. The Bank of Slovenia is responsible for the overall organisation of the national user group, including the organisation of meetings, the preparation of materials, the presentation of new features and project developments, the chairing of meetings and the preparation of minutes, as well as the preparation of responses to ECB consultations on behalf of the national user group.

The Eurosystem's single technical platform

Update of credit operation collateral management

In March 2007, the Governing Council of the ECB decided to update the Eurosystem collateral management handling procedures, in particular with regard to the construction of a single technical platform owned by the Eurosystem, called the CCBM2[26].

The objective of the CCBM2 is to ensure greater efficiency in collateralisation of credit operations

The execution of Eurosystem orders will continue to be based on the principle of decentralisation, where national central banks will be able to distinguish, on a single technical platform, the internal infrastructure for the use of domestic and cross-border underlying assets, which is currently carried out with the help of a Correspondent Central Banking Model (CCBM). The objective of the CCBM2 is to ensure greater technical and cost efficiency and the harmonisation of the general collateral framework and the execution of Eurosystem credit operations, while reducing counterparty costs.

Participation in CCBM2 will be voluntary

The technological design of the platform will base on a modular architecture, in which the participating central bank will select the functionality of the platform based on its own needs. Participation in CCBM2 will be voluntary for Eurosystem central banks, which requires the establishment of interoperability with existing systems. The CCBM2 framework will enable the management of eligible domestic and cross-border underlying assets (marketable and non-marketable) in real time and with different techniques of collateralisation. Harmonisation with the TARGET2 payment system and the planned T2S settlement platform will be ensured for more efficient operations.

The preparation of CCBM2 user requirements has begun

With the help of market participants, the Eurosystem began preparing CCBM2 user requirements in the summer of 2007, with the aim of having them ready by the summer of 2008. The Governing Council of the ECB will then take decisions regarding the provider of CCBM2, the governance structure, financing and a pricing policy. At the same time, Eurosystem central banks will give their commitment for connection to the CCBM2.

The Bank of Slovenia participates in all the aforementioned activities with the ESCB working groups, including the analysis of all Eurosystem materials relating to the CCBM2 and the preparation of responses to ECB consultations.

Single Euro Payments Area

SEPA is the Single Euro Payments Area which comprises of 31 countries

The Single Euro Payments Area (SEPA) is an area in which consumers, companies and other payment service users can make and receive payments in euros, within Europe, both domestically and across borders, under the same conditions and with the same rights and obligations regardless of their location. Geographically, the SEPA includes the European Union Member States (EU27) and four more countries (Iceland, Liechtenstein, Norway and Switzerland). Its focus is on euro area countries as payments therein are in euros. The ultimate goal of the SEPA is the possibility of making payments from a single account using the same set of payment instruments (credit transfers, direct debits and payment cards) for all non-cash payments in euros within the SEPA, whereby the distinction between payments within a country and across borders will cease to exist.

The head of the SEPA project is the European Payments Council; in Slovenia, the Bank Association of Slovenia

The SEPA is a banking sector project. Thus the head of the project to establish the SEPA at the European level is the European Payments Council (EPC), while the

26 Collateral Central Bank Management (CCBM2).

Bank Association of Slovenia (ZBS) has assumed that role in Slovenia. With the establishment of working and support groups for individual topical fields at the ZBS in 2006 and subsequently in June 2007, a formal organisation, which facilitates the implementation of SEPA requirements, was established at the national level with the involvement of the project manager. The Bank of Slovenia contributed significantly to the establishment of an appropriate SEPA project manager under the aegis of the ZBS. The Bank of Slovenia also ensured that ECB recommendations and requirements were take into account in subsequent project activities. The Bank of Slovenia serves three functions in the SEPA project: a) as a catalyst, facilitator and coordinator of banking sector activities; b) as a bank (for customers); c) as a payment systems operator.

National SEPA Programme was confirmed

In February 2007, the Supervisory Board of the ZBS formally confirmed the National SEPA Programme – Slovenia, whose purpose was to translate SEPA requirements for the national plan to establish the SEPA. At the end of the year, the National SEPA Programme was supplemented based on ECB requirements relating to the standardisation of content among individual countries. Formal confirmation will be made at the beginning of 2008.

Activities in the area of SEPA credit transfers were carried out

In 2007, intensive work was carried out in preparation for the establishment of the SEPA, both within ZBS working groups (10 working and support groups) and at the banks themselves and at the Bank of Slovenia. Activities in the area of SEPA credit transfers were especially intense. The objective is this regard was adherence to the SEPA Credit Transfer Scheme and harmonisation with the SEPA Credit Transfer Scheme Rulebook of 28 January 2008. To that end, banks were required to ensure technological support which facilitates the sending and receipt of SEPA credit transfers and a connection to other banks in the SEPA, which also joined the SEPA Credit Transfer Scheme, via participation in one or more payment systems. Based on successful testing, more than 4,100 banks and savings banks from the SEPA joined the SEPA Credit Transfer Scheme on 28 January 2008, amongst them, 21 banks and savings banks in Slovenia (including the Bank of Slovenia) which provide payment services. At the beginning of 2008, SEPA requirements came into force in the area of payment cards (banks were obliged to offer the first SEPA payment cards on 1 January 2008), while the establishment of a SEPA Direct Debit Scheme is foreseen in November 2009.

The offer of SEPA payment instruments by Slovenian banks was also the subject of communication activities, carried out by the ZBS in 2007. The SEPA represents changes in various segments of the payments market. Therefore its success is also dependent on the involvement of interested parties, i.e. stakeholders in the national environment and across the SEPA.

Activities were also carried out with regard to the payment infrastructure

In addition to activities related to the establishment of support for SEPA payment instruments, activities were also carried out in 2007 with regard to the payment infrastructure. Therefore in the autumn of 2006, the Bank of Slovenia had already prepared a concept for establishing a new payment system which would enable the processing of SEPA credit transfers and direct debits, whereby the processing of payments of participants of this infrastructure would be carried out internally, and a connection to pan-European payment systems would be established for payments to and from European banks. Notwithstanding the general process of consolidation which (among others) is the result of the establishment of the SEPA, the establishment of a local infrastructure itself for low-value payments allows for the retention of a high level of payment services (particularly in terms of the speed of payment settlement) in Slovenia.

The concept of establishing a SEPA infrastructure for low-value payments (SIMP)

In February 2007, the concept of establishing a SEPA infrastructure for low-value payments (SIMP) was presented to banks, which expressed an interest to establish this type of infrastructure in the banking sector (outside the Bank of Slovenia), and under the (direct or indirect) ownership of banks. On this basis, a project to establish the SIMP was created in May 2007. The project is managed and financed by Bankart, with the cooperation of banks and the Bank of Slovenia, within the project council. The project is being developed simultaneously in two areas: a) a business-technical part with the objective of preparing a business model, technical specifications and implementation solutions; b) an institutional part with the objective of establishing an automated clearing house to manage the SIMP, with only processing handed over to Bankart. Banks adopted a decision regarding the selection of Bankart for processing SEPA transfers, based on a ZBS public tender in which bidders from Slovenia and abroad were included. By selecting Bankart, banks have defined the following: to maintain, at a minimum, the current level of payment services, to establish a solution for SEPA credit transfers by 1 July 2008, and to ensure the influence of the Slovenian banking sector over the development of services.

Establishment of a single entry point for SEPA credit transfers at the Bank of Slovenia

It is vital to ensure the reachability of every account at every SEPA bank

Ensuring the reachability of every account at every SEPA bank is vital for establishing the SEPA. This is only possible if an individual bank is (directly or indirectly) connected to one or more payment systems intended for the processing of payments with SEPA payment instruments and/or a pan-European clearing house. One of these systems is the STEP2 SCT pan-European payment system for SEPA credit transfers, managed by EBA Clearing.

Given that activities to establish a SEPA payment infrastructure in the banking sector (i.e. SIMP) began relatively late, it could not be expected that an appropriate infrastructure in the Slovenian banking sector would be established on time, i.e. by 28 January 2008.

Temporary establishment of a SEPA infrastructure in Bank of Slovenia

Accordingly, a proposal for the (temporary) establishment of a SEPA infrastructure at the Bank of Slovenia was prepared: in July 2007, the decision was made to include the Bank of Slovenia in the STEP2 SCT system, and to facilitate the indirect participation of domestic banks in the system and thus their reachability and connection to other SEPA banks as of 28 January 2008, by establishing a single entry point for SEPA credit transfers.

Banks agreed to participate in the STEP2 SCT system

Based on the business model presented, a majority of banks opted to participate in the single entry point for SEPA credit transfers by signing a statement of intent in September 2007 regarding direct participation in the STEP2 SCT system via a single entry point for SEPA credit transfers to be established by the Bank of Slovenia.

Technical support was established by banks and the Bank of Slovenia and a legal basis regarding participation in the STEP2 SCT system and the relationship with EBA Clearing, as the operator of the system, was defined. Thus the Bank of Slovenia became a direct participant in the pan-European STEP2 SCT system, and at the same time enabled the indirect participation of 17 banks and savings banks in Slovenia in the STEP2 SCT system as of 28 January 2008 through the establishment of single entry point for SEPA credit transfers. Three banks are included in the STEP2 SCT system as indirect participants via a selected foreign bank.

In the initial phase, the single entry point for SEPA credit transfers will be interesting primarily for cross-border payments

In the initial phase, primarily cross-border SEPA credit transfers are expected to be submitted by banks and their customers via the single entry point for SEPA credit transfers, as the current conditions of the system managed by EBA Clearing do not provide for a level of services comparable with the existing Giro Clearing system for domestic credit transfers. Increased use of SEPA credit transfers will be largely dependent on ensuring a higher level of services for domestic SEPA credit transfers, which should be provided by the establishment of the SIMP in the second half of 2008.

2.7.1 Oversight of payment systems

Responsibility of the Bank of Slovenia for oversight of payment systems

Based on the Law on the Bank of Slovenia and the Payment Transactions Act, the Bank of Slovenia is responsible for the oversight of payment systems. The objective of this oversight is to protect the financial system from possible systemic consequences if one or more payment system participants has financial difficulties, and to ensure the operational security and efficiency of payment systems.

Oversight is carried out based on reports and on-site examinations

In 2007, the Bank of Slovenia, in accordance with its responsibilities, oversaw payment systems on the basis of regular and extraordinary reports by operators of payment systems in Slovenia, who are obliged to submit such reports to the Bank of Slovenia. The operators' reports concern the regular operation of the systems and any planned or unplanned deviations, as well as changes in the concept of the functioning of payments systems. The Bank of Slovenia also monitored the implementation of recommendations made to payment system operators on the basis of on-site examinations for adapting payment systems to the requirements of the legal framework and the guidelines of the Core Principles for Systemically Important Payment Systems, which were issued by the Bank for International Settlements (BIS) in 2001 and were approved by the Governing Board of the Bank of Slovenia as the basis for oversight. The Bank of Slovenia also conducted regular annual on-site examinations of payment system operators, based on its annual plan of oversight.

Oversight at the Eurosystem level

Following inclusion in the Eurosystem in 2007, the Bank of Slovenia's activities also included examinations of payments systems transfer schemes and important payment systems infrastructures carried out at the Eurosystem level. These activities primarily include the preparation of methodologies for conducting oversight of payment systems and transfer schemes and the cooperative oversight of payment systems, payment schemes and important payment system infrastructures present in several countries (TARGET2, SWIFT[27], CLS[28], international payment card schemes and SEPA schemes).

2.7.2 Payment systems statistics

The Bank of Slovenia operates TARGET2-Slovenija, the Giro Clearing system and the single entry point to STEP2

As of 1 January 2007 with the adoption of the euro, the Bank of Slovenia was a full participating member of the TARGET system via the German RTGS^{plus} system and a member of the Eurosystem. Since 19 November 2007, when it migrated from the TARGET system (RTGS^{plus}) to the TARGET2 system, the Bank of Slovenia operates TARGET2-Slovenija, through which it ensures the conditions for the inclusion of Slovenian participants in the system. In 2007, the Bank of Slovenia also managed the Giro Clearing system for low-value payments, and through the single entry point it also provided banks access to the STEP2 pan-European payment system, which makes it possible to process cross-border low-value payments in euros.

27 Society for Worldwide Interbank Financial Telecommunications (SWIFT)
28 Continuous Link Settlement (CLS)

In 2007, 728,846 domestic transactions (between domestic participant in the system) were settled through the TARGET/TARGET2 systems with a total value of EUR 364.7 billion, representing a 54% decrease in the number of transactions and a 15% increase in the value of transactions from 2006 (in 2006, high-value domestic payments and urgent payments were still settled in the RTGS system at the Bank of Slovenia). On average, 2,881 transactions were settled daily, the average value of which was EUR 0.5 million. The sharp decrease in the number of domestic transactions in the TARGET/TARGET2 systems in 2007 compared to the previous year was due to the increase of the threshold for low-value payments (from EUR 8,350 to EUR 50,000), and the resulting redirection of payment to the Giro Clearing system. In addition to domestic transactions, 119,405 cross-border inflow transactions (between Slovenian and foreign participants in the system) were settled through the TARGET/TARGET2 systems in 2007, with a total value of EUR 80.4 billion, while there were 72,208 cross-border outflow transactions, with a total value of EUR 68.9 billion.

A decrease in the number of domestic transactions in TARGET/TARGET2

In 2007, the Giro Clearing system processed 53,619,827 transactions, with a total value of EUR 45.7 billion, an increase of nearly 3% in the number and a 99% increase in the value of transactions compared to 2006. The main reason for the sharp increase in the value of transactions is the aforementioned raising of the threshold for low-value payments in the Giro Clearing system. The net settlement value of these payments from the Giro Clearing system via the TARGET/TARGET2 systems was EUR 1.1 billion or 20% of the gross value of transactions, meaning a netting ratio of 80%. On average 216,209 transactions were processed daily, with an average value of EUR 853.

The number and value of transactions in the Giro Clearing system rose

In 2007, a total of 667,104 outflow transactions and 451,814 inflow transactions were processed via the single entry point, meaning an increase of 33% and 29%, respectively, in the number of transactions compared to 2006. The value of outflows was EUR 4.6 billion, and the value of inflows EUR 2.0 billion, meaning an increase of 44% and 39%, respectively, in the value of transactions compared to 2006.

Increase of processed transactions via single entry point

2.8 Payments of Bank of Slovenia clients

2.8.1 Transactions for the government sector

Administration of budget user accounts

The Bank of Slovenia administers the government's single treasury account and 209 standard municipal treasury accounts, open in a number of currencies. The accounts of direct and indirect users of the national and municipal budgets, the Health Insurance Institute of Slovenia and the Pensions and Disability Insurance Institute (included in the single treasury account system as set out in the Public Finances Act), were opened as sub-accounts of the government or municipal treasury accounts. The sub-accounts are managed by the Public Payments Administration, to which direct and indirect users of the national and municipal budgets present payment instructions and from which they receive a full set of return information about payments transacted.

The Bank of Slovenia manages the treasury accounts of the government and municipalities

In 2007, EUR 27.9 billion in inflows and EUR 28.1 billion in outflows were processed through the government's single treasury account and EUR 28.5 billion in inflows and EUR 28.5 billion in outflows through the municipal treasury accounts.

Special-purpose accounts

In addition to the single treasury accounts, the Bank of Slovenia also manages 86 special purpose accounts for the government and other budget users.

International payments

The Bank of Slovenia conducts payment transactions and other transactions for the Republic of Slovenia on the basis of the Payment Transactions Act.

The majority of transactions with the rest of the world for the government sector are in euros

In 2007, the Bank of Slovenia performed EUR 910.1 million in payments to the rest of the world and paid out EUR 1.0 million in cash. Remittances totalling EUR 1,420.4 million were made from the rest of the world, and EUR 0.2 million in foreign currency cash was repaid. A total of EUR 73.9 million in foreign currency was sold to budget users, and EUR 6.5 million in foreign currency was purchased from them. Analysis of the currency composition of inflows and outflows shows that 99.5% of inflows were in euros, 0.2% were in US dollars, 0.3% in Croatian kuna, and a mere 0.1% in other currencies, while 90.6% of outflows were in euros, 5.0% in US dollars, 2.3% in Croatian kuna, and 2.1% in other currencies.

Administration of accounts for foreign financial institutions and EU institutions

The Bank of Slovenia also administers foreign currency accounts for foreign financial institutions and EU institutions, via which inflows of EUR 533.0 million and outflows of EUR 477.9 million were processed.

2.8.2 Administration of accounts for the CSCC and CSCC members

The Bank of Slovenia administers a guarantee fund cash account, a CSCC fiduciary account and the accounts of CSCC members

The Bank of Slovenia administers a guarantee fund cash account and a fiduciary account for custodian services for the Central Securities Clearing Corporation. In addition, the Bank of Slovenia also administers the accounts of CSCC members through which cash settlements are made for securities transactions. At the end of the 2007, there were 24 CSCC members, including 12 commercial banks and 12 investment firms, with open transaction accounts for customer funds and clearing accounts at the Bank of Slovenia.

In 2007, EUR 9.8 billion in inflows and EUR 9.7 billion in outflows were processed through the CSCC accounts and CSCC member accounts.

2.9 Participation in the committees and working groups of the ECB and EU

Participation in sessions of committees and working groups which work within the ESCB and EU institutions

In 2007, Bank of Slovenia representatives attended sessions of committees (15 in total) and their working groups, when meetings were conducted in the wider composition of the European System of Central Banks (ESCB) and in the narrower composition of the Eurosystem. The Bank of Slovenia also attended sessions of committees, working groups and other bodies that are active within the institutions of the European Union with a focus on financial and monetary matters. These include sessions of the Economic and Financial Committee (EFC) and its subcommittees, meetings of the Committee of European Banking Supervisors (CEBS) and its working groups, meetings of the Committee on Monetary, Financial and Balance of Payments statistics (CMFB) and other working groups from the relevant area which are active within the European Commission and the EU Council.

2.10 International cooperation

The European Central Bank, the Eurosystem and the European System of Central Banks

With the introduction of the euro in Slovenia on 1 January 2007, the Bank of Slovenia became a part of the Eurosystem, which comprises the European Central Bank (ECB) and the national central banks of euro area Member States. The Governor of the Bank of Slovenia attended the sessions of the Governing Council of the ECB in 2007, which were generally held twice a month. The Governing Council of the ECB comprises the six members of the Executive Board and the governors of the national central banks of euro area Member States. The Governing Council of the ECB defines the monetary policy for the euro area. In addition, the Governor of the Bank of Slovenia is still a member of the General Council of the ECB, the third decision-making body of the ECB which meets four times a year. The General Council comprises the President and the Vice-President of the ECB and the governors of the national central banks of all EU Member States.

The Governor of the Bank of Slovenia attended sessions of the Governing Board and General Council of the ECB

The national central banks are the sole subscribers to and holders of the capital of the ECB. Pursuant to the Statute of the ESCB and ECB, the shares of the national central banks in the ECB's capital key are weighted according to the proportion of the respective Member States in the total population and gross domestic product of the EU. The national central banks of EU Member States that have introduced the euro have paid up their entire share to the capital of the ECB. Other national central banks of EU Member States that have not yet introduced the euro have not paid up their entire share, but only 7% of the amount that they will have to pay up when they introduce the euro.

The criterion for determining the subscription of capital to the ECB is dependent on the total population and GDP of a euro area country

The Bank of Slovenia's key for subscription to the ECB's capital was 0.3194% in 2007. The total amount of paid-up ECB capital of all national central banks is EUR 4,127 million.

The Bank of Slovenia subscribed to approximately 0.3% of the ECB's capital

International Monetary Fund

Slovenia's quota at the International Monetary Fund (IMF) was unchanged at SDR 231.7 million, representing 0.12% of the voting power of all IMF members.

Since 1998, Slovenia has been among the IMF Member States that finance loans under the Financial Transactions Plan (FTP). Slovenia did not participate in new FTP payments in 2007, but did receive a proportion of returned IMF loans from previous years from Turkey and Bulgaria in the total amount of SDR 8.4 million. At the end of December 2007, Slovenia's reserve tranche position at the IMF diminished with comparison to year 2006 and stood at SDR 15.9 million.

In 2007, Slovenia received a proportion of returned IMF loans under the FTP

In March, IMF representatives held regular annual consultations with Slovenia pursuant to Article 4 of the IMF Statute. The Board of Executive Directors discussed the report from the IMF Commission in mid-May. It was published on 23 May 2007.

Report on consultations with Slovenia pursuant to Article 4 of the IMF Statute

Other areas

In 2007, the Bank of Slovenia continued to collaborate in the process of resolving succession issues related to the former Socialist Federal Republic of Yugoslavia, with regard to the implementation of the Agreement on Succession Issues.

Collaboration in resolving succession issues

3 APPENDICES

3.1 Secondary legislation affecting banking supervision

In 2007, secondary legislation affecting banking supervision was issued primarily due to the new Banking Act (Official Gazette of the Republic of Slovenia, No. 131/06; hereinafter the ZBan-1) and due to continuing harmonisation with Directive 2006/48/EC and the opinions of the Capital Requirements Directive Transposition Group (CRDTG). All secondary legislation relating to banking supervision and issued in 2007 are listed below. A brief description of more important legislation is also given.

Amendment of the Guidelines on the content and method for reporting inter-bank deposits	**March**
Regulation amending the regulation on risk management and implementation of the process of assessing internal capital adequacy for banks and savings banks	
Regulation on the documentation for demonstrating the fulfilment of conditions to perform the function of a management board member of a bank or savings bank	
Regulation on the documentation for the granting of authorisations to provide banking and financial services	
Regulation on the documentation for the granting of authorisation to establish a branch office of a third country bank	
Regulation on the books of account and annual reports of banks and savings banks This regulation defines in detail the types and layouts of financial statements and consolidated financial statements of banks and savings banks, the detailed content of annual reports and consolidated annual reports and the contents, form, method and deadlines for the submission of monthly reports on the account items of banks. The regulation was adopted in December, and requires that banks include the balance sheet and income statement in abbreviated format (previously in long format) and the statement of changes in equity in the new format in the annual report and consolidated annual report.	
Guidelines for preparation of the balance sheet and income statement of banks and savings banks	
Guidelines for calculating performance indicators of banks and savings banks	
Guidelines for submission of monthly reports of account balances	
Regulation on the assessment of credit risk losses of banks and savings banks	
Guidelines for on implementing the regulation on the assessment of credit risk losses of banks and savings banks	
Regulation on the auditing of the annual report of banks and savings banks	
Regulation on the information that must be published by branches of Member State banks	

Regulation on the reporting of branches of Member State banks
This regulation introduced reporting adapted to the introduction of the euro and the new ZBan-1.

Regulation on the reporting of certain facts and circumstances relating to banks and savings banks
This regulation was harmonised with the ZBan-1 and replaced the regulation on detailed content of reports set out in Article 127 of the Banking Act. The ZBan-1 prescribed additional reporting. These requirements are regulated in detail by this regulation. The aforementioned regulation was adopted in December 2007, when the Bank of Slovenia's requirement regarding the submission of the auditor's report to the management board of a bank or savings bank was abolished.

Regulation on the conditions to be met by credit intermediaries
Pursuant to the first paragraph of Article 20 of the Consumer Credit Act (Official Gazette of the Republic of Slovenia, No. 77/04 [official consolidated version]), this regulation was recast, as there is no longer any basis for the issue of such regulations in the ZBan-1. The provisions of the regulation now apply only to credit intermediaries during the conclusion of credit agreements for consumer loans.

Regulation on the holders of qualifying holdings of banks and savings banks
This regulation followed the arrangement of this area in the ZBan-1, and transposed in the Slovenian legal system the Bank of Slovenia's policy relating to the granting of authorisation for the direct or indirect acquisition of a qualifying holding in a bank or savings bank and the criteria used in the assessment for granting authorisation. This regulation sets out in detail the criteria for assessing the eligibility of a future holder of a qualifying holding in a bank or savings bank, the detailed content of the documentation that must be enclosed in the application for granting authorisation, and the detailed content of notifications of qualifying holdings and the method in which they are to be sent to the Bank of Slovenia.

Regulation on the minimum requirements for ensuring an adequate liquidity position at banks and savings banks

Guidelines for implementing the regulation on the minimum requirements for ensuring an adequate liquidity position at banks and savings banks

Regulation on electronic money issuing companies
The purpose of the regulation on electronic money issuing companies was to establish rules regarding risk management by electronic money issuing institutions that are identical to those applying to banks and savings banks, while taking into account the particularities of these companies.

Regulation on the diligence of members of the management and supervisory boards of banks and savings banks
This regulation prescribes the detailed rules regarding the conduct of members of the management and supervisory boards of banks and savings when performing such a function in accordance with the standards of professional diligence.

Guidelines for implementing the regulation on the reporting of capital and capital requirements of banks and savings banks

---

May Regulation on the deposit guarantee scheme
This regulation introduced certain new features and prescribed special points regarding the definition of a guaranteed deposit in caretaker or similar accounts, which the holder (e.g. notary or administrator) opens in his own name and for

the account of third persons. Changes in the calculation of the liabilities of banks with regard to liquid investments and maximum annual liabilities, as well as other changes, were also introduced.

Guidelines for completing and submitting guaranteed deposit reports

Regulation amending the regulation on the minimum requirements for ensuring an adequate liquidity position at banks and savings banks This regulation eliminated daily liquidity flow planning and liquidity flow reporting. Due to changes on the market, the September amendment to this regulation introduced a change in the criteria for inclusion of sources of funds, whereby the entire undrawn portion of approved credits, which do not meet the criteria for eligibility as collateral for Eurosystem claims as defined in the Bank of Slovenia regulation governing the general rules for implementing monetary policy, is taken into account. Guidelines amending the guidelines for implementing the regulation on the minimum requirements for ensuring an adequate liquidity position at banks and savings banks	**June**
Regulation amending the regulation on the minimum requirements for ensuring an adequate liquidity position at banks and savings banks	**September**
Regulation on the reporting of capital and capital requirements of banks and savings banks Regulation amending the regulation on the supervision of banks and savings banks on a consolidated basis Regulation amending the regulation on the calculation of capital requirements for market risk for banks and savings banks Regulation amending the regulation on the calculation of the capital requirements for credit risk using a internal ratings-based approach for banks and savings banks Regulation amending the regulation on the calculation of capital requirements for credit risk using a standardised approach for banks and savings banks Regulation amending the regulation on large exposures of banks and savings banks Regulation amending the regulation on risk management and implementation of the process of assessing internal capital adequacy for banks and savings banks Regulation amending the regulation on the calculation of capital of banks and savings banks Regulation amending the regulation on the calculation of the capital requirements for credit risk in securitisation Regulation amending the regulation on credit protection Regulation amending the regulation on the reporting of certain facts and circumstances relating to banks and savings banks Regulation amending the regulation on the books of account and annual reports of banks and savings banks	**December**

3.2 Governance and organisation

3.2.1 Governing Board of the Bank of Slovenia as at 31 December 2007

President of the Governing Board

Marko Kranjec, Ph.D.
(Governor of the Bank of Slovenia)

Other members of the Governing Board

Andrej Rant
(Vice-Governor – Deputy-Governor of the Bank of Slovenia)

Darko Bohnec
(Vice-Governor)

Janez Košak
(Vice-Governor)

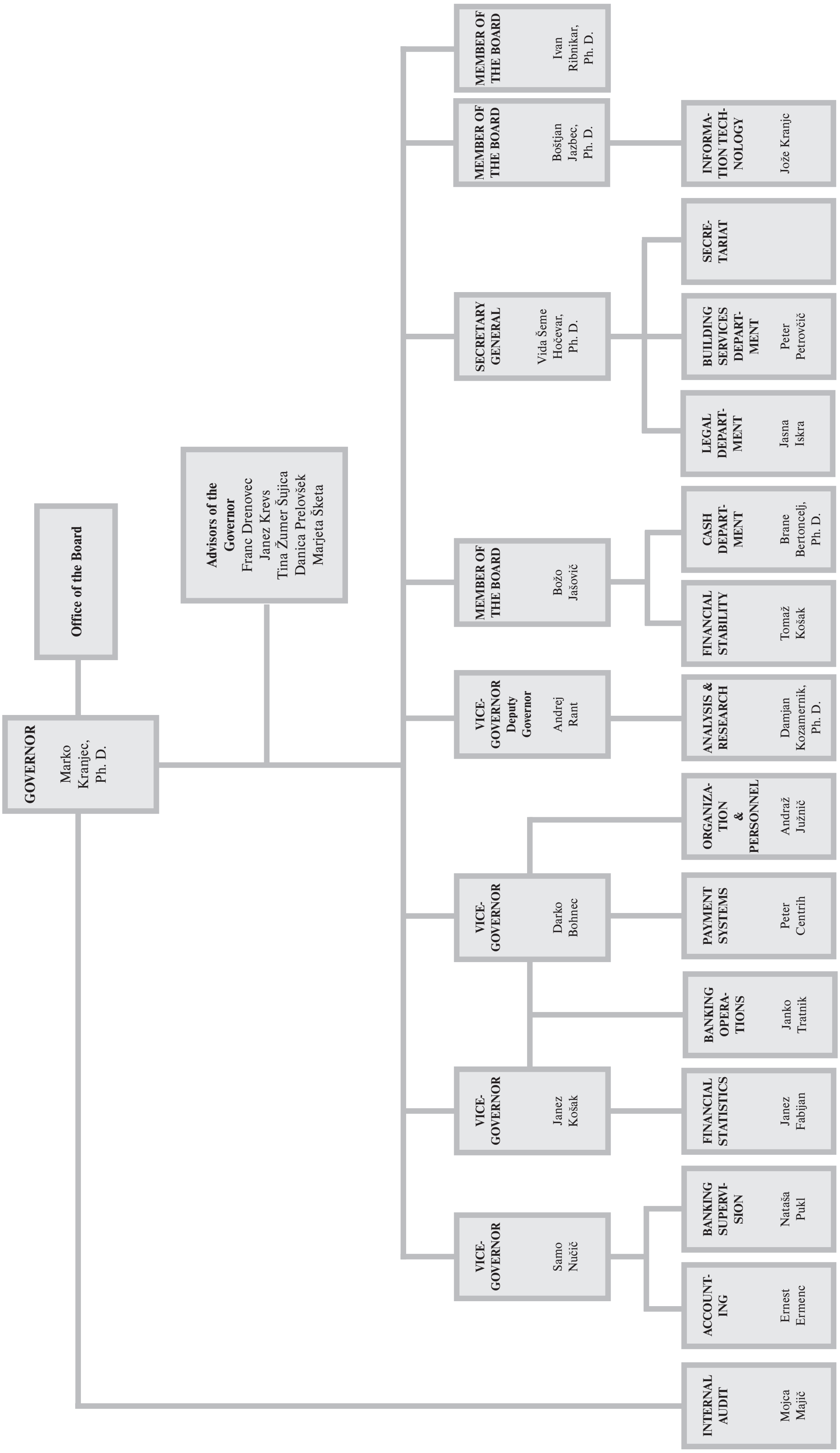
Samo Nučič
(Vice-Governor)

Božo Jašovič
(member of the Governing Board)

Boštjan Jazbec, Ph.D.
(member of the Governing Board)

Ivan Ribnikar, Ph.D.
(member of the Governing Board)

3.2.2 Organisational structure of the Bank of Slovenia as at 31 December 2007



3.2.3 Commissions and committees of the Governing Board in 2007

- Commission of the Governing Board of the Bank of Slovenia for the Preparation of Opinions in Connection with Procedures for Ruling on the Issue of Authorisations to Provide Banking Services, Authorisations to Acquire a Qualifying Holding and Other Authorisations, Approvals and Opinions Pursuant to the Banking Act (president: Božo Jašovič)

- Commission of the Governing Board of the Bank of Slovenia for the Preparation of Opinions for the Issue of Authorisations to Hold Office as a Member of a Bank's Management Board (president: Ivan Ribnikar, Ph.D.)

- Research Commission (president: Ivan Ribnikar, Ph.D.)

- Audit Committee (president: Dušan Zbašnik, Ph.D.)

- Investment Committee (president: Janez Košak)

3.3 Publications and website

Content	Title and basic information
Macroeconomic statistics with an emphasis on monetary statistics, exchange rates and economic relations with the rest of the world. Economic and financial developments; methodological appendix; review of Slovenian banks, calendar of data releases.	**Monthly Bulletin** • monthly • in Slovene Bilten • English translation
Report by the Bank of Slovenia to the National Assembly of the Republic of Slovenia. Description of economic developments, monetary policy, operations of banks and the Bank of Slovenia, and other activity of the Bank of Slovenia.	**Annual Report** • annual (released in spring) • in Slovene Letno poročilo • English translation
Statistical review of direct and portfolio investment vis-à-vis Slovenia, both inward and outward (on an annual basis).	**Neposredne naložbe/ Direct Investment** • annual • bilingual release in Slovene and English
Comprehensive review of unconsolidated and consolidated sectors of the financial account of the Republic of Slovenia in an internationally comparable manner.	**Financial Accounts of Slovenia** • annual • bilingual release in Slovene and English
Analytical and methodological presentations in monetary, balance of payments and related areas.	**Prikazi in analize [Surveys and Analyses]** • quarterly • in Slovene
Statistical review of non-monetary financial intermediaries, the securities market and interest rates.	**Finančni trgi [Financial Markets]** • quarterly • in Slovene
Monetary policy actions, outline of inflation trends and projections of key macroeconomic indicators for Slovenia for the next two years.	**Price Stability Report** • half-yearly • in Slovene Poročilo o cenovni stabilnosti • English translation
Collection of articles on all topics of professional and operational relevance to central banking. Content of articles may be analytical or merely informative.	**ARC Working Papers**
Analytical monitoring of developments in the banking sector, and articles by experts on maintaining financial stability.	**Financial Stability Review** • annual • in Slovene Poročilo o finančni stabilnosti • English translation
Website of the Bank of Slovenia with information about the institution, Slovenian banknotes and coins, laws and regulations governing the work of the central bank, and other useful information. Current data on exchange rates, interest rates and Bank of Slovenia securities, and major publications available for download in electronic form.	**website** • index of Slovenian pages http://www.bsi.si/... .../html/kazalo.html • index of English pages http://www.bsi.si/... .../eng/index.html

3.4 Glossary of selected terms

Benchmark allotment – The amount of an MRO allotment which enables credit institutions to regularly meet their **minimum reserve requirement**.

Capital (in accounting sense) – Subscribed capital, capital reserves, profit reserves, retained earnings and net losses from previous years, capital revaluation adjustment, net profit not yet distributed, net loss not yet covered and security deposit.

Capital (in regulatory sense) – An amount calculated on the basis of original and additional capital that banks can use to cover their capital requirements in accordance with the regulation on capital adequacy of banks and savings banks (Official Gazette of the Republic of Slovenia, Nos. 135/06 and 104/07).

Capital adequacy ratio– The ratio of capital to the sum of capital requirements for specific risks (credit, market and operational) multiplied by 8.

Correspondent Central Banking Model (CCBM) – A mechanism established by the ESCB with the aim of enabling counterparties to use underlying assets in a cross-border context. In the CCBM, national central banks act as custodians for one another.

ECB key interest rate – The interest rate used by the Eurosystem to signal the monetary policy stance. It is the same as the main refinancing rate.

ESCB – The European System of Central Banks.

Eonia – Euro Overnight Index Average – Reference interest rate for overnight interbank deposits in euros.

Financial institutions – In the official sector classification based on ESA95, the financial institutions sector is divided into five sub-sectors: the central bank, other monetary financial institutions, other financial intermediaries except insurance companies and pension funds, ancillary financial institutions, and insurance companies and pension funds. Monetary financial institutions include the central bank and other monetary financial institutions engaged in financial intermediation. Non-monetary financial institutions comprise other financial intermediaries excluding insurance companies and pension funds, ancillary financial institutions, and insurance companies and pension funds.

Deposit facility – A standing facility of the Eurosystem which counterparties may use to make overnight deposits at a national central bank at an interest rate which is lower than the market interest rate.

Interest margin – The ratio of net interest (interest income less interest expenses) to average assets.

Interest spread (nominal) – The difference between the average nominal interest rate that the bank earns on its investments and the average nominal interest rate that the bank pays on its liabilities of the same maturity.

Large exposure – An exposure of a bank to a counterparty equalling or exceeding 10% of the bank's capital.

Liquidity deficit – The sum of the **structural liquidity deficit** and the balance of accounts used by credit institutions to meet its **reserve requirement**.

Liquidity ratio – The ratio of the sum of financial assets in domestic and foreign currency to capital and liabilities in domestic and foreign currency with regard to residual maturity. Banks must allocate financial assets and capital and liabilities according to residual maturity into two categories, one with a residual maturity of up to 30 days, and one with a residual maturity of up to 180 days. In accordance with latest regulations the liquidity ratio in the first category must be at least 1, while that in the second category is of an informative nature.

Marginal lending facility – A standing facility of the Eurosystem which counterparties may use to receive overnight credit from a national central bank at an interest rate which is higher than the market interest rate.

Money market – The market on which participants gather and invest short-term assets and trade them via instruments with an original maturity of up to one year.

Net impairments and provisions – The difference between impairments of financial assets not measured at fair value through profit or loss, impairments of other assets, costs related to the formation of provisions and the elimination of impairments of financial assets not measured at fair value through profit or loss, the elimination of other impairments and revenue from eliminated provisions.

Nominal interest rate – The total interest rate, comprising the part which compensates the lender or investor for inflation and the real part.

Non-interest margin – The ratio of non-interest income to average assets.

Non-marketable retail mortgage-backed debt instruments – A debt instrument (note or bill) which is secured by residential mortgages and does not fully meet the securitisation criteria.

Operating costs – Labour costs, general and administrative expenses and amortisation/depreciation.

Other assets – Investments in the equity of entities in the same group (subsidiaries, associates and joint ventures) and other customers, intangible non-current assets, tangible assets, treasury stock, uncalled capital, deferred expenses and accrued income, and other assets such as cheques, inventories and claims arising from interest, fees and commissions.

Other liabilities – Liabilities arising from interest and fees and commissions, accrued expenses and deferred income, long-term provisions for liabilities and costs, provisions for general banking risk, and other liabilities.

Other risk-weighted items – Equal to the sum of the capital requirements for currency and market risk, multiplied by conversion factors corresponding to the required minimum capital adequacy ratio (e.g. 12.5 for a capital adequacy ratio of 8%).

Persons in a special relationship with a bank – Major shareholders in a bank and members of a bank's bodies, and parties related to them.

Provisions – Provisions for reorganisation, provisions for unsettled lawsuits, provisions for tax suits, provisions for pensions and similar liabilities to employees, provisions for off-balance sheet liabilities, provisions for onerous contracts and other provisions.

Quick tender – The tender procedure used by the Eurosystem for fine-tuning operations when it is deemed desirable to have a rapid impact on the liquidity situation in the market. Quick tenders are executed within a time frame of 90 minutes and are restricted to a limited set of counterparties.

Reserve requirement – The minimum prescribed amount of money that credit institutions are obliged to maintain on account at a central bank in a given period. The amount is calculated by multiplying the basis (e.g. selected liabilities in credit institutions' balance sheets) by the reserve ratio. The reserve ratio in the euro area is 2% for liabilities with a contractual maturity of up to two years, and 0% for liabilities with a maturity of more than two years and those arising from repo transactions. Liabilities to the Eurosystem and other institutions subject to the minimum reserve system of the Eurosystem are not included in the base.

Reverse transaction – An operation whereby the national central bank simultaneously buys and sells (or vice-versa) financial assets under a repurchase agreement or conducts credit operations against collateral, with differing settlement dates. The opposite is an outright transaction comprising only one part (there is no reversing part).

Secondary liquidity – Investments in financial instruments that are highly liquid and can be sold quickly.

Standard tender – A tender procedure used by the Eurosystem in its regular open market operations. It is carried out in a time frame of 24 hours, while the set of participating counterparties is broader than in a **quick tender**.

Standing facility – A central bank facility available to counterparties at their own initiative. The Eurosystem offers two overnight standing facilities: the **marginal lending facility** and the **deposit facility**.

Structural liquidity surplus/deficit – The difference between the autonomous supply of liquidity of a central bank and its autonomous demand for liquidity. It is equal to net autonomous factors, i.e. the sum of autonomous factors from the asset side of a central bank's balance sheet less the sum of autonomous factors from the liability side of the balance sheet. A positive result represents a structural surplus; a negative result represents a liquidity deficit of the money market (e.g. credit institutions) against the central bank. Autonomous factors are those items in the central bank's balance sheet not affected by the central bank's targeted monetary policy conduct. Nevertheless, changing autonomous factors result in a change in the liquidity of credit institutions. Examples of autonomous factors are banknotes, government deposits with the central bank, items in the course of settlement, foreign exchange reserves and other assets of the central bank, as well as its capital and reserves.

TARGET – The Trans-European Automated Real-Time Gross Settlement Express Transfer system has been operating since 1999 with the aim of providing support for the implementation of Eurosystem monetary policy and the secure, reliable and efficient settlement of domestic and cross-border payments. The system consists of the interconnected national real-time gross settlement systems of the euro area, the UK, Denmark, Sweden (until 31 December 2006), Poland and Estonia.

Total assets – The sum of all asset or liability items on the balance sheet (of a bank).

3.5 FINANCIAL STATEMENTS

Financial statements of the Bank of Slovenia for the Year 2007

Statement of responsibilities of the Governing Board

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

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

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

Deloitte

DELOITTE REVIZIJA d.o.o.
Dunajska cesta 9
1000 Ljubljana
Slovenija
Tel: +386 1 30 72 800
Faks: +386 1 30 72 900

www.deloitte.si

INDEPENDENT AUDITOR'S REPORT

To the Governing Board of the Bank of Slovenia

Report on the Financial Statements

We have audited the accompanying financial statements of Bank of Slovenia (the 'Bank'), which comprise the balance sheet as at December 31, 2007 and the income statement for the year then ended and a summary of significant accounting policies and other explanatory notes.

Responsibility for the Financial Statements
The Governing Board is responsible for the preparation and fair presentation of these financial statements in accordance with the Guideline of the European Central Bank of 10th November 2006 on the legal framework for accounting and financial reporting in the European System of Central Banks (ECB/2006/16) and articles of Law on Bank of Slovenia that are applicable for financial reporting. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility
Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of Bank of Slovenia as of December 31, 2007, and of its financial performance for the year then ended in accordance with the Guideline of the European Central Bank of 10th November 2006 on the Legal Framework for Accounting and Financial reporting in the European System of Central Banks (ECB/2006/16) and articles of Law on Bank of Slovenia, applicable for financial reporting.

Without qualifying our opinion, we draw attention to Note »Changes in Accounting Principles and Standards« to the financial statements, where discusses that Bank of Slovenia due to transition to a financial reporting framework per Guideline ECB/2006/16 did not present comparative data due to impractibility, as concluded by the Governing Board of Bank of Slovenia.

DELOITTE REVIZIJA d.o.o.

Andreja Bajuk Mušič
Certified auditor

Yuri Sidorovich
Partner

Ljubljana, February 15th, 2008

Constitution

The Bank of Slovenia (the Bank) was constituted by the Law on the Bank of Slovenia dated 25 June 1991. The Bank is a legal entity, governed by public law, which independently disposes of its own property. The Bank is wholly owned by the state and is autonomous as regards its finances and administration. The Bank is supervised by Parliament. The Bank shall take care of the stability of domestic prices and of general liquidity of the financial system. According to the Bank of Slovenia Act (Official Gazette of the Republic of Slovenia No. 58/02 and No. 72/06), from the day of introduction of the euro, the Bank shall begin to perform the tasks in accordance with the Treaty establishing the European Community and in accordance with the Statute of the ESCB and the ECB[1].

Accounting policies

Introduction of euro
Republic of Slovenia introduced the euro as a new legal tender on the 1 January 2007. The Bank became part of the Eurosystem and took over joint responsibility for monetary policy and for exercising the common strategic goals of the European System of Central Banks (ESCB)[2].

Changes in accounting principles and standards
Until the end of 2006, the Bank applied International Financial Reporting Standard valid in EU as the legal basis for the accounting and reporting. With effect from 1 January 2007, those standards were replaced with the Guideline of the European Central Bank of 10 November 2006 on the legal framework for accounting and financial reporting in the European System of Central Banks (ECB/2006/16)[3] (Accounting Guideline). According to the Bank of Slovenia Act and according to the Statute of the ESCB and the ECB, this legal framework was adopted by the Governing Board of the Bank at its 343rd meeting on 20 December 2006.

Financial statements are presented in accordance with the valuation rules as defined by the Accounting Guideline.

In cases that are not covered by the Accounting Guideline or are governed by non-mandatory provisions, the valuation principles in accordance with International Financial Reporting Standards valid in EU and with the Bank of Slovenia act were applied.

With regard to the change in accounting standards and principles, the comparison with the previous year would be technically pretentious, which would cause the costs greater that the benefits arising from the comparison. Consequently, the Governing Board decided not to present comparable data.

Basic principles
The financial statements were prepared in conformity with the provisions governing the Eurosystem's accounting and reporting operations, which follow accounting principles, harmonized by Community law and generally accepted international accounting standards valid in EU and with the Bank of Slovenia act.

The following fundamental accounting principles have been applied:

- economic reality and transparency: the accounting methods and financial reporting shall reflect economic reality and shall be transparent;

---

[1] Protocol (No. 18) (ex No. 3) on the Statute of the European System of Central Banks and of the European Central Bank (Protocol annexed to the Treaty establishing the European Community, OJ C 191, 29.07.1992).

[2] The term 'European System of Central Banks (ESCB)' refers to the twenty-seven National Central Banks (NCBs) of the member states of the European Union on 31 December 2007 plus the European Central Bank (ECB). The term 'Eurosystem' refers to the thirteen NCBs of the member states participating in the Monetary Union, plus the ECB on the same date.

[3] OJ L 348, 11.12.2006, p. 1-37.

- prudence: the valuation of assets and liabilities, as well as the recognition of income, shall be carried out prudently. In the context of the Accounting Guideline, this implies that unrealised gains are not recognised as income in the profit and loss account, but are transferred directly to a revaluation account;
- post-balance-sheet events: assets and liabilities shall be adjusted to take into account events that occur between the end of financial year and the date on which the annual accounts are approved by the Governing Board, if they materially affect the fair presentation of assets or liabilities at the balance sheet date;
- materiality: deviation from the accounting rules shall not be allowed unless they can reasonable be judged to be immaterial in the overall context and presentation of the financial statements;
- going concern basis: when assessing assets and liabilities, it must be assumed that the activities will continue;
- the accruals principle: income and expenditure shall be recognised in the accounting period they were earned or incurred, regardless of when the payment is made or received;
- consistency and comparability: the criteria for balance sheet valuation and income recognition shall be applied consistently to ensure comparability of data in the financial statements.

Recognition of assets and liabilities
An asset or liability is only recognised in the Balance Sheet when it is probable that any associated future economic benefit will flow to or from the Bank, substantially all of the associated risks and rewards have been transferred to the Bank, and the cost or value of the asset or the amount of the obligation can be measured reliably.

Economic approach
On the basis of definition of alternative economic approach in the Accounting Guideline, transactions in financial assets and liabilities are reflected during the year in the accounts on the basis of the date on which they were settled.

For transactions in foreign currency, agreed in one year but maturing in a subsequent year, the trade date approach is applied. Transactions are recorded in off-balance sheet accounts on the trade date. On the settlement date, the off-balance sheet entries are reversed and transactions are booked on-balance sheet. Purchases and sales of foreign currency affect the net foreign currency position on the trade date and realised results arising from sales are also calculated on the trade date.

Securities transactions are recorded according to the cash/settlement approach. Accrued interest, premiums and discounts related to financial instruments in foreign currency are calculated and booked daily from the settlement date, and the foreign currency position is also affected daily by these accruals.

Conversion of foreign currencies
Foreign currency transactions whose exchange rate is not fixed against the euro are recorded in the balance sheet at market rates prevailing on the day of the transaction. At year-end, both financial assets and liabilities are revalued at current market rates of the last day of the year, as derived from the ECB's daily quotation of reference exchange rates. This applies equally to on balance-sheet and off-balance-sheet transactions. The revaluation takes place on a currency-by-currency basis.

Income and expenses are converted at the exchange rate prevailing on the recording date.

Gold and gold receivables
Gold and gold receivables are valued at market price prevailing at the year-end. No distinction is made between the price and currency revaluation differences for gold. Instead, a single gold valuation is accounted for on a basis of the price in euro per fine ounce of gold, derived from the gold price in US dollar as at the balance sheet date.

Securities
All marketable securities are valued at the mid-market prices prevailing at the balance sheet date. Price revaluation is performed on a security-by-security basis (ISIN code). Investments in securities are included in the balance sheet items 'Claims on non-euro area residents denominated in foreign

currency', 'Claims on euro area residents denominated in foreign currency', 'Claims on non-euro area residents denominated in euro', and 'Securities of euro area residents denominated in euro'.

Securities lending transactions under automated security lending contracts are concluded as part of the management of Bank's own assets. Securities lent by the Bank are collateralised. Income arising from lending operations is included in profit and loss account. Automated security lending is conducted via agent and custodian banks. Transactions outstanding at year-end are recorded off-balance sheet.

Tangible fixed assets

Depreciation is calculated on a straight line basis, beginning in the month after acquisition so as to write off the cost of the assets over their estimated economic lifetime at the following annual percentage rates:

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

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

Properties located in Austria are included in Bank's fixed assets. They are carried at fair value and are not depreciated. The fair value is demonstrated as half of appraisal value, obtained by an external certificated valuer (the Bank revalues these properties once every 5 years; the last revaluation was performed in year 2004). This revaluation method represents the deviation from generally accepted accounting principles: in this manner the Bank follows the conservatism principle and it is of the opinion that the method used is more suitable for the institution like a central bank, because it reduces the volatility of financial statements.

ESCB capital key

The capital key is essentially a measure of the relative national size of EU member countries and is a 50:50 composite of GDP and population size. The key is used as the basis of allocation of each NCB's share capital in the ECB and must be adjusted every five years under ESCB statute and every time when a new country joins EU.

The Eurosystem key is an individual NCB's share of the total key held by Eurosystem members and is used as the basis for allocation of monetary income, banknotes in circulation and the ECB's profit/loss.

Banknotes in circulation

The ECB and the thirteen euro area NCBs[4], which together comprise the Eurosystem, issue euro banknotes[5]. The total value of euro banknotes in circulation is allocated on the last working day of each month in accordance with the banknote allocation key[6].

The ECB has been allocated a share of 8% of the total value of euro banknotes in circulation, whereas the remaining 92% has been allocated to NCBs according to their weightings in the capital key of the ECB. The share of banknotes allocated to the Bank is disclosed under the balance sheet liability item 'Banknotes in circulation'.

---

[4] Central bank of Malta and Central bank of Cyprus joined the Eurosystem on 1st January 2008.

[5] Decision of the European Central Bank of 6 December 2001 on the issue of euro banknotes (ECB/2001/15), OJ L 337, 20.12.2001, p. 52-54, amended by Decision of the European Central Bank of 18 December 2003 (ECB/2003/23), OJ L 9, 15.01.2004, p. 40-41 and by Decision of the European Central Bank of 22 April 2004 (ECB/2004/9), OJ L 205, 09.06.2004, p. 17-18 and by Decision of the European Central Bank of 15 December 2006 (ECB/2006/25), OJ L 24, 31.01.2007, p. 13-14.

[6] Banknote allocation key means the percentages that result from taking into account the ECB's share in the total euro banknote issue and applying the subscribed capital key to the NCBs' share in such total.

The difference between the value of the euro banknotes allocated to each NCB in accordance with the banknote allocation key and the value of the euro banknotes that it actually puts into circulation also gives rise to remunerated intra-Eurosystem balances. These claims and liabilities[7] are disclosed under the sub-item 'Net claims/liabilities related to the allocation of euro banknotes within the Eurosystem' (see 'Intra-Eurosystem balances' in the notes on accounting policies).

From the cash changeover year[8] until five years following the cash changeover year the intra-Eurosystem balances arising from the allocation of euro banknotes are adjusted (smoothing mechanism) in order to avoid significant changes in NCBs' relative income positions as compared to previous years. The adjustments are effected by taking into account the differences between the average value of banknotes in circulation of each NCB in the reference period[9] and the average value of banknotes that would have been allocated to them during that period under the ECB's capital key. The adjustments will be reduced in annual stages until the first day of sixth year after the cash changeover year when income on banknotes will be allocated fully in proportion to the NCBs' paid-up shares in the ECB's capital. For the Bank of Slovenia, the adjustment period will end on 31 December 2012.

The interest income and expense on these balances is disclosed under 'Net interest income' of the profit and loss account.

The Governing Council of the ECB has decided that the seigniorage income of the ECB, which arises from the 8% share of euro banknotes allocated to the ECB, shall be due to the NCBs in the same financial year it accrues and distributed on the second working day of the following year in the form of an interim distribution of profit[10]. It shall be so distributed in full unless the ECB's net profit for the year is less than its income earned on euro banknotes in circulation and subject to any decision by the Governing Council to reduce this income in respect of costs incurred by the ECB in connection with the issue and handling of euro banknotes. The Governing Council may also decide to transfer part or all of the ECB's seigniorage income to a provision for foreign exchange rate, interest rate and gold price risks. With respect to 2007, the Governing Council decided that the full amount of such income should be retained by the ECB.

Provisions

Provisions for legal claims are recognised when the Bank has a present legal or constructive obligation as a result of past events, when: it is more likely than not that an outflow of resources will be required to settle the obligation; and the amount can be reliably estimated.

In compliance with Article 49a of Bank of Slovenia Act, after introduction of the euro as the Republic of Slovenia's currency, the Governing Board of the Bank may, with the intention of maintaining the real value of assets, take a decision to create provisions for anticipated exchange rate, interest rate and price risks. Provisions may not be created if, together with the unrealised exchange rate differences, securities' valuation effects and gold valuation effects, they exceed 20% of established net income. The relevant amount of provision for such risks is determined annually on the basis of Value-at-Risk (VaR) method. VaR is defined as the maximum loss of foreign currency portfolio with a given diversification of that portfolio at a certain level of probability (95%) and for a given holding period (one

---

[7] Decision of the European Central Bank of 6 December 2001 on the allocation of monetary income of the national central banks of participating member states from financial year 2002 (ECB/2001/16), OJ L 337, 20.12.2001, p. 55-61 amended by Decision of the European Central Bank of 18 December 2003 (ECB/2003/22), OJ L 9, 15.01.2004, p. 39 and by Decision of the European Central Bank of 19 May 2006 (ECB/2006/7), OJ L 148, 02.06.2006, p. 56-60.

[8] Cash changeover year refers to the year in which the euro banknotes are introduced as legal tender in the respective Member State, for Bank of Slovenia this is 2007.

[9] The reference period refers to the 24 months which start 30 months before the day on which euro banknotes become legal tender in the respective Member State, for Bank of Slovenia this is the period from July 2004 to June 2006.

[10] Decision of the European Central Bank of 17 November 2005 on the distribution of the income of the European Central Bank on euro banknotes in circulation to the NCBs of the participating Member States (ECB/2005/11), OJ L 311, 26.11.2005, p. 41-44.

year). The provision will be used to fund future unrealised losses not covered by the revaluation accounts.

Intra-Eurosystem balances
Intra-Eurosystem transactions are cross-border transactions that occur between two Eurosystem central banks. These transactions are processed primarily via TARGET[11] and give rise to the daily net bilateral position vis-à-vis the ECB. This position in the books of the Bank represents the net claim or liability of the Bank against the rest of the ESCB members connected to TARGET.

Intra-ESCB balances arising from the allocation of euro banknotes within the Eurosystem are included as a net single asset under 'Net claims related to the allocation of euro banknotes within the Eurosystem' (see 'Banknotes in circulation' in the notes on accounting policies).

Income recognition
Income and expenses are recognised in the financial year in which they are earned or incurred. Realised gains and losses are taken to the profit and loss account.

Gains arising from the initial valuation of foreign currency assets and liabilities (including gold), on the date the Bank became the Eurosystem member, are separated from the unrealised valuation gains which arose after that date, and are included in the profit and loss account.

From the beginning of 2007, the foreign exchange and price valuation is performed on a quarterly basis in accordance with the Accounting Guideline. Net unrealised valuation gains which arose before the euro adoption are separated from the unrealised valuation gains recorded after that date. They are considered as a 'pre-Stage Three' revaluation reserves and are included into the liability balance sheet item 'Reserves'.

At the end of year, unrealised gains are not recognised as income in the profit and loss account but are recorded in the revaluation accounts on the liabilities side of the balance sheet.

Unrealised losses are taken to the profit and loss account if they exceed previous revaluation gains registered in the corresponding revaluation account. Such losses can not be reversed against any future unrealised gains in subsequent years. Unrealised gains and losses in respect of securities and foreign currency denominated items are entered on an item-by-item basis and a currency-by-currency basis. Netting is not allowed.

Premiums and discounts arising on purchased securities are calculated and presented as part of interest income and are amortised over the remaining life of the security according to the internal rate of return (IRR) method.

Cost of transactions
With regard to gold, foreign currencies and securities, the average cost method as defined in the Accounting Guideline is used daily to establish the acquisition cost of items sold when calculating effects of exchange rates and prices.

When net acquisitions of currency (or gold) are made, the average acquisition cost for the day's acquisition with regard to each individual currency is added to the previous day's holdings to obtain a new weighted average of the exchange rate (or gold price) respectively. In case of net sales, the realised result is calculated on the basis of the average acquisition cost of the previous day for the respective foreign currency position.

Gains and losses on disposals of securities are calculated on the basis of the weighted average price of individual security.

The market prices and rates applied in the opening balance sheet as at 1 January 2007 are considered as the opening average cost of Bank's assets and liabilities. In case of foreign currency positions and gold, the opening costs are the exchange rates prevailing on 1 January 2007, communicated by the ECB. For securities investments, the securities prices as at 31 December 2006

[11] Trans-European Automated Real-time Gross settlement Express Transfer system

represents the opening average prices, which serve as a starting-point for premium and discount amortisation and calculation of realised gains and losses in case of their sale.

Off-balance-sheet instruments

Forward legs of foreign exchange swaps are included in the net foreign currency position for the purpose of calculating the average cost of currencies and foreign exchange gains and losses. Gains and losses arising from the forward legs are recognised and treated in a similar manner to on-balance sheet instruments. Unrealised valuation gains are not recognised as income but are transferred to the revaluation accounts. Unrealised valuation losses are taken to the profit and loss account when exceeding previous revaluation gains registered in the revaluation accounts. Unrealised valuation gains/losses of the forward legs of foreign exchange swaps are recorded from the trade date to the settlement date under 'Other assets/liabilities'.

Since spot and forward amounts in foreign currencies are converted to euro at the same exchange rate, foreign exchange swaps do not influence profit and loss accounts or the revaluation accounts on the liabilities side.

Post-balance-sheet events

Assets and liabilities are adjusted for events that occur between the annual balance sheet date and the date on which the Governing Board approves the financial statements, if such events materially affect the condition of assets and liabilities on the balance sheet date.

On 1 January 2008, Malta and Cyprus adopted euro as a new legal tender and paid up its capital share to the ECB in full. As a result, the Bank's share in the fully paid-up capital of the ECB declined from 0,460% to 0,458% on 1 January 2008.

Cash flow statement

Taking account of the Bank's role as a central bank, the publication of a cash flow statement would not provide the readers of the financial statements with any additional relevant information. Therefore, such a statement is not included as part of these statements.

Taxation

The Bank is not subject to Slovenian profit taxes.

Appropriations

In accordance with the Bank of Slovenia Act, net profit is allocated to general reserves and the Budget of the Republic of Slovenia. Unrealised income deriving from exchange rate and price changes is allocated in its entirety to the revaluation accounts and it is not included in a net profit available for distribution. Revaluation accounts may only be used to cover a shortfall deriving from unrealised losses as a result of exchange rate and price movements.

A net loss of the Bank is covered from general reserves. In case that the net loss arises from unrealised exchange rate and price changes, it shall be covered from the special reserves created for that purpose. Any net loss which cannot be covered from general reserves is covered by the budget of the Republic of Slovenia.

Auditing of financial statements

The financial statements were audited by Deloitte revizija d.o.o., Ljubljana, who was appointed as the external auditor of the Bank for the financial years 2006 to 2008.

Balance Sheet as at 31 December 2007

ASSETS (thousands of euro)			31 December 2007	1 January 2007
1	Gold and gold receivables		**58,262**	**78,433**
2	Claims on non-euro area residents denominated in foreign currency		**657,258**	**821,755**
	2.1	Receivables from the IMF	25,663	37,224
	2.2	Balances with banks and security investments, external loans and other external assets	631,595	784,531
3	Claims on euro area residents denominated in foreign currency		**498,029**	**623,328**
4	Claims on non-euro area residents denominated in euro		**1,082,740**	**1,025,843**
	4.1	Balances with banks, security investments and loans	1,082,740	1,025,843
	4.2	Claims arising from the credit facility under ERM II	-	-
5	Lending to euro area credit institutions related to monetary policy operations denominated in euro		**156,036**	**-**
	5.1	Main refinancing operation	80,000	-
	5.2	Longer-term refinancing operations	76,036	-
	5.3	Fine-tuning reverse operations	-	-
	5.4	Structural reverse operations	-	-
	5.5	Marginal lending facility	-	-
	5.6	Credits related to margin calls	-	-
6	Other claims on euro area credit institutions denominated in euro		**971,625**	**1,259,444**
7	Securities of euro area residents denominated in euro		**2,103,187**	**2,448,184**
8	General government debt denominated in euro		**-**	**-**
9	Intra-Eurosystem claims		**2,576,384**	**1,904,680**
	9.1	Participating interest in the ECB	55,098	18,400
	9.2	Claims equivalent to the transfer of foreign reserves	183,995	-
	9.3	Claims related to promissory notes backing the issuance of ECB debt certificates*	-	-
	9.4	Net claims related to the allocation of euro banknotes within the Eurosystem	2,335,394	1,886,280
	9.5	Other claims within the Eurosystem (net)	1,897	-
10	Items in course of settlement		**-**	**20**
11	Other assets		**220,129**	**193,995**
	11.1	Coins of euro area	3,838	-
	11.2	Tangible and intangible fixed assets	17,831	16,391
	11.3	Other financial assets	47,714	50,038
	11.4	Off-balance sheet instruments revaluation differences	1,673	-
	11.5	Accruals and prepaid expenses	63,936	62,835
	11.6	Sundry	85,138	64,731
12	Loss for the year[12]		**36,443**	**85,305**
Total assets			**8,360,095**	**8,440,987**

* Only an ECB balance sheet item

[12] Balance as at 1 January 2007 relates to the 2006 net loss, established under the provisions of IFRS.

LIABILITIES (thousands of euro)		31 December 2007	1 January 2007
1	**Banknotes in circulation**	**2,899,978**	**3,282,158**
2	**Liabilities to euro area credit institutions related to monetary policy operations denominated in euro**	**356,069**	**3,425,030**
	2.1 Current accounts (covering the minimum reserve system)	334,869	387,558
	2.2 Deposit facility	16,200	397,091
	2.3 Fixed-term deposits	5,000	2,640,380
	2.4 Fine-tuning reverse operations	-	-
	2.5 Deposits related to margin calls	-	-
3	**Other liabilities to euro area credit institutions denominated in euro**	**52,846**	**13,259**
4	**Debt certificates issued**	**-**	**135,408**
5	**Liabilities to other euro area residents denominated in euro**	**392,355**	**360,418**
	5.1 General government	341,251	337,100
	5.2 Other liabilities	51,103	23,318
6	**Liabilities to non-euro area residents denominated in euro**	**69,584**	**15,585**
7	**Liabilities to euro area residents denominated in foreign currency**	**65,679**	**72,610**
8	**Liabilities to non-euro area residents denominated in foreign currency**	**-**	**-**
	8.1 Deposits, balances and other liabilities	-	-
	8.2 Liabilities arising from the credit facility under ERM II	-	-
9	**Counterpart of special drawing rights allocated by the IMF**	**27,313**	**29,032**
10	**Intra-Eurosystem liabilities**	**3,490,619**	**17,097**
	10.1 Liabilities equivalent to the transfer of foreign reserves*	-	-
	10.2 Liabilities related to promissory notes backing the issuance of ECB debt certificates	-	-
	10.3 Net liabilities related to the allocation of euro banknotes within the Eurosystem	-	-
	10.4 Other liabilities within the Eurosystem (net)	3,490,619	17,097
11	**Items in course of settlement**	**-**	**-**
12	**Other liabilities**	**157,714**	**179,037**
	12.1 Off-balance sheet instruments revaluation differences	-	-
	12.2 Accruals and income collected in advance	22,044	31,159
	12.3 Sundry	135,670	147,878
13	**Provisions**	**30,413**	15,778
14	**Revaluation accounts**	**17,657**	-
15	**Capital and reserves**	**799,867**	**895,578**
	15.1 Capital	8,346	8,346
	15.2 Reserves	791,521	887,232
16	**Profit for the year**	**-**	**-**
Total liabilities		**8,360,095**	**8,440,987**

* Only an ECB balance sheet item

Profit and Loss Account for the year ended 31 December 2007

thousands of euro	2007
1.1 Interest income	268,702
1.2 Interest expense	-169,937
1 Net interest income (expenditure)	**98,765**
2.1 Realised gains/losses arising from financial operations	5,055
2.2 Write-downs on financial assets and positions	-120,731
2.3 Transfer to/from provisions for foreign exchange and price risks	-15,300
2 Net result of financial operations, write-downs and risk provisions	**-130,976**
3.1 Fee and commission income	7,317
3.2 Fee and commission expense	-1,192
3 Net fee and commission income	**6,125**
4 Income from equity shares and participating interests	404
5 Net result arising from allocation of monetary income	1,897
6 Other operating income	17,350
Total net income	**-6,436**
7.1 Staff costs	-17,706
7.2 Administrative expenses	-8,219
7.3 Depreciation of tangible and intangible fixed assets	-2,043
7.4 Banknote production services	-1,565
7.5 Other expenses	-476
7 Total operating expenses	**-30,007**
8 Loss for the year	**-36,443**

The notes on pages 14 to 30 form an integral part of the financial statements.

The unaudited financial statements were approved by the Governing Board on 15 February 2008 and these audited financial statements were approved by the Governing Board on 22 April 2008 and were signed on its behalf by:

Marko Kranjec, Ph. D.
President of the Governing Board and
Governor of the Bank of Slovenia

In accordance with Article 49 of the Bank of Slovenia Act, the Bank of Slovenia shall inform the National Assembly of the Republic of Slovenia of these annual financial statements.

Notes to the balance sheet

Assets

1. Gold and gold receivables

With the exception of gold stocks held in the Bank, the Bank's gold holdings consist of deposits with foreign banks. In 2007 the gold holdings declined mainly due to the transfer of gold holdings to the ECB according to the Article 30 of the Statute of the ESCB and the ECB. In the annual accounts gold has been valued on the basis of the euro price per fine ounce (ozf) derived from the quotation in USD established at the London fixing on 31 December 2007. This price, notified by the ECB, amounts to EUR 568.236 per ounce of fine gold compared with EUR 482.688 on 1 January 2007. Unrealised valuation gains of EUR 8.8 million were disclosed under the liability balance sheet item 'Revaluation accounts'.

	000 EUR	Fine troy ounces
Balance as at 1 January 2007	78,433	162,172
Transfer of gold to the ECB at market price	-28,746	-59,555
Sales in 2007 at market price	-187	-388
Revaluation of gold stock as at end of 2007	8,763	-
Balance as at 31 December 2007	58,262	102,229

2. Claims on non-euro area residents denominated in foreign currency

This item includes holdings of Special Drawing Rights (SDRs) allocated by the International Monetary Fund (IMF) and foreign currency claims on non-euro area residents included in the Bank's foreign reserves.

The sub-item 2.1 'Receivables from the IMF' consists of drawing rights within the reserve tranche and special drawing rights. They are remunerated by the IMF at a remuneration rate that is updated weekly.

The reserve tranche corresponds to the difference between Slovenian's quota in the IMF and the IMF's holdings of EUR with the Bank. The tranche is usually used for the purpose of financing the balance of payments deficit in the member countries.

SDRs are reserve assets created by the IMF and allocated by it to its members in order to increase international liquidity. They are used in transactions between official monetary authorities. The SDR is defined in terms of a basket of currencies. Its value is determined as the weighted sum of exchange rates of four currencies (USD, GBP, JPY and EUR).

Both claims are shown in the balance sheet on the basis of the market rate of SDR 1 = EUR 1.074 (1 January 2007: SDR 1 = EUR 1.1416) calculated by the ECB at the end of the year for all central banks participating in the Eurosystem. At the balance sheet date, the market rate of SDR was below the average cost and valuation losses were therefore recognised in accordance with the accounting rules in the profit and loss account.

	31 December 2007		1 January 2007	
	000 SDR	000 EUR	000 SDR	000 EUR
Quota	231,700	248,846	231,700	264,509
Less IMF holdings of EUR	-215,775	-231,742	-207,344	-236,704
Reserve tranche in the IMF	15,925	17,104	24,356	27,805
SDR Holdings	7,969	8,559	8,251	9,419
Total	23,895	25,663	32,607	37,224

The sub-item 2.2 'Balances with banks and security investments, external loans and other external assets' includes the foreign currency assets held with non-euro area residents (including international and supranational organisations). Foreign currency assets are shown under this sub-item at their euro equivalent as calculated on the basis of market exchange rates on 31 December 2007.

Breakdown of foreign currency assets by type of investment:

	31 December 2007	1 January 2007
	000 EUR	000 EUR
Current accounts	1,180	3,333
Time deposits	15,828	174,472
Securities	614,587	606,726
Total	631,595	784,531

Breakdown of securities according to their residual maturity:

	31 December 2007	1 January 2007
	000 EUR	000 EUR
≤ 1 year	146,462	189,003
>1 year and ≤5 years	446,980	402,632
> 5 years	21,145	15,091
Total	614,587	606,726

3. Claims on euro area residents denominated in foreign currency

The foreign currency assets held with euro area residents are invested in sight deposits, time deposits and securities in foreign currencies. Foreign currency assets are shown at their euro equivalent as calculated on basis of market exchange rates on 31 December 2007.

Breakdown of foreign currency assets by type of investment:

	31 December 2007	1 January 2007
	000 EUR	000 EUR
Current accounts	242	1,251
Time deposits	135,163	283,500
Securities	362,624	338,578
Total	498,029	623,328

Breakdown of securities according to their residual maturity:

	31 December 2007	1 January 2007
	000 EUR	000 EUR
≤ 1 year	173,244	98,637
>1 year and ≤ 5 years	182,534	217,491
> 5 years	6,847	22,450
Total	362,624	338,578

4. Claims on non-euro area residents denominated in euro

The claims on non-euro area residents denominated in euro included under this balance sheet item are invested in sight deposits, time deposits and securities.

Breakdown of euro denominated assets by type of investment:

	31 December 2007	1 January 2007
	000 EUR	000 EUR
Current accounts	10	3,764
Time deposits	326,830	58,317
Securities	755,899	963,763
Total	1,082,740	1,025,843

Breakdown of securities according to their residual maturity:

	31 December 2007	1 January 2007
	000 EUR	000 EUR
≤ 1 year	182,444	229,373
>1 year and ≤ 5 years	316,031	470,487
> 5 years	257,424	263,903
Total	755,899	963,763

5. Lending to euro area credit institutions related to monetary policy operations in euro

This item shows operations carried out by the Bank within the framework of the single monetary policy of the Eurosystem and reflects the volume and pattern of the Bank's refinancing of the Slovenian credit institutions.

Main refinancing operations are regular liquidity-providing operations which are conducted with a weekly frequency in the form of reverse transactions and executed through standard tenders. In 2007 the main refinancing operations were conducted as variable-rate tenders with a minimum bidding rate. As a main monetary policy instrument, they play a pivotal role in fulfilling the objectives of Eurosystem's market operations and provide the bulk of refinancing to the banking sector.

Longer term refinancing operations are regular liquidity-providing reverse transactions with a monthly frequency and a maturity of three months. They are aimed at providing the financial sector with additional longer-term refinancing. In the year under review they were held as variable-rate standard tenders.

	31 December 2007	1 January 2007
	000 EUR	000 EUR
Main refinancing operations	80,000	-
Longer term refinancing operations	76,036	-
Total	156,036	-

6. Other claims on euro area credit institutions denominated in euro

This item comprises claims on credit institutions which do not relate to monetary policy operations. Claims consist almost entirely of fixed-term euro-denominated deposits which are held at euro area credit institutions. As at 1 January 2007 the item also includes the claim, related to the frontloaded euro banknotes to the credit institutions amounting to EUR 855.0 million.

	31 December 2007	1 January 2007
	000 EUR	000 EUR
Current accounts	3,126	879,444
Time deposits	968,500	380,000
Total	971,626	1,259,444

7. Securities of euro area residents denominated in euro

This item covers the portfolio of marketable securities, issued by governments and credit institutions of the euro area.

Breakdown of securities according to their residual maturity:

	31 December 2007	1 January 2007
	000 EUR	000 EUR
≤ 1 year	868,289	856,219
>1 year and ≤ 5 years	886,930	1,228,276
> 5 years	347,969	363,688
Total	2,103,187	2,448,184

9. Intra-Eurosystem claims

Sub-item 9.1 shows the Bank's participating interest in the ECB. In accordance with Article 49.1 of the Statute of the ESCB and the ECB and the legal acts adopted by the Governing Council of the ECB, the Bank paid up as at 1 January 2007 a remaining 93% of its capital subscription amounted to EUR 17.1 million. The total amount of paid-up capital, considering the changed capital key 0.3194% (31.12.2006 = 0.3345%; changes upon the accession of Bulgaria and Romania on 1 January 2007) is EUR 18.4 million. The capital key for Slovenia was set by the European Commission in accordance with its population and GNP, and remained unchanged during the year.

The participating interests of the 27 European central banks in the capital of the ECB on 31 December 2007 are the following:

	Capital key per cent	EUR	Of which fully paid up	Eurosystem key
Nationale Bank van België/ Banque Nationale de Belgique	2.4708	142,334,200	142,334,200	3.5546
Deutsche Bundesbank	20.5211	1,182,149,240	1,182,149,240	29.5229
Central Bank and Financial Services Authority of Ireland	0.8885	51,183,397	51,183,397	1.2782
Bank of Greece	1.8168	104,659,533	104,659,533	2.6138
Banco de España	7.5498	434,917,735	434,917,735	10.8616
Banque de France	14.3875	828,813,864	828,813,864	20.6987
Banca d'Italia	12.5297	721,792,464	721,792,464	18.0260
Banque centrale du Luxembourg	0.1575	9,073,028	9,073,028	0.2266
De Nederlandsche Bank	3.8937	224,302,523	224,302,523	5.6017
Oesterreichische Nationalbank	2.0159	116,128,992	116,128,992	2.9002
Banco de Portugal	1.7137	98,720,300	98,720,300	2.4654
Banka Slovenije	0.3194	18,399,524	18,399,524	0.4595
Suomen Pankki-Finlands Bank	1.2448	71,708,601	71,708,601	1.7908
Total euro-area NCBs	69.5092	4,004,183,400	4,004,183,400	100.0000
Česká národní banka	1.3880	79,957,855	5,597,050	
Danmarks Nationalbank	1.5138	87,204,756	6,104,333	
Eesti Pank	0.1703	9,810,391	686,727	
Central Bank of Cyprus	0.1249	7,195,055	503,654	
Latvijas Banka	0.2813	16,204,715	1,134,330	
Lietuvos bankas	0.4178	24,068,006	1,684,760	
Magyar Nemzeti Bank	1.3141	75,700,733	5,299,051	
Central Bank of Malta/Bank Ċentrali ta' Malta	0.0622	3,583,126	250,819	
Narodowy Bank Polski	4.8748	280,820,283	19,657,420	
Národná banka Slovenska	0.6765	38,970,814	2,727,957	
Sveriges Riksbank	2.3313	134,298,089	9,400,866	
Bank of England	13.9337	802,672,024	56,187,042	
Bulgarian National Bank	0.8833	50,883,843	3,561,869	
Banca Naţională a României	2.5188	145,099,313	10,156,952	
Total non-euro area NCBs	30.4908	1,756,469,003	122,952,830	
Total euro area and non-euro area NCBs	100.0000	5,760,652,403	4,127,136,230	

In accordance with Article 49.2 of the Statute of the ESCB and the ECB and the legal acts adopted by the Governing Council of the ECB, the Bank also made a contribution of EUR 36.7 million to the ECB's foreign exchange, gold and security price revaluation accounts and to the ECB's provision for foreign exchange rate, interest rate and gold price risks. The payment was made in two parts. As a result of a difference between the euro equivalent of FX reserves to be transferred to the ECB at current exchange rates and the claim of the Bank in accordance with its capital key (disclosed under asset item 9.2), the amount of EUR 7.6 million was used as the advance contribution to the ECB reserves, provisions and provisions equivalent to reserves on 3 January 2007. The rest of the contribution was paid after the approval of the ECB 2006 Annual Accounts by the Governing Council of the ECB in March 2007.

	31 December 2007
	000 EUR
Contribution to revaluation accounts	25,752
- paid on 3 January 2007	7,647
- paid on 12 March 2007	18,105
Contribution to provisions	10,947
- paid on 12 march 2007	10,947
Total	36,699

Sub-item 9.2 contains the Bank's euro-denominated claims arising from the transfer of foreign reserves to the ECB. In accordance with Article 30.1 of the Statute of the ESCB, on 2 and 3 January 2007 the Bank transferred a part of foreign reserves assets to the ECB with a total value equivalent to EUR 191.6 million (15% in gold and 85% in USD). The Bank's claim according to the capital key amounts to EUR 184.0 million. The difference was used as an advance contribution to the ECB reserves, provisions and provisions equivalent to reserves. As the transferred gold does not earn interest, the claim is remunerated at 85% of the latest available marginal rate for the main refinancing operations.

Sub-item 9.4 'Net claims related to the allocation of euro banknotes within the Eurosystem' shows the claim which arise from applying the euro banknote allocation key. The net position bears interest at the marginal interest rate applying to the main refinancing operations.

Sub-item 9.5 'Other claims with the Eurosystem (net)' contains the claim arising from the allocation of monetary income to the national central banks (see profit and loss item 5 'Net result arising from allocation of monetary income').

11. Other assets

The Bank's holding of coins, issued by Republic of Slovenia, are shown in sub-item 11.1 'Coins of euro area'.

Sub-item 11.2 'Tangible and intangible fixed assets' comprises land and buildings, computer hardware and software, furniture and other equipment.

	Land and buildings	Computers & equipment	Total
	000 EUR	000 EUR	000 EUR
Cost or valuation			
At 1 January 2007	14,441	16,893	31,334
Additions	1,535	2,091	3,626
Disposals	-107	-184	-291
At 31 December 2007	**15,869**	**18,800**	**34,669**
Depreciation			
At 1 January 2007	2,966	11,978	14,943
Disposals	-27	-180	-207
Charge for the year	112	1,990	2,102
At 31 December 2007	**3,051**	**13,787**	**16,838**
Net book value			
At 1 January 2007	11,476	4,915	16,391
At 31 December 2007	**12,818**	**5,013**	**17,831**

As at 31 December 2007 an amount of EUR 5.8 million relating to investment properties in Austria is included in land and buildings.

Sub-item 11.3 'Other financial assets' contains the Bank's participating interests in international financial organisations and other financial assets.

Sub-item 11.4 'Off-balance sheet instruments revaluation differences' includes the positive revaluation effect arising from the forward legs of foreign currency swaps, which are recorded on off-balance-sheet account.

Sub-item 11.5 'Accruals and prepaid expenses' contains the accrued income identified at 31 December 2007. This consists mainly of interest income which is due in the new financial year from the transfer of foreign reserves to the ECB, from money market deposits and from securities investments.

Sub-item 11.6 'Sundry' consists of fiduciary and other assets.

Liabilities

1. Banknotes in circulation

The total value of euro banknotes issued by the central banks in the Eurosystem is distributed among these banks on the last day of each month in accordance with the key for allocating euro banknotes (see Accounting policies). In accordance with the banknote allocation key applying on 31 December 2007, the Bank has a 0.4225% share of the value of all euro banknotes in circulation. During the year 2007 the total value of banknotes in circulation within the Eurosystem rose from EUR 628,240 million to EUR 676,677 million. In accordance with the allocation key, the Bank shows holdings of euro banknotes amounting to EUR 2,858.8 million at the end of the year. The value of the euro banknotes actually issued by the Bank was EUR 523.4 million. As this was less that the allocated amount, the difference of EUR 2,335.4 million is shown in asset sub-item 9.4 'Net claims related to the allocation of euro banknotes within the Eurosystem'.

In changeover year 2007 also banknotes denominated in Slovenian tolars, that ceased to be legal tender with the adoption of euro, were included into the banknotes in circulation figure. As at 1 January 2008, these banknotes were transferred to the liability balance sheet item 12 'Other liabilities'.

	31 December 2007	1 January 2007
	000 EUR	000 EUR
Banknotes denominated in EUR		
EUR 5	110,729	17,150
EUR 10	-8,891	21,920
EUR 20	25,391	79,250
EUR 50	-406,415	191,930
EUR 100	768,905	274,970
EUR 200	29,674	143,929
EUR 500	4,005	43,023
Total euro banknotes actually put into circulation by the Bank	523,398	772,172
Redistribution of euro banknotes in circulation within the Eurosystem	2,584,130	2,116,843
Euro banknotes issued by the ECB (8%)	-248,736	-231,229
Total EUR banknotes according to the Bank's banknote allocation key	2,858,791	2,657,786
Banknotes denominated in SIT	41,187	624,372
Total	2,899,978	3,282,158

2. Liabilities to euro area credit institutions related to monetary policy operations denominated in euro

These interest bearing liabilities arise from the monetary policy conducted by the Bank on behalf of the ESCB.

Sub-item 2.1 'Current accounts' contains the deposits of the credit institutions, which are used to meet the minimum reserve requirement and settle payments. The main criterion for including these deposits in this sub-item is that the respective business partners appear in the list of institutions which are subject to the minimum reserve regulations in the Eurosystem. Minimum reserve requirements have to be respected on average over the reserve maintenance period in accordance with the schedule published by the ECB. Banks' minimum reserve balances have been remunerated on a daily basis at the prevailing interest rate for the Eurosystem's main refinancing operations.

Sub-item 2.2 'Deposit facility' contains overnight deposits placed with the Bank by Slovenian banks at a predetermined interest rate (standing facility). As at 1 January 2007, overnight deposits placed with the Bank by commercial banks as a result of excess liquidity at the end of last reserve maintenance period before euro adoption, were included into these deposits.

Sub-item 2.3 'Fixed-term deposits' contains deposits made at the Bank for liquidity absorption purposes in connection with fine-tuning operations in the Eurosystem. The respective balance as at 1 January 2007 amounting to EUR 2,640.4 million represents short and long term commercial bank's deposits and Bank of Slovenia bills, issued for liquidity absorption purposes before the euro adoption.

	31 December 2007	1 January 2007
	000 EUR	000 EUR
Current accounts (covering the minimum reserve system)	334,869	387,558
Deposit facility	16,200	397,091
Fixed-term deposits	5,000	2,640,380
Total	356,069	3,425,030

3. Other liabilities to euro area credit institutions denominated in euro

This balance sheet item contains other credit institutions' accounts unrelated to the monetary policy operations.

4. Debt certificates issued

On 1 January 2007 this balance represents the outstanding amount of Bank's bills issued in year 2006. All bills matured until the end of January 2007.

5. Liabilities to other euro area residents denominated in euro

Sub-item 5.1 'General government' encompasses the balances of the government sight and fixed-term deposits and its special funds in euro. The deposits of other public depositors constitute balances held by local communities.

Sub-item 5.2 Other liabilities' includes among other also stock exchange market customers' accounts and fixed term deposit of Guarantee fund of Central Securities Clearing Corporation.

6. Liabilities to non-euro area residents denominated in euro

Balance sheet item 'Liabilities to non-euro area residents denominated in euro' contains euro balances of international and supranational organisations and non-Eurosystem central banks. The IMF account No. 2 is also included in this balance sheet item.

7. Liabilities to euro area residents denominated in foreign currency

This item contains the foreign currency sight and fixed-term deposits of central government and its special funds.

9. Counterpart of special drawing rights allocated by the IMF

The counterpart of special drawing rights allocated by the IMF corresponds to the allocation of SDRs to the Republic of Slovenia as a result of its membership of the IMF. The liability is shown in the balance sheet at the end of 2007 on the basis of the market rate of SDR 1 = EUR 1.074 (1 January 2007: SDR 1 = EUR 1.1416) calculated by the ECB at the end of the year for all central banks participating in the Eurosystem. The decrease in the amount of this liability in 2007 is solely due to valuation effects, i.e. the appreciation of the euro against the SDR.

10. Intra-Eurosystem liabilities

Sub-item 10.4 'Other liabilities within the Eurosystem (net)' contains a net TARGET balance, arising from cross-border transfers via TARGET with other NCBs in the ESCB and the ECB. This position is remunerated at the latest available marginal rate for the main refinancing operations. The settlement takes place monthly on the second business day of the month following that to which the interest relates. The creation of this liability reflects outflows of funds from domestic credit institutions to other euro area countries. These funds came from the gradual release of credit institutions' deposits with the Bank after Slovenia joined EMU on 1 January 2007. These deposits are disclosed under liability items 'Deposit facility', 'Fixed term deposits' and 'Debt certificates issued'.

12. Other liabilities

Sub-item 12.2 'Accruals and income collected in advance' contains the accrued expenses identified at 31 December 2007. This consists mainly of interest expenditure which is due in the new financial year but was incurred in the financial year just ended and which arose in connection with the Bank's TARGET balance, deposits which are used to fulfil the minimum reserve requirement and fixed-term government deposits.

Sub-item 12.3 'Sundry' consists mainly of liabilities for payments to public sector arising from the nominal value of euro coins received from the state, and fiduciary liabilities.

13. Provisions

	31 December 2007	1 January 2007
	000 EUR	000 EUR
Provisions for employees and for known risks	15,113	15,778
Provisions for general risks	15,300	-
Total	30,375	15,778

Provisions for post-employment benefits are calculated in accordance with IAS 19 – Employee benefits on the basis of actuarial assumptions as at 31.12.2006. The latter consider the stipulations of the Bank collective agreement, expected future salary increase and a rate of 4.7% used to discount the future obligations, determined by reference to 10-years high quality corporate bonds in the euro area.

Litigation provisions have been made and approved by the Governing Board for the certain legal claims pending or threatened involving the Bank, which have not yet been settled. Claims mainly arise from the labour disputes, initiated in the beginning of the previous decade. Detailed information in accordance with IAS 37 'Provisions, Contingent Liabilities and Contingent Assets' has not been given as this is considered by the Governing Board to be prejudicial to the Bank's position in these cases.

Taking into account the Bank's exposure to interest rate risks, provisions for future unrealised interest rate losses amounting to EUR 15.3 million have been created and approved by the Governing Board in order to safeguard the real value of the Bank's funds and for smoothing out variations in profit and loss arising from changes in exchange rates. The provision will be used to fund future unrealised valuation losses not covered by the revaluation accounts. This amount represents the Value-at-Risk (VaR) with a 95% confidence level based on a one month horizon. The provisions will be replenished in the subsequent years, based on the Bank's assessment of its future exposure to interest rate risks, up to the amount representing the Value-at-Risk with a 95% confidence level based on a one year horizon.

14. Revaluation accounts

The positive difference between the market value and the average acquisition costs in the case of gold holdings, net positions in each foreign currency and securities portfolio is shown in this balance sheet item.

In case of valuation of securities, gains of EUR 7.4 million arose from the valuation of USD denominated assets, EUR 1.3 million from the GBP denominated portfolio and marginal gains from securities denominated in other currencies.

In case of gold the acquisition cost is 1 ozf = EUR 482.688, comparing with market price at the end of 2007, which was EUR 568.236 per fine ounce of gold. Market value of gold position exceeded its acquisition price and resulted in a revaluation gain amounting to EUR 8.8 million.

As at 1 January 2007, there is no balance on the revaluation accounts. Net unrealised gains from gold, foreign currencies and securities valuation that arose prior to euro adoption were through the profit distribution in individual years taken directly to special reserves of the Bank.

	31 December 2007	**1 January 2007**
	000 EUR	**000 EUR**
Price effect	8,893	-
- securities in foreign currencies (asset items 2 and 3)	8,647	-
- securities in euro (asset items 4 and 7)	246	-
Exchange rate effect	1	-
Gold value effect	8,763	-
Total	17,657	-

15. Capital and reserves

In accordance with the Article 5 of the Bank of Slovenia Act, the capital of the Bank was created from the general reserves in the amount of EUR 8.3 million in year 2002. Banka Slovenije's initial capital may be increased by allocating of funds from the general reserves in an amount to be determined by the Governing Board.

The reserves of the Bank of Slovenia are composed of general reserves and special reserves. General reserves serve to cover general risks associated with the operations of the Bank of Slovenia. Special reserves serve to cover exchange rate and price risks. Special reserves are equal to the amount of unrealised income deriving from exchange rate and price changes until the end of 2006. Investment properties revaluation reserve was created out of the gains arising from the appraisal of the investment properties in Austria, performed by the independent real estate assessor.

	31 December 2007	1 January 2007
	000 EUR	000 EUR
Composition of reserves:		
Initial capital of the Bank of Slovenia	8,346	8,346
General reserve	278,875	306,923
Special reserve for foreign exchange differences	463,638	539,291
Special reserve – price risk (securities)	-	-
Special reserve – price risk (gold)	43,236	35,245
Investment properties revaluation	5,772	5,772
Total reserves	799,867	895,578

Notes to the off-balance-sheet items

Foreign currency swaps

As at 31 December 2007, the forward foreign currency position arising from EUR/AUD swap transactions amounts to EUR 202.9 million. The forward liability in foreign currency was revalued at the same exchange rates as those used for spot holdings in foreign currencies.

	31 December 2007		1 January 2007	
	000 Foreign currency	000 EUR	000 Foreign currency	000 EUR
Forward liabilities in AUD	340,000	202,900	-	-
Total	340,000	202,900	-	-

Securities lending

As at 31 December 2007, securities with a market value of EUR 1,490 million (1 January 2007: EUR 1,342 million) were lent under automated security lending contracts with the agents, which were, in case of collateral, reinvested into reverse repo transactions, prime asset backed securities, bank bonds and certificates of deposits.

Notes to the profit and loss account

1. Net interest income (expenditure)

Interest income

Net interest income consists of interest income on foreign reserve assets and euro-denominated portfolio and interest income on euro-denominated claims. Euro-denominated claims include monetary policy instruments, foreign reserve assets transferred to the ECB and net claim arising from the allocation of banknotes within the Eurosystem.

	31 December 2007
	000 EUR
Interest income	
Gold	27
Current accounts and deposits	64,684
- In foreign currency	12,699
- In euro	51,985
Securities	166,644
- In foreign currency	53,839
- In euro	112,805
IMF	778
Monetary policy operations	4,599
- Main refinancing operation	1,629
- Longer-term refinancing operations	2,958
- Other refinancing operations	12
Intra Eurosystem claims	31,915
- Claims arising from the transfer of foreign reserves to the ECB	6,216
- Net claims related to the allocation of banknotes within the Eurosystem	25,699
Other interest income	55
Total	268,702

Interest expense

Interest expense arises from the liabilities in form of government accounts and deposits and monetary policy operations with the aim to absorb liquidity. The latest mainly concerns interest paid on banks' minimum reserves. Interest expense relating to pre-Eurosystem monetary policy instruments that matured in year 2007 (overnight deposits, fixed short-term and long-term deposits, Bank of Slovenia bills in domestic currency) are included in the interest expenditure arising from the monetary policy operations amounting to EUR 10.6 million. Interest expense also includes interest paid on TARGET balances.

	31 December 2007
	000 EUR
Interest expenditure	
Current accounts and deposits	**15,192**
- In foreign currency	3,350
- In euro	11,841
Monetary policy operations	**24,389**
- Minimum reserves	13,534
- Overnight deposits	128
- Fixed term deposits	10,727
Intra Eurosystem liabilities	**128,833**
- TARGET balances	128,833
Other interest expense	**1,523**
Total	**169,937**

2. Net result of financial operations, write-downs and risk provisions

The net income shown in sub-item 'Realised gains/losses arising from financial operations' arose from the sale of gold, currency positions and securities.

Write-downs of financial assets and positions largely reflect the decline in market prices of balance sheet items as at 31 December 2007 below the average cost of the respective currencies or securities. The valuation losses occurred mostly in EUR denominated securities as well as in the USD and GBP position.

Transfer to provisions for general risks, foreign exchange risks and price risks represent the amount of provisions created for covering the future unrealised losses arising from interest rate risk in accordance with the Article 49.a of the Bank of Slovenia Act.

	31 December 2007
	000 EUR
Realised gains/losses	
Gold	23
Currency position	6,463
Securities	-1,431
Total	5,055
Write-downs	
Currency position	-82,920
Securities	-37,811
Total	-120,731
Transfer to provisions for general risks, foreign exchange and price risks	-15,300
Total	-130,976

3. Net fee and commission income

Fees and commissions receivable mainly arise from payment and settlement service, supervisory and regulatory functions and security lending transactions. Fees and commissions are paid for the domestic and foreign bank's payment services and to the commercial banks for their readiness to provide liquidity loans to other banks.

4. Income from equity shares and participating interests

This item represents the Bank's dividends received on Bank's shares in the international financial institutions.

5. Net result arising from allocation of monetary income

The monetary income of the Eurosystem national central banks is allocated in accordance with the decision taken by the Governing Council of the ECB[13]. The amount of monetary income allocated to each NCB is measured on the basis of the actual income which arises from the earmarkable assets held against its liability base.

Any interest paid on the items of the liability base is to be deducted from the monetary income to be pooled by the NCB.

Where the value of a central bank's earmarkable assets exceeds or falls short of its liability base, the difference shall be offset by applying to the value of the difference the average income from the earmarked assets of all the national central banks taken together. At the end of each financial year the total monetary income transferred by all national central banks is distributed among the national central banks in proportion to their respective paid-up shares in the capital of the ECB. The difference between the monetary income pooled and that reallocated to the individual NCB constitutes the net result arising from the calculation of monetary income recorded in the profit and loss.

In the year 2007 the allocation of monetary income resulted in a net claim of EUR 1.9 million for the Bank. This net claim represents the difference between the EUR 104.5 million of monetary income paid by the Bank into the common pool and the Bank's claim of EUR 106.4 million on the common pool, corresponding to the Bank's share in the ECB's paid-up capital.

6. Other operating income

Other operating income includes income from non-bank services like rental income, income from confirmations issued, numismatics etc. In this item is also included the reduction of accrued expense for the frontloaded banknotes production, established in 2006 in the amount of EUR 14.6 million. The difference within the accrued expenses of banknotes production that the Bank is obliged to return to the Eurosystem arises from the substantial lower realised production price per unit, as it was assumed in the time of the frontload.

7. Operating expenses

Staff costs

Staff costs include salaries and other staff costs together with the related taxes and contributions.

The Bank employed 425 employees as at 31 December 2007.

---

[13] Decision of the European Central Bank of 6 December 2001 on the allocation of monetary income of the national central banks of participating member states from the financial year 2002 (ECB/2001/16) as amended by the Decision of the European Central Bank of 19 May 2006 (ECB/2006/7).

In accordance with the contract between the Bank and the Trade union from March 2002 Bank employees have been included into Voluntary supplementary pension insurance, which is defined as a contribution plan. Staff costs include contribution of the Bank for Voluntary supplementary pension insurance of EUR 0.4 million.

In 2007 the remuneration of the Governing board members of the Bank was of EUR 0.9 million.

Other operating expenses

This item consists mainly of expenses relating to the building and equipment maintenance, renting expenses, business travel and training costs, communication and energy costs, IT related expenses (software maintenance, system assistance), expenses for services outsourced, expenses for small goods and materials and other office expenses.

Depreciation of tangible and intangible fixed assets

Depreciation of buildings, furniture and office equipment, computer hardware and software was performed according to the adopted depreciation rates.

Banknote production services

Expenses for banknotes production services includes mainly the accrued expenses related to the production and transportation of euro banknotes, that the Bank is obliged to return to the Eurosystem in relation to the frontloaded banknotes during the currency changeover.

Other expenses

Other expenses consist mainly of contributions of the Bank, taxes and other operating expenses.

8. Loss for the year

According to the newly adopted Accounting Guideline, according to which the unrealised valuation losses shall be covered from the current financial result, whilst the unrealised valuation gains are transferred directly to revaluation accounts, the Bank shows the loss amounted to EUR 36.4 million. The main reason for the overall loss is the depreciation of foreign currencies represented in the Bank's foreign reserves vis-à-vis euro and the decrease of securities prices as a result of the increase in interest rates during the year 2007.

According to the Bank of Slovenia Act, the net loss which arises from the unrealised foreign exchange and price losses shall be covered from special reserves, which were created from the unrealised gains from exchange rate and price movements. Covering of the net loss from the special reserves for foreign exchange risks ensures the basis for the transfer of funds to the Republic of Slovenia budget amounting to EUR 11.6 million. This amount represents the legally determined 25% budget share of the net financial result according to the second paragraph of the Article 50 of the Bank of Slovenia Act, which was calculated without taking into account the loss resulting from the write-downs of foreign exchange positions.