Chapter 36

Slovenia: Slovenia's Monetary Policy and Experience in the Euro Area

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Abstract

The Bank of Slovenia decided on its strategy of monetary targeting due to the stable money demand function, stable velocities, and stable monetary multipliers, and balanced the approach with limited exchange rate flexibility. Inflation was proven to be conditioned by trade margins, accounting for 39% of the variance in inflation in the 18 months after the introduction of the euro in Slovenia. The 2008 banking crisis required a new approach to the recapitalisation of Slovenian banks. Privatisation laws were in full swing throughout the overheating of the Slovenian economy between 2004 and 2008. Slovenia decided to transfer bad banking claims to a bad bank (DUTB); however, the project was executed too late at the deepest point of the economic cycle. The difference between the Slovenian specifics and the EU terms was that the banks in Slovenia were primarily owned by the state, and thus the state stepped into the recapitalisation process as an owner and not a state. All regulations and directives of the euro area were implemented under national laws. The Bank of Slovenia, similar to the entirety of the Eurosystem, implemented the Pandemic Emergency Purchase Programe and other non-standard monetary policy instruments.

Keywords: *monetary policy, euro, inflation, banking crisis, state aid rules, directives and regulations of the euro area, non-standard monetary policy instruments*

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1. Introduction

A key issue for macroeconomic reform programs in transition countries is whether the persistence of moderate inflation resulted from the traditional causes of insufficiently tight financial policies and wage pressures or from the sizeable adjustment of relative prices necessary for the transition to a market-based economy. The following key variables explain the stickiness of inflation in transitional economies:[1] (i) inflation inertia reflects explicit or implicit wage indexation and slow adjustment of inflation expectations; (ii) wage increases are not in line with productivity gains;[2] (iii) monetary growth is fuelled by fiscal obligations; (iv) underlying pressure for the appreciation of the real exchange rate coupled with a policy of resisting nominal appreciation through official intervention in foreign exchange markets; (v) insufficient stimulation of foreign capital investment;[3] (vi) relative price adjustment combined with downward price rigidity; (vii) the persistence of relative price variability may reflect the limited speed of structural reforms.

The establishment of the Maastricht convergence criteria also encouraged the achievement of realistic conditions during the adjustment period for entry into the optimal currency area. Slovenia had to solve the problems arising from the inferiority of the Slovenian economy,[4] obtain stability in the real sector, lower the inflation rate, and develop a strategy for institutional, monetary, and fiscal accommodation.[5] While shocks were symmetrically distributed across all European Union (EU) economies,[6] the loss of an independent exchange rate or monetary policy at the national level would not have impeded the ability of such countries to adjust to them.[7] With the possibility of exchange rate changes among countries no longer under the European Monetary Union, adjustments in labour mobility and wages played a larger role and should have absorbed the shocks. Ultimately, Slovenia independently implemented its monetary policy.

1 IMF, 1998, pp. 241–244; Festić. 2002; Inotai, 1994.
2 Festić, 2000.
3 See: Babetskii, 2004
4 See: Ribnikar, 1994.
5 For more details, see: Festić, 2001b.
6 For more details, see: Borowski, 1999.
7 For more details, see: Cukierman, 1995.

2. Lessons related to the introduction of the euro: Experience in the Eurozone and pros and cons regarding the common currency

In general, the central bank can only regulate base money, whereas the monetary aggregates M1, M2, and M3 are endogenous variables.[8] To increase policy transparency, it would be useful for authorities to produce a clear statement on how deviations from the target would be dealt with.[9]

The instruments used by the Bank of Slovenia (BS) were subordinated to the intermediate target and oriented towards the chosen final goal (price level stability and lower inflation rate per annum) and base money growth.[10] Until 1996, the BS targeted the monetary aggregate, M1 (as an intermediate target). Subsequently, the BS followed restrictive monetary policy and announced M3 annual targets in 1997. The BS originally chose the M3 target because this aggregate was fairly stable, primarily because of the movements between the tolar and foreign currency deposits included in the M3 aggregate.[11]

The BS partially reached its final goal indirectly through the exchange rate. Formally independent (exogenous) monetary stock (base money) control is inferior to formally dependent (endogenous) exchange rate formation. Owing to the transition and unclear and inadequate social ownership, it was impossible to introduce full capital liberalisation and clean floatation. In addition, because of the openness of the Slovenian economy and appreciation pressures, there was a need for an exchange rate policy, with the BS intervening in the foreign currency market within the limits of the chosen monetary target.[12] According to Ribnikar, existing systems react favourably to basic macroeconomic events.

2.1. The Maastricht convergence criteria and Slovenia's economic compliance

To understand the former Slovene monetary system and its ability to fulfil the Maastricht criteria, we must first establish the reasons for appreciation pressure in Slovenia:[13] (i) a current account surplus, with exports increasing foreign currency inflows; (ii) inflation and real appreciation movements due to prices in non-tradable sectors (especially services) continuously increasing faster than prices in the tradable sector (price increases in the non-tradable sector have been a consequence of high labour costs and increasing controlled prices);[14] (iii) a slower nominal depreciation

8 See: Cassel, 1995; Pfister, 1997.
9 See: Fischer and Dueker, 1996.
10 Cecchetti and Bryan, 1994.
11 See: Festić, 2001a; Ovin, 1998; Bekő and Festić, 2006; Bekő, 1997.
12 See: Ovin, 1998; Ribnikar, 1993.
13 Bekő, 1997, pp. 173–179.
14 Festić, 2000.

behind relative inflation, which means that the nominal exchange rate in the market lagged behind purchasing power parity; (iv) higher added value improved the terms of trade for transition economies;[15] (v) better capacity utilisation and increased productivity;[16] (vi) foreign currency inflows resulting from high returns on tolar portfolio investments due to structural–transitional reasons, high real interest rates, and the expected high profitability of medium-term portfolio investments. In addition, such inflows were determined by the difference between the expected nominal exchange rate increase (depreciation rate), domestic inflation, and the revaluation of the interest rate;[17] (vii) the higher tolar interest rate meant that loans granted abroad were more attractive, leading to exchange rate pressure (appreciation); this was due to short-term foreign currency inflows to the household sector, along with increased indebtedness of banks, enterprises, and the public sector;[18] (viii) lower prices in Slovenia (e.g. for oil derivatives and related products) drove early foreign currency inflows.

In the case of the BS, commercial papers have always been more important than base money.[19] Base money is important for control of the monetary stock, whereas commercial paper is crucial for exchange rate control. Commercial papers have been nominated in both foreign and domestic currencies. The BS can be said to have had multiple goals, including the management of M3 and the exchange rate.

As the BS did not have sufficient foreign assets, it issued short-term commercial papers. Foreign currency reserves are formed through the issuance of commercial paper in foreign currencies and the use of base money. For commercial papers in foreign currency, the central bank received foreign currency used for foreign deposits abroad, base money creation, and purchases of foreign securities. By issuing commercial papers in foreign currency, the BS was able to obtain assets that enabled it to mediate capital outflows to prevent capital inflows from representing net capital inflows (i.e. capital imports).

The BS can be said to have had three functions. First, it is the monetary authority responsible for monetary policy, evident in its creation of base money by credits. Second, it is also responsible for implementing an exchange rate policy; specifically, it carries out this function by issuing attractive commercial papers in foreign currency, depositing foreign assets obtained by commercial papers in foreign banks (long-term commercial papers in foreign currency), and requiring 60% of the minimum reserve requirements to be held in commercial papers (short-term commercial papers in foreign currency). Long-term commercial papers in foreign currencies and short/

15 Halpern and Wyplosz, 1996, pp. 13–14.

16 Grafe and Wyplosz, 1997. This text explores the problem of real wages in transition economies. Increased production costs (due to higher productivity) depreciated and thus increased wages in transition economies did not endanger export competitiveness from 1995 to 1996 in Slovenia.

17 Bole, 1997.

18 Ovin, 1998.

19 See: Festić, 2002.

long-term tolar commercial papers reflect the BS's sterilisation policy; this is why the tolar did not appreciate.[20]

Slovenia has dismissed non-market instruments of monetary policy, replacing them with new ones; namely: open market policy, Lombard loans, minimum reserve requirements, bills with warrants, twice bills, and foreign currency bills. In Yugoslavia, the central bank's reaction was stochastic. The relationship between government-owned enterprises and their financial needs requires strong discretion in monetary policy.[21]

Foreign currency reserves at the BS were formed partially by indebtedness abroad and the balance of payment flows. The BS absorbed part of the foreign currency money stock directly from the non-banking sector (i.e. foreign currency deposits of the government at the BS) and indirectly from commercial banks through commercial papers or direct purchases.[22]

The factors influencing M3 can be divided into factors linked to demand (e.g. income, transactions, interest rates, inflation) and supply (balance of payments behaviour of commercial banks, monetary policy instruments). Commercial banks issue money through two main channels:[23] (i) net foreign assets; (ii) domestic assets.

Commercial banks use disposable base money to monetise foreign currency (monetisation of foreign currency inflows from the non-banking sector) and extend credit (e.g. domestic loans, purchasing securities). Domestic portfolio investments are represented by loans, capital investments, and securities portfolios in the domestic non-banking sector. The issuance of M3 over net foreign assets was reduced for foreign asset deposits of the government at the BS and increased for both domestic portfolio investments in foreign assets (e.g. loans, government bonds) and commercial papers outside banks.[24]

The balance between payment movements and domestic credit creation prevailed in the creation of M3. The inflow of foreign currency increased M3 through the conversion of foreign currency into domestic currency.

Commercial banks fulfil their minimum reserve requirements for foreign currency deposits abroad, cash, interbank foreign currency liabilities, commercial papers of the BS nominated in foreign currency, different securities, and special rights to purchase foreign currency. From 1996 onwards, banks were required to hold 60% of their foreign currency reserves in short-term commercial bills.[25]

Overnight liquidity facilities are offered to net borrowers in the interbank market at uniform interest rates. The quantity of regular loans granted to banks is contingent on both their share in the foreign currency's total position and the overall volume of loans provided. The interest rate aligns with that for short-term bills of a comparable

20 See: Ribnikar, 1999; Festić, 2001a.
21 For more details, see: Ribnikar, 1993.
22 See: Festić, 2002; Festić, 2001a.
23 Ribnikar, 1999.
24 See: Košak, 1997.
25 See: Festić, 2000; Festić, 2001c, pp. 31–39.

maturity (of no more than three months).[26] Lombard loans have rarely been used as instruments of monetary policy; commercial banks may obtain a five-day Lombard loan based on the commercial papers of the BS and treasuries.[27]

Foreign currency bills are transferable, registered securities that are not issued in series. They are offered on a permanent basis and could be purchased by the banks themselves or by other legal persons through the banks. Bills with warrants are short-term bearer securities issued in series in paper form with a nominal value of half a million tolars; they are purchased in tolars at a discount and have a nominal interest rate. The warrants attached to securities hedge against inflation and exchange rate depreciation at rates higher than officially projected.[28] The tolar segment is revalued using a tolar revaluation clause.

Košak[29] found that the structural position of the money market showed a trend of high variability in the short term and one of decreasing variability in the long term. The disadvantage of high structural variability in the money market requires the BS to react intensively and promptly to changes in the money market and movements derived from autonomous transactions.[30]

Excess liquidity in the money market caused an increase in the demand for commercial papers issued by the Bank of Slovenia, which enabled a decrease in real and nominal interest rates in 1998.[31] The reversible instruments enabled the permanent flow of base money between the BS and commercial banks. In doing so, money market conditions were regulated, and the ultimate objective was successfully achieved.[32]

2.2. Pros and cons of accession to the Eurozone

At the money market level, the BS defined suitable short-term operational aims for bank liquidity and money market rates, which made the attainment of the annual money stock and key economic target variables possible in the longer run.[33] At the intermediate target level, represented by the annual target for M3 growth, the BS more or less continuously examined throughout the year, whether, when, and to what

26 See: Festić, 2001c, pp. 34–48.
27 See: Festić, 2001c, pp. 31–39; Festić, 2000, pp. 13–15.
28 See: Festić, 2000.
29 Košak 1997, p. 30.
30 Ribnikar, 1999. The positions that represented autonomous transactions included net foreign assets (foreign currency reserves), net government deposits (i.e. the difference between the deposits of the government and eventual loans to the government), currency in circulation, and other net liabilities.
31 See: Ovin, 1998.
32 In Slovenia, big banks also obtained liquid assets in transactions with the BS when the BS had been taking money from circulation. Liquid assets were poured out of small banks in favour of big banks. Medium-sized banks accessed less liquidity from the BS than big banks. Medium-sized banks were active in giving inter-bank loans. The BS increased base money over the group of big banks and decreased base money over small and medium banks. In 1996, the BS started to withdraw base money from circulation across all three groups of banks. See: Košak, 1997, pp. 31–36
33 For more details, see: Amano and Wirjanto, 1996; Blinder, 1994; Cukierman and Leviatan, 1992.

extent deviations in M3 from the target path were corrected by adjusting the conditions of the money market[34] and other financial markets.[35] The BS used a monetary targeting policy owing to the stability of velocity, monetary aggregate multipliers, and stable money demand. Stable money demand coincides with stable velocity.[36]

The BS's approach was unique. Their exchange rate targeting method involved monetary intervention (in foreign currency markets) and sterilisation – the BS purchased and sold foreign currencies and changed the quantity of the base money. Autonomy was evident here: the monetary policy caused changes in the domestic money stock over induced changes in foreign currency reserves (the balance of payments component of the money stock) in the case of fixed exchange rates.[37]

International integration and capital mobility require continual intervention by the BS to maintain the exchange rate at the targeted level. Similar to the disadvantages of interest rate regulation, 'artificial' exchange rate regulation could not be successful in an open economy given open financial markets and a high substitution rate between domestic and foreign assets.[38] Small open economies are influenced by the movements of foreign economies and thus by foreign monetary shocks.[39] Arguments against the fixed exchange rate regime, according to the specifics of the Slovenian economy, include:[40] (i) a surplus supply of foreign securities and excess demand for domestic securities can lead to a decrease in domestic interest rates, necessitating central bank intervention; (ii) when economic subjects expect foreign currency appreciation and demonstrate a preference for foreign securities, demand for foreign currency will increase, compelling the devaluation of the domestic currency; this also requires central bank intervention;[41] (iii) in small open economies, domestic prices are related to foreign price levels, and the relative prices between tradable and non-tradable sectors change;[42] (iv) if economic entities anticipate foreign currency depreciation in the presence of unstable money demand and substitution effects, the domestic currency will appreciate.

The flexible exchange rate was a more suitable and less rigid approach because the BS was in a position[43] to choose between different strategies, such as: (i) stabilising the base money by absorbing external shocks through exchange rate and interest rate movements; (ii) stabilising the exchange rate after a monetary shock by manipulating the interest rate; (iii) stabilising the interest rate after a shock by

34 See: Cukierman, 1995.
35 See: Festić, 2001a; Festić 2001b.
36 Festić, 2002; Cimperman, 1996. The growth of the money stock should vary less than the movement of actual production. Changes in the velocity of the circulation of money do not simply reflect the business cycle. For more details, see: Cassel, 1995, pp. 139–145; Büttler et al., 1979.
37 See: Pfister, 1997, pp. 103–111.
38 See: Bekő, 1997.
39 See: Borowski, 1999.
40 For more general details, see: Cassel, 1995, pp. 139–145; Siebke, 1995, pp. 36–50.
41 For more details, see: Ovin, 1998.
42 See: MacDonald and Wójcik, 2004.
43 Bole, 1997; Ovin, 1998.

manipulating the exchange rate (notably, this technique has demonstrated strong effects than stabilising the money stock); (iv) a combination of money stock, interest rate, and exchange rate movements.

In the absence of productivity disturbances and supply shocks, inflation-rate targeting worked extremely well, since there was no trade-off with employment stabilisation.[44] When changes in the money stock are transmitted quickly to changes in the price level, inflation targeting is relatively easy to implement.[45] However, the lack of predictability poses two important problems for inflation-targeting strategies.[46] Thus, it is difficult to directly confirm the link between inflation and economic performance. Here, it is important to remember that inflation is an endogenous variable.[47]

The BS chose the strategy of monetary targeting[48] and balanced the approach with limited exchange rate flexibility.[49] The arguments against inflation targeting in Slovenia are as follows:[50] (i) transition economies were required to solve the problems that initially resulted from inferior development; this requires the central bank to obtain the credibility required to influence inflation expectations; (ii) theoretically, inflation targeting is suitable when the real sector is stable, and Slovenia did not meet this requirement in the 1990s; (iii) the inflation targeting approach contained a considerable degree of what economists term 'policy discretion', which is not suitable for a region that needs to establish a stable economic environment; (iv) the central bank's flexibility can be understood as its accommodation of intermediate M3 targets for money demand and potential output movements;[51] (v) a small, open economy depends on cyclical movements in foreign economies; therefore, supply shocks represent potential disturbances – inflation targeting is unsuitable for supply shocks; (vi) inflation targeting is suitable in cases with very high annual inflation rates per annum; however, inflation rates were not very high in Slovenia (less than 10% per annum) and the monetary authorities did not pay any attention to the surprise creation of base money; (vii) monetary aggregates (base money, M1, M2, and M3) are easier to control than the inflation rate because inflation is an endogenous process; (viii) the time series was too short at the end of the 1990s in Slovenia, and the econometric results tended to be questionable; a tradeoff between inflation and unemployment was observed in the long term; (ix) the Granger causality from domestic household loans to real domestic consumption, as well as the Granger causality from real domestic consumption to real GDP, could be understood as evidencing the

44 See: Bernanke and Mishkin, 1997; Festić, 2003.
45 See: Archer, 1995.
46 Cukierman and Liviatan, 1992, pp. 439–458.
47 Fischer and Dueker, 1996.
48 See: Festić, 2001c.
49 For more details, see: Festić, 2001a; Festić, 2001b; Festić, 2002.
50 See: Festić, 2001b; Festić, 2001c; Festić, 2003.
51 For more details, see: Cukierman, 1995.

indirect influence of monetary aggregates on real GDP; this may be recognized as an insignificant 'trade-off'.[52]

The following facts were considered in Slovenia when policymakers discussed developments after 2000:[53] (i) institutional conditions enabled a less flexible and competitive labour market; (ii) the dynamics of wages in the non-tradable sector were transmitted into the costs (i.e. wages) of tradable goods; (iii) nominal wages were determined for a longer period, and labour costs did not react to increased unemployment; (iv) labour market laws (e.g. regulations concerning redundancy, early retirement schemes, part-time work) have not been sufficiently developed;[54] (v) labour force productivity increased as a consequence of the dismissed labour force in the initial period of transition and due to intensive capital investment in advanced technology, with technical improvements giving rise to intensive capital production (investment imports in Slovenia increased); (vi) productivity increased faster in industry than in the service sector, but wages in both sectors increased at the same pace, increasing inflation; (vii) the former Yugoslavia faced the phenomenon of 'hidden' unemployment, with too many employees with low productivity; (viii) the labour force was not prepared to accommodate itself to new market conditions or improve the value of human capital; (ix) unsolved problems related to social, health insurance, and pension funds inhibited decreases in labour costs; (x) the difference between gross and net wages was high (about 45% of gross tolar wages were contributions and duties); (xi) Slovenia has one of the highest rates of employees taking sick leave of all economies; (xii) structural unemployment problems increased; (xiii) the government stimulated an increase in employment (particularly in the public sector); (xiv) the number of strike actions by workers increased in the pre-election period; (xv) an important indicator of cyclical movements in the labour market was the rate of workers who were not searching for work because they believed that there were no jobs (i.e. no labour demand); consequently, they did not contribute to lowering the registered unemployment rate in Slovenia.

2.3. Before and after the Eurozone

The experiences of EU Member States that were the first to introduce the euro indicated that after its introduction, the divergence of inflation rates, as well as the inflation rate itself, increased due to the adaptation of relative prices and as a consequence of asymmetrical shocks.[55] Internal factors contribute to inflation due to weak competition in particular sectors and an increase in demand in Slovenia.

Producer prices did not essentially affect the rise of the harmonised index of consumer prices (they even slowed down the growth of the common price level),

52 See: Festić, 2003.
53 See: Festić, 2000; Festić, 2001a.
54 See: Festić and Romih, 2009.
55 See: Horvath and Rátfai, 2004.

while retail prices, together with the increase in trade margins, contributed to the start of the inflationary spiral in 2007, when economic growth was favourable in Slovenia.[56]

At the end of 2007, the price growth trend reached 9.3% in December 2007 and 9.9% in January 2008; price growth slowed down at the end of the first quarter of 2008 and reached 6.3% in May 2008 (UMAR 2008). The econometric analysis showed that 39% of the variance in inflation was conditioned by trade margins 18 months after the introduction of the euro.[57]

The dynamics of price trends in the euro area corresponded to the dynamics of price trends in Slovenia, but the level in the euro area was lower. In the state administration, the growth of wages and salaries strengthened the pressure on labour costs, which had otherwise stabilised over the previous year.[58] The growth in loans decelerated, while the surplus of loan repayments over the increase in new loans contributed to uncertainty in financial markets.[59]

The price increase of primary consumer goods resulted in a decline in average purchasing power.[60] Until May 2008, Slovenian inflation overtook euro area inflation by 2.58 %, with the largest differences observed in the price growth of food, housing costs, and tourist services.[61] The pressure of price growth in Slovenia was above average, corresponding to a cumulative difference in inflation between Slovenia and the euro area in food prices (2.85%), prices of clothing and footwear (0.62%), housing costs (4.05%), housing equipment (0.85%), recreation and culture (1.17%), tourism (3.2%), and services (0.30%). In comparison to the euro area, Slovenia had lower price growth, with only transport services lagging behind by 3.7%. Notably, food price growth triggers an increase in prices in other sectors and strengthens inflationary inertia.[62]

The reasons for the banking sector crisis after 2008, which required both state aid intervention[63] and a change in the central bank's supervisory practices,[64] were endogenous in Slovenia. Privatisation laws were in full swing during the overheating of the Slovenian economy between 2004 and 2008. The intertwined ownership relationships of companies and privatisation through holding companies also contaminated healthy companies within the real sector. The base for the crisis in the banking sector was derived from the privatisation laws introduced in the late 1990s in Slovenia.[65]

56 See: Festić et al., 2009.
57 Festić et al., 2009.
58 See: UMAR, 2008.
59 See: Festić, Repina and Kavkler 2009; Festić and Križanič, 2011; Festić, Kavkler and Repina, 2011.
60 Festić and Križanič, 2011.
61 Festić et al., 2009.
62 For more details, see: Festić, et al. 2009.
63 Festić, 2011.
64 See: Festić and Glogovšek, 2008; Festić and Bekő, 2008, 2009.
65 Festić, 2013.

The *Investment Funds and Management Companies Law* (ZISDU 1999[66]), adopted in the 1990s, created the conditions for the establishment of investment funds for collecting privatisation certificates by Special Investment Companies (PIDs) and for the transformation of state industrial property, which situated investment funds as private entities. The legal form of the PIDs was that of a publicly limited company classified as a closed investment fund.[67]

Citizens who invested their ownership certificates in PIDs were able to raise more than half of all the certificates in funds and, in doing so, held a majority in the ownership structure. In addition, there was a difference between the value of the issued certificates and the value of the state assets intended for privatisation – the so-called 'privatisation gap' – and this was the main reason why the period for the compulsory conversion of PIDs into another type of legal entity was extended until the end of 2003.[68] Meanwhile, many PIDs transformed into regular stock companies, resulting in fewer assets being transformed into real investment companies and mutual funds.[69]

By the end of 2003, PIDs had to be transformed into investment companies and mutual funds (ZPSPID 2005) or ordinary publicly limited liability companies called 'financial holding companies'.[70] Investment funds took over the market portfolio, whereas financial holding companies made fewer liquid investments in management to increase their value in the long run.[71]

The chosen model of the privatisation of state assets through the so-called 'PIDs' allowed for the creation of holding companies – the least-regulated entities in terms of investment structure. In the initial stage, their ownership structure was highly dispersed. Stakeholders had access to all information on the value of PIDs' investments or holding company portfolios, which helped them make informed decisions. A small, well-organised interest group could easily establish leadership in the assembly[72] and redeem their own securities at a discount price from citizens without this information (this speaks to the problem of information asymmetry and the consequent misuse of internal information).

Moreover, poor liquidity in the securities market led to market manipulation with the aim of minimising prices prior to planned equity consolidation. Holding companies have proven to be long-term unsuitable indirect owners of companies in the ownership structure of financial holding companies, as they were not developmentally oriented, but only required capital and dividend returns in the short run. As a rule, holding companies financed their investment portfolios by borrowing from

66 ZISDU – Zakon o investicijskih skladih in družbah za upravljanje, Official Gazette No. 26/99, 56/99.
67 Festić, 2013.
68 See: ZPSPID – Zakon o prvem pokojninskem skladu Republike Slovenije in preoblikovanju pooblaščenih investicijskih družb, Official Gazette No. 26/05.
69 For more details, see: Festić, 2013.
70 See: ZGD – Zakon o gospodarskih družbah, Official Gazette No. 65/09.
71 For more details, see: Festić, 2013.
72 Festić, 2019a, 2019b.

banks (owned by the Republic of Slovenia) and, to a lesser extent, from their own capital.

Intertwined corporate ownership relationships were linked to the difficulties faced by banks and companies, with leverage ratios higher than 136% in 2008 and subordinated companies being overdebted with takeover loans, with mostly healthy business models. Privatisation had depleted real sector companies through the holding structure and ruined the business models of real sector companies.[73] The poor creditworthiness of companies was transferred to the problems of the banking sector, something which also added to the crisis of the construction sector, which was most prone to cyclical fluctuations. This gave rise to a need to recapitalise state-owned banks.[74]

2.4. Slovenia's experience in the European Banking Union

The banking crisis of 2008 required a new approach towards both the recapitalisation of Slovenian banks and monetary policy instruments.[75] A series of EU regulations and directives have been transposed into the Slovenian legal order.

The Bank Recovery and Resolution Directive[76] was intended to treat creditors in an equitable manner when covering bank losses:[77] the bail-in toll to liabilities had the potential to destroy asset values.[78] The resolution authority needed to be able to exclude partial/total liabilities when necessary to avoid widespread contagion and systemic financial instability.[79]

Notably, subordinated debt holders participate in annual losses to restore the issuing capital, and contractual loss sharing can be triggered before an institution fails. Creditors are paid before shareholders receive equity.[80]

73 See: Festić, 2013; Bohinc, 2015; Bohinc, 2022.

74 See: Festić, 2011.

75 For more details, see: Festić and Krüger, 2009; Festić and Borak, 2019.

76 Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council, OJ L 173, 12.6.2014, 190–348 (BRRD).

77 Schelo, 2015, p. 86.

78 These concerns are the drivers for total loss absorbing capital (TLAC), gone concern loss absorbing capital (GLAC), and minimum required equity liabilities (MREL). It is also possible to offer more equity to creditors with a deeper haircut. See: BRRD.

79 Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010, OJ L 225, 30.7.2014, 1–90.

80 For more details, see: Tanzer, 2012.

The BS,[81] carrying out the tasks of the Bank Resolution Authority, governs resolution planning procedures and measures to force winding-up procedures.[82] The BS ensures the immediate availability of funds to finance compulsory liquidation measures for a single bank.[83] It also provides a mechanism for collecting and transferring contributions from banks established in the Republic of Slovenia to the Single Resolution Fund, in accordance with Regulation EU No 806/2014 of the European Council and the Agreement on the transfer and reciprocity of contributions under the Single Resolution Fund (Regulation 2010, 2012, 2013, 2014).

2.5. Slovenia as a Eurozone Member State

In 2013, Slovenia transferred bad banking claims to a bad bank. According to bad banks' best practices, bad banking claims should be transferred at the beginning of a recession. The Law on Measures to Strengthen the Stability of Banks (ZUKSB) and the Law on Banking (ZBan1, ZBan2, and ZBan3) were consistent with the criteria for transferring bad banking claims to bad banks in the ECB and EC guidelines. However, unlike the EU's terms, banks in Slovenia were mostly owned by the state. Therefore, Slovenia entered the recapitalisation process as an owner rather than a state.

The practice and trends in the euro area reflect the increased role of central banks in guiding banks in restructuring and other supervisory measures that interfere with financial stability. Alternatives to strengthen financial stability in light of good foreign practice (e.g. setting up banks or other capital participants to cover losses, transferring the bad banking claims of the special purpose vehicle (SPV), selling claims at a discount, transferring claims to a revitalisation centre within a bank, and transferring banks' assets/liabilities to SPVs, contractually settling creditor-debtor relationships in banks, and debt/equity swaps) arose from the criteria of transferring the bad banking claims in accordance with economic logic in terms of the supervisory function of the central bank and the necessary strengthening of banks' capital.

However, it is essential that banks first recognise losses and cover them against existing or available capital and subordinated debt. By eliminating bad claims and identifying banks' capital needs (based on an appropriate valuation of assets and market value), measures (e.g. disinvestment, reducing costs, improving bank governance and organisation, revitalising debtors) aimed at improving financial

81 ZRPPB – Zakon o reševanju in prisilnem prenehanju bank, Official Gazette No. 97/14, 91/15, 44/16, 71/16, 92/21; ZOSRB – Zakon o organu in skladu za reševanje bank, Official Gazette No. 97/14, 91/15, 44/16, 27/17.

82 This law transposes Directives 2001/24/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EC into Slovenian law. BRRD.

83 ZRPPB and ZORSB do not apply to The Law on the Slovenian export and development bank (ZSIRB – Zakon o slovenski izvozni in razvojni banki, Official Gazette No. 20/09.).

stability contributed to banks' long-term capacity to support the economy with national savings (their primary function).

Such good practices further confirm that the measures pertaining to financial stability also have a precise timeline (three to five years) for the state's disinvestment and exit from the bad bank (in Slovenia, the DUTB). This timeline has proven to be too short for the financial restructuring of the assets transferred to the bad bank in Slovenia, and was therefore prolonged (this was done through the Law on Measures to Strengthen the Stability of Banks 2017, 2020).

We must not ignore the fact that problems exist within the real sector in Slovenia. Foreign practices have demonstrated that bad banking claims could not be transferred to the agency without simultaneously engaging in remediation in the real sector. Foreign examples of good practices (e.g. in Sweden, Securum and Retriva) point to the best use of the transfer of bad banking claims to bad banks in cooperation with the banks. The success of Sweden's Securum and Retriva was greatly influenced by their ability to acquire skilled experts in managing (bad) claims as well as specialists with industry-specific knowledge in restructuring and refining bank business models. After more than ten years, Securum and Retriva were completely sold off to strategic investors. Notably, corporate debts were transferred from banks to Securum and Retriva during the initial period of the crisis, which was unfortunately not the case in Slovenia in 2013.[84]

In addition to the endogenous crisis in Slovenia, we cannot discuss a 'balance sheet recession' in which the debt/EBIT ratio decreases; this did not apply in Slovenia. Corporate indebtedness can decrease only with positive growth in revenues and profits, a condition that is unattainable during a recession. Consequently, it is difficult to manage the crisis. The average coverage of banking claims from insolvency procedures was estimated to be approximately 50%. Since there were no strategic investors interested in buying insolvent companies, the recovery of bad banking claims was difficult in Slovenia.[85]

It is important not to ignore that (i) countries in which the majority of systematically important banks were state-owned did not start bank recoveries because they did not want to recapitalise them; (ii) these countries felt it was more important to try to save companies by transferring bad debts (bad banking claims); and (iii) when a state replaced non-performing loans with bank bonds in situations in which the state was not the sole owner or guarantor of the non-performing loans, the state increased the capital of other owners.[86] In the case of the recapitalisation of banks in Slovenia in 2013, subordinated bonds were deleted because the banks' capital was assessed as negative However, it must be said that their valuations of loan collateral

84 For more details, see: Festić, 2013.

85 For more details, see: Festić, 2011.

86 See: Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132, OJ L 172, 26.6.2019, 18–55.

change depending on whether the economy is doing well or poorly. Thus, excess impairments (and provisioning for loan losses) created in bad times can be released in good times, increasing banks' extraordinary revenues. These revenues from the released impairments should first be used to repay state aid and then deleted subordinated bonds, regardless of the bank's current ownership.[87]

In the case of Slovenia, the law on the recovery resolution and compulsory winding-up of banks (ZRPPB), which was already in force in 2015, was not respected when state-owned banks were sold (in a "fire-sale") with the clause that holders of subordinated bonds would be repaid by the state Thus, the issue of deleted holders of subordinated bonds remains open to the European Court as the country did not reach a settlement agreement on the reduced share of the value of the deleted subordinated bonds in 2013.

2.6. Slovenia's monetary policy tools and their efficiency in the Eurozone

A notable macro-prudential instrument in this context is the gross loan-to-deposit flow ratio (GLTDF), which reflects annual changes in the balance of gross loans to the non-banking sector before considering impairments and annual changes in the position of non-bank sector deposits. Banks with a positive annual increase in non-bank sector deposits were recommended to have a negative annual increase in loans to the non-banking sector. The instrument was introduced in June 2014 to slow the dynamics of the reduction in the loan-to-deposit ratio in the banking sector. The GLTDF remained in force to prevent the excessive use of unstable wholesale financing. Credit activity notably declined due to reduced demand for credit given the deterioration of economic conditions during the COVID-19 pandemic.[88] In the context of declining demand for loans, the instrument was limited to asking banks to continue to renew the loans that companies were using to finance their current costs. In October 2021, Slovenia decided to terminate the GLTDF.

The decision on macro-prudential restrictions on consumer credit adapted the macro–prudential constraints already imposed by previous decisions; namely, the decision on macro-prudential restrictions on consumer lending and the decision on macro-prudential restrictions on consumer credit. This measure aimed to mitigate and prevent excessive growth in lending and leverage.[89]

Slovenia, as part of the Eurosystem, implemented non-standard measures from the financial crisis onwards and during the COVID-19 crisis to offer support to individual market segments. In August 2012, the Governing Council of the ECB adopted the Outright Monetary Transactions Program on Secondary Government Bond

87 See: Festić, 2011; Festić, 2013.

88 For more details, see: Brezigar et al., 2020.

89 Sklep o makrobonitetnih omejitvah kreditiranja prebivalstva (2022), Official Gazette No. 64/19, 75/20, 60/22 (valid till 30 June 2023); Sklep o makrobonitetnih omejitvah kreditiranja potrošnikov (2023), Official Gazette No. 60/22, 63/23; Sklep o določitvi zneska minimalne kreditne sposobnosti potrošnika (2023), Official Gazette No. 63/23.

Markets to ensure the proper transmission of monetary policy. Between Autumn 2014 and the end of 2018, the Eurosystem purchased debt securities through a securities purchase programme (specifically, the Asset Purchase Programme; APP), which was limited to the reinvestment of the principals of maturing securities from 1 January to 31 October 2019. To maintain favourable financing and prevent the negative impact of the pandemic on inflation trends, the Eurosystem also began implementing the Pandemic Emergency Purchase Programme in March 2020. Purchases included all eligible investment classes from the existing APP programme and certain short-term debt securities. The programme was continued until the end of March 2022 and the Eurosystem fully reinvested the principal amount of mature securities purchased under the APP programme until the end of February 2023; additionally, the principals of the maturing securities purchased under this programme will continue to be reinvested until at least the end of 2024.

The ECB increased interest rates for the first time at the end of July 2022. In its June report, it mentioned that high inflation posed a challenge to everyone. High price growth in May 2022, which was significantly driven by high energy and food prices, intensified due to the war in Ukraine. In 2022, the ECB began raising interest rates in the wake of the US Federal Reserve's own hikes. Ultimately, strong expansionary monetary policy, the start of easing and economic recovery, and disrupted supply chains and energy markets all contributed to inflation.

3. Conclusion

The establishment of the European Monetary Union required a long adjustment period during which economic policies were gradually unified and the macroeconomic environment became comparable. By increasing the integration of economies through uniform economic policies – particularly monetary policies – supply and demand shocks have become symmetrical. The comparability of inflation, interest rates, government debt, and the general government deficit established the conditions for lowering the exchange rate fluctuation interval.

Meanwhile, the adoption of the common currency eliminated exchange rate risks, while inflation increased after the introduction of the euro in countries that lagged slightly behind the leading euro area countries. Slovenia introduced Eurozone regulations and directives into national laws and thus established a comparable macroeconomic and banking environment.

Bank recovery took place in 2013 under state aid rules and European Commission requirements. As part of the Eurosystem, the Bank of Slovenia lost sovereignty over its monetary policy, while simultaneously establishing a commitment to the euro area's policy, thus becoming an equal member of the single currency area.

Slovenia's experience with the EU and euro area is positive, as the international production chain of value and exports requires greater integration of the economy in the monetary field, which is especially evident through a common monetary policy. This makes it easier to control inflation and comparable lending rates and is a sign of a comparable level of development and GDP structure. The integration process resulted in a comparable GDP structure, a single monetary and coordinated fiscal policy, and insignificant speculative capital flows, which further strengthened the potential for stable interest rates, export competitiveness, and national economic accumulation (savings), which can, in turn, finance Slovenia's own development.

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