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

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Introduction

The global financial crisis did not affect Slovenia until the end of 2008. The majority of economic indicators deteriorated rapidly in November. Prior to that, there was still a relatively high level of economic activity. The same held true for employment, wage growth and general government revenues and spending. However, it was already evident at the beginning of 2008 based on economic developments that the period of high economic growth, which was not only a reflection of developments in the global economy, but was also stimulated by events in Slovenia, was likely drawing to a close.

The financial turmoil of 2008, especially its reflections in a lack of confidence and a considerable decrease in interbank lending, affected Slovenian banks. Since banks did not have a significant portion of investments in securities, the market values of which were wiped out or nearly wiped out, the fact that the Slovenian economy is highly banking oriented proved to be the main reason of turmoil. Companies finance themselves almost entirely via bank loans, while domestic savings, such as that of households, only partly pass through to banks. We cannot steer domestic savings to companies other than by banks borrowing from foreign banks and on the financial markets in the rest of the world. Savings not passed through to banks go through non-banking financial intermediaries abroad, and then return in the form of bank borrowing in the rest of the world. The economy would not change and become less banking oriented if domestic savings were passed directly to Slovenian companies, and not through the rest of the world. The banking and financial system must adapt to this characteristic of the economy. However, given the easy access to credit and low interest rates around the world, bank borrowing in the rest of the world has resulted in more than the return of domestic savings. Slovenia's net external debt has also risen. Total gross external debt stood at EUR 15 billion or 56% of GDP at the end of 2004. In the four years ending in autumn of 2008, it had risen to EUR 40 billion, or 108% of GDP.

Following high economic growth in 2006 and 2007, economic growth remained high in the first half of 2008, at 5.6%. By the third quarter, it had already fallen to 3.9%, and was negative in the final quarter of the year. At the same time, the drivers of growth changed, the main driver becoming growth in domestic spending. Growth in exports was down from approximately 13% in 2006 and 2007 to 8% in the first half of 2008. Taking into account seasonally adjusted figures, growth in merchandise exports had stagnated by the beginning of 2008.

The main driver of growth in domestic spending was investment growth, which averaged 11% in 2006 and 2007, and was still 14% in the first half of 2008, primarily on account of investment in construction works, particularly non-residential construction. Thus in the first half of 2008, annual growth in value added was 20% in construction, 11% in financial intermediation and 7% in retail, while annual growth in manufacturing was down to just 2.5%. Based on seasonally adjusted figures from manufacturing, we have seen stagnation since autumn 2007. Excluding the best performing sector, namely pharmaceuticals, stagnation in manufacturing was evident back in 2006.

Employment growth was also high due to strong activity in sectors linked to domestic spending. In 2008 employment growth still averaged 2.2%, and 12% in the construction sector. The surveyed unemployment rate fell until the final quarter of 2008, when it stood at 4.2%, taking into account seasonally adjusted figures. Since the end of 2006, high growth in employment has translated into increased wage growth. Growth in average gross wages was around 8.5% for most of 2008. Wage growth in the trade sector fell sharply in the final months of 2008, at a time when the government significantly increased the wages of public employees.

Strong economic activity in Slovenia, falling growth in exports and the deterioration of (international) terms of trade contributed to the widening of the current account deficit to 5.5% of GDP. Inflation reached its highest level in the middle of 2008, at around 7%, but has fallen since that time. The high inflation in the middle of 2008 was the result of several external shocks. However, core inflation (inflation excluding the prices of energy, food, alcohol and tobacco) was approximately 4% during the same period. Despite its rapid fall, inflation remains significantly above the euro area average.

Since the end of October, banks have not been able to borrow in the rest of the world under the same conditions as they did previously. In particular, the maturities and interest rates on loans have deteriorated, resulting in a significant drop in growth in bank loans. Thus the economy has faced liquidity problems, which are not yet critical. Weaknesses have been seen in the banking and financial system. However, banks and other financial institutions remain sound. The level of bad loans in Slovenia and non-performing investments in the rest of the world is relatively low.

The majority of difficulties faced by companies are driven by falling domestic and foreign demand. The significant decrease in investment demand is primarily the result of slowing construction activity. For example, in 2008 construction accounted for 9% of total value added. Manufacturing companies have been hit hardest. In the final two months of 2008, year-on-year growth in merchandise exports and manufacturing output was -14% and -16% respectively.

As Slovenia enters 2009 certain weaknesses in the real sector, which have been present for some time, are becoming even more evident. Despite adopting certain bad practices in recent years, the financial system has proven to be sufficiently robust. The main challenge in the coming years will be establishing an environment for the accelerated technological and sectoral modernisation of the economy. Only in this way will the economy provide for an appropriate level of international competitiveness, and thus a sound balance of payments, low inflation and a stable financial system.

Ljubljana, April 2009

Governor of the Bank of Slovenia
Marko Kranjec

1 ECONOMIC AND FINANCIAL DEVELOPMENTS

1.1 International economic and financial developments

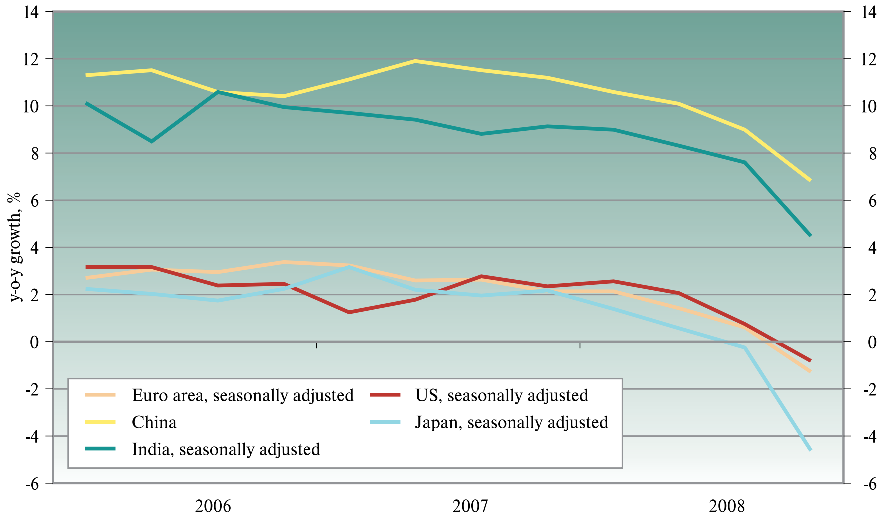
The year 2008 was characterised by two dissimilar periods of economic activity. Continued strong, but gradually declining economic growth, accompanied by high growth in commodity and energy prices, prevailed during the first half of the year. Instability on the financial markets in the second half of the year, and the resulting slowdown in interbank activities and the drop in demand had the effect of a drastic cooling of the global economic climate. As a result price movements also slowed significantly. Driven by the strong economic activity in the first half of the year, the major economies, with some exceptions, recorded positive economic growth in 2008. In January 2009 the European Commission's estimate of global economic growth in 2008 was 3.3%. According to estimates economic growth in the euro area and US was 0.8% and 1.1% respectively. Growth in the Asian economies was also lower than the growth recorded in 2007. According to estimates the Japanese economy contracted by 0.6%, while growth in China, in recent years considered the main driver of the global economy, stood at 9% according to initial estimates. These growth rates are considerably lower than the IMF's October 2007 forecasts for 2008, which projected global economic growth of 4.8%, 2.1% in the euro area, 1.9% in the US, 1.7% in Japan and 10.0% in China.

Instability on the financial markets, and the resulting slowdown in interbank activities and the drop in demand had the effect of a drastic cooling of the global economic climate in 2008.

The cooling of the global economic climate also affected the economic activity in Slovenia's most important trading partners. According to initial estimates, economic growth in Germany in 2008 stood at 1.3%, -1.0% in Italy and 0.8% in France. Tightened conditions on the financial markets, the drop in demand and lower domestic spending also affected other important trading partners.

Economic growth in Slovenia's most important trading partners has fallen sharply.

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



Sources: OECD, Eurostat

Until the middle of the year, the instability on the financial markets was limited to the US market and US banks. The Federal Reserve responded to the instability by accelerating cuts in its key interest rate. In contrast the ECB raised its key interest rate to 4.25% in July due to rising euro area inflation. The collapse of Lehman

Central banks cut their interest rates significantly in response to the global drop in demand.

Brothers Bank in September resulted in the transfer of the financial turmoil to the European financial system. The interbank market came to a standstill, while the lack of confidence due to the accelerated drop in leverage at banks and other financial institutions began to threaten the financing of commercial activities, also affected by the economic downturn. The tightened conditions required the active participation of central banks. Central banks responded to the economic downturn and the liquidity shortage in the banking system by expanding selection of banks and securities accepted as loan collateral, and through coordinated actions to provide global liquidity. The accelerated cuts in interest rates continued until December, when the Federal Reserve set a target interval for its key interest rate of between zero and 0.25%. By December the Bank of Japan had cut its key interest rate to 0.10%, while the Bank of England cut its key rate to an all-time low of 2.00%. The ECB's key rate stood at 2.50% at the end of 2008.

Economic risks markedly increased in certain EU Member States towards the end of 2008.

The premiums on the bonds of a number of EU Member States rose towards the end of 2008. The premiums of Spain, Italy, Greece, Portugal, Ireland and particularly of Latvia over German government bonds confirm that economic risks markedly increased in the aforementioned countries. The consequences of the financial turmoil and economic crisis in these countries are more profound due to their external imbalances, high levels of public debt and the significant falls in prices on the real estate market. At the end of the year the premiums over 10-year German government bonds in euro area countries ranged from 86 basis points in Spain to 227 basis points in Greece. In Latvia the premium over 9-year German government bonds stood at 610 basis points.

Box 1: **Measures of governments, central banks and international institutions to revive the economy**

The financial turmoil and economic crisis intensified in 2008, particularly after September's announcement of the bankruptcy of Lehman Brothers investment bank, and required the active participation of governments, central banks and international institutions.

Central banks' initial response to the financial turmoil and its transfer to the real sector was the comprehensive and rapid cutting of key interest rates, which reached historical lows in some countries at the end of 2008. Major central banks made coordinated cuts in interest rates in October 2008, when the situation was particularly critical following the announcement of the collapse of Lehman Brothers investment bank. In addition, foreign exchange swaps between central banks provided a sufficiently high level of liquidity in currencies in shortfall on the market. The ECB began providing refinancing with a fixed rate full allotment liquidity provision procedure, meaning that banks were granted access to essentially unlimited liquidity at a pre-determined interest rate. Furthermore, many central banks also began implementing non-standard measures. The selection of eligible parties and securities, used by central banks as collateral for the provision of liquidity, has been further expanded (See section 2.1.1 for more on the Eurosystem's monetary policy measures).

Government measures were initially aimed at expanding deposit guarantee schemes, and later at ensuring sufficient funding for the lending activity of banks. Significant among these measures were those relating to capital injections and guarantee schemes for bank borrowing. Governments opted for comprehensive capital injections in those banks of great importance to economy. According to International Monetary Fund (IMF) estimates, developed countries of the G20 had earmarked an average of almost 3% of GDP by the middle of February 2009 for capital injections in banks. The governments of some countries also provided direct loans and purchased the toxic assets of financial institutions. According to IMF estimates, developed countries of the G20 had earmarked an average of more than 5% of GDP by the middle of February 2009 for this purpose.

With the spread of the financial turmoil to the real sector, a great deal of emphasis was also placed on measures to stimulate demand and preserve jobs. The public debt and the sustained servicing thereof, represent an objective obstacle to this stimulation. The effects of measures and lower budget revenues due to the recession impact the general government deficit and the rising public debt. According to March 2009 IMF estimates, public debt in developed G20 countries is expected to rise by an average of 10 percentage points of GDP in

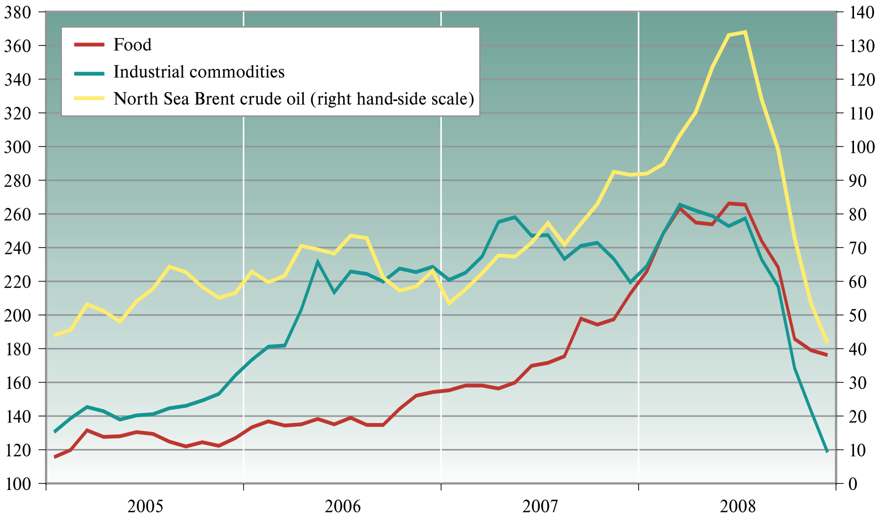
2009. Therefore, the European Commission called on EU Member States to practice moderation with regard to such action and to respect the Stability and Growth Pact when adopting measures.

The deepening of the financial turmoil reemphasises the importance of international institutions and international cooperation. At the centre of efforts is the strengthening of the IMF with sufficient funding for expected interventions to support individual countries on a global level. The EU has also increased potentially available funds as balance of payment aid to Member States, which has already been used in specific cases (e.g. Latvia and Hungary).

Commodity prices rose sharply in the first half of the year, then fell significantly in the second half of the year.

Commodity prices rose sharply in the first half of the year. The price of a barrel of Brent crude reached its high in July when it averaged USD 133.8. The prices of other commodities rose by 30% on average in year-on-year terms in the first half of the year. The collapse of Lehman Brothers Bank resulted in a reversal and in the transfer of the effects of the financial instability to the real sector. There was a drop in commodity prices in autumn. The pace of the fall picked up speed towards the end of the year due to lower demand and the cooling of the economic climate. The price of barrel of Brent crude fell below USD 50 towards the end of the year, despite OPEC's significant cuts in production. The prices of other commodities also fell. In year-on-year terms, the prices of other commodities rose by an average of 12%, while the US dollar price of a barrel of Brent crude was up 34%. The prices of industrial commodities were down 7% year-on-year in 2008.

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

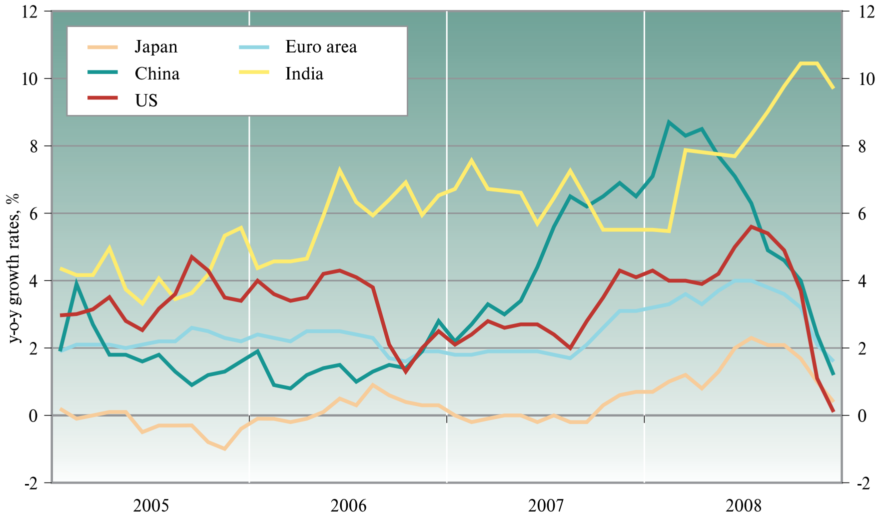


Note: Index 2000 = 100; oil price is for North Sea Brent in USD per barrel.
Sources: The Economist, London; Bloomberg

Inflation, which was high in the first half of the year and began to slow in the second half of the year moved in line with growth in commodity and oil prices.

Inflation in the euro area and the US was relatively high in the first half of 2008, while in the final months of the year, consumer price indices experienced significant month-on-month falls. Average inflation in 2008 stood at 3.3% in the euro area, compared with 3.8% in the US. Commodity prices had a significant impact on year-on-year movements in inflation. The prices of food, housing and energy contributed most to the growth in consumer prices in the euro area. Average core inflation as measured by the consumer price index excluding energy and unprocessed food stood at 2.4% in the euro area and at 2.3% in the US as measured by the consumer price index excluding energy and food. Core inflation fell in both the euro area and the US towards the end of the year.

Figure 3: **International comparison of growth in consumer price indices**

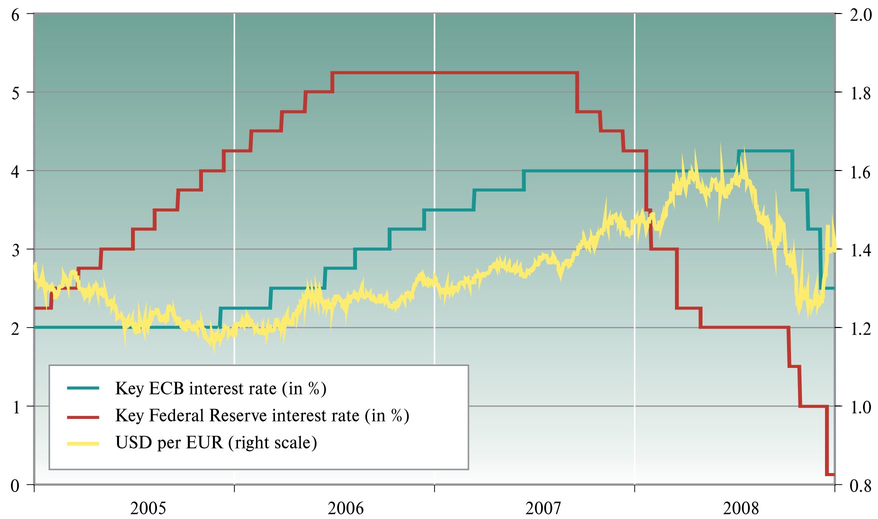


Sources: OECD, Eurostat

The euro appreciated against the US dollar in the first half of the year, but began to depreciate in the second half of the year.

Uncertainty on the financial markets and the sudden reversal in economic activity resulted in increased exchange rate volatility. As a consequence the euro appreciated against the US dollar in the first half of 2008, but depreciated in the second half of the year. Nevertheless, the euro appreciated by an average of 7.3% against the US dollar in year-on-year terms, the EUR/USD exchange rate averaging 1.4707.

Figure 4: **Euro-US dollar exchange rate and key ECB and Federal Reserve interest rates**



Sources: ECB, Federal Reserve

1.2 Economic and financial developments in Slovenia

1.2.1 Economic Activity and the Labour Market

In 2008 economic growth outstripped euro area growth by 2.8 percentage points.

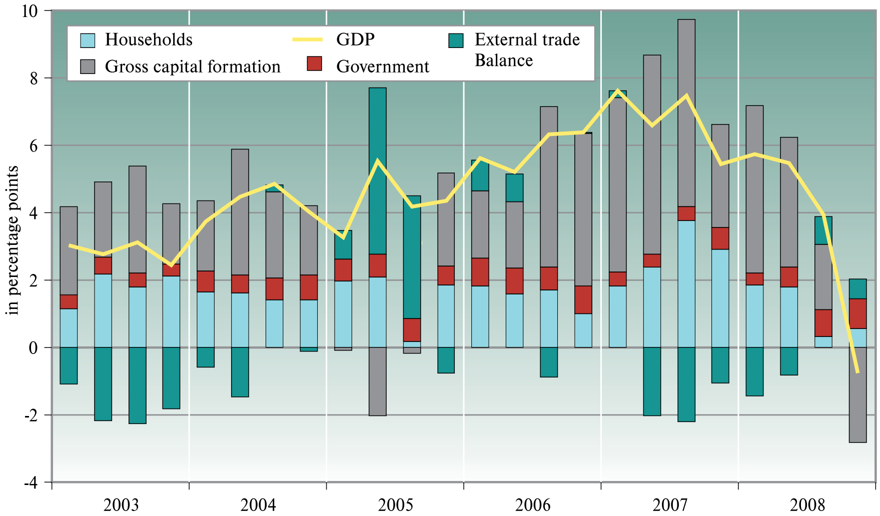
Real gross domestic product (GDP) rose by 3.5% in Slovenia in 2008. This was partly the result of continued relatively high growth in gross domestic investment, particularly in the first half of the year, and also due to still solid exports of merchandise and, in particular, services. In line with this, the largest increases in value-added in Slovenia during 2008 were recorded by construction (14.1%) and by certain service sectors, particularly financial intermediation (11.9%) and retail (5.5%), while value-added was down 1.5% in manufacturing. This annual result is a reflection of two significantly different periods. While the economic activity was still high in the first half of the year, the deepening of the financial turmoil resulted in a sharp deterioration in economic results during the second half of the year. Economic activity was down in the final quarter of 2008 due to the rapid drop in aggregate demand. At the same time, there was an easing of pressures from the international environment on price growth in Slovenia.

Growth in investment spending and exports of goods and services, as the main drivers of economic growth in 2008, fell sharply in the second half of the year.

Domestic and foreign demand, which were both up moderately from 2007, contributed significantly to economic growth in 2008. Similar to 2007, gross fixed capital formation was notable among components of domestic consumption. Gross fixed capital formation recorded annual growth of 6.2%, 13.6% in the first half of the year, but slowed considerably in the second half of the year, and was actually down 5.3% in the final quarter. The acceleration of investment spending was strongest in the construction sector, where the activity had slowed considerably at the end of the year. Other investments, particularly in plant and equipment, were down 6.1% in year-on-year terms in the final quarter of 2008, compared with the high year-on-year growth of 8.2% recorded in the first half of the year.

Household consumption rose by an average of 2.2% year-on-year in 2008 and, following 3.6% growth in the first half of the year, slowed sharply, particularly in the final quarter, when the first serious signs of the economic slowdown were seen on the labour market. Government spending was up 3.7% relative to the previous year, primarily as a result of increased spending in the final quarter, when growth reached 5.0%. Exports of goods and services recorded solid growth of 7.8% in the first half of the year, but slowed significantly in the second half of the year, particularly in the final quarter, when exports were down 6.2% in year-on-year terms. Thus exports of goods and services recorded modest growth of just 3.3% compared with 2007, while being outpaced by growth in imports of goods and services. Therefore, the ratio of growth in exports to growth in imports resulted in a negative contribution to GDP of 0.2 percentage points in 2008.

Figure 5: **Contributions to economic growth – expenditure structure**



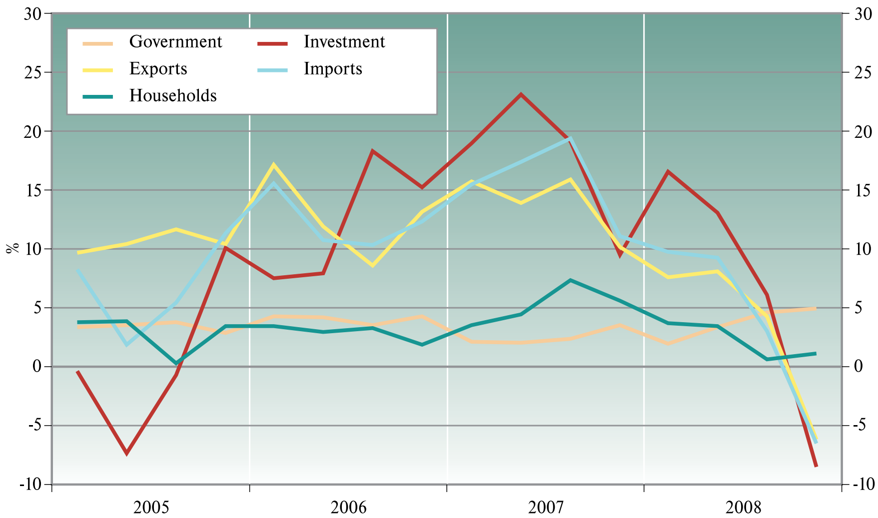
Sources: SORS, Bank of Slovenia calculations

Table 1: **Contributions to economic growth – expenditure structure**

in percentage points	2003	2004	2005	2006	2007	2008
Household consumption	1.8	1.5	1.5	1.5	2.7	1.1
Gross capital formation	2.5	2.6	0.1	3.4	4.9	1.9
General government	0.4	0.6	0.6	0.8	0.5	0.7
External trade balance	-1.9	-0.5	2.2	0.2	-1.3	-0.2
Economic growth	2.8	4.3	4.3	5.9	6.8	3.5

Sources: SORS, Bank of Slovenia calculations

Figure 6: **Year-on-year growth in expenditure components of GDP**



Sources: SORS, Bank of Slovenia calculations

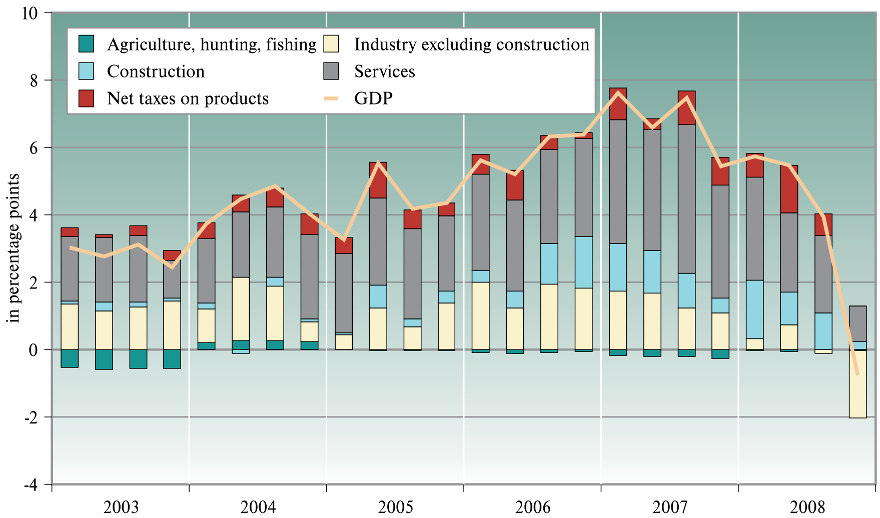
Industrial sales revenue was down in the second half of 2008 in line with slowing economic growth and declining foreign and domestic orders.

In line with the decrease in value-added in manufacturing, growth in total industrial production also slowed in 2008. It was down 1.9% on 2007, according to figures excluding the effect of the number of working days. Industrial production in Slovenia fell notably at the end of 2008, recording a year-on-year contraction of 19.2% in December, while the 11.1% month-on-month drop recorded in November was the largest in the euro area. A slowdown in industrial production in the second half of the year was seen for all types of goods, particularly for capital goods, which were down 23.0% in December in month-on-month terms. In 2008 production of capital goods was down 3.4% overall on 2007, driven by conditions in the EU and the wider economic environment, and pessimistic outlooks regarding trends in economic activity and developments on the labour market. The most significant decreases in industrial production in 2008 were recorded by predominantly export-oriented manufacturing sectors. According to non-seasonally adjusted figures, several sectors recorded a year-on-year decline in industrial production last year: the manufacture of leather and leather products (13.5%), the manufacture of textiles (10.5%), the manufacture of wood and wood products (9.2%), the manufacture of furniture and other manufacturing activities (7.8%), and the manufacture of metals and fabricated metal products (5.8%). A drop in industrial production was evident for most types of goods, particularly in the production of capital goods (down 3.4% year-on-year) and in the production of intermediate goods (down 2.9% year-on-year). This was driven for the most part by the gradual decline in investment, particularly in construction, and the slowdown in exports of goods and services to old and new EU Member States. Given the deteriorating economic conditions in the second half of the year and the subdued growth in the first half of the year, total industrial sales revenue was negative: sales revenue was down 2.4% on 2007, while sales revenue in manufacturing was down 22.2% year-on-year in December alone. Figures by product categories show that sales revenue in 2008 from the production of capital goods and the production of intermediate goods recorded the largest year-on-year declines, of 2.8% and 3.1% respectively. In December alone, industrial sales revenue on the domestic market fell by 19.3% in year-on-year terms and by 23.7% on the foreign market.

The slowdown in economic activity in industry was also more evident in the service and construction sectors at the end of the year.

While the decline in economic activity was significant in manufacturing, the service and construction sectors still demonstrated higher growth. Following high 20.5% year-on-year growth in value-added in the first half of the year, activity in construction began to slow, most notably in the final quarter. The number of building permits issued was down in year-on-year terms in the second and third quarters, while there were 4% fewer building permits issued in the final quarter of last year. In December alone, the value of construction work performed was down 20.5% on November and down 4.1% on December 2007. The slowing trend of value-added was also noteworthy in the retail sector, where year-on-year growth in sales revenue was just 2.2%. Sales revenue from trade in motor vehicles and fuels, which was up 4.8% in 2008 on the previous year, contributed most to this increase. However, the slowdown in economic activity was also more evident in trade at the end of the year: in December alone sales revenue in the retail sector was down 3.2% on November. The deteriorating economic climate in the final quarter of last year was also reflected in other service sectors, such as transport, as in December alone the volume of merchandise moved at ports and airports was down 14.4% and 19.1% in year-on-year terms respectively. A similar trend was seen in accommodation and food service activities, where overnight stays were down 18.7% in December from the previous year.

Figure 7: **Contributions to economic growth – output structure**



Sources: SORS, Bank of Slovenia calculations

Table 2: **Selected economic indicators**

	2003	2004	2005	2006	2007	2008
Real GDP growth[1] (%)	2.8	4.3	4.3	5.9	6.8	3.5
GDP (EUR million)	23,784	26,191	28,251	30,398	33,106	35,691
GDP per capita	11,892	13,096	14,126	15,199	16,553	17,382
Composition of GDP (%)						
Agriculture, forestry and fishing	2.3	2.3	2.2	2.1	1.8	2.0
Industry and construction	30.9	30.8	30.2	30.7	30.5	29.4
- Manufacturing	22.3	22.4	21.5	21.2	20.9	19.5
Services	54.1	54.2	54.9	55.0	55.4	55.6
Total value added	87.3	87.3	87.4	87.9	87.7	87.5
Compensation of employees	50.9	51.1	50.9	50.5	49.8	51.8
Taxes on production and imports less subsidies	14.0	13.9	13.7	13.1	12.7	12.2
Gross operating surplus and gross mixed income	35.1	35.0	35.4	36.5	37.5	36.0
- Exports of goods and services	55.4	58.2	61.5	66.1	71.0	70.0
- Imports of goods and services	56.1	58.9	60.6	66.3	72.7	71.5
Net trade	-0.7	-0.7	0.9	-0.2	-1.7	-1.4
Household final consumption expenditure	54.9	54.0	53.1	51.8	51.3	50.6
General government final consumption expenditure	19.0	18.9	18.7	18.7	18.0	17.7
Gross capital formations	25.5	26.4	28.7	28.4	31.5	32.2
Labor force (ILO)[2], in thousands	961	1,007	1,015	1,022	1,035	1,042
Self-employed persons and persons paid employment by natural persons (ILO)	897	943	949	961	985	996
Unemployed (ILO)	64.2	63.3	66.1	60.8	49.2	46
Unemployment rate (ILO)	6.7	6.3	6.6	6.0	4.9	4.4
Nominal growth in gross wages (%)	7.6	4.6	4.9	4.8	5.9	8.4
Growth in labor productivity (%)	3.2	4.0	4.5	4.3	3.7	0.6

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 figures compiled according to ILO methodology.

Sources: SORS, Bank of Slovenia calculations

Conditions on the labour market were favourable for employees over the first three quarters of 2008. The surveyed unemployment rate fell to 4.4% on average for the year.

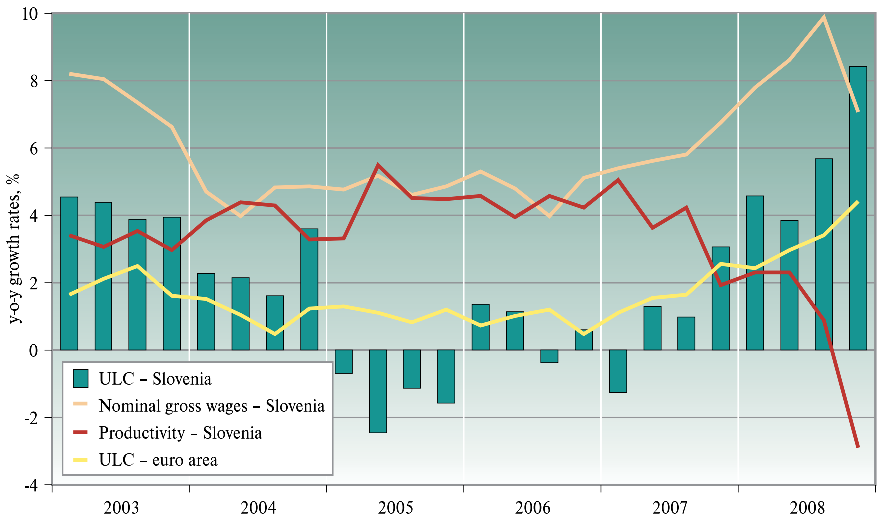
Conditions on the labour market in 2008 moved in line with the economic cycle, and were still relatively favourable for employees until the final quarter. The labour force stood at 880.3 thousand at the end of the year, up 1.8% on 2007. There was a sharp increase in employment from the previous year at companies (3.1%) and in the small business sector (3.4%), including the self-employed and employees of the self-employed. In 2008 the largest increases in employment were again recorded by the sectors of construction (11.8%) and real estate, renting and business services (7.6%). The trend of falling employment in manufacturing, which was interrupted in 2007, continued in the second half of 2008, resulting in an average year-on-year drop in the number of employees of 0.6%. As in previous years, within the manufacturing sector the largest decline in employment was recorded in labour-intensive sectors, particularly in textiles, foodstuffs and leather, while employment in the manufacture of transportation equipment rose 3.2% year-on-year, primarily as a result of the increased volume of work in the automobile industry in the first half of the year. The number of unemployed in December 2008 was down 2,172 or 3.2% from a year earlier, while the registered unemployment rate in December stood at 7.0%, down 0.3 percentage points from the previous year. There was also a sharp decline in the surveyed unemployment rate (ILO methodology), which fell to a record low in the third quarter of 2008, and was 4.4% on average for the year. According to the Labour Force Survey, the activity rate was down slightly (0.2 percentage points) in 2008 to 59.5%, while the employment rate was unchanged at 56.9%.

Growth in the average nominal gross wage was up 2.4 percentage points in 2008, to reach 8.3%. Growth in the average nominal gross wage in the private sector was 7.9%, compared with growth of 9.7% in the public sector. The fastest growing wages were in the real estate and business services sector (12.2%), healthcare (12.1%) and financial intermediation (8.9%), while the slowest growth was recorded by the transport sector (5.8%), which achieved relatively high growth in previous years.

Growth in nominal unit labour costs was significantly higher in 2008 than in the previous three years.

Growth in nominal unit labour costs was significantly higher in 2008 than in the previous three years, and averaged 7.7% in year-on-year terms, with the highest growth recorded in the final quarter, at 10.3%. The reason for the increase lies in the widening gap between growth in productivity and total labour costs. Year-on-year growth in productivity was down from 2.3% in the first quarter to -2.9% in the final quarter. Growth in gross wages contributed most, 5.9 percentage points, to rising labour costs in 2008, followed by growth in employers' social security contributions, which contributed 0.9 percentage points. On the other hand, the gradual abolition of payroll taxes contributed 0.9 percentage points to the slowing of growth in labour costs. The high growth in unit labour costs exceeded the level consistent with maintaining price stability, as seen by the increase in average core inflation in 2008. In the context of weak economic conditions in the final quarter of last year and at the beginning of 2009, high growth in unit labour costs represents a significant risk for the economy, in terms of employment and corporate competitiveness. A comparison of growth in unit labour costs with the euro area indicates that the cost competitiveness of the Slovenian economy deteriorated significantly, particularly at the end of 2008. In the final quarter growth in unit labour costs in Slovenia outstripped growth in the euro area by 4 percentage points.

Figure 8: **Productivity, unit labour costs and nominal gross wages**



Note: The calculation of labour costs for Slovenia includes gross wages (SORS), other employment earnings (AJPES), employers' social contributions and payroll taxes (MoF).

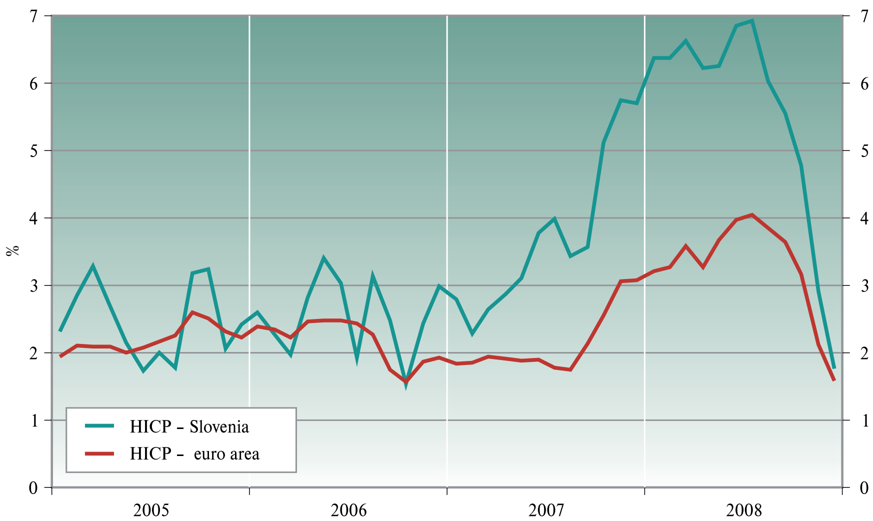
Sources: SORS, Bank of Slovenia calculations for Slovenia; Eurostat for the euro area

1.2.2 Price Developments

Average inflation in 2008 was up 1.7 percentage points on 2007.

Average inflation, as measured by the Harmonised Index of Consumer Prices (HICP), was 5.5% in 2008, up 1.7 percentage points on the average rate in 2007. Inflation averaged 6.5% over the first six months of 2008, and fell to 4.2% in the second half of the year. The relatively high inflation in the first half of the year was driven primarily by the high economic activity in the preceding period, rising labour costs and growth in commodity prices on world markets. While growth of labour costs was still relatively high, the falling prices of oil and other commodities as a consequence of the economic crisis and financial turmoil contributed most to the drop in inflation in the second half of the year. Following a long period of widening gaps between year-on-year growth in Slovenian and euro area prices, these gaps had nearly closed by the end of the year due to the sharp drop in demand.

Figure 9: **Year-on-year growth in prices in Slovenia and the euro area**

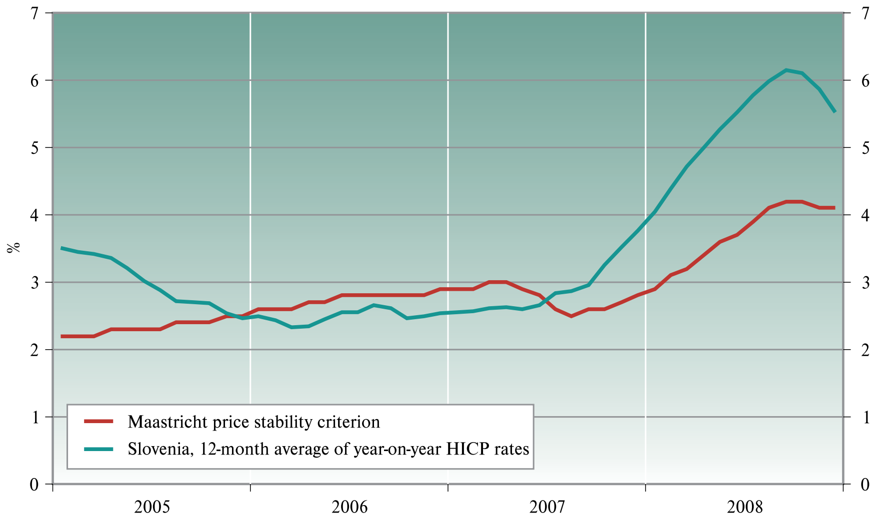


Source: Eurostat

Deviation from the Maastricht criterion stood at 1.4 percentage point by the end of the year.

These gaps are closing much slower, with regard to the Maastricht price criterion. An upward deviation from the Maastricht price criterion continued in the first half of the year. Rising inflation in EU Member States resulted in an increase in the Maastricht criterion itself. However, price growth was lower in other EU Member States than in Slovenia. This deviation decreased in the second half of the year, in line with falling inflation. The deviation stood at 1.4 percentage points at the end of 2008. The 12-month average growth in prices in Slovenia was 5.5%, while the Maastricht criterion was 4.1%.

Figure 10: **Price stability convergence criterion**



Sources: Eurostat, Bank of Slovenia calculations

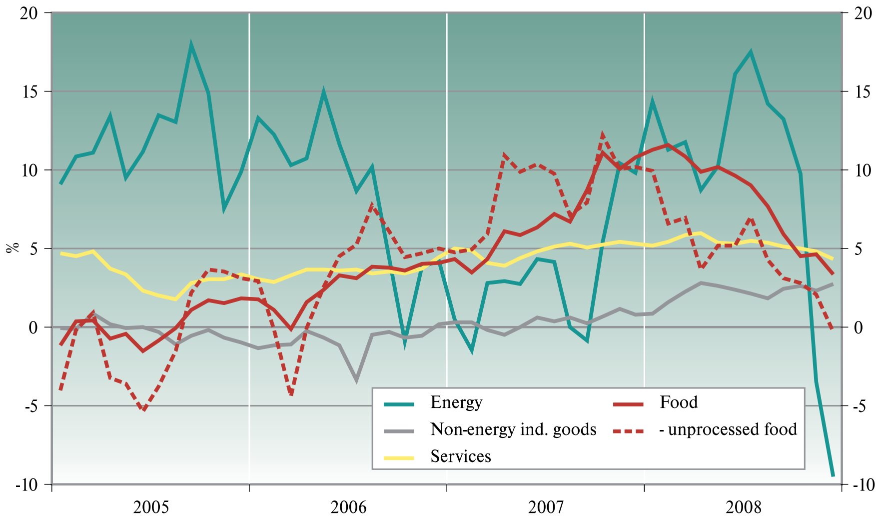
Primarily external factors affected energy prices, while the domestic climate also impacted food prices.

Impacts from the international environment were reflected more in energy prices than in food prices. Growth in energy prices averaged 9.4% last year, up 6.0 percentage points on the previous year, but 0.9 percentage points less than in the euro area. Energy prices rose over the first seven months of the year, driven by record oil prices on world markets. Growth in energy prices slowed later in the year, and was actually negative in the last two months of the year due to conditions on international markets. The average price for a barrel of oil on world markets last year was approximately USD 98, an increase of USD 25 on 2007. These movements resulted in an increase in the overall contribution of energy prices to inflation from 0.4 percentage points in 2007 to 1.2 percentage points in 2008. The contribution of food prices to headline inflation was down in line with falling global food commodity prices and slowing domestic demand.

The growth in prices of services and non-energy industrial goods was primarily driven by internal factors.

Average annual growth in the prices of services was up 0.4 percentage points, compared to previous year, to 5.3%. The relatively high growth, which reached its peak in April at 6.0%, was primarily a result of high economic growth in the preceding period and high aggregate demand. As a consequence the average contribution of prices of services rose from 1.6 percentage points in 2007 to 1.8 percentage points in 2008. Growth in prices of non-energy industrial goods was also up sharply, from 0.3% in 2007 to 2.2% in 2008. This increase is not in line with developments in the euro area, where growth in the prices of non-energy industrial goods was down 0.2 percentage points on the previous year, to 0.8%.

Figure 11: **Year-on-year growth in prices of individual sub-groups of inflation**

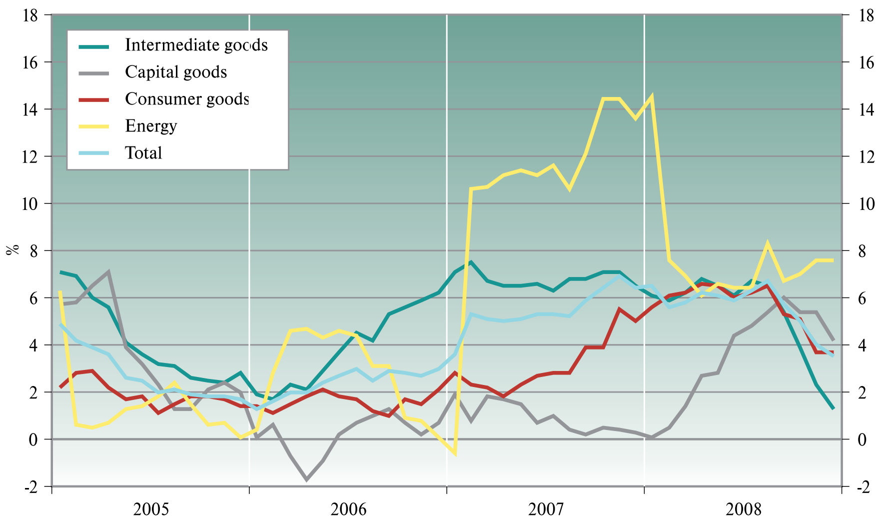


Source: Eurostat, Bank of Slovenia calculations

Growth in producer prices of manufacturers on the domestic market was lower than in the euro area.

Producer prices of manufactured goods on the domestic market rose by 5.6% on average last year, 0.1 percentage points more than in 2007 and 0.5 percentage points less than in the euro area. The largest increase was recorded by energy prices (7.6%), while growth in commodity prices stood at 5.3%. Likewise average growth in prices of capital goods rose from 0.9% in 2007 to 3.6% in 2008, while growth in prices of consumer goods rose from 3.2% in 2007 to 5.6% in 2008.

Figure 12: **Year-on-year growth in producer prices of manufactured goods on the domestic market**



Sources: SORS, Bank of Slovenia calculations

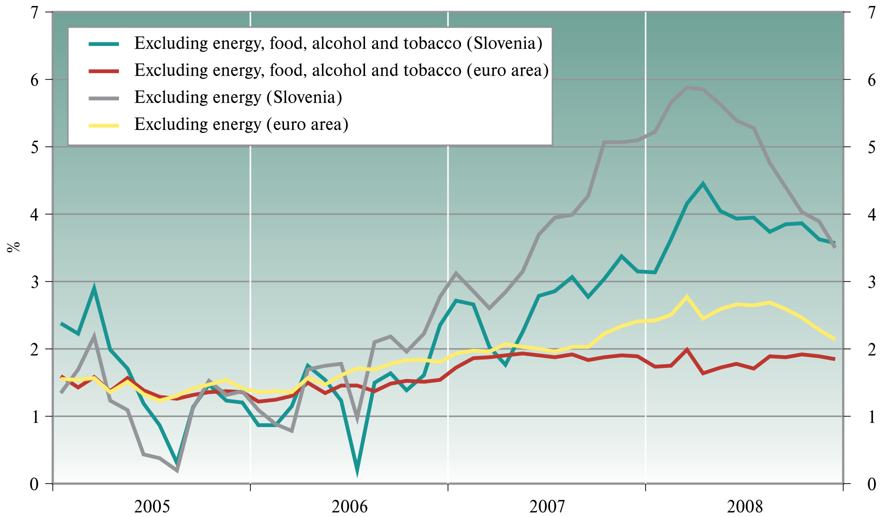
Administered prices were up 1.1% on 2007.

Administered prices excluding energy rose by an average of 1.1% in 2008. The prices of liquid fuels for transport and heating rose by 28.7% in the same period. Furthermore, the prices of remote heating rose by 12.3% last year. In 2008 the prices of passenger railway services within Slovenia rose by 3.0%, while the prices of municipal services were up 0.5%.

Core inflation indicators rose in the first half of the year, and slowed somewhat in the second half of the year, mainly reflecting factors from the domestic macroeconomic environment. Average core inflation expressed as the growth in the harmonised index of prices excluding energy, food, alcohol and tobacco rose from 2.7% in 2007 to 3.8% in 2008. This growth is high, particularly compared with the euro area, where average core inflation was 1.8%, a decrease of 0.1 percentage points from a year earlier. The largest contribution to this discrepancy came from the prices of services and non-energy industrial goods, which grew twice as fast as in the euro area. The difference with regard to the euro area indicates inflation inertia and excess demand in Slovenia compared with the euro area.

Core inflation rose 1.1 percentage point on average relative to 2007.

Figure 13: **Year-on-year growth in core inflation indicators for Slovenia and the euro area**



Sources: Eurostat, Bank of Slovenia calculations

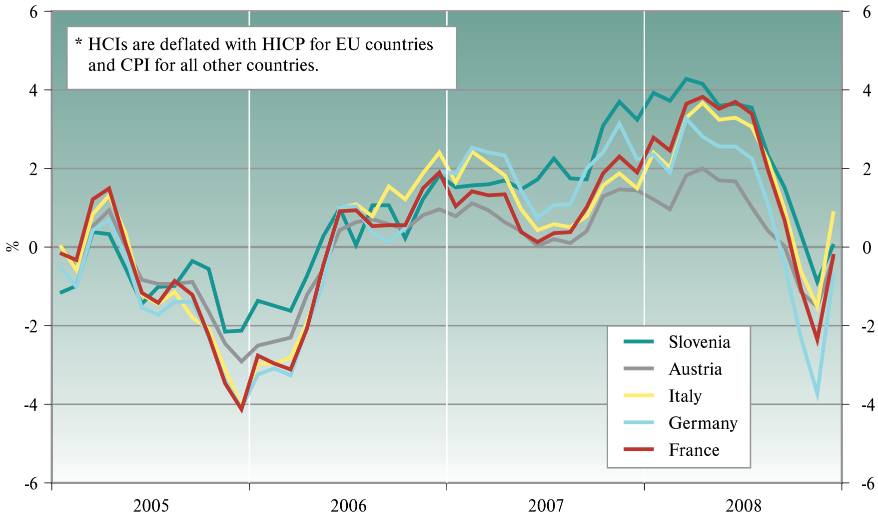
1.2.3 Price competitiveness

Slovenia's price competitiveness deteriorated in 2008 due to the appreciation of the euro and the unfavourable relationship in the movement of domestic and foreign prices. The nominal effective euro exchange rate in Slovenia, as measured by the harmonised national competitive indicator and subject to the weighting of 56 of Slovenia's external trade partners, appreciated by an average of 0.9% year-on-year in 2008. The year-on-year appreciation of the domestic currency rose until April 2008 when it reached 1.8%, and gradually fell from that point until December as a result of the depreciation of the euro against the US dollar and other currencies. The year-on-year rise in the average value of the domestic currency was affected by external factors that are primarily reflected in the movement of exchange rates on external financial markets, particularly in the euro's appreciation of 7.3% against the US dollar and 16.4% against the pound sterling, while the euro depreciated by 3.4% against the Swiss franc over the same period. The real effective euro exchange rate as measured by the ratio of the domestic cost of living to the cost of living abroad appreciated by an average of 2.6% year-on-year in 2008. 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 euro exchange rate. Similar to the nominal effective euro exchange rate, the real effective euro exchange rate also recorded the highest year-on-year appreciation in the first quarter of 2008 due to growth in domestic prices outpacing the growth of

The nominal effective euro exchange rate, as measured by the harmonised national competitiveness indicator, appreciated by 0.9% in 2008.

foreign prices. Since that time, the gap between growth in the index of domestic prices and the basket of foreign prices has been gradually narrowing.

Figure 14: **Year-on-year growth in harmonised price competitiveness indicator**



Note: Harmonised price competitiveness indicator: 42 countries outside the euro area and 14 euro area Member States.
Source: ECB

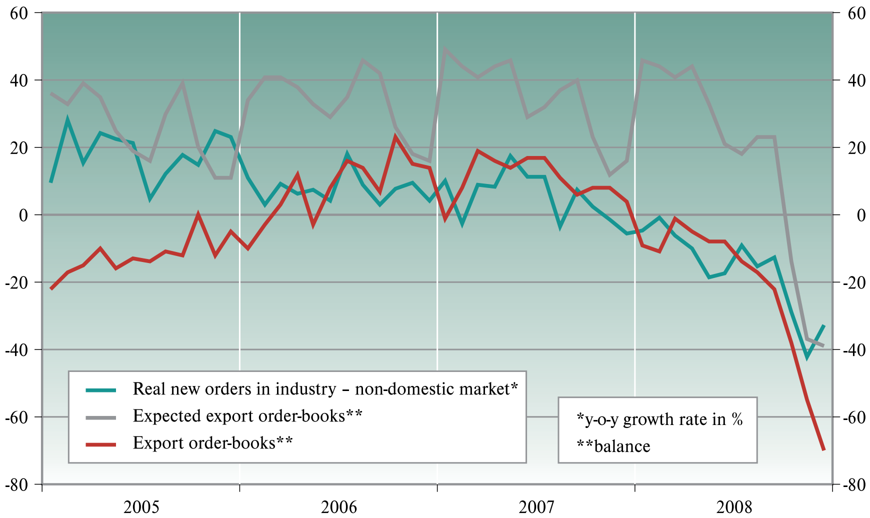
In 2008 the trend of year-on-year growth in the harmonised price competitiveness indicator in Slovenia, as measured by the consumer price index, was similar to that recorded in its most important euro area trading partners. While with a similar dynamic, it is evident that Slovenia's price competitiveness was worse over the entire period compared to the competitiveness of its most important EU trading partners. In year-on-year terms, this indicator appreciated from the second half of 2007, and reached its peak in March and April 2008 and stagnated at this level until July. Appreciation reached its peak in March in Slovenia at 4.3% and in Germany at 3.3%, and in April in Austria (2.0%), France (3.8%) and Italy (3.7%). Although the trend of year-on-year growth in the price competitiveness indicator is similar in the countries observed, the factors that affect it vary. The main contributing factor in the year-on-year growth in the price competitiveness indicator in Austria, Germany, France and Italy was the appreciation of the nominal effective euro exchange rate. Alongside the appreciation of the nominal effective exchange rate of the domestic currency, another factor in the movement in Slovenia's price competitiveness was domestic prices outpacing growth in the basket of foreign prices. This contributed some 2.5 percentage points to the March 2008 appreciation of 4.3%. In March and April the domestic prices of trading partners grew slower than their own basket of foreign prices, thus contributing to an improvement in their price competitiveness and mitigating the adverse effects from the appreciation of the nominal effective euro exchange rate.

In the context of falling prices of oil and refined petroleum products since August and the depreciation of the euro against other global currencies in the second half of 2008, the appreciation of the price competitiveness indicator fell rapidly and moved into depreciation, which reached its low in November 2008 at -1.5% in Austria, -3.7% in Germany, -2.3% in France, -1.5% in Italy and -0.9% in Slovenia. The price competitiveness indicator has appreciated again since December 2008. However, the appreciation of this indicator in all countries, including Slovenia, is primarily the result of the appreciation of the nominal effective euro exchange rate, while growth in the basket of foreign prices is outpacing growth in domestic prices, thus contributing to improving price competitiveness.

Deteriorating price competitiveness was accompanied by the deepening of the global financial turmoil and its transformation into an economic crisis at the end of 2008. This has gradually led to falling demand for Slovenian products from the rest of the world, while the sharpest impact on exports and domestic economic activity was seen in the last quarter of 2008. Real industrial sale revenue was down 2.1% in 2008, with real sales revenue down 2.6% on the domestic market and 1.8% on foreign markets. The global financial turmoil and economic crisis had the most rapid and significant impact on transactions with euro area Member States, where real industrial sales revenue recorded an above-average year-on-year fall of 3.8%. Positive growth in real sale revenue on foreign markets was only achieved in transactions with countries outside the euro area, including other EU Member States and the rest of the world. Overall real growth in sales revenue with these countries reached 1.1%. In this regard, only real revenue from the sale of consumer goods was up in year-on-year terms (by 4.1%), primarily as a result of a 10.3% increase in sales of consumer non-durables. With regard to foreign markets, only revenue from the sale of consumer goods was up in real terms, by 1.1%. Sales revenue from capital goods decreased by 1.5%, but the largest decrease of 4.2% was recorded in revenue from the sale of intermediate goods, which is an additional indication of the drop in economic activity in Slovenia's most important trading partners. Falling sales revenue in 2008 also confirms the deterioration in the indicators of export expectations, export orders and new orders from foreign markets, which began to decline sharply in the final quarter.

Real industrial sales revenue was down year-on-year, less on foreign markets than on the domestic market.

Figure 15: **Export orders and export expectation indicators**



Source: SORS

1.2.4 Public finances

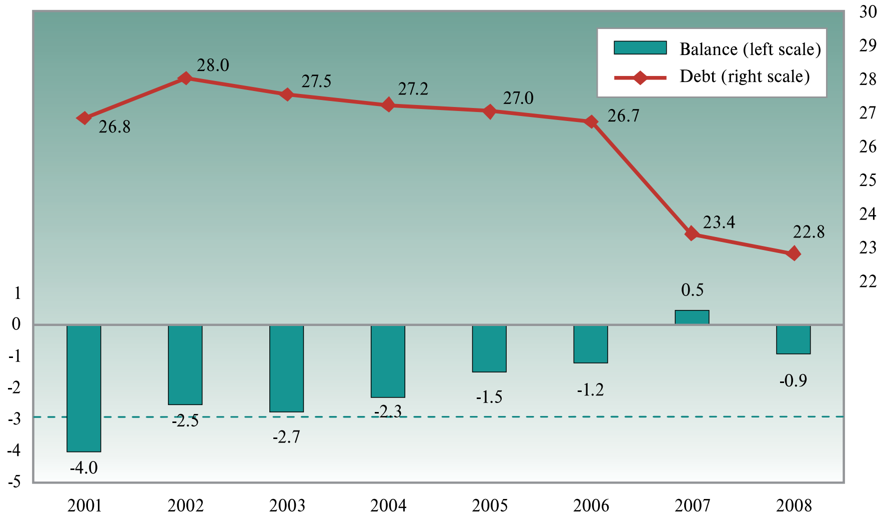
The general government deficit in 2008 according to the ESA95[1] methodology stood at 0.9% of GDP. The general government debt according to the ESA95 methodology stood at 22.8% of GDP at the end of the year, and was lower than

According to the ESA95 methodology, in 2008 the general government deficit stood at 0.9% of GDP, its debt 22.8% of GDP.

[1] The 1995 European System of Accounts (ESA95) methodology ensures that countries follow the same standards and the same definitions of categories and classifications, and the same accounting rules. The ESR 95 methodology defines in detail the criteria for classifying units in 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 booking transactions at the moment when a claim or liability arises. The ESA95 methodology is used to verify compliance with the Maastricht fiscal criterion.

at the end of 2007 (23.4%). These figures also form the basis for verifying that the reference values for the deficit and the general government debt are met. According to figures from the Stability Programme update and given the estimates of the European Commission, Slovenia also met its medium-term goal in 2008, which is defined as a structural deficit in the amount of 1% of GDP.

Figure 16: **Balance and debt of the government sector according to ESA95 methodology in % GDP**



Sources: SORS, Ministry of Finance

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

Preliminary estimates put the consolidated general government deficit calculated according to the national methodology[2], which covers four public treasuries, namely the state budget, municipal budgets and the treasuries of the Pension and Disability Insurance Institute and the Health Insurance Institute of Slovenia, at EUR 99.7 million in 2008 or 0.3% of GDP. Given the lower economic growth than in 2007, the general government position deteriorates, as a surplus of 0.3% of GDP was recorded in the previous year. The state budget and Health Insurance Institute recorded surpluses in the amounts of EUR 65 million and EUR 7 million respectively, while the position of the Pension and Disability Insurance Institute was balanced. Last year's general government deficit was a reflection of the relatively large deficit in local government, which according to Ministry of Finance estimates stood at EUR 170 million or 0.5% of GDP, as a result of high investment growth. According to the national methodology, the consolidated general government surplus stood at EUR 174 million in the first half of the year, compared with a deficit of EUR 77 million in the same period the previous year. In year-on-year terms, there was a significant deterioration in this position in the second half of the year (primarily due to developments in the state budget), when a deficit of EUR 293 million was recorded compared with a surplus of EUR 213 million in the second half of 2007.

Box 2: **A higher deficit and municipal debt in 2008**

According to preliminary figures, local governments recorded a deficit in the amount of 0.5% of GDP in 2008. The deficit was financed primarily via net borrowing and decreasing account balances. In previous years, local governments recorded a considerably more balanced position, with a deficit or surplus of up to 0.2% of

[2] The consolidated balance sheet position according to national methodology is compiled on the cash-flow principle in line with the IMF methodology. Owing to the methodological differences (mainly in sectorisation and the cash flow principle) these figures differ from those required to verify that the fiscal criterion for the general government deficit is met, as implemented by the EU.

GDP. In 2008 local government resources, based to a large extent on personal income tax and transfers from the state budget, were no longer sufficient to cover expenditure, in which investment spending in particular rose. Local governments financed the deficit, which stood at EUR 170 million in 2008, primarily via loans at domestic banks, which recorded a net increase of EUR 100 million. Another important source to finance the local government deficit was the reduction of funds on accounts in the amount of EUR 65 million. The remainder in the amount of EUR 5 million is represented by the difference between loans raised and loans given, and changes in capital holdings.

In May 2008 the National Assembly passed the Act Amending the Local Government Financing Act. With its implementation, opportunities for local government borrowing increased significantly[3]. The act set out the maximum permissible level of local government borrowing, while local governments may borrow further to co-finance investments from the EU budget up to the approved amount of funds, until the latter are received. The act permits local governments to borrow during the current budget year, provided that the repayment of liabilities arising from loans, finance leases and trade credits and contingent liabilities arising from guarantees issued for the fulfilment of the liabilities of direct budget users and public undertakings founded by local governments do not exceed 8% of realised revenues from the revenue and expenditure accounts of the local government budget in the year prior to borrowing, less donations received, transfers from the state budget for investments, funds received from the EU budget and revenues from public utilities. Local governments are only permitted to borrow domestically and to an extent that is in line with the amount defined in the ordinance by which the local government budget is adopted, excluding funds to co-finance investments from the EU budget.

Local government debt accounts for a small proportion of the total general government debt. Total local government debt rose slightly in 2008, but remains below 1% of GDP. At the same time, local government debt rose to 3.8% as a proportion total general government debt. The debt of individual local governments differs greatly within this figure.

Growth in expenditure outstripped growth in revenues.

Growth in general government expenditure in 2008 outstripped growth in general government revenues. General government revenues were up 9.5% in 2008 from the previous year, 1.4 percentage points less than the growth in general government expenditure.

Slowing economic activity in the second half of the year resulted in declining revenues.

General government revenues amounted to EUR 15,335 million in 2008, or 41.3% of GDP. Tax revenues, which account for the majority of general government revenues, rose by 9.2% in 2008. Of the major types of tax revenue, personal income tax revenues rose by 21.1% and corporate income tax revenues were up 12.9%, while social security contributions increased by 10.8%, despite unchanged contribution rates. The higher personal income tax revenues were driven by favourable wage and employment trends in the first half of the year, lower tax rebates and higher payments of personal income tax based on other sources. Revenues from tax on goods and services were 6.8% higher than last year, with growth in VAT revenues reaching 8.2%, while excise duties rose by approximately 4.8%. High growth was also recorded for some less significant taxes (e.g. motor vehicle fees). Taxes on international trade rose by 2.6% last year, and accounted for less than 1% of revenues. Last year revenues from payroll taxes recorded the sharpest drop of 41.3%, resulting from the gradual lowering of the aforementioned tax since 1 January 2007. On 1 January 2009 the payroll tax was completely abolished. The reasonably strong growth in all main categories of tax revenue is primarily the result of the relatively high economic growth in the first half of the year (5.5%) and the related rise in employment. Since August the growth in revenues from the majority of tax categories has slowed in line with the slowdown in economic activity.

3 Court of Audit of the Republic of Slovenia: Report on the conference by the Court of Audit with local government representatives in 2007 and 2008.

The state budget recorded a net deficit of EUR 64.7 million against the EU budget in 2008.

Non-tax revenues, which account for approximately 5% of all revenues, were up 20.3% on the previous year. The state budget recorded a net deficit of EUR 64.7 million against the EU budget. Funds received from the EU rose by 5% relative to 2007. However, realisation of available funds from the EU budget was only 46.4%. No other revenues, except those relating to pre-accession assistance, were fully realised.

Growth in expenditure was up in the final quarter of the year.

General government expenditure amounted to EUR 15,435 million in 2008, or 41.6% of GDP. The largest increases among major expenditures last year were recorded by expenditure on goods and services, investment expenditure and transfers and payments to the EU budget. Expenditure on goods and services and investments expenditure were up 14.2% and 10.7% respectively. Growth in investment expenditure was high for the third consecutive year, with the largest increase recorded by local government expenditure for new build, reconstructions and adaptations, which accounts for more than a half of all investment expenditure. Payments to the EU budget were also up significantly (20.2%) on the previous year, primarily due to higher liabilities from gross national income. A new public sector wage system was also introduced in 2008. With the payment of August wages, the first of four public sector wage increases aimed at gradually eliminating wage discrepancies was made in September. As a result the average wage in the public sector last year was 9.7% higher compared with 2007, representing an additional burden for the payment of wages. Expenditure on transfers to individuals was up sharply in the second half of 2008, particularly in the final quarter.

Transfers to individuals and households were up 10.3% in 2008 relative to 2007.

In 2008 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 10.3% higher relative to 2007. Growth was higher in the second half of last year in all categories. There were several reasons for this, including the payment of a cost-of-living allowance to pensioners in August, a pension increase with retroactive settlements, and subsidies for school meals. Within transfers to individuals and households, pension expenditures were up 9.7% during this period. Old age pensions were the most important factor in this increase; with the number of old age pensioners increasing by 3.1% in 2008 compared with the previous year. The basic pension was 8.3% higher in 2008 than the previous year. Transfers for family benefits and parental allowances were also up sharply (by 14.4%), while social security transfers and sick pay were up 13.5% and 8.7% respectively. The high growth in parental allowances was the result of an increase in the number of claimants (according to initial estimates there were 10% more births in 2008 than in the previous year), and the level of the allowance itself. Fewer payments for unemployment were the sole contributing factor to the favourable trends in the first half of the year; later this trend ceased. After several years of decline, expenditure on the unemployed began rising again towards the end of the year.

The government recorded a net increase in borrowing in the context of a general government deficit.

In the context of a surplus in revenues over expenditure of EUR 99.7 million and a deficit in net loans granted and sales of capital holdings in the amount of EUR 86.3 million, the government borrowed in the net amount of EUR 135.6 million in 2008, while lowering its bank balances by EUR 321.6 million. In 2008 the government borrowed EUR 1,142 million, with funds received for the issue of securities on the domestic market totalling EUR 961 million, the majority of which related to the issue of reference bond in February 2008. The government also repaid debt in the amount of EUR 1,278 million.

According to the national methodology, the central government debt stood at EUR 7,182 million at the end of 2008, or 19.2% of GDP. At the end of 2008, domestic debt accounted for 65% of total government debt, down 1 percentage point from the end of the previous year. The prevailing 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 2008. It released nine issues of 3-month treasury bills. The individual issues amounted to EUR 50 million, with the interest rates ranging from 3.90% to 4.53%. In February 2008 the Ministry of Finance issued 11-years reference bond in the amount of EUR 1 billion, with an interest rate of 4.375%. The bond matures in 2019.

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

	2007			2008			y-o-y
	in EUR mio	(% GDP)	share	in EUR mio	(% GDP)	share	growth
Consolidated general government accounts*							
Revenue	**14,010**	**41.8**	**100.0**	**15,335**	**41.3**	**100.0**	**9.5**
Taxes	12,758	38.0	91.1	13,937	37.5	90.9	9.2
- on goods and services	4,498	13.4	32.1	4,805	12.9	31.3	6.8
- social security contributions	4,598	13.7	32.8	5,095	13.7	33.2	10.8
- on income and profit	2,918	8.7	20.8	3,442	9.3	22.4	18.0
Receipts from the EU budget	348	1.0	2.5	365	1.0	2.4	5.0
Other	904	2.7	6.5	1,033	2.9	6.7	14.2
Expenditure	**13,914**	**41.5**	**100.0**	**15,435**	**41.6**	**100.0**	**10.9**
Current expenditure	5,947	17.7	42.7	6,555	17.6	42.5	10.2
Current transfers	6,143	18.3	44.2	6,741	18.2	43.7	9.7
Investment expenses and transfers	1,468	4.4	10.6	1,710	3.4	11.1	16.5
Payments to the EU budget	356	1.1	2.6	428	1.1	2.8	20.2
Balance	**96**	**0.3**		**-100**	**-0.3**		
Central government debt	**7,395**	**22.0**		**7,182**	**19.2**		
General government debt (ESA 95)	**8,071**	**23.4**		**8,473**	**22.8**		

Note: Figures in the table are based on the national methodology, except for the general government's debt, which is based on ESA95. * The general government comprises the state budget, the Pension and Disability Insurance Institute, the Health Insurance Institute and local government budgets.

Sources: SORS, Ministry of Finance

Box 3: **Fiscal policy measures to mitigate the effects of the financial turmoil**

The Slovenian government has responded to the deteriorating economic conditions with a broad range of measures to mitigate the effects of the crisis. The measures are aimed at ensuring the smooth functioning of the financial system and at bolstering confidence.

The government adopted the first package of anti-crisis measures in the final quarter of 2008, which included an unlimited guarantee on bank deposits of individuals until 31 December 2010, pursuant to Article 310 of the Banking Act. In this regard, banks established in the Republic of Slovenia guarantee the payment of deposits at a bank against which bankruptcy proceedings have been initiated up to a net deposit balance of EUR 22,000, above which the Republic of Slovenia guarantees payment in the manner set out in the aforementioned act. At the same time, the Act Amending the Public Finance Act was passed to improve the economic stability of banks. The amended act stipulates that the government may seek additional borrowing for the purpose of granting loans to the credit institutions set out in the Banking Act, and to insurance companies, reinsurance companies and pension companies established in Slovenia, for government guarantees totalling EUR 12 billion for the refinancing of credit institutions established in Slovenia, for capital investments by the government in credit institutions, insurance companies, reinsurance companies and pension companies established in Slovenia, and for the purchase of receivables of credit institutions.

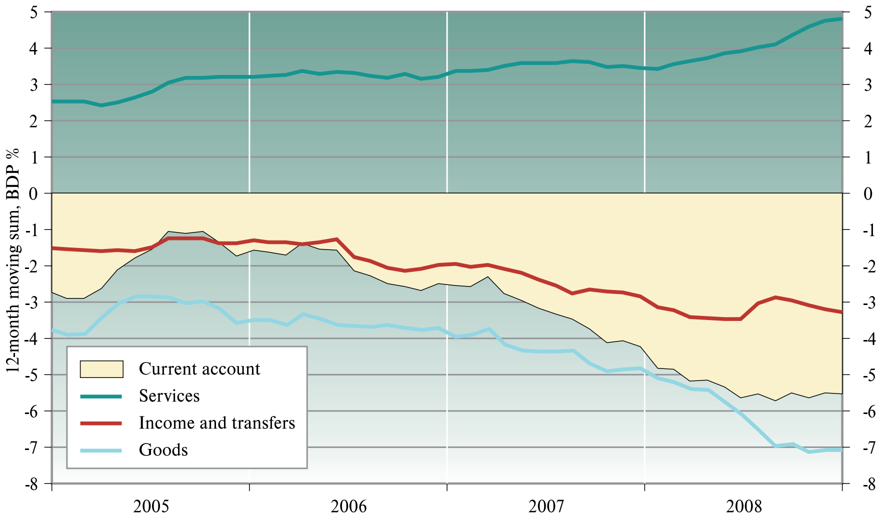
In December the government adopted the Partial Subsidisation of Full-Time Employment Act aimed at maintaining the number of jobs and ensuring the social security of the population. Subsidies have been available to employers since February. Employers that shorten working hours from 40 to 36 hours a week are entitled a subsidy of EUR 60 and an additional subsidy of EUR 15 for each additional hour, to a limit of 32 hours a week. Subsidies may be received for a maximum of six months, while the application for subsidisation must be submitted no later than 30 September 2009. While receiving subsidies an employer must pay wages and social contributions for those workers for whom they receive subsidisation, and may not release employees for business reasons, order overtime work or pay bonuses to management and supervisory bodies during the fiscal year. EUR 230 million was earmarked for this measure in the revision to the state budget for 2009. Among other measures aimed at improving the state of the economy, the government passed the Act Amending the Tax Procedure Act, which relates to the change to the method of determining corporate income tax prepayments. Also adopted was the Act Amending the Personal Income Tax Act, which is linked to increasing tax relief for investments in equipment and intangible fixed assets, applicable to investments made in 2008.

1.2.5 Balance of payments and external debt

The current account deficit widened to 5.5% of GDP in 2008.

A more significant current account deficit has been present since 2003, and it has widened by approximately 1.5 percentage points of GDP annually over the last two years. The deficit stood at EUR 2,055 million in 2008 or 5.5% of GDP and was 1.3 percentage points higher than the 2007 deficit of 4.2% of GDP. The deficit reached its highest level since Slovenia's independence. The biggest contribution to the current account deficit in 2008 came from developments in merchandise trade with the rest of the world: over the first three quarters, in the context of falling foreign demand, year-on-year growth in imports of goods outpaced year-on-year growth in exports by more than 5 percentage points in the context of relatively high domestic investment spending and high growth in import prices. The merchandise trade deficit was up more than EUR 1 billion on the previous year, at EUR 2,622 million. In addition to the merchandise trade deficit, the deficit in the transfer account of EUR 188 million and net outflows of factor income in the amount of EUR 1,026 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 1,782 million.

Figure 17: **Balance of payments current account**



Sources: SORS, Bank of Slovenia

The trade deficit widened to 8.6% GDP, the highest level since independence.

The widening of the current account deficit with the rest of the world derives primarily from merchandise trade. Slovenia's trade deficit with the rest of the world reached EUR 3,209 million in 2008[4] or 8.6% GDP, and was more than 2 percentage points higher than in 2007. It also exceeded the previously highest trade deficit of 7.7% of GDP recorded in 1999. Merchandise trade with the rest of the world rose in 2008, primarily in terms of value; volume was up only on the import side, while exports stagnated. Exports of goods totalled EUR 19.8 billion, up 2.0% on 2007. Imports of goods grew nearly 5 percentage points faster than exports, and were up 6.9% on 2007 at EUR 23.0 billion. The coverage of imports by exports fell by 4 percentage points to 86.0% in the context a widening gap between growth in exports and imports.

Export prices rose significantly slower than import prices.

In terms of volume, growth in imports and exports of goods was lower in 2008 than indicated by indices calculated from the figures expressed in euros. The reason for this difference is that export and import prices of goods in 2008, calculated from national accounts figures, were up on 2007. In contrast to a year earlier, growth in import prices significantly outstripped growth in export prices. The faster growth in import prices than export prices began in the final quarter of 2007, and reached its peak in the third quarter of 2008, when import prices were up 6.2% year-on-year compared with export prices, which were up 1.8%. The growth in US dollar prices of food and oil on world markets contributed most to the growth in import prices, in which intermediate goods prevail. The year-on-year growth in US dollar food and oil prices exceeded 50% in the first half of 2008, and was only partially offset by the simultaneous appreciation of the euro against the US dollar of more than 15%. Commodity prices on world markets began to ease in the third quarter as a result of the financial turmoil and economic crisis. These have fallen sharply since mid-September. Therefore, year-on-year growth in prices of all major product categories were profoundly negative in the final quarter of 2008: prices of manufactured goods, food and metals were down 38.2%, 10.5% and 42.1% respectively, while the price of a barrel of North Brent crude was down 37.1%. The favourable effect of falling import prices was partially offset by the depreciation of the euro against the US dollar by 9.1% in the final quarter of 2008.

Terms of trade deteriorated significantly compared to 2007.

Terms of trade deteriorated significantly from the previous year as a result of faster growth in import prices than export prices over the first three quarters of 2008. On average, euro export prices rose by 1.5% year-on-year in 2008, and euro import prices by 3.5%. In 2008 terms of trade deteriorated by 2% compared with 2007, the largest annual deterioration since 2005. Deterioration in terms of trade with the rest of the world contributed slightly less than EUR 500 million or 1.3% of GDP to the merchandise trade deficit.

Exports and imports of capital goods recorded the fastest growth.

Similar to the previous year, trade in high value added merchandise recorded the fastest growth in Slovenia in 2008. By individual economic categories of merchandise trade in 2008, the fastest growth was recorded by Slovenian exports and imports of capital goods. Exports of capital goods were up 15.2% year-on-year, the largest year-on-year increase recorded in the third quarter (27.6%), while growth in the first half of the year was slightly less than 15%, and less than 6% in the final quarter. The largest increase was recorded in exports of specialised industrial machinery, office and automated data processing machinery, other transport equipment and prefabricated buildings. Year-on-year growth in intermediate goods of 3.1% was approximately five times lower than growth in exports of capital goods. The most significant effect of the global financial turmoil and economic crisis was seen in a decrease in foreign demand for consumer goods, exports of which were down 3.2% in year-on-year terms in 2008. Alongside products from the textile and

4 Trade deficit according to SORS figures. * Exports f.o.b. and imports c.i.f.

footwear industries, exports of road vehicles recorded the largest decrease. Similar to exports, growth in imports of consumer goods recorded the sharpest drop, from 25.7% in 2007 to 4.5% in 2008. Growth in imports of intermediate goods was affected by high growth in import prices of energy and commodities, particularly in the second and third quarters and, at 6.5%, grew somewhat slower than overall growth in merchandise imports. Strong growth in imports of capital goods, except in the final quarter, was also present in 2007, when imports of capital goods were up 18.1% year-on-year. This trend continued in 2008, when growth reached 13.3%. Growth in imports of consumer and capital goods in 2008 was affected by high growth in domestic consumption, primarily investment spending which, similar to 2007, was the main engine of Slovenian economic growth over the first three quarters of 2008.

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

	EXPORTS			IMPORTS			TRADE BALANCE		
EUR million	2006	2007	2008	2006	2007	2008	2006	2007	2008
European Union (27)	**11,767**	**13,707**	**12,861**	**14,896**	**16,976**	**16,732**	**-3,129**	**-3,269**	**-3,871**
Eurozone	**9,032**	**10,147**	**9,474**	**12,527**	**14,135**	**13,873**	**-3,495**	**-3,988**	**-4,399**
Austria	1,451	1,513	1,451	2,245	2,692	2,615	-794	-1,179	-1,164
France	1,135	1,278	1,228	1,129	1,152	1,120	6	126	108
Italy	2,157	2,565	2,254	3,405	3,928	3,876	-1,248	-1,363	-1,622
Germany	3,296	3,652	3,528	3,743	4,178	4,036	-447	-526	-508
New member states	**1,923**	**2,676**	**2,611**	**1,841**	**2,252**	**2,321**	**82**	**424**	**290**
Czech Republic	390	489	454	399	506	523	-9	-17	-69
Hungary	385	647	580	671	758	813	-286	-111	-233
Poland	488	617	662	303	355	386	185	262	276
Slovakia	272	311	336	259	283	290	13	28	46
EFTA	**196**	**242**	**207**	**267**	**225**	**195**	**-71**	**17**	**11**
Non-European OECD members	**658**	**619**	**516**	**615**	**1,114**	**1,020**	**43**	**-495**	**-505**
United States	384	329	258	199	280	355	185	49	-97
Canada	36	42	29	33	65	89	3	-23	-60
South Korea	16	18	16	110	477	307	-94	-459	-291
Countries of former Yugoslavia	**2,736**	**2,990**	**3,074**	**1,350**	**1,585**	**1,482**	**1,386**	**1,405**	**1,592**
Bosnia and Herzegovina	485	536	585	313	321	296	172	215	289
Croatia	1,464	1,570	1,585	736	849	780	729	721	805
Macedonia	126	144	168	38	58	43	87	86	125
Serbia	509	670	660	239	352	361	270	318	300
Countries of former Soviet Union	**870**	**1,055**	**1,091**	**436**	**555**	**447**	**435**	**500**	**644**
Russian Federation	600	692	764	357	490	340	242	202	424
Other countries	**530**	**804**	**852**	**775**	**1,061**	**1,581**	**-246**	**-257**	**-729**
China	54	61	62	246	346	408	-192	-285	-346
TOTAL	**16,757**	**19,385**	**18,599**	**18,339**	**21,508**	**21,457**	**-1,582**	**-2,123**	**-2,858**

Note: Exports f.o.b. and imports c.i.f.
Sources: SORS; figures for 2008 are preliminary.

The proportion of Slovenian exports and imports to and from EU Member States is declining.

Last year the global financial turmoil and economic crisis had the fastest impact on Slovenia's most important EU trading partners, which is reflected in changes in the regional breakdown of Slovenia's merchandise trade with the rest of the world. EU Member States accounted for 69.0% of total exports, down 1.6 percentage points year-on-year, and for 77.7% of imports, down 1.2 percentage points. In this regard, primarily the proportion of trade with the euro area is declining (exports were down 1.6 percentage points to 50.7%, while imports were down slightly less, by 1.3 percentage points to 64.4%), while merchandise trade with countries which joined the EU after May 2004 is rising. Among Slovenia's most important euro area trading partners, exports to Germany (up 2.2%), Austria (up 2.7%) and France (up 0.9%) recorded above average growth. Only exports to Italy recorded a decline (by 7.0%), resulting in a drop in exports to Italy as a proportion of total exports from 13.2% in 2007 to 12.1% in 2008. Among new EU Member States, exports to Poland and Slovakia recorded above average growth of more than 15%, while exports to Hungary were down 4.9% also due to the high basis from 2007 (when an increase of 68.1% was recorded), as were exports to the Czech Republic (down 0.6%). Among Slovenia's more important partners, growth in imports from France (2.0%), Austria (4.9%) and Germany (3.1%) was below average, while only growth in imports from Italy was above average (5.6%).

In 2008 exports to the former Yugoslav republics grew faster than imports.

After Slovenia joined the EU and until the end of 2007, imports from the former Yugoslav republics grew faster than exports. This trend reversed in 2008, when exports to the former Yugoslav republics grew by 10.1% year-on-year, while imports were up 0.5%. Above average increases were recorded by merchandise exports to Macedonia (25.7%), while imports declined by 20.7%, and to Bosnia and Herzegovina (exports: 16.8%; imports: -2.9%). Trade with Croatia grew somewhat below the average trade with the former Yugoslav republics (exports: 7.9%; imports: -1.9%), and with Serbia, where exports were up 5.8% and imports were up 8.8%, which is well above growth of total imports from the former Yugoslav republics. Growth in exports to the Russian Federation was also above average in 2008 at 15.8%, while imports were down more than a quarter in year-on-year terms.

The deficit in merchandise trade with EU Member States is widening, while the surplus with non-EU counties is narrowing.

Slovenia's deficit in merchandise trade has been widening at an accelerated pace in the last two years. In 2008 the deficit widened by EUR 1.1 billion, to reach EUR 3.2 billion, or 8.6% of GDP. The deficit in merchandise trade with EU Members States is widening, having reached EUR 4.2 billion or 11.4% of GDP in 2008. Slovenia has recorded surplus in merchandise trade with non-EU countries, which has gradually fallen since Slovenia joined the EU. The surplus fell by EUR 125 million in 2008, relative to the previous year, to EUR 1.0 billion, or by 0.5 percentage points to 2.8% of GDP.

The surplus in trade in services reached a record 4.8% GDP.

In 2008, growth in trade in services significantly outstripped growth in merchandise trade, particularly on the export side. Growth in exports of services was actually more than twice as high as growth in imports of services. Exports of services were up 20.8% year-on-year in 2008 at EUR 5.2 billion, while imports were up 9.8% at EUR 3.4 billion. In the context of faster growth in exports of services than imports, the surplus in trade in services increased by EUR 0.6 billion year-on-year to EUR 1.8 billion. Between 2005 and 2007 the surplus in trade in services held steady at just over 3% of GDP. Despite the global financial turmoil and economic crisis, the surplus was up more than one percentage point in 2008 to reach a record of 4.8% of GDP.

The surplus in tourism is widening despite the deteriorating economic conditions.

Results in the tourism sector were the largest factor in the services surplus. Revenues from tourism, totalling EUR 2,080 million, were up 14.8% year-on-year which, given the 1% increase in the number of arrivals of foreign tourist in Slovenia and the decline in the number of overnight stays by foreign visitors of 1%, indicates increased spending by foreign tourists in Slovenia. In the context of deteriorating economic conditions, which were particularly evident in the second half of 2008, expenditure on tourism grew three times slower than revenues from tourism. Expenditure stood at EUR 865 million, an increase of just 4.1% from 2007. The tourism trade surplus was up EUR 235 million year-on-year to EUR 1,215 million, representing 68.0% of the overall surplus in trade in services in 2008.

The transport services surplus has grown, while the deficit in other services has narrowed significantly.

Since Slovenia's entry to the EU, transport services have recorded the most significant improvement, as the transport services surplus more than doubled between 2003 and 2008. In 2008 transport revenues grew by 14.0% year-on-year while transport expenditure was up 15.2%, taking the surplus up by just under one-eighth to EUR 589 million. Other services in total recorded a net outflow, the deficit of EUR 22 million representing just 7% of the deficit recorded in 2007. The largest increase among other services in 2008 was recorded by trade in patents, licences and copyrights, with exports and imports up 103.8% and 39.9% respectively. Expenditure on construction and assembly work in Slovenia was down 4.2% year-on-year to EUR 154 million, as a result of a slight decrease from 2007 in domestic investment in construction. On the other side, revenues from exports were up 95.3% year-on-year, at EUR 296 million. In contrast to 2007, a surplus of EUR 142 million was recorded in 2008 in the context of the aforementioned growth in exports and imports. Alongside construction services and assembly work, trade in communication and financial services also recorded above-average growth in 2008. Among other business services, exports and imports of various business and technical services recorded above-average growth of 29.8% and 10.9% respectively. In addition to the latter, revenues from operating leases were up 12.0% on the export side, while revenues and expenditure from foreign trade intermediation were both down.

Net outflows of factor income have risen again, outflows of capital income most significantly.

Between 2003 and 2006 net outflows of factor income held steady at around 1% of GDP. However, in addition to the widening deficit in merchandise trade with the rest of the world, they have become the most significant factor in Slovenia's current account deficit with the rest of world over the last two years. Net outflows of factor income rose by EUR 300 million year-on-year in 2008, to reach EUR 1,026 million. In the context of increasing employment of foreign labour in Slovenia, net inflows of labour income have been falling for a number of years. In 2007 net inflows were down by just under one-third on the previous year, while a net outflow of EUR 25 million was recorded in 2008. Net outflows from capital income have recorded the most significant increase in recent years under the influence of foreign direct investments (FDI), increasing indebtedness abroad and rising interest rates on world financial markets until the last quarter of 2008. The deficit in capital income was up EUR 215 million on 2007 at EUR 1,001 million. The trend of a net repatriation of dividends and profit distributions from FDI, which began after 2005, continued in 2008. Last year foreign-owned companies reinvested just EUR 16.0 million in Slovenian companies of the EUR 540 million in earnings from equity, while transferring the remainder to parent companies in the rest of the world. With regard to capital income, income and expenses from investments in securities rose by 12.6% and 4.3% respectively. As a result of these trends the net inflow of income from these investments was up EUR 40 million in year-on-year terms to EUR 262 million in 2008. On the income side, the largest increase was recoded by banks' income from bonds and notes. The relatively rapid change from net claims of EUR 0.9 billion at the end of 2005 to a net external debt of EUR 9.5 billion at the end of 2008, and the rise in interest rates on global financial markets at the beginning of 2008 were the main factors in the deterioration in net factor income during this period. Net outward interest payments were up EUR 244 million last year to EUR 792 million.

The deficit in current transfers was down more than one-third on 2007 at EUR 188 million, and contributed nearly 10.0% to the current account deficit. The largest year-on-year improvement in 2008 was recorded by private transfers, from a deficit of EUR 51 million in 2007 to EUR 6 million. The most significant factor in the improvement in private transfers was the surplus in taxes and social contributions on the gross earnings of workers, which increased from EUR 62 million to EUR 80 million in 2008. There was also somewhat smaller improvement in official transfers in 2008, the deficit narrowing by EUR 39 million in year-on-year terms to EUR 183 million. The majority of the improvement in official transfers relates to receipts from subsidies on products, other subsidies on production, and taxes on income, wealth and other. The net position of the budget of the Republic of Slovenia against the EU budget deteriorated significantly relative to 2007, and contributed EUR 64.7 million to the deficit in official transfers.

The deficit in current transfers narrowed by one-third year-on-year.

Table 5: **Balance of payments**

EUR million	2003	2004	2005	2006	2007	2008
A. CURRENT ACCOUNT	**-196**	**-720**	**-498**	**-771**	**-1,455**	**-2,055**
- in % of GDP	***-0.8***	***-2.6***	***-1.7***	***-2.5***	***-4.2***	***-5.5***
1. Goods	-543	-1,009	-1,026	-1,151	-1,666	-2,622
2. Services	540	688	920	993	1,193	1,782
2.1. Transport	260	324	398	456	525	589
2.2. Travel	522	608	743	783	980	1,215
- exports	1,186	1,312	1,451	1,555	1,811	2,080
2.3. Other	-243	-245	-221	-247	-312	-22
3. Income	-219	-322	-295	-440	-708	-1,026
3.1. Labour income	135	138	128	107	78	-25
3.2. Investment income	-353	-460	-424	-547	-786	-1,001
4. Current transfers	26	-76	-97	-173	-274	-188
B. CAPITAL ACCOUNT	**-1**	**1**	**-114**	**-131**	**-52**	**-84**
C. FINANCIAL ACCOUNT	**197**	**719**	**612**	**902**	**1,507**	**2,139**
1. Private sector:	-135	942	1,448	-361	-2,314	1,410
1.1. Claims	-467	255	-3,337	-4,699	-9,035	-1,897
Outward FDI	-6	-28	-516	-687	-1,319	-983
Portfolio investments	5	1	-1,383	-2,094	-3,705	358
Trade credits	-235	-320	-227	-442	-394	-211
Loans	-4	-57	-340	-733	-1,890	-540
Cash and deposits	-227	659	-872	-743	-1,727	-522
1.2. Liabilities	332	688	4,784	4,338	6,721	3,307
Inward FDI	138	295	473	513	1,050	1,239
Portfolio investments	-2	48	210	176	94	-124
Trade credits	18	11	293	479	511	169
Loans	49	317	2,758	2,179	3,883	1,877
Deposits at banks	128	18	1,051	991	1,182	147
2. Government	449	138	-159	383	900	762
3. Bank of Slovenia	-359	-1,149	-189	1,287	3,639	59
4. Other	241	787	-488	-407	-718	-92

Source: Bank of Slovenia

The relatively large current account deficit of EUR 2.1 billion was financed by net financial inflows of EUR 1.4 billion into the private sector and EUR 0.8 billion into the government sector. The financial inflow into the general government sector was primarily the result of February's issue of government bonds in the amount of EUR 1.1 billion.

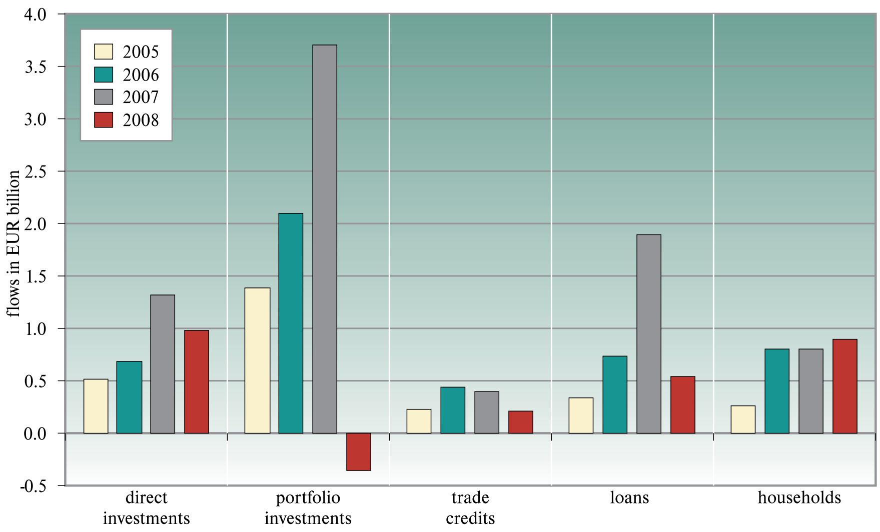
The financial account was affected by developments in the real economy and the consequences of the financial turmoil.

Developments on the balance of payments financial account were linked to developments in the real economy and, as a consequence, the demand for financing, while the most significant factor since September was the deepening of the financial turmoil. This has resulted in both increased risk tied to investments abroad and in the tightening of financing conditions in the rest of the world. In the first half of the year both the private sector's external claims and liabilities increased at a pace similar to that in 2007, under the influence of still relatively rapid economic growth and Slovenia's increasing involvement in international financial flows. During this period the private sector's external claims and liabilities were up EUR 3.1 billion and EUR 3.8 billion respectively. In the second half of the year, the private sector's external claims and liabilities were down EUR 1.2 billion and EUR 0.5 billion respectively, as a result of the economic slowdown and, even more so, the financial turmoil from September on. Thus the overall increase in the private sector's external claims and liabilities in 2008 was down significantly relative to 2007.

In 2008 all categories of claims were down relative to 2007.

The largest increases among external claims in 2008 were recorded by FDI (EUR 1.0 billion), loans (EUR 0.5 billion) and deposits in the rest of the world (EUR 0.4 billion). The increases of all types of claims were down significantly from 2007, primarily as a result of a decline in investments since September due to the financial turmoil. This was most evident in loans to the rest of the world, which increased by EUR 0.5 billion in the first eight months of the year, but remained unchanged between September and December, and in currency and deposits, which increased by EUR 1.1 billion in the first eight months of the year, then declined by EUR 0.6 billion between September and December.

Figure 18: **Breakdown of financial flows to the rest of the world**

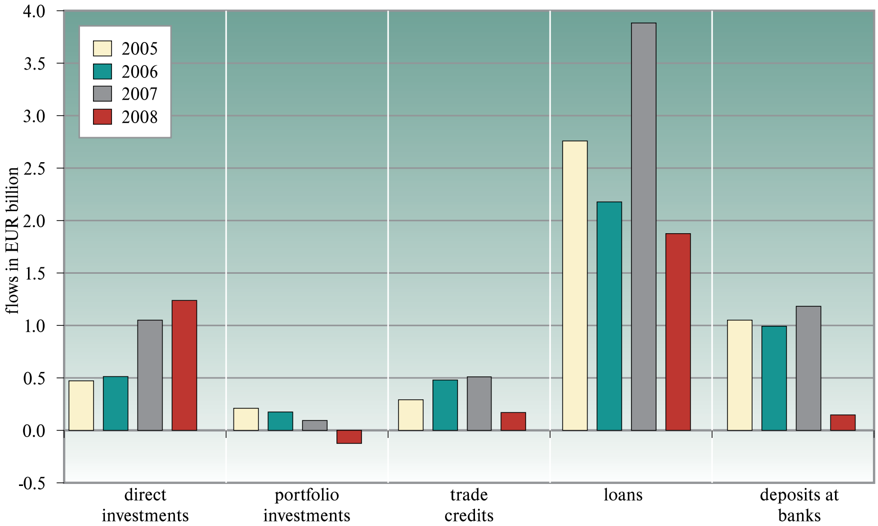


Source: Bank of Slovenia

Loans and deposits were also prevalent among outflows.

Most prevalent among the private sector's external liabilities in 2008 were loans from the rest of the world and FDI. Of the total increase of EUR 3.3 billion in the private sector's external liabilities, loans from the rest of the world accounted for EUR 1.9 billion and FDI for EUR 1.2 billion, two-thirds of the loans going to banks, and one-third to corporates. The increases of all categories of liabilities other than FDI declined significantly compared with 2007, primarily as a result of the lower demand for financing from the middle of the year, and the financial turmoil from September on. This was most evident in loans from the rest of the world, which increased by EUR 2.1 billion in the first half of the year, but declined by EUR 0.2 billion in the second half of the year, and deposits at banks, which increased by EUR 0.6 billion in the first half of the year, but declined by EUR 0.4 billion in the second half of the year.

Figure 19: **Breakdown of financial flows from the rest of the world**



Source: Bank of Slovenia

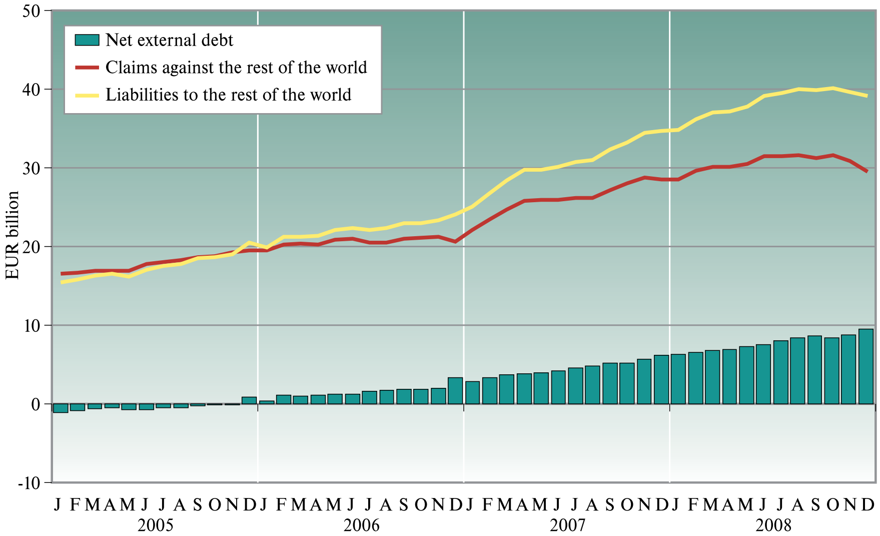
Gross external claims and liabilities declined from September on.

The continuation of relatively strong flows with the rest of the world until August, in which debt instruments were prevalent, was reflected in an increase in gross external claims and liabilities, but gross external claims and liabilities both declined from September on primarily as a result of the effects of the financial turmoil. Slovenia's gross external claims increased from EUR 28.6 billion at the end of 2007 to EUR 31.7 billion at the end of August 2008, while its gross external debt increased from EUR 34.8 billion to EUR 40.0 billion over the same period. Both external claims and liabilities declined from September on, gross external claims reaching EUR 29.6 billion and the gross external debt EUR 39.1 billion.

Net external debt stood at EUR 9.4 billion at the end of 2008.

The prevailing net financing from the rest of the world via debt instruments is reflected in an increase in net external debt and deterioration in the current account. Net external debt rose by EUR 2.5 billion in 2006, EUR 2.8 billion in 2007 and EUR 3.3 billion in 2008. Over the first eight months of 2008 the net external debt increased primarily on account of higher borrowing, but from September on it was primarily on account of a decline in outward investments. The net external debt thus stood at EUR 9.5 billion at the end of the year. An increase in the net external debt also increased the burden of financing, which leads to additional deterioration in the current account.

Figure 20: **External debt**



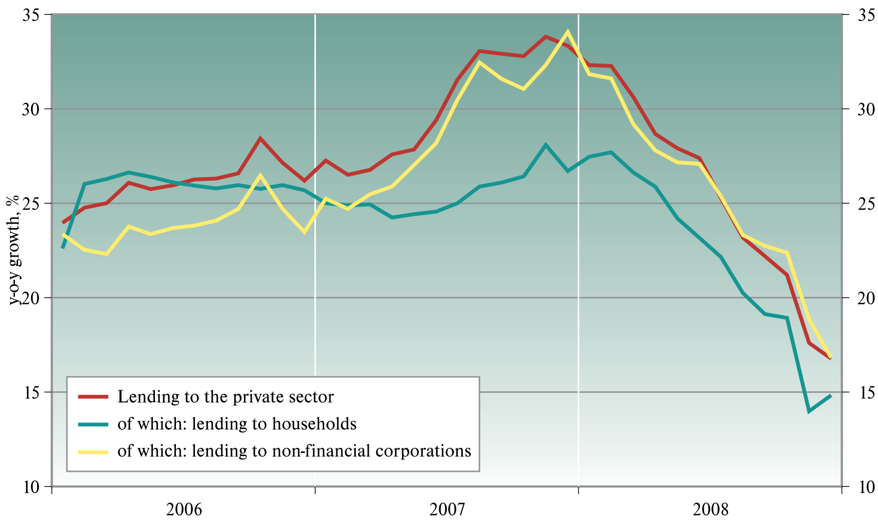
Source: Bank of Slovenia

1.2.6 Financing conditions

Diminishing demand for financing from the private sector, primarily due to the slowdown in economic activity.

In 2008 diminishing demand for financing from the domestic private sector [5] was linked to the slowdown in economic activity, particularly investment activity, the slowdown particularly evident in the second half of the year. The rapid easing of prices and turnover on the real estate market also contributed to the diminishing demand for financing. Developments in the final months of the year and the related deterioration in borrowing terms resulted in difficult access to financing, particularly in the rest of the world. The process of financial deepening has continued, where the development of the domestic financial sector is catching up with the level of more developed economies, but at a slower pace.

Figure 21: **Lending to the domestic private sector**



Source: Bank of Slovenia

5 The domestic private sector includes non-financial corporations, households and non-monetary financial institutions.

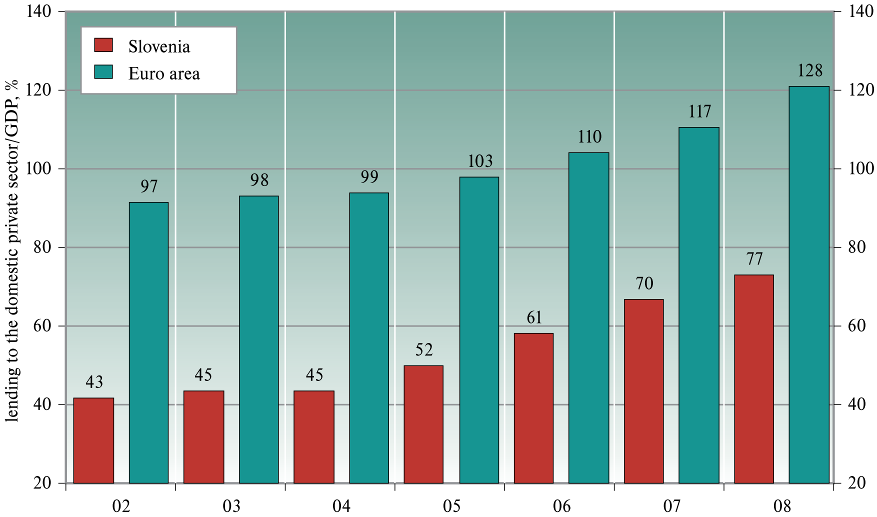
Similar to the previous year, needs were financed primarily via bank credit channels. Bank lending to the private sector, which achieved year-on-year growth of nearly 35% by the end of 2007, slowed relatively quickly in 2008, falling to below 20%. Decrease in growth of lending was a bit more notable within non-financial corporations than within households.

The rate of growth in lending to private sector has slowed.

The process of financial deepening slowed in 2008 in the context of somewhat slower growth in borrowing by the domestic private sector at banks. The depth of financial intermediation, measured by lending 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 was up 7% to 77% of GDP in 2008. Measured as such, the difference of financial deepening between the euro area and Slovenia has fallen from approximately 60% of GDP in 2003 to around 50% of GDP in recent years.

Slower growth in financial deepening.

Figure 22: **Financial deepening**



Sources: ECB, Bank of Slovenia

Box 4: **Measures taken by the Bank of Slovenia following the deepening of the financial turmoil**

Dependence on funding from the international banking market has increased the vulnerability of the domestic banking sector in the context of crisis conditions. September's deepening of the financial turmoil significantly restricted banks' access to funding in the rest of the world. This was also seen in a reversal of flows from bank borrowing in the rest of the world, as banks borrowed EUR 2.6 billion abroad in the first eight months of 2008, and made repayments of EUR 1.2 billion from September to December 2008. Banks responded to the tightened financing conditions in the rest of the world by increasing borrowing from the Eurosystem and by stimulating domestic saving in the form of deposits.

In addition to its operations within the ESCB framework, the Bank of Slovenia adopted several measures to strengthen the position of Slovenian banks with regard to funding lending activity:

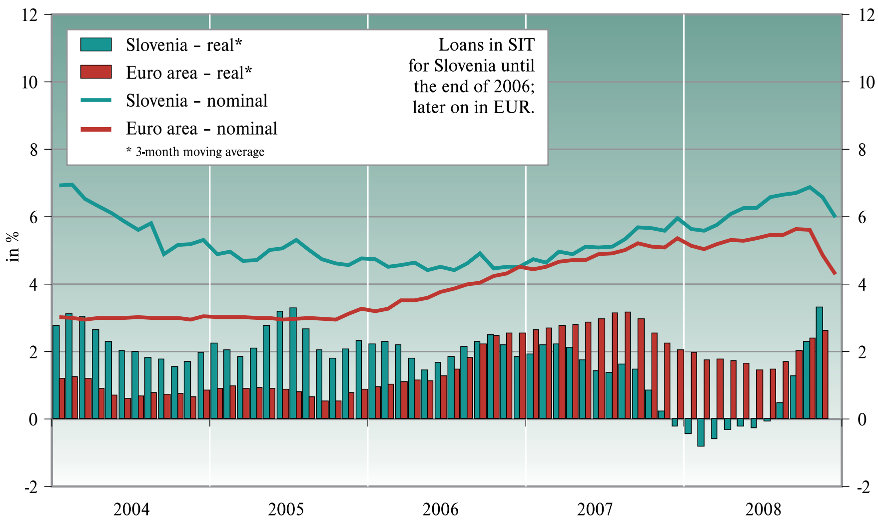
- In October it amended the Regulation on the Assessment of Credit Risk Losses of Banks and Savings Banks, eliminating the effects of the prudential filter in the formation of impairments and provisions. This produced an anti-cyclical effect and resulted in the improved capital adequacy of banks.
- In November it adjusted the liquidity ladder with regard to the value of pledged collateral at the central bank, and thus facilitated banks' greater access to liquidity at the Eurosystem.
- At the end of November it called on banks to halt the excessive raising of interest rates on sight deposits. It also called on banks to appropriately assess credit risks in the context of deteriorating economic conditions and to form an appropriate level of impairments.

- In January it sent banks recommendations linked to measuring the value and impairments of financial assets for final accounts and the compilation of annual reports for the 2008 financial year. It also amended the Regulation of the Assessment of Credit Risk Losses of Banks and Savings Banks by requiring monthly reporting on the formation of impairments and provisions and classified assets from April 2009 on. Due to the continued tightening of conditions on the financial markets, the Bank of Slovenia recommended that banks coordinate their planned credit activity with available and stable sources of funding, and retain their 2008 earning to improve banks' capital strength.

Less favourable financing conditions for non-financial corporations towards the end of the year.

The relatively rapid slowdown in lending to non-financial corporations was primarily linked to slowing economic and investment activity, and additionally due to the effects of the financial turmoil towards the end of the year. Despite the gradual rise in nominal interest rates, financing conditions for non-financial corporations remained favourable until the final quarter. Since the end of 2006 the movement and level of nominal interest rates on loans to non-financial corporations in Slovenia have been comparable to those in the euro area, an indication of the Slovenian financial system's significant level of integration with the euro area. During this period real interest rates in Slovenia were lower than euro area rates due to somewhat higher inflation. Financing conditions in Slovenia were therefore more favourable than in the euro area, which stimulated lending. In the final quarter of 2008 real interest rates in the euro area, and particularly in Slovenia, rose due to somewhat lower inflation, despite falling nominal interest rates. This, in addition to the financial turmoil and associated uncertainties, resulted in a further reduction of growth in lending activity in Slovenia and the euro area.

Figure 23: **Interest rates for loans of more than EUR 1 million for non-financial corporations**



Sources: ECB, Bank of Slovenia

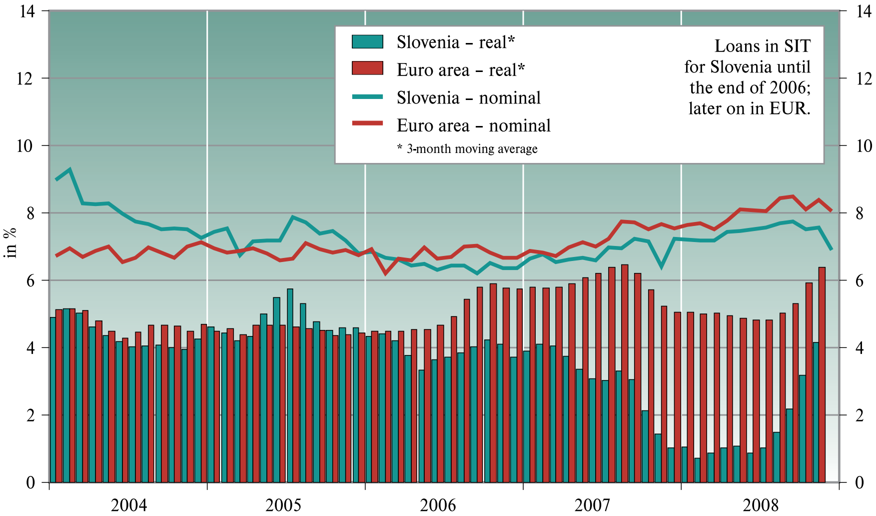
Lower growth in lending to households primarily due to a slowdown in real estate market.

The slowing growth in lending to households is primarily due to the easing of prices and a drop in the number of transactions in the real estate market, as well as the cooling of domestic private consumption. Year-on-year growth in housing loans fell from nearly 40% at the beginning of the year to just above 25% by the end of the year. This growth rate is still significantly higher than the rate recorded by consumer loans, where year-on-year growth fell from approximately 20% at the beginning of the year to around 5% by the end of the year. This is in line with growth of domestic private consumption, which fell from 5.3% in 2007 to 2.2% in 2008.

Financing conditions for household consumption were also more favourable in Slovenia than in the euro area until the middle of the year. Since the beginning of 2006 nominal, and to a greater extent, real interest rates for consumer loans in Slovenia have been lower than in the euro area. This was particularly evident with regard to real interest rates due to somewhat higher inflation in Slovenia than in the euro area. In the final quarter of 2008 real interest rates rose due to lower inflation, despite falling nominal interest rates, which additionally decreased lending of consumer loans.

Financing conditions for households also tightened towards the end of the year.

Figure 24: **Interest rates for consumer loans to households**



Sources: ECB, Bank of Slovenia

The flow of loans to banks from the rest of the world and the flow of deposits by non-residents amounted to EUR 2.6 billion over the first eight months of 2008, while the flow of loans to the domestic private sector stood at EUR 3.7 billion. This means that banks financed more than two-thirds of loans to the domestic private sector during this period by borrowing abroad. Extensive financing from the rest of the world increased the vulnerability of Slovenian banks to changing conditions for raising loans on unstable international financial markets. Since September banks have made net repayments (EUR 1.2 billion) of loans and deposits from the rest of the world, primarily due to the effects of the financial turmoil, while flows via loans to the domestic private sector have also slowed (EUR 0.8 billion). This is also evident from the indicators of the net indebtedness of non-financial corporations and households, defined as the ratio of lending stock to the deposits of an individual sector. This ratio 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 the third quarter of 2008, it had risen to more than 5.5 for non-financial corporations and to nearly 0.6 for households. The ratio fell gradually for both non-financial corporations and households in the final quarter of 2008.

Net indebtedness at banks stopped rising in the second half of the year.

Figure 25: **Net indebtedness at banks**

Source: Bank of Slovenia

1.3 Banking system

1.3.1 Composition of the banking sector

Slovenia's banking sector is dominated by banks. Banks held a market share of 99.3% at the end of 2008 as measured by total assets, with savings banks accounting for the remainder.

At the end of 2008 there were 18 banks, 3 savings banks and 3 branches of foreign banks operating in Slovenia.

As at 31 December 2008 there were 18 banks operating in Slovenia, eight of which were subsidiaries. There were also three savings banks, and three branches of foreign banks (Austrian and French). With the merger of NLB Koroška banka d.d., NLB Banka Zasavje d.d. and NLB Banka Domžale d.d. with Nova Ljubljanska banka d.d., Ljubljana, there were three fewer credit institutions than in the previous year.

At the end of 2008 the proportion of capital held by non-residents and the state was 38.2% and 17.7% respectively.

In addition to the eight subsidiaries and the three branches that were under majority foreign ownership as at 31 December 2008, there were two banks under full domestic ownership (six at the end of 2007), and eight banks under majority domestic ownership (of which half had less than 3% foreign equity). The proportion of capital held by non-residents as at 31 December 2008 as measured by equity was up 0.4 percentage points on 31 December 2007 at 38.2% (of which the proportion held by non-residents holding more than 50% stood at 27.6%, or 0.8 percentage points more than a year earlier). The proportion held by non-residents as measured by total assets was 2.9 percentage points higher than the proportion held by non-residents as measured by equity as at 31 December 2008. State ownership as at 31 December 2008 as measured by equity was up 2.6 percentage points on 31 December 2007 at 17.7%, as a result of an increase in the state's share in SID – Slovenska izvozna in razvojna banka d.d., Ljubljana, the only Slovenian bank under direct majority state ownership.

Table 6: **Ownership structure of the banking sector (by equity)**

	31. Dec 2006	31. Dec 2007	31. Dec 2008
Non-residents (more than 50% voting rights)	27.7%	26.8%	27.6%
Non-residents (less than 50% voting rights)	10.0%	11.0%	10.6%
Central government	17.9%	15.1%	17.7%
Other domestic persons	44.4%	47.2%	44.1%

Source: Bank of Slovenia

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

	31. Dec 2006	31. Dec 2007	31. Dec 2008
Non-residents (more than 50% voting rights)	27.3%	27.8%	30.3%
Non-residents (less than 50% voting rights)	12.8%	13.8%	10.8%
Central government	22.3%	18.6%	19.2%
Other domestic persons	37.6%	39.7%	39.7%

Source: Bank of Slovenia

Razmerje med bilančno vsoto bank in hranilnic in BDP iz leta v leto narašča, čeprav je še vedno precej pod povprečjem v EU.

Table 8: **Total assets in mio EUR and relative to GDP**

in EUR million	2006	2007	2008 [1)]
Average total assets of banks and savings banks	34,080	42,598	47,818
GDP at current prices	31,008	34,471	37,126
Average total assets (as % of GDP)	109.9	123.6	128.8

[1)] Excluding Nova Ljubljanska banka branch in Italy.

Source: Bank of Slovenia

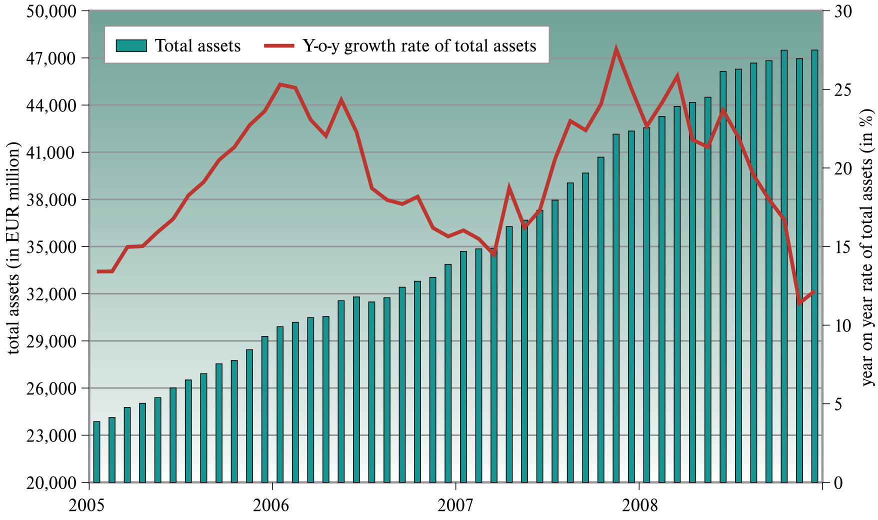
1.3.2 Balance sheet

Total assets stood at EUR 47,498 million, up 12% on the previous year.

Total assets of the banking system at the end of 2008 stood at EUR 47,498 million. Total assets rose by EUR 5,155 million during the year, an increase of 12% in relative terms. Events on the international markets had no direct effect on the Slovenian banking system, but had an indirect impact on banks' operations. Year-on-year growth in total assets over the first seven months of the year remained high at around 23%, and was followed by a rapid drop, with the lowest growth in the last five years of 11.4% recorded at the end of November. Following high growth in 2005 and 2006, the foreign banks achieved 22% growth for the second consecutive year, while the domestic banks recorded modest growth of 8%, following 26% growth in 2007. As a result, the market share of the domestic banks was down 2.4 percentage points at 68.8%[6].

6 The market share of foreign banks stands at 31.2%.

Figure 26: **Total assets and year-on-year growth**



Source: Bank of Slovenia

The market share of the largest bank was down 0.7 percentage points at 30.2%, despite the takeover of three subsidiary banks. Falling market shares is also characteristic of most banks under majority domestic ownership[7], while the banks under majority foreign ownership have strengthened their market shares.

[7] The exceptions are SID banka and Factor banka.

Table 9: **Total assets and market shares**

Bank	Total assets (EUR thousands)		Nominal growth (%)		Market share (%)	
	31. Dec 2007	31. Dec 2008	2007/2006	2008/2007	31. Dec 2007	31. Dec 2008
Nova LB d.d. Ljubljana	13,093,567	14,346,977	25.71	1.28	30.9	30.2
Nova KB d.d. Maribor	4,218,792	4,564,756	14.98	8.20	10.0	9.6
Abanka Vipa d.d. Ljubljana	3,439,008	3,823,337	20.17	11.18	8.1	8.0
UniCredit Banka d.d. Ljubljana	2,132,695	2,891,241	-2.50	35.57	5.0	6.1
SKB banka d.d. Ljubljana	2,295,677	2,600,224	10.08	13.27	5.4	5.5
Banka Koper d.d. Koper	2,239,211	2,501,864	20.09	11.73	5.3	5.3
Banka Celje d.d. Celje	2,305,449	2,413,474	17.64	4.69	5.4	5.1
Hypo Alpe-Adria-bank d.d. Ljubljana	1,906,206	2,268,317	68.30	19.00	4.5	4.8
SID banka d.d. Ljubljana	1,248,711	2,087,717		67.19	2.9	4.4
Gorenjska banka d.d. Kranj	1,732,976	1,825,836	16.14	5.36	4.1	3.8
Raiffeisen Banka d.d. Maribor	1,259,559	1,339,651	31.51	6.36	3.0	2.8
Probanka d.d. Maribor	1,041,857	1,192,228	29.47	14.43	2.5	2.5
Banka Sparkasse d.d. Ljubljana	886,628	1,182,444	23.39	33.36	2.1	2.5
Factor banka d.d. Ljubljana	630.760	877,407	20.01	39.10	1.5	1.8
Banka Volksbank d.d. Ljubljana	618,324	866,175	27.55	40.08	1.5	1.8
Deželna banka Slovenije d.d. Ljubljana	756,905	839,183	24.12	10.87	1.8	1.8
Poštna banka Slovenije d.d. Maribor	626,309	702,559	10.85	12.17	1.5	1.5
BAWAG d.d. Ljubljana	596,297	701,469	54.92	17.64	1.4	1.5
BKS Bank AG Ban. podružnica Ljubljana	196,194	404,701	100.37	106.28	0.5	0.9
Zveza Bank podružnica Ljubljana	22,776	44,987	94.17	97.52	0.1	0.1
RCI Banque Societe anonime, ban.podr.Lj	22,709	23,902		5.25	0.1	0.1
NLB Banka Domžale d.d.	451,177		4.59		1.1	
NLB Koroška banka d.d.	364,453		3.19		0.9	
NLB Banka Zasavje d.d.	257,012		1.00		0.6	
All banks and foreign branches	42,343,252	47,498,449	25.02	12.17	100.0	100.0

Source: Bank of Slovenia

Deposits represent the majority of liabilities, while a portion of funding was obtained by borrowing from the Eurosystem.

Financial liabilities measured at amortised cost (deposits), despite being down 2 percentage points at 86.4%, still represent the majority of banks' total equity and liabilities. This is primarily a result of a decrease in the proportion of non-banking sectors' deposits of 1.4 percentage points and a modest decrease in liabilities to foreign banks. These deposits represent 43.4% of total liabilities to non-banking sectors, while liabilities to banks remains stable at 37%. Borrowing from the Eurosystem has become more important source and reached EUR 1,226 million. As a result, the proportion of liabilities to the central bank, which in previous years was negligible, accounts for 2.6% of total liabilities.

Table 10: **Principal items in the banking sector balance sheet**

BALANCE SHEET	Amount (in thousand EUR)		Proportion (in %)		Growth (in %)	
Balance in EUR thousand, growth in %	31. Dec 07	31. Dec 08	31. Dec 07	31. Dec 08	07/06	08/07
Assets	**42,343,252**	**47,498,449**	**100.0**	**100.0**	**25.0**	**12.2**
Cash	603,729	1,242,982	1.4	2.6	-42.9	105.9
Loans and receivables	32,374,246	37,335,332	76.5	78.6	37.9	15.3
To banks	4,072,415	4,022,635	9.6	8.5	32.8	-1.2
To non-banking sectors	28,301,831	33,312,697	66.8	70.1	38.6	17.7
of which to non-financial corporations	17,039,063	20,034,188	40.2	42.2	37.8	17.6
... to households	6,428,844	7,386,343	15.2	15.6	27.1	14.9
... to government	465,139	506,360	1.1	1.1	-18.9	8.9
... to other financial institutions	2,114,261	2,828,720	5.0	6.0	68.1	33.8
... to non-residents	2,213,113	2,508,724	5.2	5.3	94.4	13.4
Financial assets held for trading	1,595,957	1,176,214	3.8	2.5	25.7	-26.3
of which government securitues	203,447	56,011	0.5	0.1	-5.5	-72.5
... securitues issued by Bank of Slovenia	0	0	0.0	0.0	0.0	0.0
Available-for-sale financial assets	4,870,408	4,531,309	11.5	9.5	-10.5	-7.0
of which government securitues	3,123,736	2,859,644	7.4	6.0	45.8	-8.5
... securitues issued by Bank of Slovenia	0	0	0.0	0.0	-100.0	0.0
Held to maturity financial assets	992,601	1,385,442	2.3	2.9	-1.6	39.6
of which government securitues	955,484	1,163,053	2.3	2.4	164.5	21.7
... securitues issued by Bank of Slovenia	0	0	0.0	0.0	-100.0	0.0
Other assets	1,906,311	1,827,170	4.5	3.8	18.3	-4.2
Liabilities	**42,343,251**	**47,498,457**	**100.0**	**100.0**	**25.0**	**12.2**
Deposits from central banks	156,528	1,226,228	0.4	2.6	100.0	683.4
Financial liabilities at amortised cost (deposits)	37,445,052	41,046,885	88.4	86.4	23.8	9.6
a) Liabilities to banks	15,631,349	17,594,683	36.9	37.0	45.1	12.6
of which foreign banks	14,111,609	15,559,817	33.3	32.8	39.9	10.3
b) Liabilities to non-banking sectors (deposits)	19,380,515	20,596,949	45.8	43.4	10.7	6.3
of which to non-financial corporations	3,674,219	3,696,861	8.7	7.8	10.0	0.6
... to households	12,104,976	13,209,745	28.6	27.8	9.3	9.1
... to government	1,510,337	1,856,753	3.6	3.9	35.6	22.9
... to other financial institutions	1,144,582	1,058,270	2.7	2.2	-20.9	-7.5
c) Debt securities	963,464	1,258,634	2.3	2.6	-1.3	30.6
d) Subordinated liabilities	1,469,724	1,596,619	3.5	3.4	48.1	8.6
Financial liabilities tied to financial assets without						
for derecognition (repo)	298,048	442,189	0.7	0.9	998.4	48.4
Capital	3,556,178	3,996,440	8.4	8.4	25.2	12.4
Provisions and other	887,445	786,715	2.1	1.7	17.7	-11.4
TOTAL ASSETS	**42,343,252**	**47,498,449**	**100.0**	**100.0**	**25.0**	**12.2**

Source: Bank of Slovenia

The majority of new funding derives from borrowing in the banking sector.

The growth in total assets is primarily a result of borrowing in the banking sector (growth of EUR 1,963 million or 12.6%). The domestic banks increased their borrowing in the banking sector by slightly less than 5%, the foreign banks by 23.6%, as access to this funding is easier via parent banks. Banks only borrowed on the interbank market during the first eight months of the year, after which the aforementioned source dried up due to the shocks on the international markets. The European Central Bank responded to the emerging conditions in the second half of the year, and increased the supply of money to banks. Slovenian banks also responded to tender auctions and increased the level of funding obtained in this manner by EUR 1,070 million.

Growth in deposits by non-banking sectors continued to rise modestly, but at 6.3%, still lags behind growth in total assets. As a result, the proportion of deposits by non-banking sectors, which totalled EUR 20,597 million, continues to fall. The largest contribution to growth in deposits by non-banking sectors in nominal terms was recorded by household deposits (EUR 1,105 million), while deposits by other sectors rose by a modest EUR 112 million, with government deposits up EUR 346 million, and deposits by non-residents down EUR 209 million.

Growth in deposits by non-banking sectors (6.3%) lagged behind growth in total assets.

Nine banks opted to issue derivatives in 2008, but only two issues were of significance. Three banks obtained a portion of their funding through repurchase transactions with foreign banks. Nevertheless, the volume of funding obtained via the aforementioned instruments remains modest.

Three banks opted for smaller issues of securities in 2008, but only one bank opted for a larger bond issue in the scope of state aid to banks and the economy following the shocks on the international markets. The aforementioned was reflected in a 30.6% increase in issued securities.

The book value of capital stood at EUR 3,996 billion as at the final day of the year, an increase of 12.4%. The increase includes the part of profit transferred to profit reserves in accordance with the Companies Act. Nine banks underwent capital injections in 2008, with one bank's capital increasing as a result of the takeover of subsidiary banks.

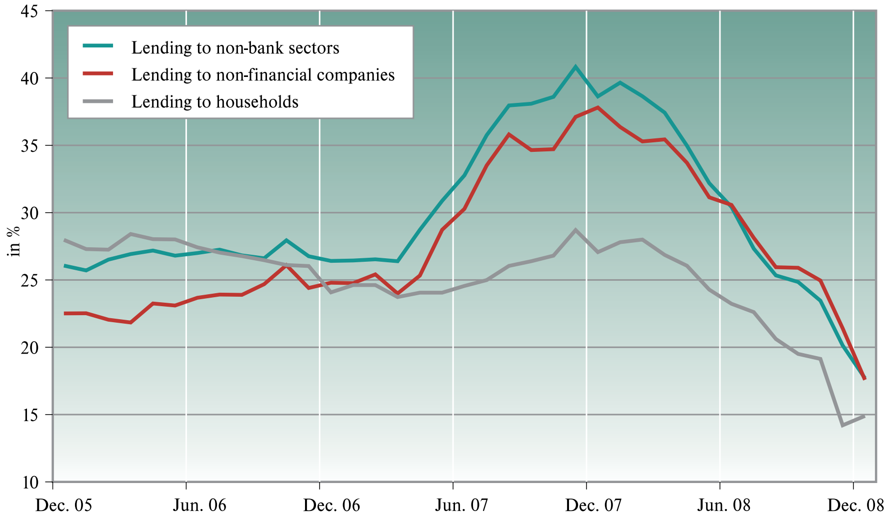
The book value of capital reached EUR 3,996 million.

Unfavourable developments on the international financial and capital markets were indirectly reflected in a change in banks' investment structure. The stock of financial assets recognised at fair value was down to due changes of fair value. Month-on-month growth in lending was down relative to 2007. However, the effect of the coming turmoil was not felt until November, when month-on-month growth in lending began to fall sharply.

Unfavourable developments on the financial and capital markets are reflected in the structure of banks' investments.

Loans to non-banking sectors, which represent the largest proportion of total assets, were up 3.3 percentage points at 70.1%, and totalled EUR 33,313 million. The proportion of loans to banks was down, at 8.5%. The proportion of financial assets held to maturity was up slightly (by 0.6 percentage points to 2.9%) due to the increase in the stock of bonds and treasury bills, while other categories were down.

Figure 27: **Year-on-year growth in lending to non-banking sectors**



Source: Bank of Slovenia

The increase in total assets was almost entirely transfered to lending to the non-banking sector.

Almost 97% of the increase in total assets was transfered to lending to non-banking sectors. The stock of loans was up 17.7% or EUR 5,011 million, and stood at EUR 33,313 million. This increase was down significantly on previous years, when growth fluctuated at around 25%, and was 38% in 2007.

As in previous years, in 2008 banks recorded the highest nominal increase in lending to non-financial corporations. The stock of lending rose by EUR 2,995 million, or 17.6% in relative terms. Lending to households and non-residents recorded similar relative growth, while lending to other financial organisations recorded above average growth (33.8%) for the fourth consecutive year.

Guarantees issued by banks were up more than 8% to stand at EUR 3,653 million at the end of the year.

Bank loans are disclosed in their entirety in accounting category loans, while securities are disclosed, with regard to purpose for which they were acquired, into the categories financial assets held for trading, financial assets recognised at fair value through profit or loss, financial assets available for sale and financial assets held to maturity.

Unfavourable trends on the capital markets, reflected in banks' investments in securities were offset by banks' investments in treasury bills and bonds.

Slovenian banks held only a very small portion of investments in securities, which became non-performing in 2008, although unfavourable trends on the capital markets were also reflected in banks' investments. Financial assets held for trading were down 26.3% at EUR 1,176 million due changes in fair value and sales. Available-for-sale financial assets, the majority of which are debt securities, were down by slightly less than 7% at EUR 4,531 million. Banks revalued existing investments in this category, and disclosed the effects as capital revaluation adjustments. In October this effect was transferred to the income statement. The relatively small decrease in this category derives from the fact that banks made more significant purchases of Republic of Slovenia treasury bills and bank bonds issued at the end of the year. Banks created impairments for a portion of financial assets held to maturity due to developments on the capital markets and at the same time a portion of Republic of Slovenia treasury bills and banks bonds were disclosed in this category. As a result the stock of financial assets held to maturity was up 39.6% to EUR 1,385 million.

Investments in securities, without regard to category, were down 7.6% at EUR 6,738 million. Government securities of EUR 4,079 million account for the largest proportion of total securities. Their stock was down 4.8% in 2008 as a result of changes in fair value and sales, and due to an increase in investments in Republic of Slovenia treasury bills. The stock of investments in other debt securities was down 6.6% to stand at EUR 2,337 million, while the stock of investments in shares and participating interests was down 36.3% to a modest EUR 322 million.

Maturity breakdown of deposits by and lending to non-banking sectors

Growth in time deposits was higher than in previous years.

Banks offered non-banking sectors higher interest rates due to the more difficult access to funding on the interbank market. At the same time, shocks on the capital markets stimulated households, in particular, to transfer their savings to safer investments at banks. As a result, short-term time deposits were up 8.6% or EUR 897 million, while long-term deposits were up more than 40% or EUR 707 million. At the same time, sight deposits were down slightly. This also had an impact on the structure of deposits by non-banking sectors. The proportion of short-term deposits was up 1.2 percentage points at 54.9%, while long-term deposits were up 2.9 percentage points to 12%. Sight deposits account for 33.2% of total deposits.

Nominal growth in long-term deposits was in line with growth in short-term deposits.

Nominal growth in short-term was equal to that of long-term loans in 2008, while the proportion of long-term loans was down 2 percentage points to 63%.

Table 11: **Maturity breakdown of deposits by and lending to non-banking sectors**

in %	31 Dec 2006	30 Jun 2006	31 Dec 2006	30 Jun 2007	31 Dec 2007	30 Jun 2008	31 Dec 2008
Sight deposits of non-banking sector	39.6	40.2	41.0	41.5	37.3	36.3	33.2
Short-term deposits of non-banking sector	47.9	47.4	46.7	48.9	53.7	54.0	54.9
Long-term deposits of non-banking sector	12.5	12.4	12.4	9.6	9.1	9.7	12.0
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	32.3	33.2	33.4	34.4	34.9	36.3	37.0
Long-term loans to non-banking sector	67.7	66.7	66.6	65.6	65.1	63.7	63.0
Claims arising from guarantees	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total loans to non-banking sector	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: Bank of Slovenia

Currency breakdown of deposits by and lending to non-banking sectors

Resources and investments in foreign currency represent a low proportion. The currency breakdown is 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. Almost all deposits in foreign currency are banks' deposits, deposits by non-banking sectors accounting for only a small portion. On the investment side, that proportion is represented primarily by lending to non-banking sectors.

Table 12: **Currency structure of principal balance sheet items**

	Proportion as at 31 Dec. 2007		Proportion as at 31 Dec. 2008	
in %	domestic currency	foreign currency	domestic currency	foreign currency
Cash	1.4	0.0	2.6	0.0
Lending	71.6	4.9	73.5	5.1
- to banks	8.6	1.0	7.7	0.8
- to non-banking sectors	63.0	3.9	65.9	4.3
Held for trading financila assets	3.6	0.2	2.4	0.1
Available for sale financial assets	11.4	0.1	9.5	0.1
Held to maturity financila assets	2.3	0.0	2.9	0.0
Other assets	3.7	0.8	3.0	0.9
Total assets	**94.0**	**6.0**	**93.9**	**6.1**
Financial liabilities to central bank	0.4	0.0	2.6	0.0
Financial liabilities at amortised cost (deposits)	83.4	5.0	81.5	4.9
- deposits by banks	33.2	3.7	33.2	3.9
- deposits by non-banking sectors	44.5	1.3	42.3	1.0
- debt securities	2.3	0.0	2.7	0.0
- subordinated liabilities	3.4	0.0	3.3	0.0
Financial liabilities tied to financial assets without terms for derecognition	0.7	0.0	0.9	0.0
Other liabilities and provisions	2.2	0.0	1.7	0.0
Capital	8.4		8.4	
Total liabilities	**95.0**	**5.0**	**95.1**	**4.9**

Source: Bank of Slovenia

1.3.3 Income Statement

In 2008 the profit of banks and branches was down for the first time (by 41%) following continuous growth in recent years...

Banks and branches recorded a pre-tax profit of EUR 304 million in 2008. This was EUR 210 million or 40.9% down on the banking system's profit in 2007. Profit was down for the first time following continuous growth in previous years.

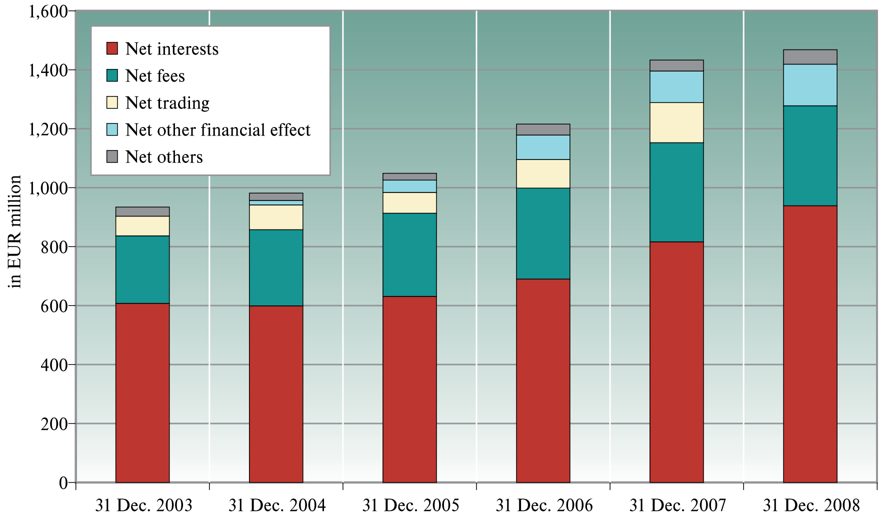
...while gross income was down 5.5%.

The banking system's gross income amounted to EUR 1,354 million in 2008, down EUR 79 million or 5.5% compared with the previous year, when an increase of 17.9% was recorded. The negative result from net trading in the amount of EUR 115 million (compared with a profit of EUR 136 million a year earlier) contributed most to the decrease in gross income. The aforementioned drop in gross income was partially offset by other categories of gross income, the largest increases recorded by net interest (up EUR 122 million or 15.0%), followed by other financial effects (up EUR 34 million or 32.0%, primarily as result of higher net income from exchange differences), while net fees and commissions (up 0.7%) were practically unchanged from the previous year.

In 2008 growth was down in all categories of gross income...

The growth rates of nearly all categories of gross income were down in 2008, with the exception of net other, which was up 30.6 percentage points on account of net profit from the derecognition of investments in subsidiaries. The net effect of trading was down 184.4% as a result of the sharp drop in securities prices. Growth in net interest was down 3.3 percentage points on the growth recorded the previous year, while the lag in growth in net fees and commissions was even more evident (8.3 percentage points).

Figure 28: **Breakdown of gross income**

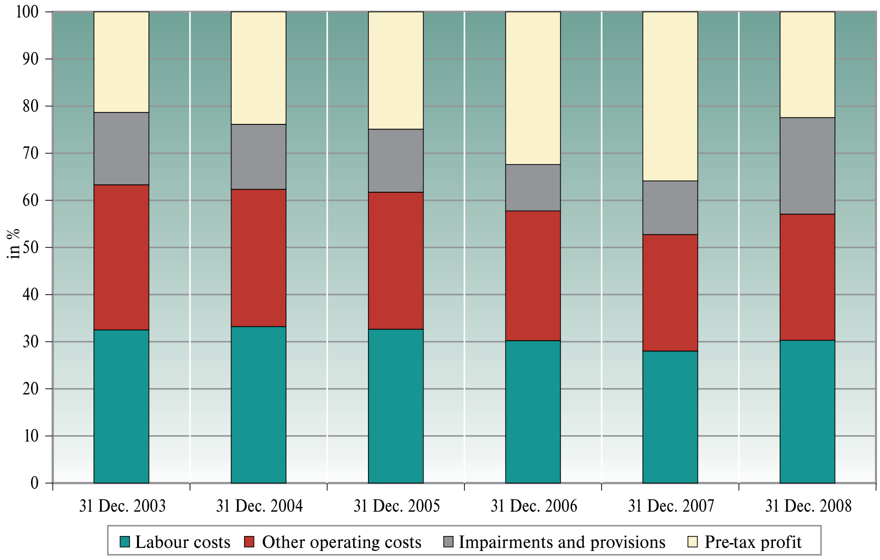


Source: Bank of Slovenia

...while net interest as a proportion of gross income was up sharply as a result of losses from financial assets and liabilities held for trading.

Despite more modest growth than in the previous year, net interest as a proportion of gross income was up sharply (from 57.0% to 69.4%) as a result of losses from financial assets and liabilities held for trading. The proportion of net fees and commissions was also up slightly (from 23.5% to 25.0%) for the same reasons. Net other financial effects accounted for more than 10% of gross income on account of higher net income from exchange differences.

Figure 29: **Disposal of gross income**



Source: Bank of Slovenia

The proportion of gross income accounted for by impairments and provisioning has risen.

Despite modest growth (2.2% growth in 2008 compared with 7.7% in 2007), the proportion of gross income accounted for by operating costs rose again, from 52.7% to 57.1%, due to the sharp decline in gross income. Additional impairments of financial assets available for sale and financial assets at amortised cost since September 2008 have resulted in a sharp increase in the proportion of gross income banks earmark for impairments and provisioning (from 11.4% to 20.5%). As a consequence, pre-tax income as a proportion of gross income was down, from 35.9% to 22.5%.

Table 13: **Principal items of adjusted income statement**

	Amount (in thousand EUR)		Proportion (in %)		Growth (in %)	
	2007	2008	2007	2008	2007/2006	2008/2007
Net interest	816,357	938,817	57.0	69.4	18.3	15.0
Net fees and commisions	336,333	338,849	23.5	25.0	9.0	0.7
Net trading	135,747	-114,596	9.5	-8.5	39.7	-184.4
Net other financial effects	107,115	141,422	7.5	10.4	29.5	32.0
Net other	37,467	49,068	2.6	3.6	0.4	31.0
Gross income	**1,433,019**	**1,353,560**	**100.0**	**100.0**	**17.9**	**-5.5**
Operating costs	755,894	772,640	52.7	57.1	7.7	2.2
- of which labour costs	401,808	410,114	28.0	30.3	9.4	2.1
Net income	**677,125**	**580,920**	**47.3**	**42.9**	**31.9**	**-14.2**
Impairments and provisions	-162,954	-276,946	-11.4	-20.5	36.0	70.0
- Net impairments of financial assets at amortised cost and provisions	-132,090	-167,337	-9.2	-12.4	14.0	26.7
Pre-tax profit	**514,171**	**303,974**	**35.9**	**22.5**	**30.6**	**-40.9**
Net profit	**411,713**	**249,705**	**28.7**	**18.4**	**36.0**	**-39.3**

Source: Bank of Slovenia

Net interest income

The growth in net interest of 15.0% in 2008 lagged behind the growth recorded the previous year.

Net interest was EUR 122 million or 15.0% higher in 2008 than in 2007, when an 18.3% increase was recorded. Similar to the last several years, both interest categories recorded growth, albeit at slower pace than the previous year. Interest expenses recorded relatively higher growth (46.3%), but in the context of a higher basis, interest income recorded higher nominal growth.

Interest income amounted to EUR 2,604 million in 2008, up EUR 650 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 622 million, despite lower growth in lending in the context of a continuing rise in lending interest rates. Interest income from securities available for sale was down EUR 21 million.

Banks recorded interest expenses of EUR 1,665 million in 2008, up EUR 527 million from the previous year. In 2008 banks began to borrow frequently from the ECB due to initial difficulties in refinancing loans raised in the rest of the world. Nevertheless, interest on financial liabilities measured at amortised cost contributed most to the increase in interest expenses in 2008, due to rising euro interest rates in the first half of the year and the favourable conditions offered by banks to stimulate longer-term forms of savings.

Net non-interest income

Growth in net fees and commissions was 0.7% in 2008.

Earnings from net fees and commission totalled EUR 339 million in 2008, a modest increase of EUR 3 million, or 0.7%, compared with the increase of 9.0% recorded in 2007. Both relative and nominal growth has slowed for the third consecutive year. In contrast to previous years, when fees and commissions received increased primarily as a result of higher fees for administrative services and higher commissions on domestic payments and securities transactions for clients, in 2008 only commissions on domestic payments were up marginally. In 2008 commissions from securities transactions for clients were down sharply (by EUR 13 million), as were fees for administrative services, which were down EUR 9 million.

A net loss of EUR 115 million was generated from financial assets and liabilities held for trading.

In 2008 banks recorded a net loss of EUR 115 million from financial assets and liabilities held for trading, compared with the net income of EUR 136 million generated in 2007. The aforementioned loss was the result of a net loss from the trading of shares and participating interests in the amount of EUR 157 million (compared with a net profit of EUR 150 million in 2007) and a net loss from trading in debt securities of EUR 7 million (compared with a net loss of EUR 26 million in 2007), as a consequence of the fall in securities prices in 2008. Banks generated a net profit from derivatives and from sales and purchases of foreign currencies.

Earnings from net other financial effects totalled EUR 141 million in 2008, an increase of EUR 34 million or 32.0%, similar to the previous year. Banks generated the majority of the aforementioned effects through dividend income in the amount of EUR 68 million, a decrease of EUR 7 million or 9.1% on 2007. The entire decrease in dividend income was driven by a drop in dividends from capital investments in group companies. Other significant categories of net other financial effects include the effects from financial assets and liabilities not measured at fair value through profit or loss in the amount of EUR 55 million (up EUR 8 million or 18.1%) and net income from exchange differences in the amount of EUR 47 million (compared with a net loss of EUR 11 million in 2007). In 2008 banks recorded a sharp increase (from EUR 6 million to EUR 23 million) in their net loss from financial assets and liabilities measured at fair value through profit or loss (investments in structured securities) as a result of conditions on the financial markets.

Operating costs

Operating costs, which stood at EUR 773 million at the end of 2008, are increasing in nominal terms, despite the fact that their growth rate is lower year-on-year. The growth rate of 2.3% in 2008 was down 5.4 percentage points on the previous year. Growth in labour costs was down sharply compared with 2007 (from 9.4% to 2.0%), as was growth in general and administrative costs, from 6.5% to 1.7%. Labour costs were down primarily as a result of lower growth in the cost of gross wages and other contract-based employee costs, and the drop in other contributions from gross wages. The main reason for lower growth in general and administrative costs lies in lower costs of material and other services.

The growth in operating costs in 2008 was significantly lower than the growth recorded the previous year.

Given that gross income was down 5.5% in 2008, operating costs as a proportion of gross income were up from 52.7% to 57.1%, despite modest growth compared with the previous year. The coverage of operating costs by net non-interest income fell again, from 81.6% to 53.7%, due to declining net non-interest income. In the context of faster growth in total assets, the trend of a declining ratio of costs to average assets continued reaching 1.7% (2.0% at the end of 2007).

Banks cover 54% of costs with non-interest income (82% in 2007).

Net impairments and provisioning

In 2008 banks created impairments and provisions of EUR 277 million, an increase of 70.0% or EUR 114 million from 2007. Of the total impairments and provisioning costs, EUR 167 million was for the impairment of financial assets measured at amortised costs and provisioning for off-balance sheet liabilities, while EUR 101 million relates to the impairment of financial assets available for sale. The remainder (EUR 8 million) relates to other provisions for litigation and provisions for pensions. Impairments of financial assets measured at amortised cost, provisions for off-balance sheet liabilities and impairments of financial assets available for sale were up sharply from the previous year: the first were up 26.7% or EUR 35 million (compared with an increase of 14% in 2007), while the second were up EUR 99 million, from EUR 2 million to EUR 101 million. Banks began to create impairments of financial assets available for sale at a faster pace in the last three months of 2008, when the effects of revaluation of available for sale securities, initially disclosed as a negative capital revaluation adjustment in the balance sheet, were transferred to the income statement.

Banks' net impairments and provisions were up 70%.

Bank performance indicators

The decline in pre-tax profit compared with 2007 also resulted in a sharp deterioration in profitability indicators. Average ROA and average ROE were halved. The former was down 0.7 percentage points at 0.7%, while latter was down 8 percentage points to 8.3%.

Average ROA and average ROE were halved compared with 2007.

Gross income per average assets, which has declined slowly and steadily in recent years, fell by 0.8 percentage points, from 3.8% to 3.0%, due to the decrease in gross income, while the interest margin was down slightly (from 2.2% to 2.1%) on account of the modest increase in net interest.

The interest margin continued its slowly declining trend…

As a result of modest earnings from net fees and commissions and the significant loss from financial assets and liabilities held for trading, the non-interest margin was down sharply on the previous year, from 1.6% to 0.9%.

…while the net non-interest margin was down sharply.

Table 14: **Selected bank performance indicators**

in %	2003	2004	2005	2006	2007	2008
Gross income per average assets	4.7	4.4	4.0	3.9	3.8	3.0
Average return on assets	1.0	1.1	1.0	1.3	1.4	0.7
Average return on equity	11.9	12.7	12.7	15.1	16.3	8.1
Interest margin	3.1	2.7	2.4	2.2	2.2	2.1
Non-interest margin	1.6	1.7	1.6	1.7	1.6	0.9
Operating costs per average assets	3.0	2.8	2.5	2.2	2.0	1.7

Source: Bank of Slovenia

The cost efficiency indicator (the ratio of operating costs to average assets) continues to improve (from 2.0% to 1.7%). Growth in operating costs is more modest than in previous years, and continues to lag behind (by just under 18 percentage points) growth in average assets, which had a favourable impact on this indicator.

1.3.4 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 2008, 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 entities in the group (20% of capital) or to persons with a special relationship with the bank (20% of capital).

Table 15: **Bank exposure with regard to capital**

	2004	2005	2006	2007	2008
Ratio of sum of large exposures to capital (%)	196	228	223	222	174
Number of large exposures	253	305	333	345	246
Number of banks with large exposures of more than 300% of capital	3	5	4	8	3

Note: Due to its differing basis for identifying large exposures, SID banka has been excluded.
Source: Bank of Slovenia

The sum of large exposures declined.

By the end of 2008 the sum of large exposures in the banking system had been reduced to 174% of capital. The total number of large exposures was down 99 from the end of 2007. The number of banks which recorded a sum of large exposure of more than 300% of their capital was down from 8 to 3.

Table 16: **Credit rating structure and level of coverage of classified assets by impairments and provisions**

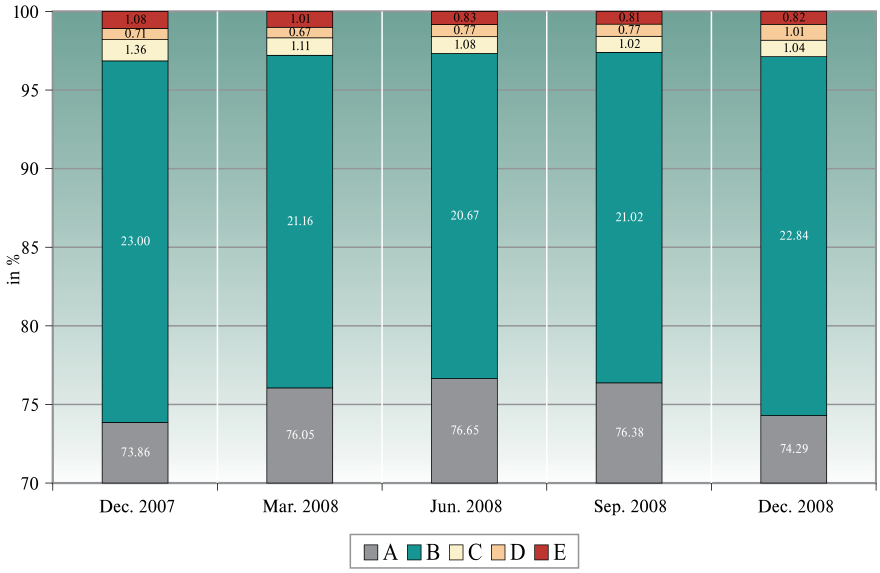
Credit rating	31 Dec. 07				31 Dec. 08			
	Classified assets		Impairments and provisions	Level of	Classified assets		Impairments and provisions	Level of
	in EUR thousand	in %	in EUR thousand	coverage in %	in EUR thousand	in %	in EUR thousand	coverage in %
A	29,945,626	73.9%	111,971	0.4%	34,455,561	74.3%	122,851	0.4%
B	9,324,671	23.0%	442,065	4.7%	10,592,357	22.8%	481,857	4.5%
C	550,088	1.4%	131,260	23.9%	483,685	1.0%	120,217	24.9%
D	286,353	0.7%	188,087	65.7%	467,389	1.0%	291,051	62.3%
E	437,731	1.1%	437,747	100.0%	382,159	0.8%	382,174	100.0%
Total	40,544,469	100.0%	1,311,130	3.2%	46,381,151	100.0%	1,398,150	3.0%

Source: Bank of Slovenia

Total exposure increased by 11.4%.

Total exposure in the banking system had increased by 11.4% by the end of 2008, and stood at EUR 55,041 million, with balance sheet claims and off-balance sheet claims accounting for 84.6% and 15.4% respectively. The amount of classified assets increased by 14.4%, to account for 84.3% of total exposure at the end of 2008.

Figure 30: **Structure of banking system's credit portfolio**



Source: Bank of Slovenia

The credit rating structure of rated claims improved.

By the end of 2008, the credit rating structure of classified assets had improved owing to an increase in the proportion of A-classified assets (up 0.43 percentage points), at the expense of a decline in B-classified assets (down 0.16 percentage points) and a decline in C-classified assets (down 0.32 percentage points). The proportion of E-classified assets was also down (by 0.26 percentage points), while the proportion of D-classified assets was up 0.30 percentage points. 84.53% of the claims of the banks under majority foreign ownership were A-rated, which is 15.2 percentage points more than at the domestic banks.

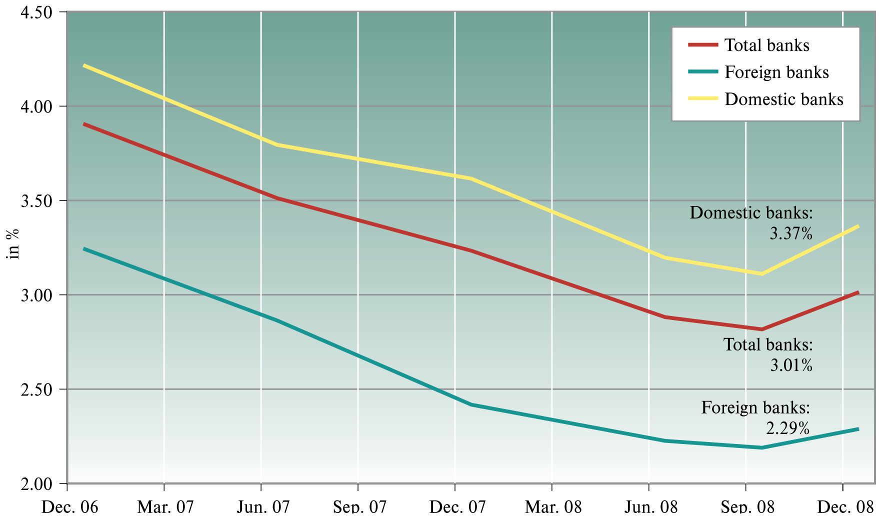
Table 17: **Credit rating structure of banking system's credit portfolio (in % and EUR thousand)**

Credit rating	Classified assets	Proportion in %	Average impairment under IFRS
1 (from 0.00% to 1.00%)	34,455,561	74.3%	0.4%
2 (from 1.01% to 5.00%)	6,895,167	14.9%	2.8%
3 (from 5.01% to 8.00%)	2,166,505	4.7%	5.8%
4 (from 8.01% to 15.00%)	1,530,685	3.3%	10.8%
5 (from 15.01% to 25.00%)	317,042	0.7%	20.5%
6 (from 25.01% to 40.00%)	166,643	0.4%	33.2%
7 (from 40.01% to 75.00%)	369,009	0.8%	55.6%
8 (from 75.01% to 99.00%)	98,380	0.2%	87.5%
9 (from 99.01% to 100%)	382,159	0.8%	100.0%
TOTAL	46,381,151	100.0%	3.0%

Source: Bank of Slovenia

In the credit rating structure of classified assets, which includes nine categories,[8] credit rating 1 accounted for the largest proportion (74.3%) at the end of 2008, followed by credit ratings 2 and 3 (14.9% and 4.7% respectively). The remaining six credit ratings account for 6.1% of classified assets, of which 1.8% are classed as non-performing (rated 7, 8 and 9).

Figure 31: **Average risk of claims in the banking system overall and in individual groups**



Source: Bank of Slovenia

Average risk of claims declined at both the foreign and domestic banks.

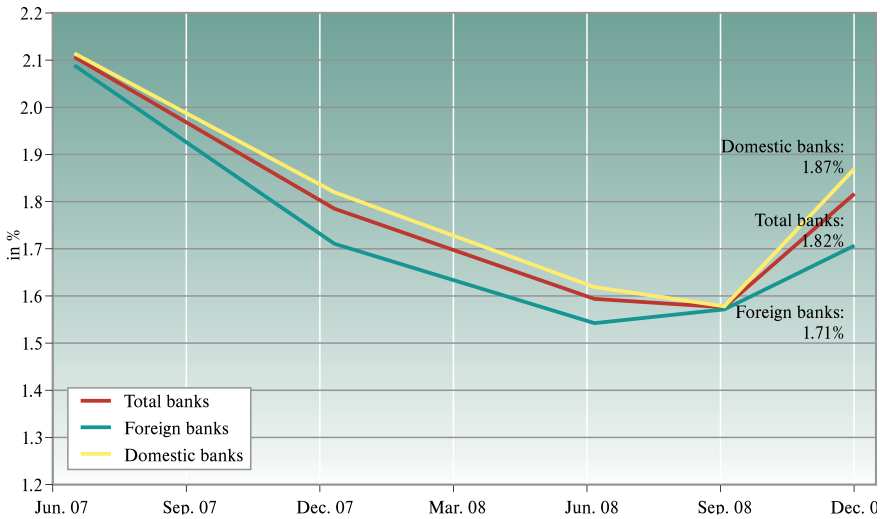
Both groups of banks are characterised by a decline in the average risk of claims[9], with the domestic banks recording a sharper decline (by 0.25 percentage points) than the foreign banks (0.13 percentage points). Overall average risk of claims stood at 3.01%. The impairments and provisions created by the domestic banks (3.37%) under the IFRS were 1.08 percentage points higher than those created

[8] 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 claims include credit rating 9.

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

by the banks under majority foreign ownership (2.29%). The level of coverage of classified assets by provisions stood at 3.23% for the banking system overall at the end of 2007 (3.62% at the domestic banks, and 2.42% at the banks under majority foreign ownership).

Figure 32: **Proportion of D- and E-classified assets, by groups of banks and for the banking system**



Source: Bank of Slovenia

The proportion of non-performing claims was up at the domestic banks.

At the end of 2008, the proportion of non-performing claims in the banking system (categories D and E or credit ratings 7, 8 and 9) was up 0.03 percentage points from the end of 2007. A comparison between the two groups of banks shows that this proportion increased (by 0.05 percentage points) at the domestic banks to stand at 1.87% at the end of 2008, while it was unchanged at the banks under majority foreign ownership at 1.71%. The proportion of non-performing claims in the banking system was up 0.24 percentage points in the final quarter of 2008. The reason lies in the deterioration of the credit rating structure as a result of the harsher economic conditions, which drove banks to increase their level of impairments and provisioning. The proportion of non-performing claims was up most notably at the domestic banks (by 0.29 percentage points), and to a lesser degree at the banks under majority foreign ownership (up 0.14 percentage points).

Table 18: **Breakdown of classified assets by institutional sector, and average credit rating of sectors**

	31 Dec. 2007		30 Jun. 2008		30 Sep. 2008		31 Dec. 2008	
	Propor. in %	Average risk	Propor. in %	Average risk	Propor. in %	Average risk	Propor. in %	Average risk
A. Industry	**20.1**		**20.5**		**21.1**		**21.2**	
- metals and machinery	3.3	4.2	3.4	3.5	3.6	3.3	3.4	3.3
- chemicals	2.6	3.1	2.6	2.6	2.7	2.6	2.6	2.6
- food and beverages	2.1	5.2	2.1	5.0	2.0	5.5	2.0	6.8
- construction	5.9	3.9	6.4	3.3	6.5	3.2	6.5	3.6
- energy supply	1.2	1.5	1.2	1.3	1.3	1.4	1.6	1.1
B. Services	**42.8**		**41.4**		**43.4**		**44.6**	
- trade, motor vehicle repair	9.5	3.7	9.6	3.4	9.4	3.5	9.7	4.3
- transport, warehousing	4.2	3.1	4.4	2.7	4.4	2.6	4.2	1.3
- financial intermediation	14.4	1.4	13.7	1.3	15.5	1.0	16.6	1.3
- Bank of Slovenia	0.2		0.1		0.1		0.6	
- real estate, leasing	2.0	2.9	2.2	2.3	2.1	2.4	2.1	2.8
- public administration, defence, social security	5.1	0.3	4.2	0.2	4.2	0.2	4.2	0.2
C. Non-residents	**12.3**	**3.3**	**12.2**	**3.4**	**11.8**	**3.4**	**11.5**	**3.6**
D. Foreign financial institutions	**10.2**	**0.2**	**11.1**	**0.1**	**9.2**	**0.2**	**8.0**	**0.7**
E. Households	**14.5**	**3.8**	**14.7**	**3.3**	**14.5**	**3.2**	**14.7**	**3.3**
Total	**100.0**	**3.2**	**100.0**	**2.9**	**100.0**	**2.8**	**100.0**	**3.0**

Source: Bank of Slovenia

Banks are still most exposed to clients in the service sector.

As at 31 December 2008 banks were most exposed to clients in the service sector, their proportion rising 1.8 percentage points from the end of 2007 to 44.6%. The increase in the financial and insurance sector (of 2.2 percentage points), in particular, contributed to this increase, while the most notable decrease (of -0.9 percentage points) was recorded by the public administration, defence and social security sectors. The level of risk in the service sector was down most in transportation and storage (by -1.8 percentage points), while trade and repair of motor vehicles recorded an increase of 0.6 percentage points.

The proportion of debt accounted for by the highest risk sector of industry increased primarily on account of the construction sector.

The proportion of debt accounted for by the highest risk sectors of industry had increased by 1.1 percentage points to 21.2% by the end of 2008, primarily on account of the construction sector (up 0.6 percentage points) and the supply of energy (up 0.4 percentage points). The largest decrease in the level of risk of the industrial sector was recorded by the metal and machinery industry (down 0.9 percentage points) and by the chemical industry (down 0.5 percentage points), while the level of risk in the food and beverages sector was up 1.6 percentage points. Exposure to households also increased slightly (by 0.2 percentage points) in the context of a lower level of risk (down 0.5 percentage points), while exposure to non-residents was down 0.8 percentage points in the context of a higher level of risk (up 0.2 percentage points).

Table 19: **Exposure to particular groups of countries**

	31 Dec. 05		31 Dec. 06		31 Dec. 07		31 Dec. 08	
in EUR thousand, %	Amount	Propor.	Amount	Propor.	Amount	Propor.	Amount	Propor.
EU	2,707,315	63.5	3,472,926	59.1	7,112,554	63.8	6,265,608	58.0
EFTA	235,641	5.5	281,255	4.8	353,605	3.2	409,061	3.8
Former Yugoslav republics	816,554	19.2	1,326,748	22.6	2,721,443	24.4	3,196,348	29.6
Other	504,006	11.8	796,273	13.5	964,125	8.6	930,971	8.6
Total	**4,263,516**	100.0	**5,877,203**	100.0	**11,151,727**	100.0	**10,801,988**	100.0
Proportion of rated claims accounted for by non-residents	12.4%		14.5%		22.5%		19.5%	

Source: Bank of Slovenia

The trend of banks' increasing exposure to the former Yugoslav republics continues.

The largest increase compared with the end of 2007 was recorded by the proportion of exposure to the former Yugoslav republics, which stood at 29.6% at the end of 2008. EU countries still prevail in the breakdown of exposure to particular groups of countries, despite a decrease of 5.8 percentage points, accounting for 58% of the total at the end of 2008. The proportion of exposure accounted for by EFTA countries was up slightly (by 0.6 percentage points), while proportion accounted for by other countries remains unchanged at 8.6%, the major countries within that group being the US (32.6%) and the Russian Federation (30.9%).

1.3.5 Capital and capital adequacy

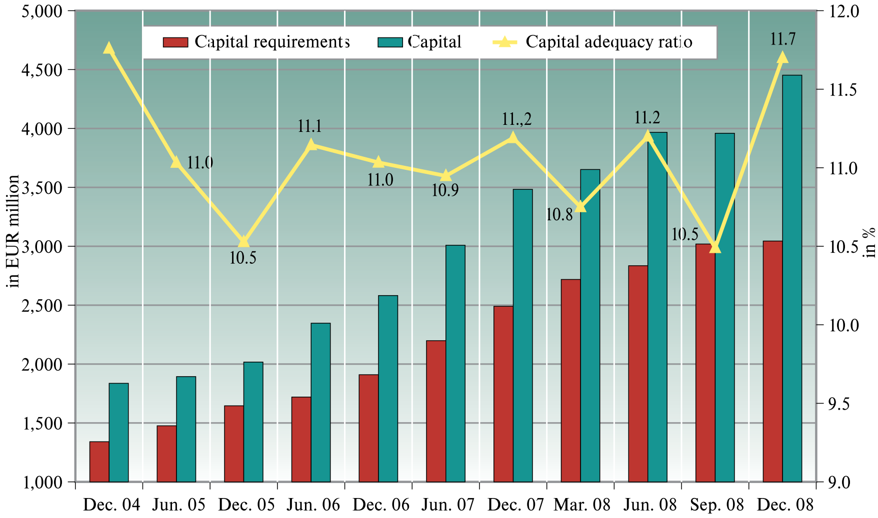
The highest level of capital adequacy of the last three years was the result of a more significant increase in capital than in capital requirements.

Capital adequacy stood at 11.7% as at 31 December 2008, up 0.5 percentage points on the end of 2007, and up 1.2 percentage points from the end of September 2008, reaching its highest level in the last three years. Capital adequacy was up on account of a significant increase in capital compared with capital requirements in the final quarter of 2008, as a result to the temporary abolishment of original capital deduction item[10] in October 2008. At the end of December 2008 capital was up 27.8% from the end of 2007, and was 5.6 percentage points higher than growth in capital requirements.

The banking system's capital stood at EUR 4,453 million at the end of 2008, up EUR 970 million or 27.8% relative to the end of the previous year. The increase in capital was solely the result of an increase in original capital by EUR 1,052 million, while additional capital was down EUR 69 million over the same period (EUR 38 million from Tier I additional capital and EUR 32 million from Tier II additional capital to cover market risks). The increase in subscribed capital and capital reserves totalling EUR 645 million contributed most to the increase in original capital. Contributing further was a decrease in original capital deduction items in the amount of EUR 266 million as a result of a decrease in undisclosed impairments and provisions. The latter were down EUR 308 million in the last quarter of 2008 alone.

10 Pursuant to Article 24 of the Regulation on the Assessment of Credit Risk Losses of Banks and Savings Banks, banks must use a weighting of 0% according to the Bank of Slovenia's methodology when calculating original capital deduction items in the group assessment of financial assets and liabilities assumed under off-balance sheet items that are classified into categories A to E for the calculation of impairments and provisions.

Figure 33: **Capital adequacy, capital and capital requirements of the banking system**



Source: Bank of Slovenia

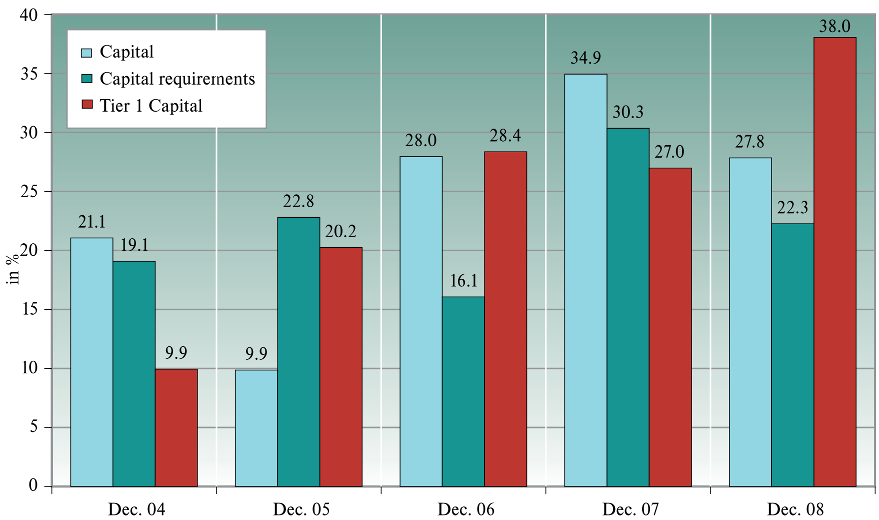
Original capital was up on account of share capital and capital reserves and the temporary abolishment of deduction item.

The decrease in Tier I additional capital is the result of a decrease in the surplus of innovative instruments in the amount of EUR 43 million, and a decrease of EUR 27 million in the revaluation surplus adjustment linked to available-for-sale share and participating interests, both of which are included in Tier I additional capital. In 2008 banks marginally increased Tier I additional capital from hybrid instruments (by EUR 11 million to EUR 517 million) and Tier 1 subordinated debt (by EUR 19 million to EUR 650 million).

The proportion of original capital was up again to 75%.

The proportion of capital accounted for by original capital was up 7.5 percentage points to 75% in 2008. Tier I subordinated debt accounted for just 17.0% of original capital, compared with 22.8% at the end of 2007.

Figure 34: **Year-on-year growth in capital, original capital and capital requirements**



Source: Bank of Slovenia

The banking system's total capital requirements to cover the risks set out in pillar 1 of Basel II stood at EUR 3,044 million as at 31 December 2008, up EUR 554 million or 22.3% on the previous year. The most significant increase was in the capital requirement for credit risk (up EUR 425 million or 17.8%). As a new feature, banks were required to provide capital to cover operational risk, in the amount of EUR 163 million, while capital requirements for market risks continue to decline (down EUR 38 million). The capital requirement for settlement risk in the trading book stood at EUR 7 million, while the capital requirement for exceeding the maximum allowable exposures from trading was EUR 2 million.

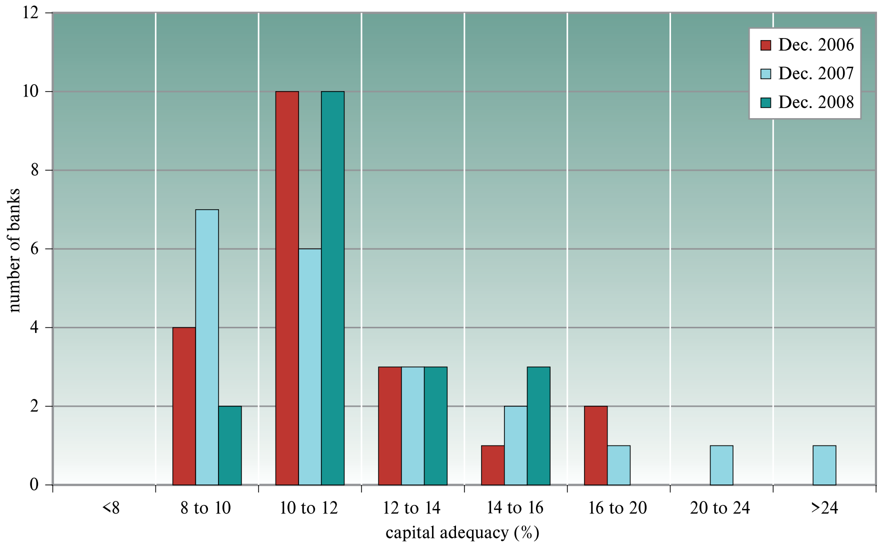
Capital requirements for credit risk account for 92.5% of total capital requirements, while capital requirements for market risks continued to decline.

Capital requirements for credit risk continue to represent the highest proportion in the structure of capital requirements (92.5%), but are decreasing on account of new capital requirements for operational risk, which account for 5.4%.

Capital requirements for market risks in the structure of capital requirements continue to decline gradually, from 3.8% to 1.9%. Capital requirements for market risks stood at EUR 56 million at the end of 2008. Capital requirements for equity instruments represent the highest proportion (47.9%), followed by capital requirements for debt instruments (42.8%), capital requirements for foreign currencies (9.3%).

The significance of capital requirements for foreign currencies continues to decrease, their proportion in the structure of total requirements falling a further 0.2 percentage points in 2008 to 0.2%.

Figure 35: **Distribution of capital adequacy**



Source: Bank of Slovenia

16 banks had a capital adequacy of more than 10%.

All banks met the minimum capital adequacy requirement as at 31 December 2008, while their capital adequacy was distributed to just four intervals compared with seven a year earlier. Compared with the end of 2007, the number of banks in the capital adequacy interval of 10% and 12% was up due to a decrease in the number of banks in the capital adequacy interval of 8% and 10% and a decrease in the number of banks with a capital adequacy exceeding 16%. As at 31 December 2008 16 of 18 banks had a capital adequacy of more than 10%.

2 BANK OF SLOVENIA ACTIVITIES

2.1 Implementation of ECB monetary policy

The implementation of monetary policy by steering the very short-term market interest rate…

Decisions regarding the ECB key interest rates affect the general price level through numerous channels. At the fore of these so-called transmission mechanisms is the implementation of monetary policy, the purpose of which is to steer interest rates on the interbank market for money borrowed in the very short term at rates close to the ECB key interest rate. The Eurosystem steers the market interest rate for the euro by continuously providing the banking system with the amount of liquidity (money) that it needs to satisfy the demand for central bank money, i.e. its need for cash in the form of banknotes or for balances on the accounts of commercial banks at the central bank, the latter representing funds used to settle non-cash payments in the domestic currency.

…is decentralised in the Eurosystem.

The Eurosystem's implementation of monetary policy is decentralised. On the basis of the ECB Governing Council's decision regarding the level of its key interest rate, the national central banks (in Slovenia, the Bank of Slovenia) manage liquidity with the banking system in their own countries by means of monetary policy instruments, which are the same throughout the euro area.

2.1.1 Use of Eurosystem monetary policy instruments in 2008

Monetary policy instruments include open market operations, standing facilities and minimum reserves.

The Eurosystem implements monetary policy with the instruments set out in the general documentation on Eurosystem monetary policy instruments and procedures, i.e. open market operations, standing facilities and minimum reserves.[11] Open market operations are the basic instrument for managing the liquidity of the banking system. By setting the rate of one of these operations, i.e. the main refinancing operation, the Governing Council of the ECB sets the monetary policy stance, which is then signalled to the public by the Eurosystem through its main refinancing operations. The Eurosystem may conduct open market operations at its own discretion, but most are implemented in the form of tenders and according to a pre-announced calendar. Standing facilities, i.e. marginal deposit and marginal lending facilities, represent additional possibilities to manage liquidity, and can be used daily by counterparties at their own discretion, at interest rates determined in advance by the Governing Council of the ECB.

Twenty Slovenian banks and savings banks were afforded the possibility to conclude transactions with the Bank of Slovenia.

The Bank of Slovenia implements monetary policy in transactions with Slovenian banks and savings banks, which are subject to the Eurosystem's minimum reserve system. At the end of 2008 a total of 20 out of 25 Slovenian institutions subject to the minimum reserve system had access to the main monetary policy instruments, namely main refinancing operations, longer-term refinancing operations and standing facilities.

[11] The general documentation on Eurosystem monetary policy instruments and procedures contains a detailed description of monetary policy instruments. The text is available on the ECB's website at: http://www.ecb.int/pub/pdf/other/gendoc2008sl.pdf.

The key element in the implementation of the Eurosystem's monetary policy in 2008 was mitigating the effects of the financial turmoil on the money market. The measures taken by the Eurosystem are described in detail in the box below.

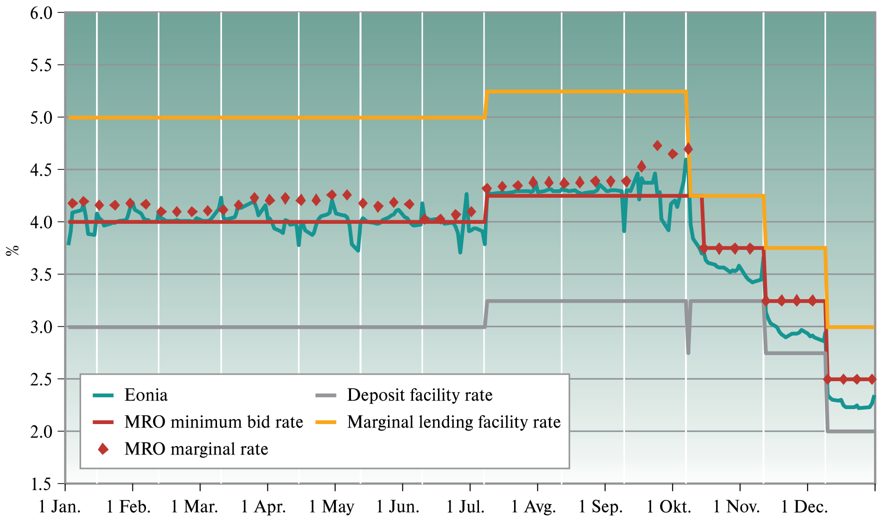
Full allotment with a fixed interest rate has been the Eurosystem's response to uncertainty on the money market in crisis situation.

Main refinancing operations (MRO) are liquidity-providing reverse transactions, executed weekly with a typical maturity of one week according to a pre-announced calendar. In 2008 there were 53 such operations in the average amount of EUR 201.1 billion (EUR 257.0 billion in 2007). This amount was slightly lower until the middle of October, averaging EUR 174.9 billion. The amount subsequently rose on account of the execution of full allotment tenders, i.e. the allotment in full, and at a fixed interest rate, of the amounts bid by counterparties. Full allotment was introduced due to a severe tightening of bank financing on the interbank market as a result of the collapse in confidence following the bankruptcy of the US investment bank Lehman Brothers in September.

Regular participation of Slovenian banks and savings banks in MROs in lower amounts…

Slovenian banks and savings banks participated in 52 MROs, in which they submitted bids totalling EUR 2.9 billion (EUR 1.2 billion in operations executed until mid-October and EUR 1.7 billion in subsequent operations), and were allotted a total of EUR 2.5 billion in liquidity (EUR 0.8 billion in operations before mid-October and EUR 1.7 billion in subsequent operations), or 86% of the bid amount, taking into account the entire year, or 66% only taking into account the period until mid-October 2008, when the full allotment procedure has been introduced.

Figure 36: **ECB interest rates and Eonia**



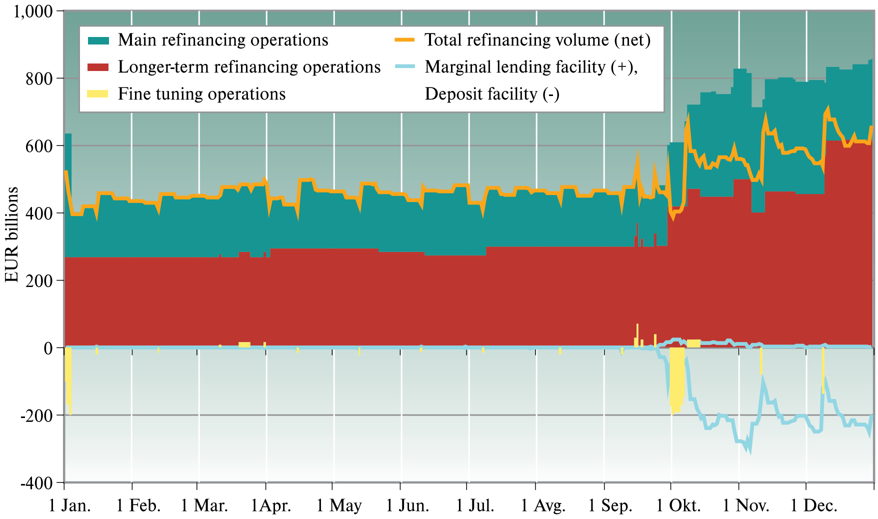
Note: Vertical lines represent the end of a reserve maintenance period.
Source: ECB

…and in LTROs in larger amounts, particularly in the final quarter of 2008.

Longer-term refinancing operations (LTRO) are aimed at counterparties' additional longer-term refinancing needs. These are liquidity-providing reverse transactions, executed monthly with a typical maturity of three months and according to a pre-announced calendar. Due to the continuation of tensions on the financial markets, in 2008 the Eurosystem continued to execute additional longer-term refinancing operations with maturities of three and six months, which it renewed at maturity. The amount of liquidity provided to the system via longer-term refinancing operations did not change significantly until mid-October, and averaged around EUR 300 billion. The amount subsequently rose to nearly EUR 600 billion. The execution of additional operations with a maturity equal to the minimum reserve maintenance period and, in particular, the transition to full allotment in all longer-term operations contributed to this increase. In addition to 12 regular three-month operations, in 2008 16 additional operations were executed, of which eight were three-month, six were six-month and two were one-month operations. Longer-term refinancing operations, as measured by their share in covering the Eurosystem's liquidity deficit, remained the main source of liquidity provision in the euro area in 2008. Since the end of 2007, the Eurosystem has compensated for the high amount of these operations by decreasing the amount of main refinancing operations, while their increase towards the end of 2008 has been compensated by increasing use of the deposit facility.

Slovenian counterparties participated in 25 LTROs, in which they submitted bids totalling EUR 2.1 billion (EUR 1.1 billion in operations executed until mid-October and EUR 1.0 billion in subsequent operations), and were allotted a total of EUR 1.5 billion in liquidity (EUR 0.5 billion in operations before mid-October and EUR 1.0 billion in subsequent operations), or 72% of the bid amount, taking into account the entire year, or 45% only taking into account the period until mid-October 2008, after which there has been full allotment.

Figure 37: **Outstanding amounts of Eurosystem monetary policy instruments in 2008 (+ increases, - decreases in liquidity)**



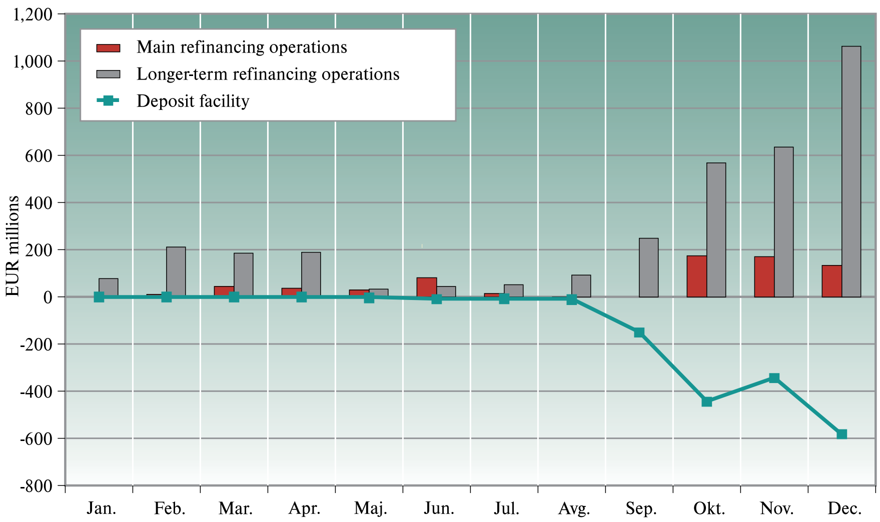
Source: ECB

Fine tuning operations (FTO) are executed on an ad hoc basis with the aim of managing liquidity imbalances in the market and stabilising interest rates. In 2008 these operations were executed as liquidity-providing reverse transactions or as collection of fixed-term deposits, each time as a quick tender. FTOs are conducted regularly on the last day of a reserve maintenance period to balance the actual liquidity of the system with its liquidity needs (determined by minimum reserves and possible excess reserves, held voluntarily by banks). In addition, the ECB also carried out FTOs during reserve maintenance periods on several occasions in 2008 due to more frequent liquidity imbalances and the increased need to manage short-term interest rates. The Eurosystem executed a total of 25 FTOs in 2008 (one more than in 2007), eight to provide liquidity in the form of loans (one more than in 2007) and 17 to absorb liquidity in the form of collection of counterparty deposits (the same as in 2007). A total of 12 FTOs were executed on the last day of the reserve maintenance period, and 13 on other days. In October the number of counterparties that may participate in these operations, which was previously limited to a smaller group of counterparties, was temporarily expanded to all counterparties with access to main refinancing operations. Slovenian banks and savings banks also participated regularly in these tenders.

Surplus liquidity due to full allotment MROs and LTROs passed through to larger use of the deposit facility.

The use of *standing facilities* is usually limited to the closing of unexpected liquidity supply/demand gaps of counterparties and is typically higher at the end of a reserve maintenance period when the possibility to balance gaps via averaging of the minimum reserve holdings or regular open market operations is smaller. However, from mid-October 2008 when the Eurosystem executed open market operations using full allotment and applying a narrower band around the main refinancing operation interest rate (see Box 1), banks regularly (daily) used the deposit facility to invest the surplus liquidity that arose with the acceptance of the full amount of counterparties' bids in open market operations. In 2008 the average daily balance of the deposit facility in the Eurosystem was EUR 49.8 billion, compared with EUR 0.5 billion in 2007. The average daily balance of the marginal lending facility was EUR 2.3 billion, compared with EUR 0.2 billion in 2007. Excluding the period of full allotment, the average daily balance of the deposits facility was EUR 2.4 billion, while the average daily balance of the marginal lending facility was EUR 0.9 billion. The use of the deposit facility by Slovenian banks and savings banks followed the pattern of the Eurosystem. Average use over the entire year in 2008 was EUR 96.1 million, while average use over the first part of the year (until the execution of full allotment main refinancing operations) was EUR 2.1 million. The marginal lending facility was not used in Slovenia in 2008.

Figure 38: **Outstanding amounts of Eurosystem monetary policy instruments in 2008: Slovenian banks and savings banks (at month-end)**

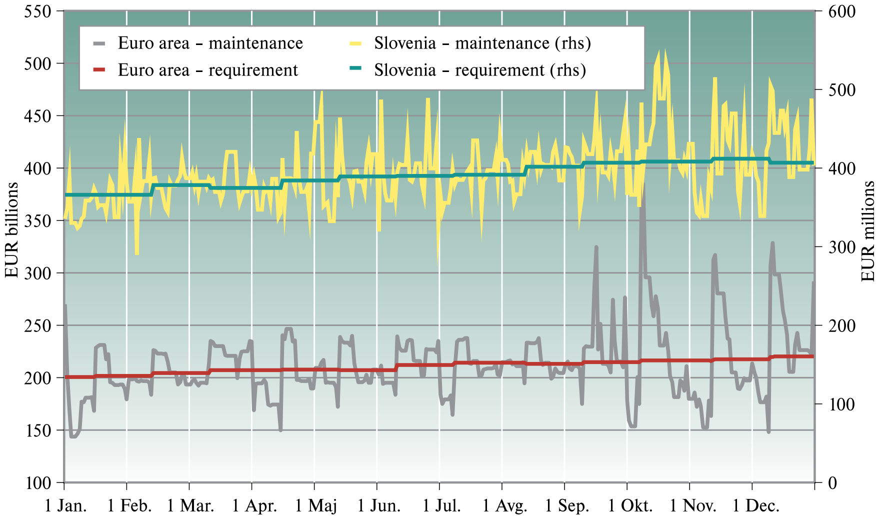


Source: Bank of Slovenia

Slowing growth in lending was reflected in lower rate of growth in minimum reserves.

The Eurosystem's *minimum reserve requirement* is determined in relation to specific items from the liability side of banks' and savings banks' balance sheet. On average, the reserve maintenance period is approximately one-month, and typically starts on the Wednesday following the meeting of the Governing Council of the ECB, when the latter sets the monetary policy stance (as a rule at the first of the two monthly meetings). The reserve requirement rose gradually during the year. It increased by 10.4% in the euro area relative to 2007 (by 14.2% in 2007 relative to 2006) and by 11.2% in Slovenia (by 15.1% in 2007 relative to 2006). The average annual balance on accounts included in the reserve requirement holdings in the euro area was EUR 212.6 billion. Slovenian institutions subject to the reserve requirement accounted for EUR 0.4 billion or 0.19% of this amount. No Slovenian bank or savings bank violated the reserve requirement in 2008.

Figure 39: **Minimum reserve requirement and maintenance**



Sources: Bank of Slovenia, ECB

Box 5: **Eurosystem monetary policy measures in 2008**

Refinancing in euros

A lack of confidence among market participants, which first appeared in August 2007 and continued into 2008, resulted in a drop in activity on the interbank market, particularly in the segment of unsecured loans, where loans with a maturity of more than one month were especially affected. This led to a sharp rise in market interest rates above the ECB's key interest rate. Volatility also passed through to interest rates set at Eurosystem operations via increased demand for the latter. In order to bring about a normalised functioning of the money market in a period of increased uncertainty, the Eurosystem opted to deviate from its policy of benchmark allotment in the second half of 2007, and shifted to a policy of providing increased liquidity early in the reserve maintenance period via regular main refinancing operations. The Eurosystem attempted to satisfy demand for three- and six-month liquidity through additional longer-term refinancing operations. In the summer of 2008 the volatility of the Eonia eased somewhat, and the gap between the Eonia and the ECB key interest rate also closed.

With bankruptcy of the US investment bank Lehman Brothers in September, conditions again tightened drastically, with tensions resulting in a global financial crisis. The Eurosystem executed main refinancing operations from 15 October onwards, and longer-term refinancing operations from 30 October onwards, with full allotment of liquidity bid by counterparties and at an interest rate equal to the ECB key interest rate.[12] At maturity it renewed all three- and six-month longer-term refinancing operations, and also executed additional one-month operations with a maturity equal to the reserve maintenance period. To decrease counterparties' difficulties in managing liquidity, the Eurosystem narrowed the gap between the interest rates on the deposit facility and the marginal lending facility on 8 October, from 200 basis points to 100 basis points.

Because increased use of operations also increased the amount of eligible collateral needed for such operations, the Eurosystem temporarily (until the end of 2009) eased certain eligibility criteria for collateral on 15 October. Thus, in addition to existing collateral, the following was also made eligible as collateral to borrow from the Eurosystem: (a) securities (with the exception of asset-backed securities) and non-marketable financial assets with a credit rating between BBB+/Baa1 and BBB-/Baa3, (b) debt securities issued by credit institutions and traded on certain over-the-counter markets, as defined by the ECB, (c) subordinated debt securities with eligible guarantee, and (d) certain debt instruments issued in the euro area and denominated in US dollars, pound sterling or Japanese yen.

12 Full allotment means that counterparties received as much liquidity as they bid for, at a pre-determined (fixed) interest rate.

Refinancing in foreign currencies

Due to a halt in US dollar refinancing by European banks, the Eurosystem provided its counterparties with financing in US dollars linked to the Federal Reserve's *Term Auction Facility*. The first two operations, in the amount of USD 10 billion each and with a maturity of 28 days, were executed in December 2007 and renewed in January 2008. Following a temporary pause, the Eurosystem renewed financing in US dollars on 11 March, as counterparties' difficulties with financing on the market continued. Initially it lent US dollars every two weeks in the amount of USD 15 billion, and subsequently increased the amount to USD 25 billion on 2 May due to increased difficulties and high demand. On 30 July an additional maturity of 84 days was introduced, while the total amount of outstanding operations remained unchanged at USD 50 billion.

Similar effects to those felt by the European money market following the collapse of Lehman Brothers were felt in the second half of September in the financing of banks in US dollars and Swiss francs markets. Due to the extraordinary rise in very short-term US dollar interest rates and the collapse of the foreign exchange swap market, the Eurosystem added overnight maturity to existing maturities of US dollar lending. In October US dollar operations too, similarly to euro-denominated open market operations, were executed with full allotment at a fixed interest rate for loans with maturities of 7, 28 and 84 days, while overnight lending was discontinued. At the same time, the Eurosystem provided counterparties without sufficient collateral for US dollar loans with the possibility of euro/US dollar foreign exchange swaps, whereby a loan in US dollars was secured by the euro deposit of counterparty with the Eurosystem. The volume of such operations was limited due to low demand from counterparties.

In a similar manner and for reasons similar to those for the US dollar, the Eurosystem, based on an agreement with the Swiss central bank, began lending Swiss francs to its counterparties on 22 October, using a euro/Swiss franc foreign exchange currency swap. It initially offered Swiss francs at a fixed interest rate in the countervalue of EUR 20 billion for 7 days and later supplemented the offer with an additional EUR 5 billion with a maturity of 84 days. Average demand for Swiss francs was considerably lower than demand for US dollars. In contrast, the demand of Slovenian banks and savings banks was more in favour of Swiss francs than US dollars. The euro equivalent of the average amount outstanding of all Swiss franc loans to Slovenian banks and savings banks in the period from 22 October (when these loans were first offered) to the end of the year was EUR 52.5 million, while the amount outstanding of US dollar loans in 2008 was EUR 9.6 million.

2.1.2 Collateral in Eurosystem credit operations

In accordance with the Statute of the ESCB and the ECB, all Eurosystem credit operations must be based on adequate collateral. Financial assets must meet uniform criteria, valid throughout the euro area, to be considered eligible collateral for Eurosystem monetary policy operations and intraday loans. Eligible assets include securities (marketable assets) and non-marketable assets, banks loans being the most important among the latter.[13]

The stock of securities in the Bank of Slovenia's pool of collateral rose in the final quarter. Bank loans were used as eligible collateral for the first time in December.

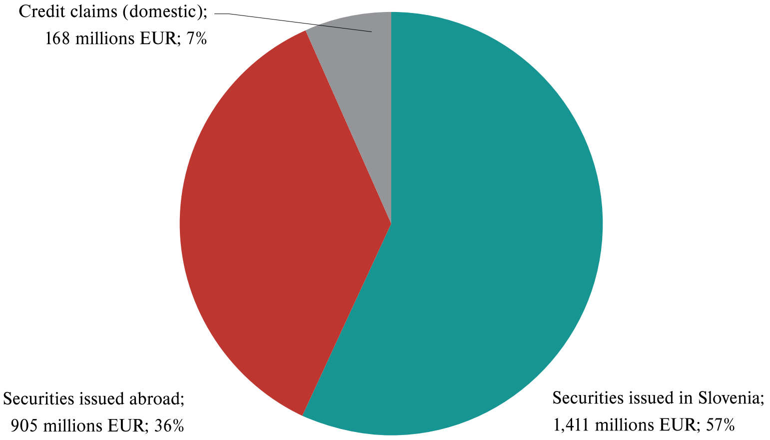
Slovenian counterparties use financial assets to secure transactions with the Bank of Slovenia by transferring them to the pool of collateral at the Bank of Slovenia. Financial assets issued, approved or settled in Slovenia are transferred to the pool by pledging eligible securities issued in KDD (Central Securities Clearing Corporation) or by a lien on a bank loan entered into the register of bank loans at the Bank of Slovenia. Financial assets issued abroad are transferred to the pool via the correspondent central bank model.[14] Due to increased demand for Eurosystem

13 Eligible assets and criteria are described in Chapter 6 of the General Documentation on Eurosystem Monetary Policy Instruments and Procedures (http://www.ecb.int/pub/pdf/other/gendoc2008sl.pdf).

14 The correspondent central bank model (CCBM) is a mechanism between Eurosystem central banks that permits counterparties to collateralise Eurosystem claims with financial assets issued or settled in a country other than the counterparties' country of origin. More information regarding the CCBM is available in an English-language brochure on the ECB's website at http://www.ecb.int/pub/pdf/other/ccbm2008en.pdf.

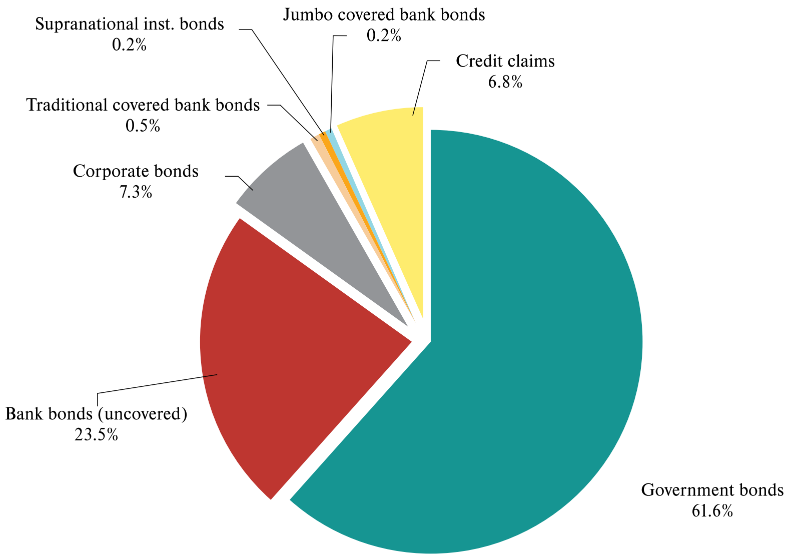
credit operations, the total value of the pool of collateral rose gradually in 2008 from EUR 1.3 billion at the beginning of the year to EUR 2.5 billion by the end of the year, when the pool was composed of securities issued in Slovenia in the amount of EUR 1.4 billion, securities issued abroad in the amount of EUR 0.9 billion and domestic banks loans totalling EUR 0.2 billion. Slovenian banks and savings banks began using domestic bank loans in December 2008, but did not use bank loans granted to borrowers abroad.

Figure 40: **Pool of collateral at the Bank of Slovenia as at 31 December 2008 – breakdown by place of issue**



Source: Bank of Slovenia

Figure 41: **Pool of collateral at the Bank of Slovenia as at 31 December 2008 – breakdown of securities by type and bank loans**



Source: Bank of Slovenia

2.2 Bank of Slovenia as a lender of last resort

Article 4 of the Law on the Bank of Slovenia 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 law, 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, i.e. it may, based on adequate collateral, lend to an otherwise solvent bank, which finds itself in unexpected liquidity difficulties.

The special liquidity loan with participation was not renewed.

One of the ways the Bank of Slovenia functioned in this role was by granting a *special liquidity loan with participation*. At the end of 2007 the Bank of Slovenia concluded an agreement on willingness to participate in liquidity loans with 13 banks and savings banks, which was the twelfth successive agreement. The agreement expired at the end of January 2009, when the Governing Board of the Bank of Slovenia decided not to renew the agreement. The banks' participation mechanism was not triggered while the agreement was in force, as has been the case ever since the agreement was put in place.

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 in 2008 also issued authorisations to obtain a qualifying holding in the capital of a bank, authorisation for the merger or acquisition of banks and authorisation to hold office as a member of a bank's management board. The decision to grant or refuse an authorisation is taken by the Governing Board of the Bank of Slovenia based on the opinion of the License Committee, except in the case of authorisations to hold office as a member of a management board, where the decision is based on the opinion of the Committee 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 22 authorisations in 2008 for the provision of various types of mutually recognised and additional financial services.

In 2008 the Bank of Slovenia issued a total of 22 authorisations for banking and various types of mutually recognised and additional financial services, for qualifying holdings, for the merger or acquisition of banks, and for holding office as a member of the management board. It rejected two applications for authorisation to hold office as a member of a bank's management board. The majority of authorisations issued in 2008 were for the provision of mutually recognised and additional financial services (10), while 8 were issued to hold office as a member of a bank's management board and 3 for the acquisition of a qualifying holding in a bank. Authorisation was also issued for the merger of three banks. The number of authorisations issued to provide mutually recognised and additional financial services was significantly higher than in 2007, when only three authorisations were issued.[15]

[15] Mutually recognised and additional financial services include: the provision of payment transaction services, the issue and management of payment instruments, trading in money market instruments, foreign legal tender, derivatives and transferable securities on own account and on behalf of clients, participation in the issue of securities, corporate consultancy services regarding capital structure, business strategy and related matters and consultancy and services related to corporate M&A activities, investment management and related consultancy services, safekeeping of securities and related services, brokering the sales of insurance policies in accordance with the law governing the insurance industry and administrative service for investment funds. Authorisation to provide banking services includes the collection of deposits from the public and the granting of loans on own account.

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 (mutually recognised) financial 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, which must be notified in writing by the relevant supervisory authority in the home Member State. In 2008 the Bank of Slovenia received 66 notifications of the direct provision of banking and other mutually recognised financial 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, 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.

In 2008 the Bank of Slovenia received 66 notifications of the direct provision of banking and other mutually recognised financial services.

2.3.2 Examinations of banks and savings banks

In 2008, the Banking Supervision Department continued to conduct examinations of banks and savings banks according to its internal risk assessment methodology, which is based on assessing risks and the 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). The most frequently examined areas were 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, the definition of the risk profiles of banks and savings banks in accordance with the Bank of Slovenia's internal risk assessment methodology, etc. Follow-ups of the implementation of requirements from orders, admonishments and recommendations (examinations of the implementation of measures) were also frequent, as it was not always clear from the documentation submitted whether the banks had rectified the irregularities.

Emphasis in 2008 was on the examination and monitoring of the implementation of the new capital framework at banks and savings banks (as a continuation of activities from 2007, when the Banking Supervision Department began the systematic monitoring of the preparations of banks and savings banks for the introduction of the new European capital framework, conducted in two cycles of examinations), and the related calculation of capital requirements for credit and operational risk in the scope of Pillar 1 and the process of calculating the required level of internal capital in the scope of Pillar 2 of Basel II.

Emphasis in 2008 was on examining and monitoring the implementation of the new capital framework at banks and savings banks.

Examinations of banks' readiness for the introduction of advanced approaches for calculating capital requirements for credit risk (IRB)[16] and operational risk (AMA)[17] continued. Primarily certain banks under majority foreign ownership opted for

16 Internal Ratings-Based Approach (IRB).
17 Advanced Measurement Approach (AMA).

one of the aforementioned approaches. Banks that have chosen to begin using an advanced approach (IRB and/or AMA) for the calculation of capital requirements in the near future 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. Cooperation with foreign supervisors, who are responsible for activities relating to joint decisions, is intensive in such cases. Only one foreign bank is currently using an advanced approach to a limited extent. The Bank of Slovenia received one additional application from a foreign bank in 2008 for the use of the IRB approach.

In October 2008 the Bank of Slovenia organised the first Supervisory College.

Cooperation with foreign supervisors is also connected with the ever expanding Supervisory Colleges, in which inspectors of the Banking Supervision Department participated in 2008. In October 2008 the Bank of Slovenia's Banking Supervision Department organised Supervisory College as competent home supervisor for the Slovenian banking group, Nova Ljubljanska banka.

In 2008 60 examinations were carried out.

Based on authorisations by the Governor of the Bank of Slovenia, 60 examinations were carried out in 2008, including the following:

- 18 examinations of the accuracy of the calculation of internal capital,
- 6 examinations of the preparedness of banks for the use of bank loans as collateral for Eurosystem claims (*in addition to securities as the basis for collateral, banks may also use eligible bank loans as collateral for Eurosystem credit operations, provided that they have carried out an initial, one-time verification of procedures, as required by the Bank of Slovenia for this purpose*),
- 7 specific examinations of the prevention of money laundering with regard to deposit transactions (*the Governing Board of the Bank of Slovenia adopted guidelines in the area of preventing money laundering and terrorist financing relating to changes in the prevention of Money Laundering and Terrorist Financing Act*), and
- several examinations of the implementation of measures (follow-up examinations) and a number of one-day examinations or monitoring of a specific area of operations.

Box 6: **New guidelines for the prevention of money laundering**

The new Act on Prevention of Money Laundering and Terrorist Financing was adopted in 2007, transposing the requirements of Directives 2005/60/EC and 2006/70/EC into the Slovenian legal system.

One of the key legislative changes is the introduction of a risk-based approach. Accordingly, banks are obliged to perform a risk analysis, taking into account the guidelines issued by the competent supervisory authority.

The Bank of Slovenia began preparing the relevant Anti Money Laundering guidelines in 2007. In November 2007 the first draft was prepared and presented to banks at annual conference of Anti Money Laundering compliance officers. At the beginning of 2008 the Bank of Slovenia carried out a preliminary examination of a selected sample of banks in order to get information on what kind of activities banks began to implement to meet the new regulatory requirements. Examinations were also intended to identify possible ambiguities with regard to understanding and the implementation of the new regulatory requirements.

The new Act brought some major changes, which have resulted in a number of questions in practice. Therefore, the decision was taken to prepare guidelines with a broader interpretation to help banks establish a comprehensive system to appropriately manage risks in this area. In addition to procedures for performing a risk analysis, the guidelines also include other sections relating to the establishment of an appropriate organisational structure, customer due diligence, transaction reporting and the implementation of the requirements set out in Regulation

(EC) No. 1781/2006. Recommendations regarding the establishment of appropriate information support are also provided in the guidelines.

A draft of the guidelines was submitted twice for public consultation. In the first phase the draft was submitted to the Office for Money Laundering Prevention and to the Committee for Money Laundering Prevention at the Bank Association of Slovenia (BAS), while banks were invited directly to submit their comments in the second phase. The majority of comments related to the process of identifying the beneficial owner and political exposure of a client. Amendments were made based on comments received, and the final content of the guidelines was reconciliated with banks at the annual conference of Anti Money Laundering compliance officers in October 2008.

The final content of the guidelines was approved by the Governing Board of the Bank of Slovenia on 18 November 2008, and the guidelines were published on the Bank of Slovenia's website in January 2009.

In the process of drawing up the guidelines, the Bank of Slovenia also prepared a comparative analysis of the requirements from Directives 2005/60/EC and 2006/70/EC and those of the Act on Prevention of Money Laundering and Terrorist Financing. The comparative analysis was submitted to the BAS as the basis for possible suggestions by banks for drawing up eventual regulatory changes.

Based on the findings of examinations at banks and savings banks, the Bank of Slovenia may issue recommendations, admonishments or orders. In 2008 the Bank of Slovenia issued seven orders to rectify breaches, several orders and decisions 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 admonishments and recommendations for improving operations. In 2008 the Banking Supervision Department also participated in three misdemeanour proceedings in which the Bank of Slovenia issued two misdemeanour decisions. One proceeding has not yet been concluded. All of the aforementioned material was discussed and approved by the Governing Board of the Bank of Slovenia.

The Bank of Slovenia received a total of 12 requests from banks and savings banks for authorisation with regard to the characteristics of components in the calculation of capital, 10 of which were authorisations issued for the inclusion of subordinated debt and hybrid instruments in Tier I additional capital.

Also discussed in 2008 were requests for recognition of the eligibility of the credit assessments of three external credit assessment institutions linked to the use of these credit assessments in banks' calculation of capital requirements for credit risk using the standardised approach. To that end, two examinations of credit assessment institutions were carried out to determine whether their methodology and credit assessments meet the prescribed conditions for recognition. One request for recognition was partially approved; one request was withdrawn, while a third is still being evaluated. The process of mapping credit assessments, the results of which are published on the Bank of Slovenia's website, was carried out for a credit assessment institution, recognised as eligible.

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 2008, and conducted a number of interviews with the management of banks and savings banks.

In 2008 the Banking Supervision Department participated in four examinations of the operations of foreign banks under the majority ownership of the two largest Slovenian banks.

In 2008 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 four examinations of the operations of foreign banks under the majority ownership of Nova Ljubljanska banka d.d. and Nova kreditna banka Maribor d.d., in cooperation with the supervisors in the countries where the subsidiary banks operate.

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 aforementioned 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 irregularities relating to the work of the other institution.

Box 7: **Crisis management team**

In accordance with the best practices of national central banks, a crisis management team was created at the Bank of Slovenia in February 2008, by decision of the Governor. The members of the aforementioned team were appointed from the Bank of Slovenia's management and four of its departments. The crisis management team carries out tasks based on a memorandum of activities of individual departments and the Memorandum of Understanding on Cooperation between Financial Supervisory Institutions, Central Banks and Finance Ministries of the European Union on Cross-Border Financial Stability of 1 June 2008. The team's work includes various activities of the banking supervisor or central bank related to crisis management at the national and cross-border levels.

2.3.3 Adopted implementing regulations

Several implementing acts and recommendations were issued in 2008, relating to the operations of banks and savings banks and their supervision. Several of these were the result of changes to legislation governing specific areas of banking operations, while others were a response to banking practice and conditions on the financial markets.

In February 2008 the *Regulation on Reporting the Effective Interest Rates of Banks and Savings Banks* was issued in accordance with the Consumer Credit Act. The new Consumer Credit Act (Official Gazette of the Republic of Slovenia No. 111/07) amended the maturities and amounts of consumer loans for reporting by banks and savings banks in accordance with the requirements of the aforementioned regulation. Also amended were the deadlines for reporting by banks on effective interest rates, based on which the Bank of Slovenia calculates and publishes the average effective interest rates of banks on consumer loans twice a year.

New recommendations were issued on the methods of calculating interest on personal banking transactions.

In July the Governing Board of the Bank of Slovenia adopted new recommendations on the methods of calculating interest on personal banking transactions, which represent amendments to the recommendations from 2004, for the purpose of harmonisation with valid legislation and to define in detail recommendations regarding deposit transactions. The purpose of the latter was primarily to establish uniform banking practices and to ensure banks take into account general regulations in force. The legality of a bank's operations must be fully respected at all times.

The following were issued in October: the Regulation amending the Regulation on the Books of Account and Annual Reports of Banks and Savings Banks, the Regulation amending the Regulation on the Assessment of Credit Risk Losses by Banks and Savings Banks, the Guidelines for the Electronic Submission of Capital and Capital Adequacy Reports and the Guidelines amending the Guidelines for the Electronic Submission of Capital and Capital Adequacy Reports.

The *Regulation on the Books of Account and Annual Reports of Banks and Savings Banks* was amended due to the obligations set out in the Financial Instruments Market Act (Official Gazette of the Republic of Slovenia, Nos. 67/07 and 100/07; hereinafter: the ZTFI) for institutions that provide investment services and transactions for clients, and relate to the disclosure of these transactions in the notes to the balance sheet and income statement. Since this obligation is only prescribed for investment firms in the ZTFI, its was necessary to prescribe this obligation for banks, on the basis of the Banking Act (Official Gazette of the Republic of Slovenia, Nos. 131/06, 1/08 and 109/08).

With the amendment to the Regulation on the Assessment of Credit Risk Losses for Banks and Savings Banks, the rate of impairment and provisioning for all categories to which banks classify financial assets and liabilities assumed under off-balance sheet items for the purpose of calculating deduction items from a bank's original own funds was lowered to 0%, effectively abolishing this deduction item.

With the *Guidelines for the Electronic Submission of Capital and Capital Adequacy Reports*, a new electronic capital and capital requirement reporting system was introduced, replacing the previous simplified reporting in the form of Excel tables. The guidelines cover the electronic means for submitting an entire package of capital and capital adequacy reports (form COREP), on both an individual and consolidated basis. Banks submitted their first reports based on the guidelines for the situation as at 30 September 2008.

The *Regulation on Credit Protection* was amended in November due to the extension of the period (until the end of 2009) in which licensed real estate valuers who have been appointed based on the law governing courts (court valuers) are also deemed appropriate for appraising the value of residential and commercial real estate, if they use an assessment method based on international valuation standards.

Amendments to the *Guidelines for Implementing the Regulation on the Minimum Requirements for Ensuring an Adequate Liquidity Position at Banks and Savings Banks* were also adopted in November. In accordance with the amended guidelines, banks are not required to take into account a decrease in the pool of underlying assets on account of longer-term refinancing operations at the ECB in the calculation of the category one liquidity ratio. Notwithstanding the aforementioned change, the category one liquidity ratio, calculated according to the old methodology, may not be lower than 0.90. The amended methodology for calculating the category one liquidity ratio is valid until rescinded or until 31 December 2009.

A new Banking Act was passed.

In the package of measures aimed at mitigating the effect of the financial turmoil, the National Assembly adopted the new Banking Act (Official Gazette of the Republic of Slovenia, No. 109/08; hereinafter: the ZBan-1B) in November, which temporarily (until the end of 2010) introduces an unlimited deposit guarantee in the event of the bankruptcy of a bank or savings bank. On this basis, in December the Bank of Slovenia issued the *Regulation amending the Regulation on the Deposit Guarantee Scheme* and amended the *Instructions for Compiling and Submitting Reports on Guaranteed Deposits*. Since banks and savings banks guarantee a net deposit up to the amount of EUR 22,000, while Republic of Slovenia guarantees the remainder above this amount, the balance of guaranteed deposits must be determined separately. In this way the liability of banks for guaranteeing liquid investments, and the liabilities of banks and the Republic of Slovenia for the payment of guaranteed deposit in the event of a bank's bankruptcy can be calculated. Banks must now report the balance of guaranteed deposits to the Bank of Slovenia on a quarterly basis, while reporting deadlines have been shortened to one month. The aforementioned changes to the regulation are followed by appropriate changes to the instructions and reporting forms.

2.3.4 Financial stability

In 2008 the Bank of Slovenia, in accordance with legally prescribed objectives, analysed the financial stability of the Slovenian financial system, and took into account all findings in the formulation of and decision-making regarding proposed measures. Alongside its regular operational tasks, the Bank of Slovenia's focus in the first half of the year was on the preparation of its comprehensive traditional yearly analysis, published in May as the Financial Stability Review. It was followed by a second, more comprehensive analysis, Macro Stress Tests for the Slovenian Banking System, which was completed in October. It included the simulated effects of possible shocks to the Slovenian banking system. A brief summary of the findings of the aforementioned analyses is given below.

Spring 2008 assessments of financial stability warned of the rising credit risk of banks and their dependence on unpredictable international financial markets.

The Financial Stability Review presents financial developments in the economy in 2007 and the first quarter of 2008. Its emphasis is on the assessment of systemic risks in the Slovenian financial system and its relationships with the corporate sector, the household sector and the rest of the world. The period assessed was characterised by high lending growth, which was mainly financed by bank borrowing in the rest of the world, and by the tightened conditions on the international financial markets following the outbreak of the financial turmoil in the US in August 2007. The Financial Stability Review finds that, with the heavy lending activity of banks, the transfer of interest-rate risk to the household and corporate sectors continued due to a rising value of loans with a variable interest rate. At the same time households, and to a lesser degree corporates, have increased their exposure to exchange-rate risk due to increased borrowing in the form of Swiss franc loans. The aforementioned rising interest-rate risk and exchange risk of the household and corporate sectors has increased bank's credit exposure, which is typically reflected in a deterioration in the credit rating structure of claims when growth in lending is down. At the same time, certain corporate sector indicators, which are precursors to a deterioration in the structure of banks' claims (increasing leverage, rising debt, deteriorating liquidity and differences in delays in the repayment of loans between economic sectors) already point to a tightening of operating conditions, a continuing increase in the premium over the EURIBOR for loans to corporates and the continued tightening of other corporate borrowing conditions. The Financial Stability Review finds that Slovenian banks and insurance companies have not been directly affected by the financial turmoil, due to their low exposure to non-liquid and high risk financial instruments (e.g. structured financial instruments). However, banks are faced with tightening borrowing conditions on the international financial markets; thus refinancing risk has increased. For this reason, the sensitivity, particularly of the banks under majority domestic ownership has risen, resulting in the further deterioration of the structure of regulatory capital. The Financial Stability Review recommended that banks improve their coverage of loans by non-banking sector deposits, and that they maintain or improve capital adequacy, primarily by increasing share capital.

The analysis Macro Stress Tests for the Slovenian Banking System presents an assessment of possible changes in the banking system's balance sheet and income statement over the next two-year period, and assesses the banking system's sensitivity to simulated shocks in selected risk factors. The analysis finds that banks are especially exposed to the risk of a simulated liquidity shock, which would have further adverse effects on banks' operations in the context of a more rapid decline in lending growth and a deterioration in the credit rating structure of claims.
The Bank of Slovenia strengthened its regular analytical monitoring of the Slovenian financial system's stability in the final months of 2008. In cooperation with other institutions in Slovenia and abroad, it analysed anti-crisis measures and scenarios for their possible application, and adopted measures necessary to maintain financial stability. In October it eliminated the effects of the prudential filter in the formation of impairments and provisions to ease the effects of the financial turmoil. This produced an anti-cyclical effect and resulted in the improved capital adequacy of banks, just after autumn's worsening of the international financial turmoil. It followed this up in November by adjusting the liquidity ladder with regard to the value of pledged collateral at the central banks, and thus facilitated banks' greater access to liquidity at the Eurosystem. Also in November, the Bank of Slovenia responded to the above-average rise in interest rates on sight deposits at some banks by calling on banks to refrain from such activities. It also called on banks to appropriately assess credit risks in the context of deteriorating economic conditions and to form an appropriate level of impairments.

2.4 Management of the Bank of Slovenia's financial investments

The Bank of Slovenia's financial investments include all of its financial assets not related to the implementation of monetary policy. They comprise financial investments denominated in domestic and foreign currencies. With adoption of the euro on 1 January 2007 the Bank of Slovenia transferred its portion of foreign currency assets in US dollars and gold to the international monetary reserves of the ECB. The main purpose of the international monetary reserves is to ensure adequate liquidity for operations on the currency market. All euro area central banks have contributed their shares to the ECB's monetary reserves, which they manage jointly with the ECB. Since 1 January 2007 the Bank of Slovenia and the Central Bank of Luxembourg have jointly managed their share of the ECB's international monetary reserves. In addition to the international monetary reserves, 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.

The value of the Bank of Slovenia's financial investments on 31 December 2008 was EUR 5,354.9 million.

The value of the Bank of Slovenia's financial investments on 31 December 2008 was EUR 5,354.9 million, of which EUR 4,667.7 million was invested in the financial instruments, which are either claims on euro area residents or claims on non-euro area residents denominated in euros. These include EUR 3,197.4 million of investments in capital market instruments, EUR 337.4 million in money market instruments and EUR 1,132.9 million in cash and deposits (of which cash and sight deposits account for EUR 1 million). In addition, EUR 687.2 million was invested in financial instruments, which are claims on non-euro area residents denominated in non-euro currencies and 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. Since 1 January 2007 Slovenia has applied the concept used by all 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 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. 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).

Table 20: **Balance of the Bank of Slovenia's financial investments**

In EUR million	Financial investments of the Bank of Slovenia		
Year	Investments in euros and all investments in instruments of euro area issuers	International monetary reserves	Total
2008	4,667.7	687.2	5,354.9

Source: Bank of Slovenia
Note: Balance as of 31 December 2008.

A three-level decision making process is employed to manage financial assets.

The management of the Bank of Slovenia's financial investments is based on a three-level decision-making process. The Governing Board of the Bank of Slovenia sets out the Guidelines for Managing the Bank of Slovenia's Financial Investments, 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 in order to limit the exposure to various types of risk. The Investment Committee also defines the methodology of measuring the performance and of quantifying risks. At the third level, portfolio managers carry out the operational aspect, within set tolerances.

The current credit risk management criteria allow investments in financial instruments exposed to sovereign, supranational or banking type of risk, issued by counterparties with an internal rating of at least A-. The ratio of the size of investments exposed to sovereign or supranational type of risk and banking risk is also prescribed. Investments in the supranational and bank sector are limited to a list of eligible counterparties, whereby there is also an upper limit on exposure to an individual entity exposed to supranational risk or to an individual banking group. The upper exposure limit depends on the Bank of Slovenia's counterparty internal rating.

The currency exposure and the limits on permitted deviations are precisely set out in the criterion for managing foreign currency risk. The criterion also lays down a target currency structure for Bank of Slovenia investments. In 2007 additional instrument, i.e. foreign exchange swap, was added to the list of eligible instruments, which allows for exposure to foreign currency area risk, while hedging the changes in the currency exchange rate itself. In this manner the Bank of Slovenia hedged the entire foreign currency exposure in January 2008, with the exception of the portion of investments representing the amount potentially called into international monetary reserves funds by the ECB.

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.

Investment policy is defined in management criteria.

The Bank of Slovenia's investment policy must comply with Articles 101 and 102 of the Treaty establishing the European Community, which prohibits the monetary financing of public sector institutions. The prohibited forms of public institution financing include deposits and purchases of primary issued securities, commercial paper and certificates of deposit if the issuer is a public institution. Purchasing EU public sector financial instruments on the primary market is prohibited, while investments are permitted on the secondary market within a fixed limit for each country.

The management of the Bank of Slovenia's financial investments was carried out in line with the criteria during 2008. More detailed information on the structure of the international monetary reserves as of 31 December 2008 is given in the section on the financial statements.

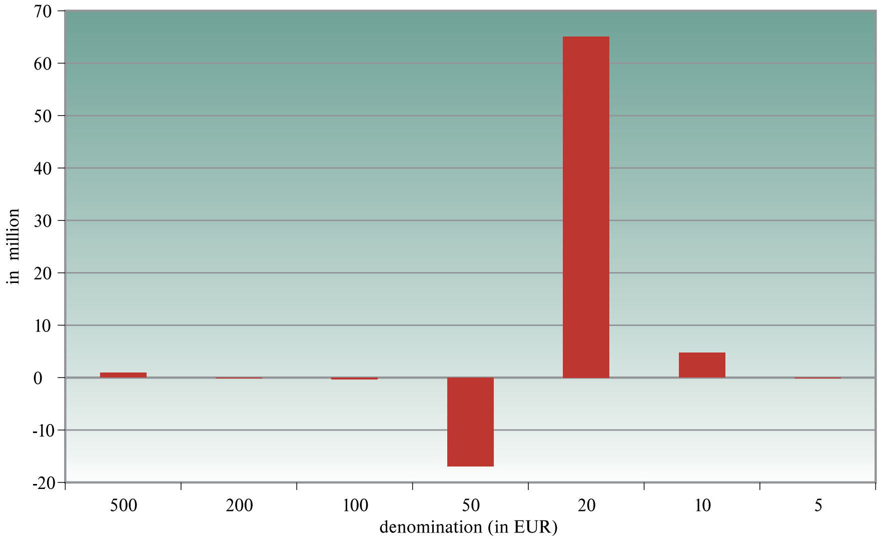
2.5 Cash operations

Euro cash worth EUR 857.05 million was released.

By 31 December 2008, the Bank of Slovenia had released EUR 857.05 million net of euro cash into circulation (taking into account cash at banks). Of this amount, EUR 817.14 million was in banknotes (52.53 million banknotes) and EUR 39.91 million was in coins (159.55 million coins). Of the aforementioned, the most common denomination of euro banknotes, in terms of quantity, was EUR 20 (64.96 million banknotes), followed by EUR 10 (4.7 million banknotes) and EUR 500 (0.8 million banknotes). The flow of EUR 200, EUR 100, EUR 50 and EUR 5 denominations was negative, since more of these notes were returned to the Bank of Slovenia than released into circulation. In terms of quantity, the most common denominations of coins released into circulation by the Bank of Slovenia are 1 euro cent (38 million coins) and 2 euro cents (33.6 million coins). The EUR 1 coin represents the smallest proportion in terms of quantity (7 million coins).

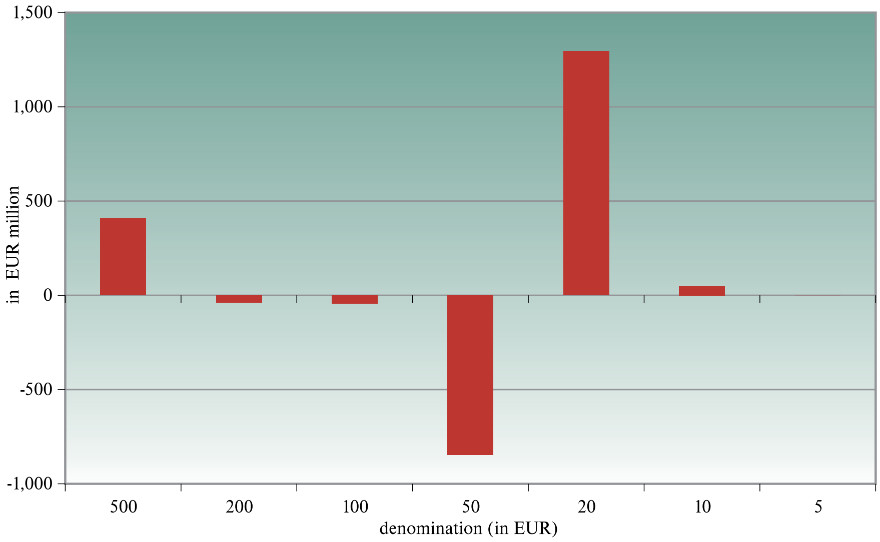
The Bank of Slovenia organised the issue, distribution and storage of general circulation and commemorative coins for the Republic of Slovenia.

Figure 42: **Banknotes released into circulation by volume**



Source: Bank of Slovenia

Figure 43: **Banknotes released into circulation by value**



Source: Bank of Slovenia

A new commemorative EUR 2 coin marked the 500th anniversary of Primož Trubar's birth.

The Bank of Slovenia released into circulation 1,000,000 new bi-coloured circulation commemorative 2-euro coins to mark the 500th anniversary of the birth of the historic figure and writer, Primož Trubar. The common European side is the same as the EUR 2 circulation coin.

First Slovenian bi-coloured EUR 3 coin.

In 2008 the following commemorative coins were also issued to mark the Slovenian presidency of the European Union: a gold coin, silver coin and a 3-euro circulation coin, while a gold coin and silver coin to mark the 250th anniversary of the birth of the poet Valentin Vodnik.

As at 31 December 2008 there were still 47.3 million tolar banknotes in circulation (worth SIT 8.63 billion), of which the most common denomination of tolar banknote was the SIT 10 (17.7 million banknotes), followed by SIT 20 (11.3 million banknotes) and SIT 100 (6.7 million banknotes). There are still 447.54 million tolar coins (worth SIT 2.2 billion) and 20.92 million payment notes (worth SIT 404.14 million) in circulation. To date 88.34% of all printed tolar banknotes or 98.62% of the total value of all printed tolar banknotes had been destroyed, while 17% of all minted tolar coins or 41.61% of the total value of all minted tolar coins and 86.35% of all payment notes issued and 98.95% of the total value of all payment notes issued have been destroyed.

The first Slovenian currency – payment note – can be exchanged at the Bank of Slovenia.

The original Slovenian payment notes and tolar banknotes are exchangeable at the Bank of Slovenia treasury without any time limit, while tolar coins can be exchanged until 31 December 2016.

A total of 6,888 treasury receipts and outlays of euro cash (2007: 7,186) and 4,824 incoming and outgoing payments of cash for the needs of government bodies were made (2007: 7,282).

The money counting unit processed 33 million banknotes and coins.

The Bank of Slovenia money counting unit counted 33.0 million banknotes and coins (2007: 106.5 million), comprising 32.1 million banknotes and 0.9 million coins (2007: 97.12 million banknotes and 9.34 million coins). A total of 21.2 million euro banknotes (compared with 4.74 million banknotes in 2007) 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 from bank depots.

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.

The Bank of Slovenia appointed an expert committee to verify, test and set up devices to process euro banknotes and coins. The committee's task is to implement procedures to verify the proper function of euro banknote processing devices in credit institutions. Regular research has been carried out regularly since 2004 into the quality of banknotes in circulation, including public opinion surveys among the population of Eurosystem Member States. In this survey Slovenia is in the upper half in terms of satisfaction with banknote quality. In Slovenia the EUR 50 denomination had the highest approval rate of any country, while the EUR 20 ranked second.

The value of euro counterfeits decreased.

According to data from the National Analysis Centre (NAC) and the Coin National Analysis Centre (CNAC) 1,970 counterfeit euro banknotes and 1,878 euro coins were discovered in 2008, compared to 1,826 euro banknotes and 1,803 euro coins in 2007. Compared with 2007 there was an increase in 2008 in the number of counterfeit euro banknotes (up 7.9%) and in the number of counterfeit euro coins (up 4.2%). In 2008 the value of euro counterfeits was EUR 212,740.50 compared to EUR 282.300.00 in 2007 (down 24.6%). The majority of counterfeit euro banknotes, both in terms of quantity and value, is represented by the four highest denominations (EUR 100, 50, 20 and 500), while EUR 2 coins represent the majority of counterfeit euro coins. The figures for counterfeit euro cash in Slovenia have been stable for several years. Eurosystem data in this area ranks Slovenia in the lowest quartile of countries by amount of counterfeit cash discovered per 1,000 inhabitants.

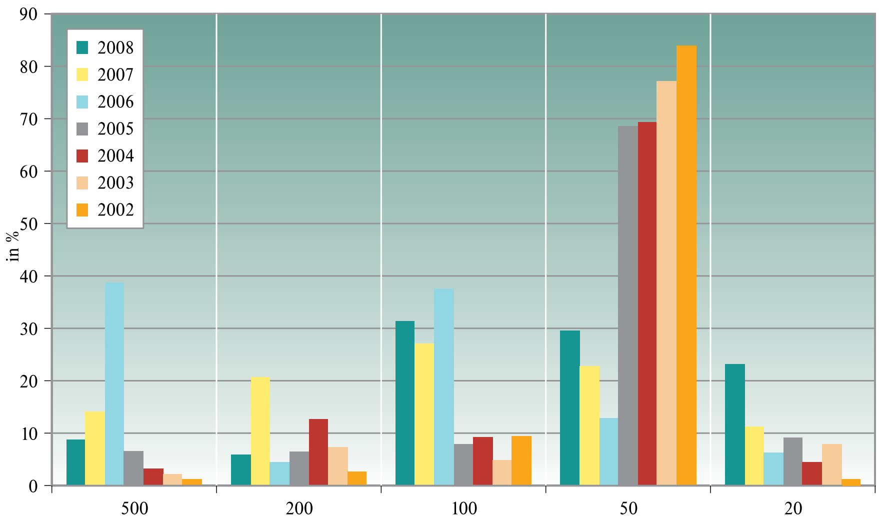
Other foreign currency counterfeits discovered.

Some 1,057 foreign currency counterfeits (US dollars, Swiss francs, Canadian dollars and pound sterling) were discovered in 2008, compared to 1,890 counterfeits in 2007. The quality of foreign currency counterfeits has improved over time, making it more difficult for users to identify them, particularly US dollar counterfeits.

The authenticity of euro cash was monitored.

In line with Regulation (EC) 1338/01, the NAC and CNAC are responsible for issuing expert opinions on the authenticity of euro banknotes and coins, respectively. These agencies operate within the Centre for Forensic Investigation (CFI) at the Ministry of the Interior (MI). Supervision of the activities of the aforementioned centres, in connection with the work of the Counterfeit Monitoring System at the ECB, is carried out at the Bank of Slovenia by the National Counterfeit Centre (NCC). The NCC is actively involved in a system of data and information exchange on counterfeiting with the European Central Bank's Counterfeit Analysis Centre, other national counterfeit centres and the European Technical and Scientific Centre (ETSC) for the analysis of euro banknotes.

Figure 44: **Breakdown of counterfeit euro banknotes discovered in Slovenia**



Source: Bank of Slovenia

2.6 Statistical system

Responsibility for monetary and financial statistics and financial accounts and international relations statistics.

As a member of the European System of Central Banks (ESCB), the Bank of Slovenia fulfils a statistical function on the basis of the Statute of the ESCB and of the European Central Bank, as one of the institutions authorised to carry out the statistical research programme, according to the National Statistics Act and other authorisations.

The Bank of Slovenia's main statistical work covers the broader areas of monetary, financial and international relations statistics, in addition to financial account statistics. The statistical process runs from data collection, via processing to transmission to users, including public announcements. The Bank of Slovenia plays a less active role in other general economic and public finance statistics.

The purpose of the Bank's statistical work entails informing the domestic and foreign public of financial and macroeconomic trends in Slovenia, and most significantly providing data support for the monetary policy of the ESCB and national economic policy, including financial stability analyses.

Statistical cooperation within the ESCB and other international organisations and institutions.

The Bank of Slovenia works together with international organisations and institutions, particularly the ECB, IMF, Eurostat, the BIS and the OECD on the development of statistical requirements, methodologies and standards. Bank of Slovenia representatives are members of the ESCB's Statistics Committee and permanent working groups on external statistics, general economic statistics, government finance statistics, monetary and financial statistics, (national) euro area accounts, and statistical information systems. The Bank of Slovenia's cooperation also includes thematic groups, such as the group developing a central ESCB securities database. The organisation of the Financial Statistics Department has been aligned with the need to cooperate within the ESCB.

In addition to regular meetings in working groups and at seminars of Eurostat, Bank of Slovenia representatives also attend plenary sessions of the Committee on Monetary, Financial and Balance of Payments Statistics (CMFB), which is the main body for coordinating strategic issues concerning European macroeconomic statistics for European central banks (including non-EU countries), statistical offices, Eurostat and the ECB.

Cooperation with MF and SORS based on an agreement on macroeconomic and financial statistics.

The most notable form of cooperation with national statistical institutions is with the Ministry of Finance (MF) and the Statistical Office of the Republic of Slovenia (SORS), based on a Memorandum of Understanding in the area of macroeconomic and financial statistics, signed in 2004 and updated in 2007. The MoU was modelled on a similar document agreed between the ECB and Eurostat. The aim of this cooperation is to reconcile competences and responsibilities in response to the increasing burden of statistical requirements, the interdependence of individual statistics and helps achieve compliance with the statistical requirements demanded by EU and EMU membership.

The MoU set out the responsibilities of the signatories and the manner of their cooperation in the provision of Slovenian macroeconomic and financial statistics to the European Commission, Eurostat, ECOFIN and the ECB. The MoU also includes cooperation in maintaining standard classification of institutional sectors, which is particularly important statistical infrastructure for 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.

The Bank of Slovenia bases its complex sets of statistics regarding financial accounts, monetary, financial and international relations on data from direct and indirect reports from banks and companies and on merchandise trade figures prepared by the SORS, in cooperation with the Customs Administration of the Republic of Slovenia (CARS). The Bank of Slovenia also collects, compiles and publishes statistics on modern means of payment and financial markets, as well general economic and public finance statistics.

Financial account statistics are based on quarterly reports collected by the AJPES.

Financial account statistics are prepared using the quarterly reports of individual institutional units (non-financial corporations, financial corporations and government units) collected by the AJPES for the Bank of Slovenia. In 2008 the Bank of Slovenia compiled quarterly financial account data for the final quarter of 2007 and the first three quarters of 2008, as well as the annual financial account data for 2007.

Quarterly financial accounts for the government sector were submitted to Eurostat and the ECB, in accordance with Regulation (EC) No 501/2004 of 10 March 2004, which requires data to be submitted within 90 days following the end of the quarter for which data is being reported.

Quarterly financial account data was submitted to the ECB pursuant to the requirements of Monetary Union Financial Accounts (MUFA), and in accordance with the Guideline of the ECB amending Guideline ECB/2002/7 on the statistical

Submission of aggregate financial accounts to the ECB and Eurostat was in accordance with prescribed requirements.

requirements of the European Central Bank in the field of quarterly financial accounts (ECB/2005/13). Data must be submitted to the ECB within 110 days following the end of the quarter for which data is being reported. The ECB adds Member States' quarterly financial accounts to other statistics to compile the euro area accounts. The ECB also strives to obtain data for the compilation of comprehensive quarterly euro area accounts, including non-financial accounts.

Annual financial accounts were submitted to Eurostat in June 2008, in accordance with Regulation (EC) No 2223/96 of 25 June 1996 on the European system of national and regional accounts in the Community, which requires annual data to be submitted within nine months following the end of the year for which data in being reported.

The Financial Accounts of Slovenia 2001-2007 was published in November 2008. The publication includes an analysis of financial account data by individual sector. Tables of financial positions, transactions 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.

Financial account reporting burden reduced.

On 1 January 2008 a reporting threshold was introduced for institutional units of the financial corporations sector (S.12) and a new reporting threshold in euros for the institutional units of other sectors (S.11 – non-financial corporations; and S.13 – general government). The final quarter reporting deadline has been extended, which, together with the higher threshold for non-financial corporations, has reduced the burden on reporting entities.

Regular reporting, processing and submission of data by other monetary financial institutions continued successfully for the monetary and financial statistics in 2008, in accordance with Regulations ECB/2001/13 and ECB/2001/18, and likewise data on investment funds, insurance companies, pension companies and securities, in accordance with the Guideline on monetary, financial institutions and markets statistics (ECB/2007/9).

Recasting of basic ECB regulations on balance sheet statistics and MFI interest rates completed.

In the field of ESCB activities, the recasting of the basic 2001 regulations on balance sheet statistics (BSI) and interest rate (MIR) statistics of monetary financial institutions (MFI) was completed in 2008. In December 2008 the ECB Governing Council adopted Regulation (EC) No 25/2009 on the balance sheet of the monetary financial institutions sector (ECB/2008/32), and in early 2009 it will adopt a recast regulation on MFI interest rate statistics. Data from the recast regulations on balance sheet MFI interest rate statistics must be ensured by June 2010.

Joint investment fund reporting established for the needs of the Bank of Slovenia and Securities Market Agency.

The preparation of harmonised statistics for non-monetary financial intermediaries is continuing within the ESCB. Based on the ECB Regulation on statistics on the assets and liabilities of investment funds (ECB/2007/8), reporting on harmonised data had to be prepared until the end of 2008. The Bank of Slovenia took this opportunity to work with the Securities Market Agency to prepare joint reporting on investment funds by management companies for the needs of both institutions, which is in line with the ECB Governing Council recommendations on the combination of statistical and supervisory reporting requirements. In addition to the regulations mentioned above, the Bank of Slovenia has also incorporated into reporting the requirements on financial accounts statistics, balance sheet statistics for money market funds and financial stability analysis data.

Towards the end of 2008 the ECB issued the Regulation concerning statistics on the assets and liabilities of financial vehicle corporations engaged in securitisation transactions (ECB/2008/30).

Phased migration from indirect to direct sources of international relations statistics continued.

In 2008 the Bank of Slovenia continued the phased migration of data sources, within its external statistics, from the indirect collection of data from commercial banks to direct collection from economic agents operating with non-residents. This included the introduction in January 2008 of monthly reporting on capital investments between residents and non-residents – transactions (SN-T report).

Reporting threshold for cross-border payments raised to EUR 50,000.

Furthermore, in November 2008 a new regulation on mandatory reporting of international transactions was published, which is based on the Bank of Slovenia Act, and no longer on the Foreign Currency Exchange Act. Full instructions on the implementation of this regulation were also published. The instructions raised the statistical reporting threshold for international transactions payment from the start of 2009 from the previous EUR 12,500 to EUR 50,000, as envisaged by Regulation (EC) 2560/2001 on cross-border payments in euro.

The Bank of Slovenia is also required to submit certain public finance and general economic data to the ECB. In addition to Maastricht criteria data on long-term interest rates, general government balance, government debt, and the harmonised consumer price index, this includes information from national account statistics, labour statistics, information about procedures concerning 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. The Bank of Slovenia is tasked with monitoring and promoting the quality of data submitted to the ECB based on the Guideline of the ECB 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).

Slovenia fully meets the SDDS requirements.

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

Key financial and macroeconomic data for Slovenia are published in a monthly bulletin and in annual publications on direct investments and financial accounts. All publications, along with information on the extended data series from the bulletin and certain other important data, are also available on the Bank of Slovenia website. The more important direct recipients of the statistical data are the ECB, Eurostat, the SORS, the IMF and the BIS.

2.7 Payment and Settlement Systems

TARGET2

The TARGET2 system is the Trans-European automated real-time gross settlement express transfer system, which was established to eliminate the deficiencies of its predecessor, the TARGET system, replacing it and ensuring increased harmonisation of services, rules and standards, technological and cost efficiency, offering rapid system adaptation to the demands of the business environment. TARGET2 is managed by the Eurosystem, operating on a single technical platform, though in legal terms each central bank in the system operates its own national component. The Slovenian component is called TARGET2-Slovenija.

The Bank of Slovenia and Slovenian banks were among the first to migrate to TARGET2 in November 2007. Migration concluded in May 2008.

The migration of all TARGET system participants to the single TARGET2 platform took place over three phases. The Bank of Slovenia, Slovenian banks and savings banks, and the Central Securities Clearing Corporation joined the new TARGET2 payment system on its first day of operation, 19 November 2007. The next migration windows for inclusion in TARGET2 were 18 February and 18 May 2008, when participants from the remaining countries[18] joined, concluding the migration process.

The TARGET2 system has a common pricing policy.

The completed migration brought the harmonised execution of urgent low-value and high-value payments in the euro area, with TARGET2 offering all participants the same functionality, and with standard criteria and pricing policy applying, regardless of the participant's country of origin. The TARGET2 pricing policy, which entered into force on 18 May 2008, also distributed the operating costs and revenues equally (according to the capital key) among the central banks as operators of the TARGET2 system.

In November 2008 the TARGET2 system was upgraded, eliminating some of the most obvious deficiencies that appeared in its operation over the first half of 2008. Guidelines were also defined during 2008 for the first major upgrade of the system (introduction of new functionalities), which are set for implementation in two phases (May 2009 and November 2009).

A national user group was formed for TARGET2 participants in Slovenia under Bank of Slovenia auspices.

Given the Eurosystem policy, according to which users participate in the development of the TARGET2 system, a Slovenian national user group for the TARGET2 system was formed in 2008 under Bank of Slovenia auspices. The group is led by the Bank of Slovenia and all direct participants of the TARGET2-Slovenija system have representatives in the group. Group activities in 2008 were focused on considering the new functionalities of the TARGET2 system, implementation of which is planned for 2009.

TARGET2-Securities

A centralised European securities settlement infrastructure under the name TARGET2-Securities is being established.

In July 2006 the ECB's Governing Council decided to explore, together with European central securities depositories and other market participants, the possibility of creating a new, centralised European securities settlement infrastructure, to be known as TARGET2-Securities (T2S). The objective of T2S is to provide a single technical platform for settling securities transactions, meaning that the securities settlement function would be shifted from 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

18 The UK and Sweden decided against joining TARGET2 and withdrew from the TARGET system altogether.

locally oriented, thus increasing the effectiveness and safety of securities settlements, and ultimately facilitating the integration and competitiveness of EU securities markets.

The final decision on establishing the T2S was passed in July 2008.

On the basis of a feasibility study, in March 2007 the ECB Governing Council decided that work could begin to define user requirements for the system. These were prepared in 2007 in cooperation between the Eurosystem and market participants, and were confirmed in May 2008 after a public consultation. They were then sent with other documentation to the central securities depositories, with a request for a statement of support for the project and of willingness to join the system. Following a positive response from the central securities depositories and expressions of support from the European Parliament and the European Commission, in July 2008 the ECB Governing Council adopted a decision to establish the T2S and to start the preparation of functional specifications. It should be emphasised that the continued support of the central securities depositories depends on finding the right solutions to open questions about the governance of the system, pricing policy, legal or contractual relations between the Eurosystem and central securities depositories and the system's technical features. The rest of the year therefore saw intense preparatory work on the T2S system specifications within the Eurosystem, while the definition of the governance structure for the development and production phase began, along with preparations of the contractual relations between the Eurosystem and the central securities depositories.

The needs of the Slovenian market and any adjustments needed were analysed at the national user group level.

The Bank of Slovenia continued with participation within the project at the Eurosystem level during 2008 (participation in the project governance) and communication with Slovenian market participants within the national user group on T2S. The latter includes representatives of the Bank Association of Slovenia, individual banks, the Association of Members of the Stock Exchange, the Central Securities Clearing Corporation, the Ministry of Finance, the Securities Market Agency and the Bank of Slovenia. Information and opinions on T2S are exchanged within the group. Its role also includes the analysis of the impact of T2S on the Slovenian market and the identification of adaptations required, as well as an analysis of user requirements and functional specifications and the preparation of comments concerning the requirements of the Slovenian market. The Bank of Slovenia is responsible for the overall organisation of the national user group. The group's key task in 2008 was the preparation of comments to the user requirements reflecting the Slovenian market needs.

CCBM2

CCBM2 is a single technical platform for the execution and collateralisation of Eurosystem credit operations in real time.

The Collateral Central Bank Management (CCBM2) will form a single technical platform owned by the Eurosystem central banks, the objective of which is to ensure greater technical and cost efficiency and the harmonisation of back office operations in central banks supporting the general collateral framework and the execution of Eurosystem credit operations, while reducing counterparty costs.

Interoperability with the TARGET2 system and the T2S settlement platform will be ensured.

Implementing Eurosystem tasks relating to the execution and collateralisation of credit operations will still be based on the principle of decentralisation, with central banks being able to outsource their back office support to the single technical platform. The technological design of the platform will be based on a modular architecture, from which each participating central bank will select the functionalities based on its own needs and those of the national market. The CCBM2 will enable the management of eligible domestic and cross-border collateral (marketable and non-marketable) in real time and with different techniques of collateralisation. Interoperability with the TARGET2 payment system and the planned T2S settlement platform will be ensured for more efficient operations.

The decision on the construction and the supplier of the platform was made in July 2008.

The initial decision on platform development was adopted in March 2007, with the final decision on the construction and platform supplier (central banks of Belgium and the Netherlands) being taken in July 2008 on the basis of the user requirements and preliminary intentions expressed by central banks on the use of the platform. A period of intense preparations within the Eurosystem followed until the end of 2008, producing User detailed functional specifications and the future project governance structure.

Activities within the Bank of Slovenia during 2008 included cooperation in preparing the User Requirements and a draft version of the User detailed functional specifications within ESCB working bodies. At the same time work took place on developing the concept of the Bank of Slovenia's inclusion in the CCBM2, taking into account its current business functions and the specific features of the Slovenian banking sector.

The CCBM2 continues the practice of central banks specialising in the provision of a centralised infrastructure for the implementation of Eurosystem tasks (e.g. TARGET2 was constructed by a group of three central banks – 3CB, while the T2S will be constructed by a 4CB group), while the single platform will provide individual central banks and hence the entire banking sector with a harmonised and more effective environment for implementing their tasks.

Single Euro Payments Area (SEPA)

The aim of SEPA is to establish the same conditions for making and receiving national or cross-border payments in euros anywhere in SEPA, regardless of where the payer or recipient are.

The establishment of the Single Euro Payments Area (SEPA) is a European banking sector project, the aim of which is to establish the same conditions for making and receiving payments in euros, anywhere in Europe, within national borders or cross border, under the same rules and with the same rights and obligations, regardless of the location of the payer and recipient (within the SEPA). Geographically, SEPA covers the European Union Member States (EU-27) plus a further four countries (Iceland, Liechtenstein, Norway and Switzerland). The ultimate goal of the project is to harmonise payments with basic payment instruments (credit transfers, direct debits and payment cards) so that payments may be made from a single account using the same set of payment instruments, with the distinction between national and cross-border payments ceasing to exist.

The establishment of SEPA in Slovenia is managed by the Bank Association of Slovenia, which is also a member of the European Payments Council (EPC). The Bank of Slovenia, like the ECB at the EU level, is supporting the project at the national level, playing a catalyst role, promoting, directing and coordinating banking sector activities, as the bank for clients (primarily public law entities) and as payment system operator.

SEPA has been in place since 1 January 2008 for payment cards, and since 28 January 2008 for credit transfers.

The phase of implementing new solutions designed in previous phases of the project began in 2008. The SEPA has been in place for payment cards since 1 January 2008, while a more visible milestone came with the introduction of SEPA credit transfers, which occurred on 28 January 2008 in 31 Member States. Since then a new standard payment instrument for credit transfers has been available, and also 21 banks and savings banks in Slovenia have joined the SEPA Credit Transfer Scheme (including the Bank of Slovenia). During the migration phase currently underway, all old national credit payment schemes will be gradually replaced by the new SEPA scheme. The migration to the new payment scheme however only achieved a negligible value in Slovenia in 2008, largely due to the fact that there was still no payment system available that would provide the retention of the same high level of service in processing SEPA credit transfers that banks were already accustomed to for domestic payments.

Intense preparations also took place in 2008 for the introduction of the SEPA Direct Debit Scheme, the last of the basic payment instruments. This is planned for introduction on 1 November 2009, in accordance with the transposition of the Directive on payment services in the internal market (2007/64/EC) into Member State law, which will provide for the formal conditions for implementing all elements of the new payment scheme.

Preparations took place to introduce the SEPA Direct Debit Scheme, planned to start on 1 November 2009.

An essential prerequisite for successful establishment of new payment instruments is ensuring the accessibility of all bank accounts for payments with SEPA payment instruments, which means that banks and savings banks as payment service providers offering transaction accounts are connected to the payment infrastructure or payment system. This enables the exchange of standardised SEPA payment instruments between payment service providers.

The STEP2 SCT Trans-European payment system, managed by EBA Clearing, has been operating at the EU level since the start of SEPA credit transfers scheme on 28 January 2008. To enable the Trans-European accessibility of the accounts of payment service providers in Slovenia the Bank of Slovenia on the same day ensured indirect participation in the STEP2 SCT system to Slovenian banks and savings banks requesting the service, whereas the Bank of Slovenia is the direct participant in the system. Other banks in Slovenia ensured accessibility for SEPA payments differently, and at the end of the year all banks and saving banks in Slovenia had brought SEPA credit transfers online.

The STEP2 SCT Trans-European payment system was established in January 2008 and is managed by EBA Clearing.

Banks and savings banks in Slovenia took the decision in 2007 to establish a new payment system, in compliance with SEPA requirements, to retain the same level of services (primarily rapid settlement of low-value payments, i.e. up to EUR 50,000) for payment processing in Slovenia that was provided by the Giro Clearing settlement system managed by the Bank of Slovenia. The new system, called *SEPA interna kreditna plačila* (SEPA internal credit transfer system) operated by Bankart d.o.o., will facilitate the exchange of SEPA credit transfers between banks and savings banks in Slovenia. In 2008 preparations were made for the start-up of the payment system, which largely involved arranging the legal framework, acquiring a Bank of Slovenia licence for the establishment and management of a payment system and the required testing with future participants. The Bank of Slovenia was participating in the project as a future system participant and as a settlement agent, since it will provide the settlement of claims and liabilities from the payment system on participants' accounts in TARGET2-Slovenija in central bank money. The system will start to operate in the first half of 2009 and will gradually replace the Giro Clearing system.

Work was carried out to set up a new SEPA credit transfer system, which will be run by Bankart and will gradually replace the Giro Clearing system.

In 2008 Bankart d.o.o. was also setting up a system called *SEPA eksterna kreditna plačila* (SEPA external credit transfers) to enable the indirect participation of banks and savings banks at the beginning of 2009 in the Trans-European STEP2 SCT payment system, with a view of integrating national and cross-border SEPA payments. Accordingly Bankart d.o.o. assumed some of the functions from the Bank of Slovenia relating to the provision of access to STEP2 SCT payment system, becoming the interface to banks and savings bank as indirect participants in the system via the Bank of Slovenia.

2.7.1 Payment systems oversight

The Bank of Slovenia follows Core Principles for Systemically Important Payment Systems when carrying out oversight.

On the basis of the Bank of Slovenia Act and the Payment Transactions Act, the Bank of Slovenia is responsible for oversight of payment systems, as important building blocks of the financial system. The objective of oversight is to promote the safety and effectiveness of payment systems through monitoring, analysis and inducing change in such systems. When implementing its oversight role, the Bank of Slovenia follows the requirements of the legal framework and the Core Principles for Systemically Important Payment Systems, which were adopted by the Governing Board of the Bank of Slovenia as the basis for oversight.

In 2008 the Bank of Slovenia, in accordance with its responsibilities, oversaw payment systems on the basis of regular and ad hoc reports of payment system operators 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 from regular operations, as well as changes in the functional concept of payments systems. The Bank of Slovenia also monitored the implementation of recommendations made to payment system operators on the basis of past on-site examinations of payment systems and their operators. The Bank of Slovenia also conducted regular annual on-site examinations of payment system operators, based on its annual plan of examinations.

In 2008 the Bank of Slovenia established a special site on its website dedicated to the business continuity of payment systems, as part of a wider ESCB initiative.

In 2008 the Bank of Slovenia established a special site on its website dedicated to the exchange of information on ensuring the business continuity of payment systems, as part of a wider ESCB initiative. Operational errors and failures in payment systems that threaten their continuous operations are one of the major risks, and can cause wider problems to financial markets and financial institutions: late or unsuccessful settlements, non-compliance with legal obligations and related costs, loss of reputation and increased financial risks in the system itself and the risks resulting from the interdependence between payment systems and financial institutions. As the links between the financial markets of different countries grow stronger, an incident occurring in one country is increasingly likely to spread to systems in other countries. Ensuring business continuity encompasses several measures, the objective of which is to ensure an agreed standard and availability of services, even when an error or failure occurs within a system, or when a specific system is affected by extraordinary external events, such as natural disasters or terrorist attacks. Business continuity is ensured by taking preventive measures and rapid action when extraordinary events occur. Exchanging information is an essential part of promoting the effective provision of business continuity, and dedicated central bank websites are part of these efforts. All ESCB central banks joined an information exchange project, the aims of which were largely to ensure central access to international and national standards and requirements on the provision of business continuity, and the facilitation of coordination in the event of extraordinary events.

The Bank of Slovenia participated in oversight activities at the Eurosystem level.

In 2008 the Bank of Slovenia also participated in the oversight of payment systems, payment 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 payment schemes and the cooperative oversight of payment systems, payment schemes and important payment systems' infrastructures providing services in several countries (TARGET2, EURO1, SWIFT, CLS, international payment card schemes and SEPA schemes). Particular mention should be made of payment instrument oversight, in relation to which the Eurosystem issued standards in 2008 for oversight of card payment schemes, which will be used in future as the basis for oversight of the other major payment instruments, including SEPA payment schemes.

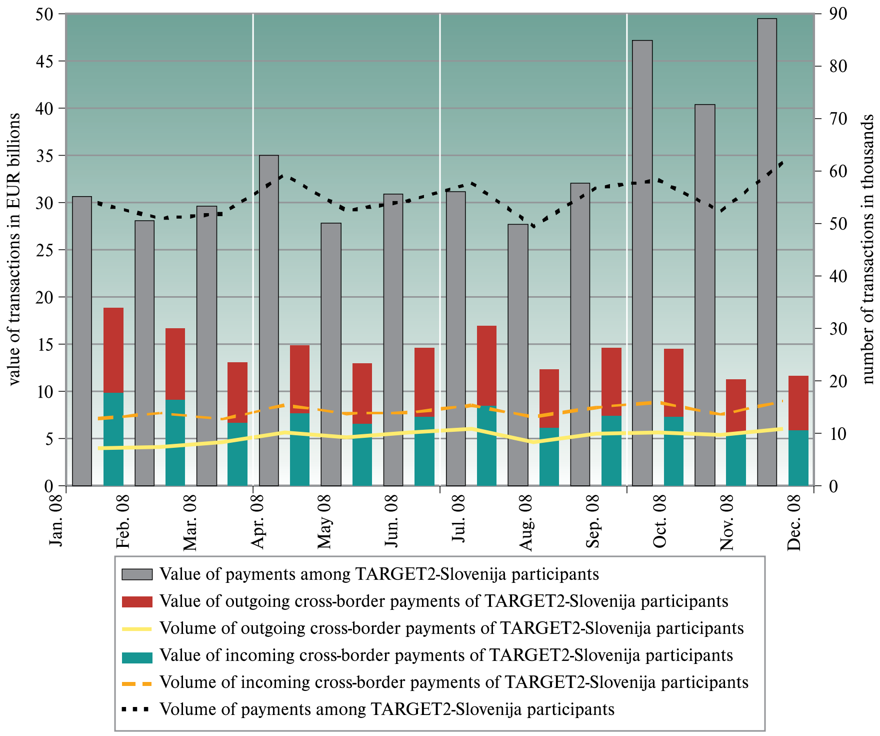
2.7.2 Statistics for payment systems and services, provided by Bank of Slovenia

The Bank of Slovenia operates the TARGET2-Slovenija system, which is primarily intended for settlement of high-value payments and urgent low-value payments in euros, and the multilateral net payment system Giro Clearing for processing non-urgent low-value credit transfers. In addition it provides banks with access to the STEP2 Trans-European payment system, which processes cross-border low-value payments in euros. In January 2008 the Bank of Slovenia also became a direct participant in the STEP2 SCT system, which is a Trans-European payment system processing SEPA credit transfers. The Bank of Slovenia provides the indirect participation in the STEP2 SCT system to banks and savings banks.

A total of 659,466 domestic transactions were settled via the TARGET2-Slovenija system in 2008, a drop of 9.52% on 2007.

In 2008 the TARGET2-Slovenija system settled 659,466 domestic transactions (between Slovenian participants) with a total value of EUR 410,351.72 million, a 9.52% fall in the number and a 12.52% increase in the value of transactions, compared to 2007. The average daily number of transactions was 2,576, with an average value of EUR 622,248.48 per transaction. In addition to domestic transactions, 171,907 incoming cross-border transactions (between TARGET2-Slovenija participants and other TARGET2 participants) were settled, with a total value of EUR 88,104.75 million, while there were 112,699 outgoing cross-border transactions, with a total value of EUR 84,617.68 million.

Figure 45: **TARGET2-Slovenija – domestic and cross-border transactions by value and number**

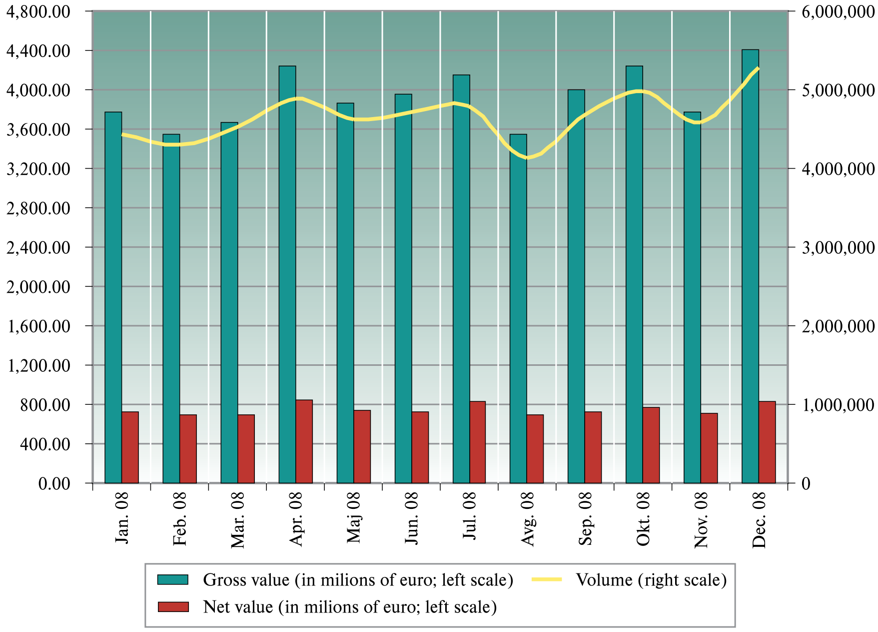


Source: Bank of Slovenia

In 2008 the Giro Clearing system processed almost 56 million transactions with a total value of EUR 49 billion.

In 2008 the Giro Clearing system processed 55,908,926 transactions with a total value of EUR 49,121.38 million, an increase of 4.27% in the number and 7.45% in the value of transactions compared to 2007. The net settlement value settled via TARGET2-Slovenija was EUR 9,368.78 million or 19.07% of the gross value of transactions, meaning a netting ratio of 80.93%. On average 222,745 transactions were processed daily, whereas the average value of transactions was EUR 878.60 per transaction.

Figure 46: **Number and value of transactions via the Giro clearing system by month in 2008**



Source: Bank of Slovenia

In 2008 a total of 719,346 outgoing transactions and 523,204 incoming transactions were sent/ received via STEP2, and 67,190 outgoing transactions and 123,119 incoming transactions via STEP2 SCT.

In 2008 a total of 719,346 outgoing transactions and 523,204 incoming transactions were processed resulting from participation of the Bank of Slovenia and its indirect participants in STEP2 system, an increase of 7.83% and 15.80% respectively compared to 2007. The value of outgoing transactions was EUR 5,036.45 million, and the value of incoming transactions EUR 2,172.55 million, representing increases of 8.89% and 8.74% respectively compared to 2007.

In 2008, a total of 67,190 outgoing transactions and 123,119 incoming transactions were processed resulting from participation of the Bank of Slovenia and its indirect participants in STEP2 SCT system. The value of outgoing transactions was EUR 239.73 million, and the value of incoming transactions was EUR 1,028.87 million.

2.8 Payments by Bank of Slovenia clients

2.8.1 Transactions for the government sector

Administration of budget user accounts

The Bank of Slovenia administers the treasury accounts of the government and municipalities and special purpose accounts for the government.

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.

In 2008 EUR 29,117 billion in inflows and EUR 29,118 billion in outflows were processed through the government's single treasury account and EUR 31,965 billion in inflows and EUR 31,966 billion in outflows through municipal treasury accounts.

In addition to the single treasury accounts, the Bank of Slovenia also manages 50 special purpose accounts for the government and other budget users.

International payments

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

A total of 99.7% of inflows and 93.7% of outflows were processed in the domestic currency.

In 2008 the Bank of Slovenia performed EUR 1,193.2 million worth of payments to the rest of the world and paid out EUR 1.7 million in cash. Remittances totalling EUR 1,902.6 million were made from the rest of the world, and EUR 0.4 million in foreign currency cash was repaid. A total of EUR 67.1 million in foreign currency was sold to budget users, and EUR 1.7 million in foreign currency was purchased from them. Analysis of the currency composition of inflows and outflows shows that 99.7% of inflows were in euros, 0.2% were in US dollars, and just 0.1% in other currencies, while 93.7% of outflows were in euros, 4.4% in US dollars, 0.5% in Japanese yen, 0.4% in Croatian kuna, and 1.0% in other currencies.

Administration of accounts for foreign financial institutions and EU institutions

The Bank of Slovenia also administers the accounts for foreign financial institutions and EU institutions, via which inflows of EUR 628.9 million and outflows of EUR 665.1 million were processed in 2008.

2.8.2 Administration of accounts for the CSCC and CSCC members

The Bank of Slovenia administers guarantee fund account, fiduciary account for the CSCC, 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, via which cash settlements are made for securities transactions. At the end of the 2008 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 2008 EUR 4,830 billion in inflows and EUR 4,883 billion in outflows were processed through the CSCC accounts and CSCC member accounts.

2.9 International cooperation

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

In 2008 Cyprus and Malta joined the euro area.

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. Since the introduction of the euro in Slovenia, the Governor of the Bank of Slovenia has participated as a member of the Governing Council of the ECB in its sessions, which normally take place 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 responsibilities of the Governing Council of the ECB include defining 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. In 2008 Cyprus and Malta joined the euro area.

Bank of Slovenia representatives attended sessions of committees and their working groups in 2008, 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 committees support the work of ECB decision-making bodies, which can request expert and technical advice from the committees.

The Bank of Slovenia's key for subscription to ECB capital was 0.3194% in 2008.

The national central banks are the sole subscribers to and holders of ECB capital. 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 Bank of Slovenia's key for subscription to the ECB's capital was 0.3194% in 2008. The total amount of paid-up ECB capital of all national central banks was EUR 4,127 million.

European Union

In 2008 the Governor of the Bank of Slovenia participated in informal sessions of ECOFIN (meetings of financial ministers, with the governors of EU member state central banks in attendance).

In 2008 Bank of Slovenia experts attended sessions of committees, working groups and other bodies that are active within the institutions of the EU 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.

IMF

In accordance with Slovenian law, the Bank of Slovenia is responsible for the Republic of Slovenia's cooperation within the International Monetary Fund (IMF) and the Governor of the Bank of Slovenia is a member of the IMF Committee of Governors.

Slovenia's quota at the IMF was unchanged at SDR 231.7 million, representing 0.12% of the voting power of all IMF members. In accordance with Resolution 63-2 on Reform of quota and voice in the IMF, which the Committee of Governors approved in April 2008, the quotas and voting shares of 54 members will increase in 2009, including those of Slovenia.

Slovenia has contributed to financing IMF loans under the FTP.

Since 1998 Slovenia has contributed to financing IMF loans under the FTP[19]. In the first half of 2008 Slovenia received funds from Turkey amounting to SDR 1.8 million under the FTP, and in the second half of the year contributed funds for loans to Turkey and Pakistan in a total amount of SDR 16.0 million. At the end of December 2008, Slovenia's reserve tranche position at the IMF stood at SDR 30.1 million, an increase on 2007.

In 2008 Slovenia joined the IMF members contributing funds to a write-off of Liberia's debts as part of the HIPC initiative[20]. Slovenia contributed SDR 524,108 to this initiative, paid to the SCA-1 account[21] and deferred charges adjustment.

In April 2008 the Bank of Slovenia organised a seminar in which IMF and Slovenian experts addressed current themes relating to macroeconomic policies and development challenges in the light of improving the competitiveness of the Slovenian economy. The IMF mission visited Slovenia in March 2009 to carry out a regular consultation pursuant to Article IV of the IMF Statute.

Bank for International Settlements

In 2008 the Governor of the Bank of Slovenia participated in meetings of central bank governors of BIS Member States, which are organised every two months. Discussions are held on the current international economic and financial situation and risk management, oversight of financial markets and work on the BCBS[22], which focuses on the further development of supervision.

19 Financial Transactions Plan.
20 Heavily Indebted Poor Countries.
21 Special Contingency Account.
22 The Basel Committee on Banking Supervision.

The Bank of Slovenia is a shareholder in the BIS and its representatives participated in the annual General Meeting of the BIS in Basel.

OECD

The Bank of Slovenia cooperated in preparations of an Initial Memorandum on Slovenia's accession to the OECD.

Slovenia began the procedure to join the Organisation of Economic Cooperation and Development (OECD) at the end of 2007, when the OECD Council approved the Accession Programme for Slovenia's entry to the organisation. Immediately after adopting the Accession Programme, the Slovenian government established an interdepartmental working group, which included a Bank of Slovenia representative. The Bank of Slovenia cooperated in preparations of an Initial Memorandum on Slovenia's accession to the OECD, which was handed to the Secretary General in July 2008, in the preparation of an Economic Survey of Slovenia, and in preparing responses to questions that will be addressed at meetings of the Committee on Financial Markets, Investment Committee, Committee on Statistics and the Steering Group on Corporate Governance. In November 2008 a Bank of Slovenia representative participated in the Economic Policy Committee, to which Slovenia was invited as an *ad hoc* observer.

Technical assistance

The Bank of Slovenia cooperates with other central banks as part of central bank technical assistance. In 2008 the Bank of Slovenia received technical assistance relating to banking supervision, cash transactions and financial statistics from five central banks (Denmark, Ireland, Germany, Netherlands and Portugal).

In 2008 the Bank of Slovenia offered technical assistance to central banks of 12 countries (Albania, Austria, Bosnia and Herzegovina, Croatia, Cyprus, Kosovo, Lithuania, Macedonia, Montenegro, Malta, Serbia and Ukraine) relating to banking supervision, cash transactions, human resources issues, transactions of central banks, legal affairs, accounting, business continuity payment systems and operating within the Eurosystem.

3 APPENDICES

3.1 Secondary legislation affecting banking supervision

Regulation on reporting effective interest rates of banks and savings banks in accordance with the consumer credit act	**February**
Recommendations on methods of calculating interest on transactions with retail customers	**July**
Guidelines for electronic submission of capital and capital adequacy reports Guidelines amending the Guidelines for electronic submission of capital and capital adequacy reports Regulation amending the regulation on the books of account and annual reports of banks and savings banks Regulation amending the regulation on the assessment of credit risk losses by banks and savings banks	**October**
Regulation amending the regulation on credit protection Guidelines amending the guidelines for implementing the regulation on the minimum requirements for ensuring an adequate liquidity position at banks and savings banks	**November**
Regulation amending the regulation on the deposit guarantee scheme Guidelines amending guidelines for completing and submitting guaranteed deposit reports	**December**

3.2 Governance and organisation

3.2.1 Governing Board of the Bank of Slovenia as at 31 December 2008

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)

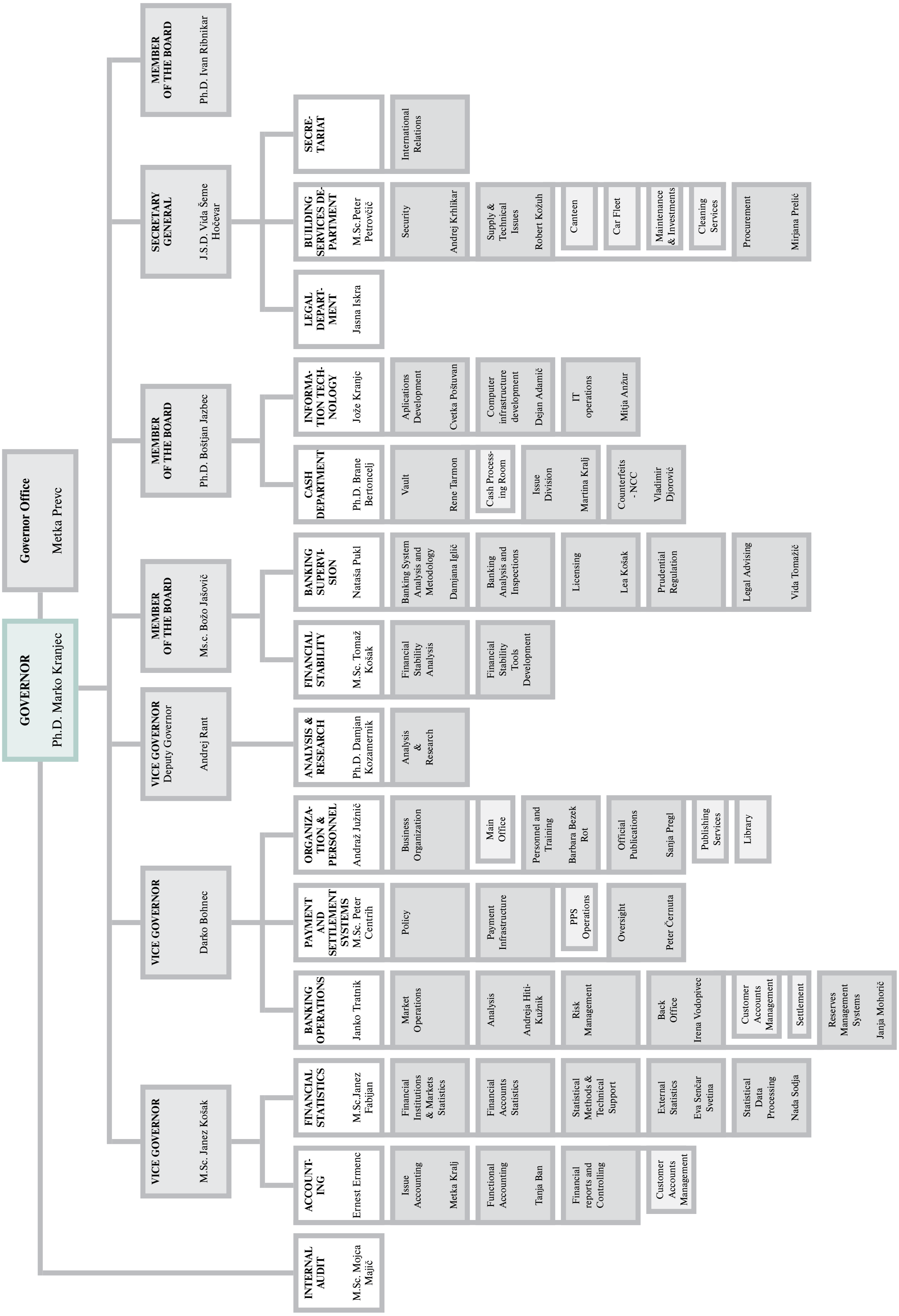
Janez Košak
(Vice-Governor)

Božo Jašovič
(Member of the Governing Board)

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

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

3.2.2 Organisational structure of the Bank of Slovenia as at 31 December 2008



3.2.3 Commissions and committees of the Governing Board as at 31 December 2008

- 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: Andrej Rant)

- Information Security Committee (head of committee: Boštjan Jazbec, Ph.D.)

- Business Continuity Committee (president: Darko Bohnec)

- Central Inventory Committee (president: Vesna Valenčič)

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.	**Bilten [Monthly Bulletin]** • Monthly • in Slovene and English
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 activities of the Bank of Slovenia.	**Letno poročilo [Annual Report]** • annual (released in spring) • in Slovene and English
Statistical review of direct and portfolio investment vis-à-vis Slovenia, both inward and outward (on an annual basis).	**Neposredne naložbe [Direct Investment]** • annual • 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.	**Finančni računi Slovenije [Financial Accounts of Slovenia]** • annual • 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.	**Poročilo o cenovni stabilnosti [Price Stability Report]** • half-yearly • in Slovene and English
Collection of articles on all topics of professional and operational relevance for 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.	**Poročilo o finančni stabilnosti [Financial Stability Report]** • annual • in Slovene and English
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/kazalo.html • index of English pages http://www.bsi.si/... /eng/index.html

3.4 Glossary of selected terms

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

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 risks, multiplied by conversion factors corresponding to the required minimum capital adequacy ratio (e.g. 12.5 for a capital adequacy ratio of 8%).

Eonia (Euro Overnight Index Average) – The effective overnight reference rate for the euro. It is calculated daily as the weighted average interest rate of overnight unsecured interbank lending by banks from a pre-selected group (the selection includes major operators on the interbank market in euros).

ESCB – The European System of Central Banks. Comprises the European Central Bank and the national central banks of EU Member States.

Euro area – The area encompassing the EU Member States which have adopted the euro as their single currency in accordance with the Treaty and in which a single monetary policy is conducted under the responsibility of the Governing Council of the ECB.

Eurosystem – Comprises the European Central Bank and the national central banks of the euro area.

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.

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.

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.

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.

ECB key interest rate – The interest rate used by the Eurosystem to signal the monetary policy stance. This is the main refinancing operation's minimum bid rate.

Correspondent Central Banking Model (CCBM) – A mechanism established by the Eurosystem 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.

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

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

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 usually higher than the market interest rate.

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

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.

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.

Benchmark allotment – The amount of an MRO allotment which enables credit institutions to meet their minimum reserve requirement smoothly over the maintenance period.

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

National central bank – Any central bank in the euro area or EU. In Slovenia it is the Bank of Slovenia.

Reserve requirement – The minimum amount of money balances that credit institutions are obliged to maintain on account with a central bank over a given period. The amount is calculated by multiplying the reserve base (i.e. 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 reserve base.

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.

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.

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

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.

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).

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.

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 executed over a 24-hour time frame.

Structural liquidity surplus/deficit – The difference between the autonomous supply of liquidity of a central bank and the autonomous demand for central bank's 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 liquidity surplus; a negative result represents a structural liquidity deficit of the money market (e.g. credit institutions) vis-a-vis the central bank. Autonomous factors are those items in the central bank's balance sheet not affected by the central bank's monetary policy implementation. Nevertheless, a change in autonomous factors results in a change in the liquidity available to credit institutions. Examples of autonomous factors are banknotes, government deposits with the central bank, items in 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.

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

3.5 Financial statements

Financial statements of the Bank of Slovenia for the Year 2008

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.
Davčna ulica 1
1000 Ljubljana
Slovenija

Tel: +386 (0) 1 3072 800
Faks: +386 (0) 1 3072 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, 2008 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, 2008, 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.

DELOITTE REVIZIJA d.o.o.

Andreja Bajuk Mušič
Certified auditor
Andreja Bajuk Mušič

Ljubljana, February 27th, 2008

Yuri Sidorovich
President of the board

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Ljubljana, Slovenija 1

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].

Accounting principles and standards
The Bank applies 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) as the legal basis for the accounting and reporting. 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 are applied.

Basic principles
The financial statements are 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;
- 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;

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[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 fifteen 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. The Accounting guideline is amended by the Guideline of the European Central Bank of 17 December 2007 (ECB/2007/20), OJ L 42, 16.02.2008, p. 85-87.

- 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
Marketable securities are valued at the market prices prevailing at the balance sheet date on a security-by-security basis. 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'.

Non-marketable securities are valued at amortised cost and are subject to impairment.

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 the 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 its prudent concept it reduces the volatility of the 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, ECB's income on euro banknotes in circulation and the ECB's profit/loss.

Banknotes in circulation

The ECB and the fifteen 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 liability balance sheet item 'Banknotes in circulation'.

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, which incur

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[4] Central bank of Slovakia joined the Eurosystem on 1st January 2009.

[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 and by Decision of the European Central Bank of 7 December 2007 (ECB/2007/19), OJ L 1, 04.01.2008, p. 7-8.

[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.

interest[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 are reduced in annual stages until the first day of sixth year after the cash changeover year when income on banknotes is 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 cleared through the accounts of the ECB and is disclosed under 'Net interest income' in 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. The amount distributed to NCBs is disclosed in the Profit and Loss account under 'Income from equity shares and participating interest'.

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 portfolio with a given diversification of that portfolio at a certain level of probability (95%) and for a given holding period (one year). The provision will be used to fund future unrealised losses not covered by the revaluation accounts.

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[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 the 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 and by Decision of the European Central Bank of 22 November 2007 (ECB/2007/15), OJ L 333, 19.12.2007, p 86-89.

[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.

Intra-Eurosystem balances
Intra-Eurosystem transactions are cross-border transactions that occur between two Eurosystem central banks. These transactions are processed primarily via TARGET2[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 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 on 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 were considered as the opening average cost of Bank's assets and liabilities. In case of foreign currency positions and gold, the opening costs were the exchange rates prevailing on 1 January 2007, communicated by the ECB. For securities investments, the securities prices as at 31 December 2006 represented the opening average prices, which served as a starting-point for premium and discount amortisation and calculation of realised gains and losses in case of their sale.

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[11] Trans-European Automated Real-time Gross settlement Express Transfer system 2

Off-balance-sheet instruments
Forward legs of foreign exchange swaps are disclosed off-balance-sheet and 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 2009, Slovakia adopted euro as a new legal tender and paid up its capital share to the ECB in full. Furthermore, ESCB capital keys were adjusted in accordance with a Statute on 1 January 2009 due to the regular quinquennial capital key change. As a result, the Bank's share in the fully paid-up capital of the ECB increased from 0,458% to 0,471% on 1 January 2009.

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 2008

ASSETS (thousands of euro)		31 December 2008	31 December 2007
1	**Gold and gold receivables**	**63,611**	**58,262**
2	**Claims on non-euro area residents denominated in foreign currency**	**618,103**	**657,258**
	2.1 Receivables from the IMF	41,711	25,663
	2.2 Balances with banks and security investments, external loans and other external assets	576,392	631,595
3	**Claims on euro area residents denominated in foreign currency**	**261,599**	**498,029**
4	**Claims on non-euro area residents denominated in euro**	**1,139,981**	**1,082,740**
	4.1 Balances with banks, security investments and loans	1,139,981	1,082,740
	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**	**1,197,600**	**156,036**
	5.1 Main refinancing operation	133,600	80,000
	5.2 Longer-term refinancing operations	1,064,000	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**	**635,778**	**971,625**
7	**Securities of euro area residents denominated in euro**	**2,441,529**	**2,103,187**
8	**General government debt denominated in euro**	**-**	**-**
9	**Intra-Eurosystem claims**	**2,650,923**	**2,576,384**
	9.1 Participating interest in the ECB	55,098	55,098
	9.2 Claims equivalent to the transfer of foreign reserves	183,995	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	2,397,955	2,335,394
	9.5 Other claims within the Eurosystem (net)	13,875	1,897
10	**Items in course of settlement**	**-**	**-**
11	**Other assets**	**299,060**	**220,129**
	11.1 Coins of euro area	1,386	3,839
	11.2 Tangible and intangible fixed assets	18,929	17,831
	11.3 Other financial assets	50,819	47,714
	11.4 Off-balance sheet instruments revaluation differences	0	1,673
	11.5 Accruals and prepaid expenses	77,356	63,936
	11.6 Sundry	150,568	85,137
12	**Loss for the year**	**29,719**	**36,443**
Total assets		**9,337,903**	**8,360,095**

* Only an ECB balance sheet item

LIABILITIES (thousands of euro)		31 December 2008	31 December 2007
1	**Banknotes in circulation**	**3,215,097**	**2,899,978**
2	**Liabilities to euro area credit institutions related to monetary policy operations denominated in euro**	**984,410**	**356,069**
	2.1 Current accounts (covering the minimum reserve system)	402,710	334,869
	2.2 Deposit facility	581,700	16,200
	2.3 Fixed-term deposits	-	5,000
	2.4 Fine-tuning reverse operations	-	-
	2.5 Deposits related to margin calls	-	-
3	**Other liabilities to euro area credit institutions denominated in euro**	**9,646**	**52,846**
4	**Debt certificates issued**	-	-
5	**Liabilities to other euro area residents denominated in euro**	**309,292**	**392,355**
	5.1 General government	267,728	341,251
	5.2 Other liabilities	41,565	51,103
6	**Liabilities to non-euro area residents denominated in euro**	**33,456**	**69,584**
7	**Liabilities to euro area residents denominated in foreign currency**	**71,543**	**65,679**
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**	**28,096**	**27,313**
10	**Intra-Eurosystem liabilities**	**3,569,815**	**3,490,619**
	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)	3,569,815	3,490,619
11	**Items in course of settlement**	-	-
12	**Other liabilities**	**201,893**	**157,714**
	12.1 Off-balance sheet instruments revaluation differences	12,628	-
	12.2 Accruals and income collected in advance	13,061	22,044
	12.3 Sundry	176,204	135,670
13	**Provisions**	**62,007**	**30,413**
14	**Revaluation accounts**	**100,830**	**17,657**
15	**Capital and reserves**	**751,818**	**799,867**
	15.1 Capital	8,346	8,346
	15.2 Reserves	743,472	791,521
16	**Profit for the year**	-	-
Total liabilities		**9,337,903**	**8,360,095**

* Only an ECB balance sheet item

Profit and Loss Account for the year ended 31 December 2008

thousands of euro	2008	2007
1.1 Interest income	313,561	268,702
1.2 Interest expense	-195,199	-169,937
1 Net interest income (expenditure)	**118,362**	**98,765**
2.1 Realised gains/losses arising from financial operations	2,812	5,055
2.2 Write-downs on financial assets and positions	-119,054	-120,731
2.3 Transfer to/from provisions for foreign exchange risks, price risks and other operational risks	-7,219	-15,300
2 Net result of financial operations, write-downs and risk provisions	**-123,461**	**-130,976**
3.1 Fee and commission income	11,845	7,317
3.2 Fee and commission expense	-1,645	-1,192
3 Net fee and commission income	**10,200**	**6,125**
4 Income from equity shares and participating interests	6,436	404
5 Net result arising from allocation of monetary income	-17,937	1,897
6 Other operating income	6,803	17,350
Total net income	**404**	**-6,436**
7.1 Staff costs	-17,899	-17,706
7.2 Administrative expenses	-7,655	-8,219
7.3 Depreciation of tangible and intangible fixed assets	-2,187	-2,043
7.4 Banknote production services	-1,582	-1,565
7.5 Other expenses	-800	-476
7 Total operating expenses	**-30,123**	**-30,007**
8 Loss for the year	**-29,719**	**-36,443**

The notes on pages 14 to 32 form an integral part of the financial statements.

The unaudited financial statements were approved by the Governing Board on 17 February 2009 and these audited financial statements were approved by the Governing Board on 17 March 2009 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 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 2008. This price, notified by the ECB, amounts to EUR 621.542 per ounce of fine gold compared with EUR 568.236 on 31 December 2007. Unrealised valuation gains of EUR 14.2 million (of which EUR 8.8 million from year 2007 and EUR 5.5 million from year 2008) were disclosed under the liability balance sheet item 'Revaluation accounts'.

	000 EUR	Fine troy ounces
Balance as at 31 December 2007	58,262	102,229
Sales in 2008 at market price	-135	-215
Realised gain	31	-
Revaluation of gold stock as at end of 2008	5,452	-
Balance as at 31 December 2008	63,611	102,014

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 1.1048 (31 December 2007: SDR 1 = EUR 1.074) 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 above the average cost and valuation gains were therefore recognised in accordance with the accounting rules under the liability balance sheet item 'Revaluation accounts'.

	31 December 2008		31 December 2007	
	000 SDR	000 EUR	000 SDR	000 EUR
Quota	231,700	255,982	231,700	248,846
Less IMF holdings of EUR	-201,607	-222,735	-215,775	-231,742
Reserve tranche in the IMF	30,093	33,247	15,925	17,104
SDR Holdings	7,661	8,464	7,969	8,559
Total	37,754	41,711	23,895	25,663

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 2008.

Breakdown of foreign currency assets by type of investment:

	31 December 2008	31 December 2007
	000 EUR	000 EUR
Current accounts	996	1,180
Time deposits	60,191	15,828
Securities	515,206	614,587
Total	576,392	631,595

Breakdown of securities according to their residual maturity:

	31 December 2008	31 December 2007
	000 EUR	000 EUR
≤ 1 year	54,204	146,462
>1 year and ≤5 years	424,347	446,980
> 5 years	36,654	21,145
Total	515,206	614,587

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. This item also includes a claim arising from reverse operations with the Eurosystem counterparties in connection with the short-term USD liquidity providing programme (US dollar Term Auction Facility). Under this program, US dollars were provided by the Federal Reserve to the ECB by means of a temporary reciprocal currency arrangement (swap line) with the aim of offering short-term US dollar funding to Eurosystem counterparties. The ECB simultaneously entered into back-to-back swap transactions with NCBs that have adopted the euro, which used the resulting funds to conduct liquidity-providing operations with the Eurosystem counterparties in the form of reverse and swap transactions. These back-to-back swap transactions between the ECB and NCBs resulted in intra-Eurosystem balances reported under 'Other liabilities within the Eurosystem'.

Foreign currency assets are shown at their euro equivalent as calculated on basis of market exchange rates on 31 December 2008.

Breakdown of foreign currency assets by type of investment:

	31 December 2008	31 December 2007
	000 EUR	000 EUR
Current accounts	245	242
Time deposits	19,169	135,163
Term Auction Facility operations	32,335	-
Securities	209,850	362,624
Total	261,599	498,029

Breakdown of securities according to their residual maturity:

	31 December 2008	31 December 2007
	000 EUR	000 EUR
≤ 1 year	69,464	173,244
>1 year and ≤ 5 years	136,566	182,534
> 5 years	3,820	6,847
Total	209,850	362,624

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 2008	31 December 2007
	000 EUR	000 EUR
Current accounts	402	10
Time deposits	264,143	326,830
Securities	875,436	755,899
Total	1,139,981	1,082,740

Breakdown of securities according to their residual maturity:

	31 December 2008	31 December 2007
	000 EUR	000 EUR
≤ 1 year	195,851	182,444
>1 year and ≤ 5 years	582,622	316,031
> 5 years	96,963	257,424
Total	875,436	755,899

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 2008 the main refinancing operations were conducted as variable-rate tenders with a minimum bidding rate until mid-October, after that they were conducted as fixed-rate tenders with full allotment. 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 maturity of one, three or six 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 until mid-October, after that they were conducted as fixed-rate tenders with full allotment.

	31 December 2008	31 December 2007
	000 EUR	000 EUR
Main refinancing operations	133,600	80,000
Longer term refinancing operations	1,064,000	76,036
Total	1,197,600	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.

	31 December 2008	31 December 2007
	000 EUR	000 EUR
Current accounts	1,578	3,125
Time deposits	634,200	968,500
Total	635,778	971,625

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 2008	31 December 2007
	000 EUR	000 EUR
≤ 1 year	288,507	868,289
>1 year and ≤ 5 years	2,045,442	886,930
> 5 years	107,580	347,969
Total	2,441,529	2,103,187

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 until the end of year 2008.

The participating interests of the 27 European central banks in the capital of the ECB on 31 December 2008 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	3.5451
Central Bank of Cyprus	0.1249	7,195,055	7,195,055	0,1792
Deutsche Bundesbank	20.5211	1,182,149,240	1,182,149,240	29.4436
Central Bank and Financial Services Authority of Ireland	0.8885	51,183,397	51,183,397	1.2748
Bank of Greece	1.8168	104,659,533	104,659,533	2.6067
Banco de España	7.5498	434,917,735	434,917,735	10.8324
Banque de France	14.3875	828,813,864	828,813,864	20.6431
Banca d'Italia	12.5297	721,792,464	721,792,464	17.9776
Banque centrale du Luxembourg	0.1575	9,073,028	9,073,028	0.2260
Central Bank of Malta/Bank Ċentrali ta' Malta	0.0622	3,583,126	3,583,126	0.0892
De Nederlandsche Bank	3.8937	224,302,523	224,302,523	5.5867
Oesterreichische Nationalbank	2.0159	116,128,992	116,128,992	2.8924
Banco de Portugal	1.7137	98,720,300	98,720,300	2.4588
Banka Slovenije	**0.3194**	**18,399,524**	**18,399,524**	**0.4583**
Suomen Pankki-Finlands Bank	1.2448	71,708,601	71,708,601	1.7860
Total euro-area NCBs	**69.6963**	**4,014,961,581**	**4,014,961,581**	**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	
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	
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	**30.3037**	**1,745,690,822**	**122,198,357**	
Total euro area and non-euro area NCBs	**100.0000**	**5,760,652,403**	**4,137,159,938**	

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 in year 2007 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' consists of the claims and liabilities of the Bank vis-à-vis the Eurosystem relating to the allocation of euro banknotes within the Eurosystem which arise from applying the euro banknote allocation key (see 'Banknotes in circulation' and 'Intra-ESCB balances' in the notes on accounting policies)[12]. The net position, taking into account the adjustment as a result of smoothing mechanism, which reduces the interest bearing claim for the compensatory amount of EUR 1,351.0 million (2007: EUR 1,566.8 million), is remunerated 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') and the claim arising from the partial distribution of ECB's income on euro banknotes in circulation (see profit and loss item 4 'Income from equity shares and participating interests').

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.

[12] According to the accounting regime chosen by the Eurosystem on the issue of euro banknotes, a share of 8% of the total value of the euro banknotes in circulation is allocated to the ECB on a monthly basis. The remaining 92% of the value of the euro banknotes in circulation are also allocated to the NCBs on a monthly basis, whereby each NCB shows in its balance sheet a share of the euro banknotes issued corresponding to its paid-up share in the ECB's capital. The difference between the value of the euro banknotes allocated to the NCB according to the aforementioned accounting regime, and the value of euro banknotes put into circulation, is recorded as a 'Net Intra-Eurosystem claim/liability related to the allocation of euro banknotes within the Eurosystem'.

	Land and buildings	Computers & equipment	Total
	000 EUR	000 EUR	000 EUR
Cost or valuation			
At 31 December 2007	**15,869**	**18,800**	**34,669**
Additions	1,646	1,700	3,345
Disposals	-31	-2,210	-2,241
At 31 December 2008	**17,484**	**18,290**	**35,773**
Depreciation			
At 31 December 207	**3,051**	**13,787**	**16,838**
Disposals	-7	-2,202	-2,209
Charge for the year	132	2,083	2,215
At 31 December 2008	**3,176**	**13,668**	**16,844**
Net book value			
At 31 December 2007	12,818	5,013	17,831
At 31 December 2008	**14,308**	**4,622**	**18,929**

As at 31 December 2008 an amount of EUR 5.8 million relating to investment properties in Austria is included in land and buildings (2007: EUR 5.8 million).

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 2008. This consists mainly of interest income which is due in the new financial year from the transfer of foreign reserves to the ECB, from the net claims related to the allocation of euro banknotes within the Eurosystem, from money market deposits and from securities investments.

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

Liabilities

1. Banknotes in circulation

This item consists of the Bank's share of the total euro banknotes in circulation (see 'Banknotes in circulation' in the notes on accounting policies').

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 2008, the Bank has a 0.4215% (2007: 0,4225%) share of the value of all euro banknotes in circulation. During the year 2008 the total value of banknotes in circulation within the Eurosystem rose from EUR 676,677 million to EUR 762,921 million. In accordance with the allocation key, the Bank shows holdings of euro banknotes amounting to EUR 3,215.1 million at the end of the year (2007: EUR 2,858.8 million). The value of the euro banknotes actually issued by the Bank was EUR 817.1 million (2007: EUR 523.4 million). As this was less that the allocated amount, the difference of EUR 2,398.0 million (2007: 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 2008	31 December 2007
	000 EUR	000 EUR
Banknotes denominated in EUR		
EUR 5	-1,146	4,005
EUR 10	46,698	29,674
EUR 20	1,299,113	768,905
EUR 50	-851,782	-406,415
EUR 100	-45,411	25,391
EUR 200	-38,934	-8,891
EUR 500	408,605	110,729
Total euro banknotes actually put into circulation by the Bank	817,142	523,398
Redistribution of euro banknotes in circulation within the Eurosystem	2,677,603	2,584,130
Euro banknotes issued by the ECB (8%)	-279,648	-248,736
Total EUR banknotes according to the Bank's banknote allocation key	3,215,097	2,858,791
Banknotes denominated in SIT	-	41,187
Total	3,215,097	2,899,978

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 counterparty appears 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 counterparties at a predetermined interest rate (standing facility).

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.

	31 December 2008	31 December 2007
	000 EUR	000 EUR
Current accounts (covering the minimum reserve system)	402,710	334,869
Deposit facility	581,700	16,200
Fixed-term deposits	-	5,000
Total	984,410	356,069

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.

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 2008 on the basis of the market rate of SDR 1 = EUR 1.1048 (31 December 2007: SDR 1 = EUR 1.074) calculated by the ECB at the end of the year for all central banks participating in the Eurosystem. The increase in the amount of this liability in 2008 is solely due to valuation effects, i.e. the depreciation of the euro against the SDR.

10. Intra-Eurosystem liabilities

Sub-item 10.4 'Other liabilities within the Eurosystem (net)' contains a net TARGET2 balance, arising from cross-border transfers via TARGET2 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.

12. Other liabilities

Sub-item 12.2 'Accruals and income collected in advance' contains the accrued expenses identified at 31 December 2008. 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 TARGET2 balance, deposits which are used to fulfil the minimum reserve requirement and fixed-term government deposits.

Sub-item 12.3 'Sundry' consists mainly of fiduciary liabilities.

13. Provisions

	31 December 2008	31 December 2007
	000 EUR	000 EUR
Provisions for employees and for known risks	15,684	15,113
Provisions for general risks	20,037	15,300
Provision in respect of monetary policy operations	26,286	-
Total	62,007	30,413

Provisions for employees and for known risks

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. It is our assessment that there is no need to change the amount of provisions for post-employment benefits as at 31.12.2008.

Provisions for known risks mainly relate to potential liabilities of the Bank towards creditors of Savings and Loan Undertakings and towards employees arising from labour disputes. The total net decrease amounts to EUR 0.6 million.

Provisions for general risks

Taking into account the Bank's exposure to interest rate risks, provisions for future unrealised interest rate losses amounting to EUR 15.3 million in year 2007 and EUR 4.7 million in year 2008 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. This amount represents the Value-at-Risk (VaR) with a 95% confidence level based on a one month horizon for the exposure of special part of the off-balance sheet position. 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.

Provisions in respect of monetary policy operations

In accordance with the general accounting principle of prudence, the Governing Council of the ECB has deemed it appropriate to establish a buffer totalling EUR 5,736 million against counterparty risks in monetary policy operations. In accordance to Article 32.4 of the Statute, this buffer will be funded among all the national central banks of participating Member States in proportion to their subscribed capital key shares in the ECB prevailing in 2008.

As a result, a provision for EUR 26.3 million equivalent to 0.45827% of the total provision was created.

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 51.1 million arose from the valuation of EUR denominated portfolio (2007: EUR 0.2 million), EUR 19.4 million from the valuation of USD denominated assets (2007: EUR 7.4 million), EUR 3.8 million from the GBP denominated portfolio (2007: EUR 1.3 million) and EUR 2.2 million from AUD denominated securities portfolio.

In case of foreign currency positions, gains of EUR 7.8 million arose from the valuation of USD position and EUR 2.0 million from the valuation of CHF position.

In case of gold the acquisition cost is 1 ozf = EUR 482.688, comparing with market price at the end of 2008, which was EUR 621.542 per fine ounce of gold (2007: EUR 568.236). Market value of gold position exceeded its acquisition price and resulted in a revaluation gain amounting to EUR 14.2 million (2007: EUR 8.8 million).

As at 1 January 2007, there was 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 2008	31 December 2007
	000 EUR	000 EUR
Price effect	76,604	8,893
- securities in foreign currencies (asset items 2 and 3)	25,501	8,647
- securities in euro (asset items 4 and 7)	51,103	246
Exchange rate effect	10,011	1
Gold value effect	14,215	8,763
Total	100,830	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 2008	31 December 2007
	000 EUR	000 EUR
Composition of reserves:		
Initial capital of the Bank of Slovenia	8,346	8,346
General reserve	313,733	278,875
Special reserve for foreign exchange differences	380,718	463,638
Special reserve – price risk (gold)	43,236	43,236
Investment properties revaluation	5,785	5,772
Total reserves	751,818	799,867

Notes to the off-balance-sheet items

Foreign currency swaps

As at 31 December 2008, the forward foreign currency position arising from EUR/foreign currency swap transactions amounts to EUR 546.0 million (2007: EUR 202.9 million).

Forward liabilities to the ECB outstanding as as 31 December 2008 arose in connection with short-term USD liquidity-providing-programme (US dollar Term Auction Facility) in agreement by the Federal

Reserve (see balance sheet asset item 'Claims on euro area residents denominated in foreign currency').

In addition, off-balance sheet items include forward liabilities to the ECB and forward claims against Slovenian counterparties outstanding as at 31 December 2008, which arose in connection with the provision of Swiss franc funding to Slovenian counterparties. Swiss francs were provided by the Swiss National Bank to the ECB by means of a swap arrangement. The ECB simultaneously entered into swap transactions with NCBs that have adopted the euro, which used the resulting funds to conduct Swiss franc liquidity-providing operations with the Eurosystem counterparties against euro cash in the form of swap transactions. The swap transactions between the ECB and the NCBs resulted in intra-Eurosystem balances reported under 'Other claims within the Eurosystem (net)'.

The forward claims and forward liabilities in foreign currencies were revalued at the same exchange rates as those used for spot holdings in foreign currencies.

	31 December 2008		31 December 2007	
	000 Foreign currency	000 EUR	000 Foreign currency	000 EUR
Forward liabilities in AUD	210,000	103,581	340,000	202,900
Forward liabilities in GBP	177,200	186,037	-	-
Forward liabilities in USD	356,800	256,377	-	-
Total	**-**	**545,995**	**-**	**202,900**
Forward liabilities to ECB in USD (TAF)	45,000	32,335	-	-
Forward liabilities to ECB in CHF	143,183	96,420	-	-
Forward claims against Eurosystem counterparties in CHF	143,183	96,420	-	-

Securities lending

As at 31 December 2008, securities with a market value of EUR 1,007 million (31 December 2007: EUR 1,490 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.

Other off-balance-sheet items

The following other financial liabilities of the Bank were stated off-balance-sheet as at 31 December 2008:

- obligation under the IMF's statutes to provide currency on demand in exchange for SDRs up to the point at which the Bank's SDR holdings are three times as high as the amount it has received gratuitously from the IMF, which was equivalent to EUR 75.8 million as at 31 December 2008;

- a contingent liability of EUR 159.7 million, equivalent to the Bank's share of the maximum of EUR 50 billion reserve assets that the ECB may require the euro area NCBs to transfer under Article 30.1 ESCB Statute (based on the Bank's share of 0,3194% in the ECB's subscribed capital as on 31 December 2008);

- a contingent liability of EUR 16.0 million, equivalent to the Bank's share of the ECB's capital of EUR 5 billion, should the ECB increase its capital by such amount under Article 28.1 ESCB Statute (based on the Bank's share in the ECB's subscribed capital of 0,3194% at the balance sheet date);

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 2008	31 December 2007
	000 EUR	000 EUR
Interest income		
Gold	**161**	**27**
Current accounts and deposits	**42,339**	**64,684**
- In foreign currency	4,463	12,699
- In euro	37,875	51,985
Securities	**207,455**	**166,644**
- In foreign currency	45,624	53,839
- In euro	161,831	112,805
IMF	**436**	**778**
Monetary policy operations	**10,928**	**4,599**
- Main refinancing operation	1,688	1,629
- Longer-term refinancing operations	9,225	2,958
- Other refinancing operations	16	12
Intra Eurosystem claims	**48,033**	**31,915**
- Claims arising from the transfer of foreign reserves to the ECB	6,418	6,216
- Net claims related to the allocation of banknotes within the Eurosystem	41,615	25,699
Foreign currency swaps	**3,949**	**-**
Other interest income	**261**	**55**
Total	313,561	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 and overnight deposits. 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) were included in the interest expenditure arising from the monetary policy operations in year 2007 amounting to EUR 10.6 million. Interest expense also includes interest paid on TARGET2 balances.

	31 December 2008	31 December 2007
	000 EUR	000 EUR
Interest expenditure		
Current accounts and deposits	**19,981**	**15,192**
- In foreign currency	1,993	3,350
- In euro	17,987	11,841
Monetary policy operations	**19,029**	**24,389**
- Minimum reserves	16,017	13,534
- Overnight deposits	2,663	128
- Fixed term deposits	348	10,727
Intra Eurosystem liabilities	**148,370**	**128,833**
- TARGET balances	148,370	128,833
Foreign currency swaps	**7,673**	**1,273**
Other interest expense	**146**	**250**
Total	**195,199**	**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 reflect the decline in market prices of balance sheet items as at 31 December 2008 below the average cost of the respective currencies or securities. The valuation losses in 2008 occurred mostly in EUR denominated securities (in 2007 also in the USD and GBP position).

According to the Governing Board decision, additional provisions have been made for the certain legal claims pending, at the same time some provisions have been released as a consequence of the closed legal claims. The total net increase of provisions for specific risks amounts to EUR 2,5 million.

Transfer to provisions for general 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 2008	31 December 2007
	000 EUR	000 EUR
Realised gains/losses		
Gold	31	23
Currency position	-1,603	6,463
Securities	4,384	-1,431
Total	2,812	5,055
Write-downs		
Currency position	-4	-82,920
Securities	-119,050	-37,811
Total	-119,054	-120,731
Transfer to/from provisions for foreign exchange risks, price risks and other operational risks		
Provisions for specific risks	-2,482	-
Provisions for general risks	-4,737	-15,300
Total	-7,219	-15,300
Total	-123,461	-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 and the ECB.

Also included under this caption is the distribution of the ECB's income on euro banknotes amounting to EUR 6.0 million (see 'Banknotes in circulation' in the notes on accounting policies). In 2008 the ECB's income on euro banknotes in circulation was partially retained by the ECB in accordance with a decision of the Governing Council with respect to the establishment of a provision for foreign exchange rate, interest rate and gold price risks. The retained amount not distributed to the Bank amounts to EUR 4.7 million.

5. Net result of pooling 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 each Eurosystem NCB's

[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), OJ L 337, 20.12.2001, p. 55-61, as amended by the Decision of the European Central bank of 18 December 2003 (ECB/2003/22), OJ L 9, 15.01.2004, p. 39 and by the Decision of the European Central Bank of 19 May 2006

monetary income is determined by measuring the actual annual income that derives from the earmarkable assets held against its liability base.

Any interest paid on liabilities included within the liability base is to be deducted from the monetary income to be pooled by the NCB.

Where the value of a NCB's earmarkable assets exceeds or falls short of the value of its liability base, the difference shall be offset by applying to the value of the difference the the latest available marginal rate for the Eurosystem's main refinancing operations. At the end of each financial year the total monetary income pooled by the Eurosystem is allocated among the NCBs according to the subscribed ECB capital key. 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 account.

In the year 2008 the allocation of monetary income resulted in a net claim of EUR 8.3 million for the Bank (2007: EUR 1.9 million). This net claim represents the difference between the EUR 117.8 million (2007: EUR 104.5 million) of monetary income paid by the Bank into the common pool and the Bank's claim of EUR 126.1 million (2007: EUR 106.4 million) on the common pool, corresponding to the Bank's share in the ECB's paid-up capital.

This item also includes the allocation to a provision in respect of monetary policy operations (see section on liability item L13 on provisions).

6. Other operating income

Other operating income includes income from non-bank services like rental income, income from confirmations issued, numismatics and other income.

7. Operating expenses

Staff costs

Staff costs include salaries and other staff costs together with the related taxes and contributions.

The Bank employed 424 employees as at 31 December 2008 (31 December 2007: 425 employees).

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 (2007: EUR 0.4 million).

In 2008 the remuneration of the Governing board members of the Bank was of EUR 0.9 million (2007: 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.

(ECB/2006/7), OJ L 148, 02.06.2006, p. 56-60 and by Decision of the European Central Bank of 22 November 2007 (ECB/2007/15), OJ L 333, 19.12.2007, p. 86-88.

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 Accounting Guideline, 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 29.7 million (2007: EUR 36.4 million). According to the Article 51 of the Law on the Bank of Slovenia, the loss is covered from the general reserves.