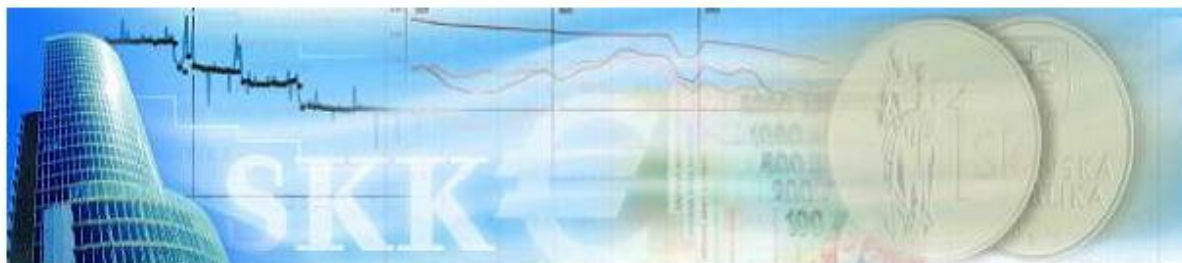




NÁRODNÁ BANKA SLOVENSKA

**MEDIUM-TERM FORECAST
(MTF-2007Q4)**

October 2007



Equilibrium variables, development of potential output

The medium-term forecast is based on the assumption that Slovakia is a converging economy, with corresponding equilibrium trends in its main macroeconomic indicators. The basic framework of the forecast is formed by the equilibrium real interest rates, the equilibrium real exchange rate, and non-inflationary growth in the economy (potential output). The long-term trends in the real monetary variables remained unchanged in the MTF-2007Q4.

Upward pressures on the increasing export performance continue to remain the basic assumption of the forecast. Compared with the previous forecast and referring to the current development in the first half of the year, the supply stimulus is expected in 2007 to be spread more evenly over the individual quarters. As a result, the growth of the economy's potential output in the first half of 2007 slowed down, while remained unchanged over the year. The revision of foreign trade and national accounts dated October 2007 is not incorporated in the forecast.

Foreign direct investments are still expected to have a positive impact on export performance in the medium term. Compared with the previous forecast, there is an unchanged assumption that the high growth in the economy's potential output (reaching approximately 9.0% in 2007) is likely to moderate in the coming years.

Current position of the economy¹

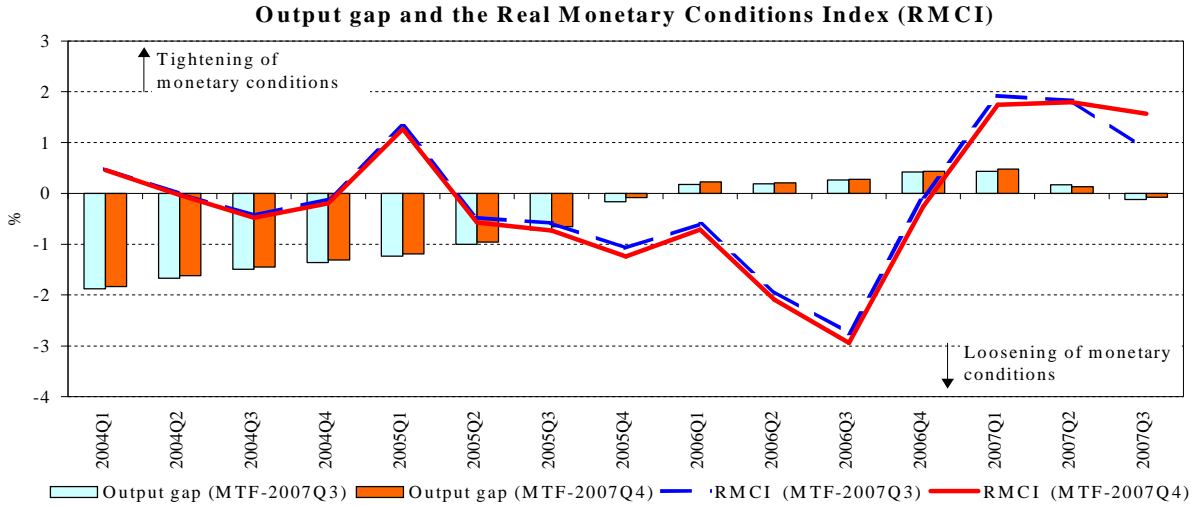
The estimate of the economy's current position is based on the estimated deviations of key macroeconomic indicators from their equilibrium trends. The impact of monetary policy through the Real Monetary Conditions Index (RMCI) in the third quarter of 2007 is still characterised by opposite developments in the individual components. The appreciation of the real exchange rate, which took place mostly through nominal appreciation, was faster compared with the assumptions on the equilibrium real exchange rate, thus maintaining its restrictive effect. The interest rate component of the monetary conditions remains somewhat below its equilibrium level. Despite the opposite effect of the interest rate component, the overall monetary conditions maintained their restrictive character in the third quarter of 2007, in line with the assumptions of the July forecast.

In the second quarter of 2007, real economic growth reached 9.4%, representing a slight drop compared with the NBS assumptions. The previous forecast was based on the assumption of a high foreign demand and a growth of the value added in the production of transport vehicles as well as in overall manufacturing production. In the second quarter of 2007, foreign demand grew in real terms by 18.0% and net export contributed 3.4 percentage points to GDP growth. The value added in manufacturing production saw a double-digit growth also in the second quarter of 2007, while the value added in the production of machinery, electrical equipment and transport vehicles increased by more than 30% in constant prices. In line with the July forecast, the structure of domestic demand reflected the pro-growth effects of all its components, which effects were in fact slightly decreased through the statistical discrepancy.

As for real economic development in the third quarter of 2007, the persistent strong foreign demand, with a year-on-year growth similar to that of the second quarter of 2007, should be again the most significant factor. The value added in the production of transport vehicles as

¹ The current position of the economy refers to its state in the third quarter of 2007 (according to a GDP growth estimate), upon which the short-term as well as medium-term forecasts are based.

well as in overall manufacturing production should still see a double-digit growth. The Slovak economy is expected to reach rapid growth at constant prices in the third quarter of 2007.



Actual and projected GDP figures for the third quarter indicate that the economy is close to its potential output level (0.1% in the second quarter of 2007, -0.1% in the third quarter of 2007). Similarly to the previous medium-term forecast, the economic cycle is not opening substantially because the cyclical gap is expected to be closed in the third quarter of 2007. The cyclical position of the economy in 2007 is greatly influenced, among other factors, by restrictive monetary conditions.

The growth in nominal and real wages in the second quarter of 2007 was in line with that expected by the NBS in the July forecast (6.7%). The highest growth in nominal wages in the second quarter of 2007 was recorded in health care, mining and quarrying, agriculture and transport, storage, posts and telecommunications. The nominal wages should continue to grow dynamically also in the third quarter of 2007, which is also indicated by preliminary data on wage developments in the selected sectors in July and August. The growth rate is expected to be higher compared with the second quarter (as according to the previous forecast). In the third quarter of 2007, real wage growth is likely to accelerate as a result of higher nominal wage growth expectations. In the second quarter of 2007, real wage growth lagged behind the real labour productivity, and the same development is expected also in the third quarter of 2007.

Employment (ESA 95) continued to grow dynamically on a year-on-year basis in the second quarter of 2007, while its development was in line with the MTF-2007Q3. The growth in employment should also continue in the third quarter of 2007, namely at a rate corresponding to that of the second quarter of 2007 and to the MTF-2007Q3. In the second quarter, the growth in employment according to the Labour Force Sample Survey was slower than assumed by the NBS, particularly as a result of a slower growth in the number of persons working abroad. Compared with the July forecast (MTF-2007Q3), in the third quarter of 2007 a slightly lower growth is expected in employment according to the Labour Force Sample Survey.

The balance of payments on current account for the first half of 2007 resulted in a deficit of SKK 32.7 billion, representing a year-on-year decrease by SKK 21.4 billion. This was mainly the result of a smaller trade balance deficit and, to a lower extent, of a smaller deficit in the balance of income. The other two current account components deteriorated in comparison with the same period of 2006. In line with the NBS expectations in the MTF-2007Q3, the trade balance improved substantially on a year-on-year basis, mainly as a result of the growing participation of newly established foreign direct investments. This was reflected in the high growth rate of exports. As a result of favourable developments in export performance, it was possible to slightly exceed the expectations of the NBS in the previous forecast concerning the estimated volumes of both the export and the import. As regards the export, the higher volumes might partly result from possible stocking-up of some companies.

The smaller year-on-year deficit in the current account balance of payments impacted on the development of its share in GDP which decreased, in comparison with the same period of 2006, by 3.2 percentage points to 3.8% in the first half of 2007. Similarly, an improvement in the development of this indicator by 4.2 percentage points to 0.7% was recorded in the balance of trade.

Despite the worse development in the trade balance in the second quarter of 2007 (compared with MTF-2007Q3), the estimated deficit of foreign trade is slightly reduced in the third quarter. With regard to the fact that a part of imports in the second quarter was very likely of a stocking-up nature, lower imports might be recorded in the following months and they might have a favourable effect on the balance of trade. The favourable effect of reduced imports of semi-finished goods should be partly mitigated in the third quarter by higher oil prices that might lead to an increased import of raw materials.

As expected, consumer prices recorded another slowdown in the year-on-year average rate of growth in the third quarter of 2007 (to 1.4%). Compared with the previous forecast (MTF-2007Q3), the level of inflation in the third quarter of 2007 was lower, mainly due to the slower-than-expected dynamics of the prices of foodstuff and industrial goods excluding energy. Despite the lower-than-expected increase in food prices, the risk of a higher growth rate started to manifest itself in September in the prices of certain commodities (bread and cereals, milk and dairy products, meat) in consequence of a significant increase in the prices of agricultural commodities. A faster rate of growth, compared with the assumptions of the MTF-2007Q3, was recorded with the prices of services. As regards the service prices, acceleration was recorded in the growth rate of the prices of services related to housing, transportation, recreation, and personal services. As regards the prices of industrial goods excluding energy, the exchange rate appreciation at the turn of 2006-2007 and in the first months of 2007 continues to manifest itself only to a minimum extent, and the growth rate of the prices is more or less stable and comparable with the previous years.

Year-on-year growth rate of prices and exchange rate in %

	SKK/EUR	Tradable goods excl. fuel* (Industrial goods excl. energy**)
2006 Q2	-3.1	-0.7 (0.2)
2006 Q3	-2.1	-0.4 (0.9)
2007 Q2	-10.5	0.0 (-1.1)
2007 Q3	-11.3	0.0 (-1.6)

* HICP in CPI structure

** including the effect of regulated pharmaceutical products whose prices were increasing in 2006 on a year-on-year basis and decreasing in 2007 as a result of

a lower VAT and methodical change (elimination of the product with higher extra payments for discontinuation of production and sale for the product with lower extra payments)

BOX

Risks in prices of goods and services (pass-through effect (PTE) and Ballassa-Samuelson effect (BSE))

Pass-through of the exchange rate in consumer prices ranks as one of significant risks of the inflation development in the medium and short run. In the last quarter of 2006 and in the first half of 2007, significant appreciation of the exchange rate was not reflected in the inflation development, which fact is most evident in the prices of tradable goods excluding fuel. Timing and strength of the impact of the above-mentioned significant exchange rate appreciation on inflation seems to be the risk of forecast.

The significant exchange rate appreciation dated 2007 is not expected, within the current forecast, to be reflected with a shift in time in the 2008 inflation development (in the majority of pass-through models the effect of depreciation and/or appreciation will manifest itself in about 8 quarters). Pass-through of the exchange rate may thus represent a downward risk. It is assumed that the exchange rate appreciation in 2007 was understood to be a temporary one. This may also be influenced by the effort of retailers to exploit opportunity for increasing their profits or for covering costs incurred in connection with the euro introduction before the exchange rate is fixed. There is a risk that, in consequence of a longer shift in time, the appreciation of the first half-year will be reflected in inflation at the turn of 2007 and 2008. As a result, a more significant deflation in the prices of tradable goods and/or industrial goods excluding fuel might be reported. With regard to the fact that the tradable goods slow down the rate of their deflation, this scenario is not feasible for the time being.

With regard to the fact that the inflation development is to a certain extent influenced by the exchange rate, namely by its long-term strengthening, it is very likely that the price growth rate will slightly accelerate after the exchange rate fixation date. As a result, the year-on-year growth rate of tradable goods prices in the Slovak Republic should gradually approximate that of the euro area. This development will be reflected in other items of the consumer basket. Yet, considering the fact that there are also other elements involved, the impact of the exchange rate is not so remarkable.

The current forecast is inclusive of the results of the PTE and BSE analyses. Compared with the previous forecast, a slight acceleration was observed in the growth rate of the prices of industrial goods excluding energy. With regard to the method of regulation (once a year), the appreciation should manifest itself within regulated prices in determining the 2008 prices. Therefore, a zero increase in gas prices in 2008 is expected by the NBS despite the increased price of this commodity. At the same time, the medium-term forecast is reflective of the impact of BSE on consumer prices (approximately 0.7 percentage points).

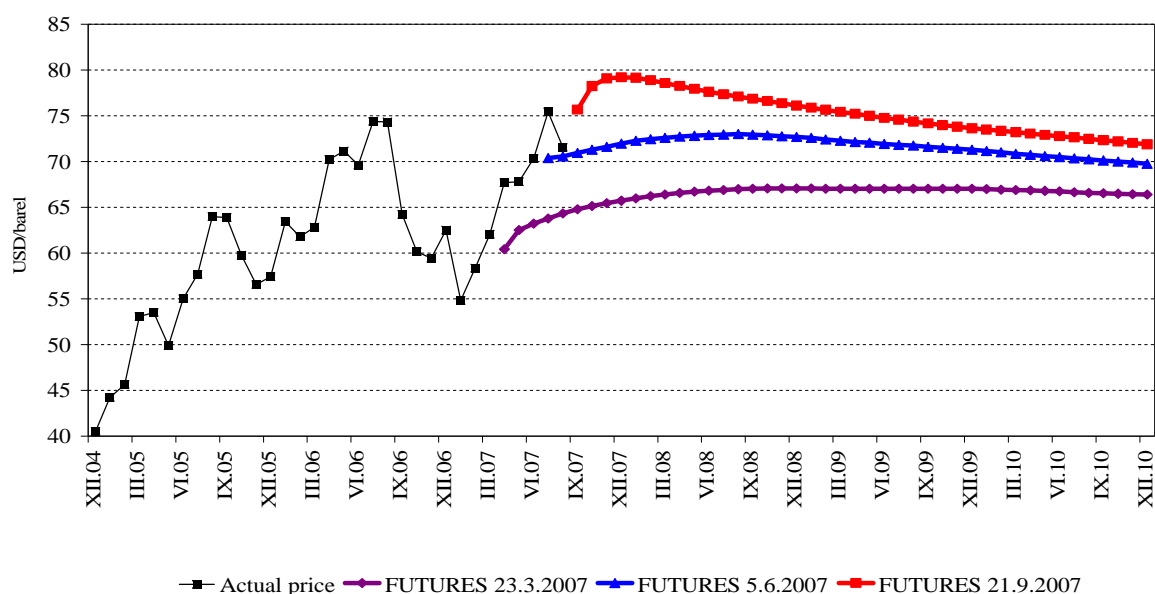
Medium-term forecast

External environment

The forecast of exogenous indicators was based on the September issue of the Consensus Forecasts (CF)². The expected developments in oil prices are based on the prices of futures as of 21 September 2007.

Compared with the MTF-2007Q3, the oil price forecast assumes a shift to higher levels for the entire projection horizon, with the maximum to be reached at the turn of 2007-2008. The growth rate of oil prices in 2007 is higher in comparison with the previous forecast. In 2008 the prices are expected to drop more significantly on a year-on-year basis (however, the average annual level will grow).

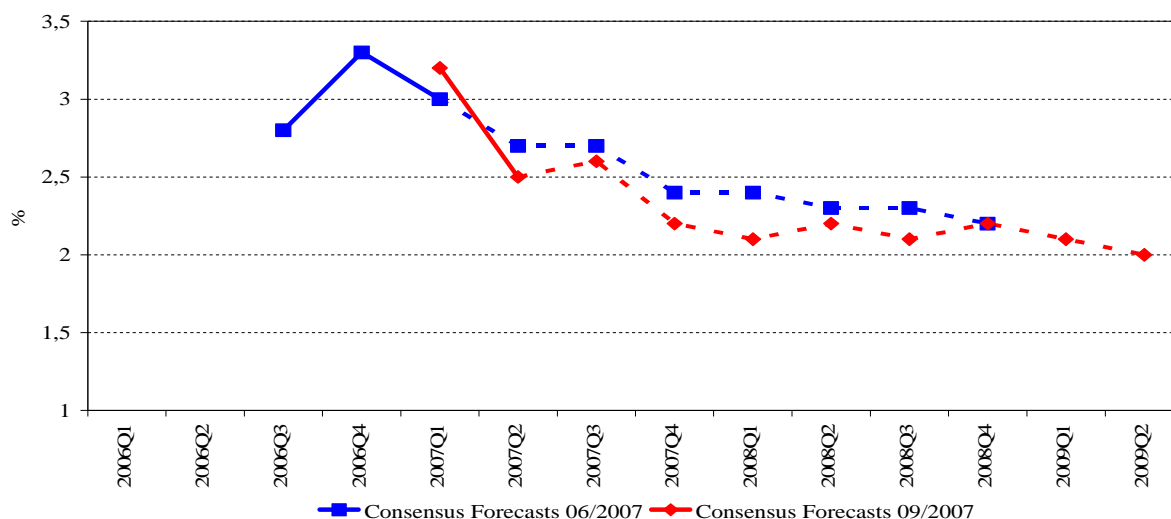
Expected oil prices



Compared with the MTF-2007Q3, the euro area GDP growth based on the CF 09/2007 is lower throughout the projection horizon by an average of 0.1 percentage points.

² A survey of forecasts made by international economic and financial institutions, from which an average is calculated. This ensures the most unbiased estimate of the trends in foreign sector indicators. With regard to the course and schedule of forecasting at the NBS, the values of input variables were obtained from the Consensus Forecasts of September 2007 and fixed at these levels throughout the forecasting process. Any new information will be taken into account in the next medium-term forecasts.

Euro-area GDP growth forecast based on the Consensus Forecasts



The estimated development of the euro area price growth should approximate in 2007 a 2008 the ECB target of 2%. Compared with the MTF-2007Q3, only a slight change was recorded in the inflation development profile and at the end of 2008 inflation is expected to reach the previous forecast levels. Food prices that might bring about higher inflation in the short run seem to pose a risk for the euro area inflation.

Compared with the previous forecast, short-term interest rates EURIBOR are expected to slightly rise to 4.4% as early as in the fourth quarter of 2007 and to maintain the same level also in 2008.

	2006	2007	2008	2009
Euro area inflation in %				
CF 06/07 (annual average)	2.2	2.0	2.0	2.1*
CF 09/07 (annual average)	2.2	2.0	2.0	2.0*
Euro area GDP growth in %				
CF 06/07	2.8	2.7	2.3	2.0*
CF 09/07	2.9	2.6	2.2	2.0*
Oil prices in USD/barrel and EUR/barrel, respectively				
5 June 2007	66.2/52.9	67.2/50.3	72.8/54.6	71.9/54.3*
21 September 2007	66.2/52.9	70.0/51.8	77.6/57.0	74.7/55.9*
Interest rates (3-month EURIBOR) (end of the relevant quarter)				
CF 06/07	3.725 (Q4)	4.3 (Q3)	4.5 (Q2)	4.2* (Q4)
CF 09/07	3.725 (Q4)	4.4 (Q4)	4.4 (Q3)	4.2* (Q4)
USD/EUR exchange rate (end of the relevant quarter)				
CF 06/07	1.317 (Q4)	1.352 (Q3)	1.338 (Q2)	1.323 (Q2)
CF 09/07	1.317 (Q4)	1.377 (Q4)	1.356 (Q3)	1.330 (Q3)

* NBS forecast

A slightly weaker economic growth in the euro area, in comparison with the previous projection, should not affect the Slovak economy. Compared with the previous forecast, upward pressures on inflation are expected from higher oil prices, while these pressures should be moderated by the US dollar which is expected to be weaker.

Forecast for 2007

The year-on-year growth rate of HICP inflation is expected to accelerate to 1.6% by the end of 2007, while inflation should continue to remain below the inflation target set for this year (2%). The higher headline inflation forecast in comparison with the MTF-2007Q3 (by 0.1 percentage points) may mainly be ascribed to expectations of more significant increases in food prices where the development in agricultural commodities prices should be reflected. It particularly refers to the prices of processed foodstuff (namely in the prices of flour, bread and bakery products) as well as to the prices of meat and dairy products. Weaker rates of growth in comparison with the previous forecast are expected with the prices of industrial goods excluding energy where the absence of increases in pharmaceutical product prices in the third quarter of 2007 was reflected (referring to the actual development, the MTF-2007Q3 predicted quarterly increases in prices). Based on the current forecast, the prices of pharmaceutical products should change no more than twice a year (in April and in October), while the pharmaceutical product price growth in these periods is envisaged in the MTF-2007Q4.

Higher growth rate in comparison with the MTF-2007Q3 should be recorded with energy prices where a more significant year-on-year increase in fuel prices resulting from the latest development in oil prices and Brent oil futures should be reflected. At the end of the year, there should be reflected in energy prices the base effect of the increase in the prices of natural gas and heat in the same period of the last year. As a result, the growth rate of energy prices should slow down.

As a consequence of these factors, the rate of headline inflation should speed up and it is likely to remain until the end of 2007 at higher levels than predicted in the previous forecast (MTF-2007Q3). At the end of 2007, HICP inflation is expected to reach 1.6% (1.7% as the average annual rate).

In the real GDP growth forecast for 2007, the overall growth rate is expected to remain unchanged in comparison with the July forecast. The final household consumption projection was increased by 0.1 percentage points in consequence of a slightly faster-than-expected rate of growth in the first half of 2007, with unchanged expectations concerning the key labour market indicators.

The gross fixed capital formation predicted for 2007 is lower by 0.4 percentage points (at the same time, there was increased contribution of the change in inventories) owing to the reviewed assumptions concerning the reclassification of investment imports to fixed investments (also with regard to the development in the second quarter of 2007).

Compared with the July forecast, the contribution of net export should be slightly higher in 2007.

With regard to the actual developments in nominal wages which did not differ markedly from the expectations of the NBS and with regard to the unchanged forecast of the other

macroeconomic indicators, the NBS foresees no change in the rate of nominal wage growth (7.2%) in the MTF-2007Q4, compared with the July forecast. The NBS based its assumptions on wage developments in the second quarter of 2007, when the risk of pass-through of the faster labour productivity growth to wage growth was not confirmed. This assumption, however, remains as a risk in the forecast due to the fact that there has been a disproportion for a long time between the wage development and the dynamic development in the labour productivity. Real wage growth is expected to be somewhat slower in comparison with the previous forecast due to a steeper rise in consumer prices.

In 2007, employment (ESA 95) should continue to grow and, with regard to the actual development in the second quarter of 2007, its rate of growth should be the same as that predicted in the July forecast (2.0%).

The risk identified in the July forecast (MTF-2007Q3) in connection with the labour market pressures in the building, automotive and electrotechnical industries was not markedly reflected in the current development of the labour market. The growth of nominal wages in these industries did not differ significantly from the previous periods' trends. This assumption still remains a risk in the current forecast (MTF-2007Q4) throughout the projection horizon.

The number of the unemployed in the second quarter of 2007 corresponded to that predicted by the NBS. Therefore, the MFT-2007Q4 predicts no change in the 2007 unemployment rate in comparison with the previous forecast (10.9%).

The balance of payments on current account in the first half of 2007, as well as the new assumptions concerning the development of oil prices affecting the current account, provided a basis for changes in the values of current account components predicted for 2007.

The foreign trade forecast for 2007 is based on the actual trade balance developments. Over the first half of 2007, exports continued to grow at a high rate (the year-on-year growth of 21.1% was recorded in export from January to June 2007), while the achieved rate of growth slightly exceeded the NBS expectations. This fact is reflected in the higher export volumes in 2007, mainly in the increased machine exports. With regard to the existing import intensity, the growth in exports led to higher import expectations. The rise in imports in the first half of the year can also be ascribed to the possible stocking-up of certain businesses, which fact might be partly reflected in the second half of the year in a lower-than-previously-expected import of semi-finished goods. The exports and imports of raw materials in 2007 are expected to be higher than predicted in the previous forecast, due to the anticipated rise in oil prices.

With regard to a higher-than-expected deficit of foreign trade in the first half of the year, as well as to due to the expected developments of oil prices in global markets, the deficit expectations in 2007 were increased in the trade balance forecast by SKK 2.3 billion to SKK 37.3 billion.

A more favourable development in the balance of other services in the second quarter of 2007 is the main reason for a higher-than-previously-predicted surplus of services balance in 2007. Compared with the previous forecast, the services balance surplus was increased by SKK 1.6 billion to SKK 18.7 billion.

Only a slight adjustment in comparison with the previous forecast was made in the total income balance deficit projection. The existing developments in receipts, factored in within

the balance of investment income, with other assumptions being unchanged, were reflected in the overall deterioration of the income balance deficit estimate by SKK 0.2 billion to SKK 2.5 billion.

With the new assumptions concerning the amount of drawings from EU funds being factored in, the estimate of the current transfers balance deficit was slightly improved. On the basis of the latest estimates, the projected current transfers balance deficit was decreased in 2007 by SKK 0.4 billion to SKK 2.1 billion.

The changes in the estimates of individual current account components led to an increase of approximately SKK 0.6 billion in the deficit projected for 2007; the share of the current account deficit in GDP remained unchanged (4.7% of GDP). Compared with the previous forecast, the degree of the openness of the economy was slightly increased to 175.0%.

The current forecast concerning the current account is exclusive of the revision of foreign trade data because the values of the revised GDP were not available at the time of the forecast preparation. Therefore, in terms of the forecast consistency, it was impossible to take account of the methodical change only in one macroeconomic indicator.

With regard to the actual development, there was maintained in the balance of foreign direct investments the estimated inflow of foreign direct investments in the form of equity capital and reinvested profit. On the contrary, the higher amount of loans provided to foreign parent companies within the current development of 2007 was reflected in a reduced estimate of the inflow of foreign direct investments in the form of other capital. The lower inflow of foreign direct investments in the form of other capital was partly offset on the asset side where the expected lower interest of the Slovak enterprises in investing abroad, in the form of foreign direct investments, had a slight dampening effect on the inflow decrease of total foreign direct investments compared with the previous forecast.

Forecast for 2008 and 2009

The current medium-term forecast foresees a year-end inflation rate of 2.3% in 2008 (an average of 2.3%), followed by an acceleration to 2.8% in 2009 (an average of 2.7%). Compared with the MTF-2007Q3, the current medium-term forecast predicts higher inflation figures for 2008 and 2009, namely by 0.3 percentage points in each year.

Within the basic structure of inflation, prices for goods and services are expected to show increased growth rates in 2008 compared with 2007. In 2008, the prices of services are likely to be slightly affected, as in the previous forecast, by somewhat higher cost impulses resulting from a faster rise in regulated energy prices anticipated in 2008. Besides regulated energy prices, inflationary pressures (stronger than in the MTF-2007Q3) are also expected from fuel prices which are likely to rise again on a year-on-year basis from 2008 onwards. The current forecast predicts an increase in the excise duty on cigarettes which should contribute 0.4 percentage points to the inflation growth in 2008.

Compared with the assumptions of the July forecast, the major contribution to the increased inflation forecast for 2008 should come from the faster growth of food prices (the effect of the development in agricultural commodities prices). With regard to the assumptions concerning the development in pharmaceutical products prices, a lower year-on-year drop should be recorded with the prices of industrial goods excluding energy. Fuel prices are expected to

grow faster. The contribution of changes in the excise duty on cigarettes is likely to be higher than predicted in the previous forecast (approximately by 0.2 percentage points). On the contrary, a slightly slower growth in comparison with the previous forecast should be recorded with the prices of services.

In 2009, the prices of goods and services are expected to follow the trend from 2008. Goods prices are likely to be influenced in 2009 by the low imported inflation as a result of the openness of the Slovak economy and, after the euro introduction, by the simplified trading and price comparison. The acceleration in inflation in 2009 compared with 2008 should be primarily caused by factors outside the range of monetary policy. One of these factors is a further increase in the excise duty on cigarettes. According to the NBS calculations, the increased excise duty on cigarettes should contribute approximately 0.4 percentage points to headline inflation. The acceleration in inflation will also be influenced by the development in regulated energy prices as well as by the introduction of euro coins and notes (the so-called 'euro changeover effect'). In the current forecast, as a precaution, the same contribution from the euro cash changeover effect (0.3 percentage points) is expected.

Compared with the 2009 assumptions of the previous forecast (MTF-2007Q3), according to the current forecast the major contribution to the increase in the forecast should come from the faster growth rate of food prices, mainly as a result of the stronger impact of changes in indirect taxes (by 0.2 percentage points). Compared with the July forecast, the development in the prices of other foodstuff components should remain unchanged because no significant changes in agricultural commodities prices, as compared with 2007, are expected to take place. On the other hand, with regard to the Draft Energy Taxes Law, the introduction of such taxes is not expected to affect consumer prices; the estimate as per the MTF-2007Q3 was up to 0.1 percentage points. A more significant year-on-year decrease compared with the previous forecast should be recorded with fuel prices, which fact is attributable to the development in futures prices whose rate of growth slowed down in 2009 more substantially than predicted in the MTF-2007Q3. The growth rate of regulated energy prices is likely to be higher than projected in the MTF-2007Q3.

As regards energy prices, the 2007 slowdown in the year-on-year growth rate should be followed starting from 2008 by an acceleration resulting from both the increase in regulated energy prices and the development in fuel prices which are expected to grow on a year-on-year basis in 2008. According to the NBS assumptions, in 2009 the prices of energy should grow faster than in 2008. Regulated prices should be positively impacted by the 2007 exchange rate development no earlier than in 2008 (with regard to the method of regulation). Therefore, the central bank works on the assumption of the minimum increase in gas and heat prices in 2008.

According to the NBS assumptions, regulated prices (energy prices and other regulated prices) are likely to rise higher than predicted in the MTF-2007Q3, namely by an average of 2.4% and 3.2% in 2008 and in 2009, respectively. Their contribution to headline inflation should be approximately 0.7 percentage points and 0.91 percentage points in 2008 and in 2009, respectively. By the end of 2008, regulated prices should rise by 1.9%, contributing approximately 0.6 percentage points to year-on-year headline inflation. By the end of 2009, their year-on-year growth is expected to reach 3.6%, contributing approximately 1.05 percentage points to headline inflation.

Comparison of HICP inflation forecasts (year-on-year change in %, average for the period)

		2006	2007	2008	2009
TOTAL (HICP)	MTF-2007Q2	4.3	1.5	1.9	2.2
	MTF-2007Q3	4.3	1.7	1.9	2.2
	MTF-2007Q4	4.3	1.7	2.3	2.7

Comparison of HICP inflation forecasts (year-on-year change in %, end-of-year figures)

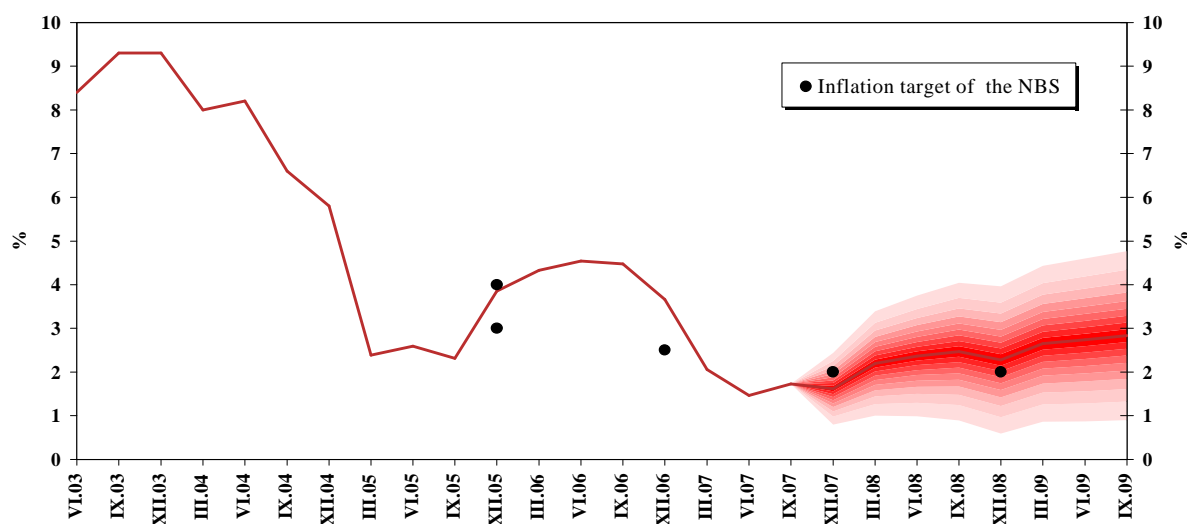
		2006	2007	2008	2009
TOTAL (HICP)	MTF-2007Q2	3.7	1.3	2.0	2.5
	MTF-2007Q3	3.7	1.5	2.0	2.5
	MTF-2007Q4	3.7	1.6	2.3	2.8

The inflationary risks include the developments in oil prices and the resulting impact on fuel prices and regulated energy prices, which may change the level of inflation rate in comparison with the current forecast (at the beginning of 2008 and 2009).

Food prices, which may be affected (more significantly than expected) by developments in the prices of agricultural commodities in the European market, also pose a persistent inflationary risk. At the same time, there is a risk that the prices of agricultural commodities will continue to grow in the future.

In the prices of services on one hand still persists the upward inflationary risk (at the same rate as according to the previous forecast) resulting from growing employment, wage growth, and household final consumption. A more significant growth resulting from the projected higher increases in regulated prices may be observed, as a secondary effect, with service prices.

HICP inflation forecast



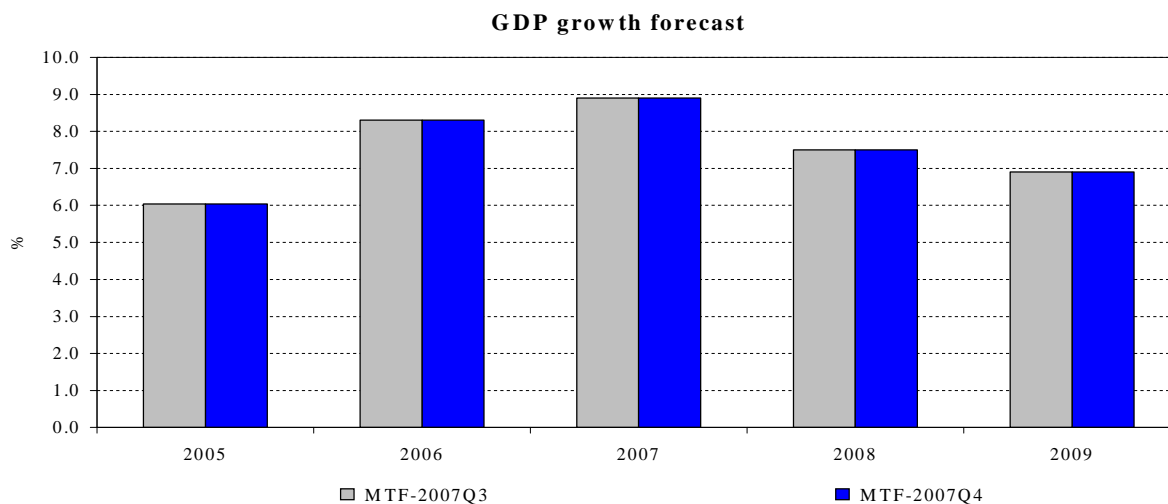
In the medium-term forecast of the real economy for 2008 and 2009, no adjustment is made in real GDP growth in comparison with the MTF-2007Q3 (7.5% in 2008 and 6.9% in 2009). Within the structure of domestic demand, all its major components are expected to have a growth-promoting effect in 2008-2009.

The household final consumption forecast is reflective of the favourable development in the labour market, and its growth rate remained unchanged in comparison with the MTF-2007Q3.

Developments in general government final consumption will be connected with the fulfilment of the general government budget, overall economic development, and drawings from the structural funds. Compared with the MTF-2007Q3, the government consumption forecast remained unchanged. An increased estimate of revenues in the upcoming years represents an upward risk.

Compared with the MTF-2007Q3, the gross fixed capital formation should remain unchanged in 2008 and 2009. The growth in fixed investments should be supported by the growing profits of companies, the stable business environment, and the planned entry of Slovakia into the euro area. In terms of their relative contribution to the year-on-year rate of GDP growth, inventories should have a dampening effect in 2008, as well as at the beginning of 2009, due to the start-up of production at the Samsung plant and/or growth in production at the PSA plant (the impact of stocking-up in the past, the impact of investment imports and their reclassification to fixed investments, and the expected impact of the realisation of finished products from inventories through export).

Similarly to the MTF-2007Q3, risks to the forecast (upwards) are still posed by the new investments, mainly in the power industry (a gas turbine power plant at Malženice, the construction of blocks 3 and 4 at the Mochovce nuclear power plant, a thermal power plant at Trebišov, and/or investments in renewable energy sources). Investments in the construction of highways through PPP projects represent a new upward risk.



The current medium-term forecast (MTF-2007Q4) predicts a slightly higher rate of nominal wage growth in 2008-2009 (0.3 percentage points every year), compared with the July forecast (7.1% in 2008, 7.6% in 2009), also in connection with average inflation which is expected to grow at a slightly higher rate. The assumption that there are pressures for faster wage growth, resulting from a possible shortage of qualified labour in the building industry, automotive industry and electrical engineering, remains a risk in the wage forecast for 2008-2009. At the same time, there is limited room for nominal wage growth due to the stronger foreign competition.

In 2008-2009, real wage is expected to growth by approximately 4.5% on a year-on-year basis. The growth in real labour productivity is likely to exceed the rate of real wage growth throughout the projection horizon.

The medium-term forecast (MTF-2007Q4) predicts the same growth in employment (ESA 95) as the previous forecast (1.7 in 2008, 1.4% in 2009). Over the projection horizon, the main factors in employment growth should continue to be investment and demand for services.

The unemployment rate (based on an LFSS) is likely to show a gradually falling tendency in 2008-2009 and should be in line with the MTF-2007Q3 (9.6% in 2008, 9.4% in 2009).

Within the current account balance, the economy is expected to maintain its strong export performance in 2008 and 2009, with the rate of export growth exceeding the 10% level in both years (in line with the previous forecast). FDI companies are expected to maintain their profound influence over the entire projection horizon, while exports should grow most dynamically in the automotive and electrical engineering industries. Exports should be positively influenced by a higher-than-previously-expected export performance of the economy in the first half of 2007, which might lead to sufficient acceleration in the rate of export growth in the upcoming years. The import intensity of exporting companies should be mainly reflected in the growing imports of semi-finished goods and machines. In both years, the higher estimates of oil prices are expected to cause a slight increase in both exports and imports in comparison with the previous forecast.

The trade balance forecast is negatively influenced in both years by the assumption of a rise in oil prices. This development should be exceeded in both years by a positive impact of export performance supported in 2009 (as in the MTF-2007Q3) by the planned entry of Slovakia into the euro area. Due to the absence of transaction costs, exports are expected to be influenced largely positively; this influence should cause an improvement in the foreign trade balance in the long term. On the other hand, a negative impact on the trade balance in the period under review may be exerted by the possible (currently under consideration) construction of new nuclear and steam/gas turbine power plants, which may cause a temporary deterioration in the foreign trade balance through increased imports.

Compared with the previous forecast, the estimated development in the balance of services in 2008 and 2009 remained unchanged, contrary to the 2007 estimate. An improvement in the estimated balance of services in 2007 resulted only from the actual development in the balance of other services in the second quarter. With regard to the fact that the development in these services has been very volatile so far, such improvement is not regarded for now as being of a long-term nature.

The total income balance deficit projection was adjusted in 2008 and 2009, especially with a higher dividend payment estimate. An increasing deficit of income balance, resulting from the higher dividend payment estimate (on the basis of the expected higher growth in total profits of the companies with foreign participation) and only partly offset by the higher estimate of receipts from compensations of employees working abroad, brought about a deterioration in the income balance deficit estimate by more than SKK 4 billion in 2008 and by nearly SKK 9 billion in 2009.

Contrary to 2007, the estimated development in the balance of current transfers was affected in 2008 and 2009 by new assumptions of the Slovak Finance Ministry concerning the amount of EU drawings, negatively. Lower expectations concerning income from EU funds caused a decrease in the surplus of the total balance of current transfers, namely by SKK 1.9 billion in 2008 and by SKK 3.0 billion in 2009. A risk for the expected transfers balance surplus may be

posed by the actual amount of funds drawn from the EU which may affect the achieved balance of current transfers where fixed payments are made to the EU budget.

The current account deficit should decrease in line with the previous forecast. The changes in the estimates of its individual components led to a deterioration in the deficit predicted for 2008 and 2009 (by more than SKK 5 billion and SKK 9 billion, respectively) and to an increase in the current account deficit as share of GDP (by 0.3 and 0.4 percentage points to 3.4% and 1.9%, respectively). Compared with the previous forecast, the degree of economic openness was increased in 2008 by more than 1 percentage point to 180.4% of GDP (estimated value). In 2009 the estimate of the given indicator slightly deteriorated to 180.5% of GDP.

Contrary to 2007 when the inflow of foreign direct investments in the form of other capital was decreased on the basis of the actual developments, no changes are projected for 2008 and 2009 in the estimated inflow to Slovakia of foreign direct investments. Compared with the previous forecast, a slightly higher inflow of total foreign direct investments is estimated (on the basis of the actual developments) in both years due to the predicted lower interest of the Slovak enterprises in investing abroad in the form of foreign direct investments.

Compared with the previous forecast, changes in the development are envisaged in the current medium-term forecast neither in the real economy nor in the monetary policy setting. The estimated fast economic growth is supported by the increasing productive capacities, while there are minimum demand stimuli. The economy still is expected to produce at the level close to the full capacity and a slight pro-growth stimulus is expected in 2009 in connection with the country's entry into the euro area. However, due to inflationary cost pressures resulting from higher prices of foodstuff and energy, there is an increasing need for adopting prudent monetary policy in 2008 with the aim to minimize, if necessary, secondary effects of the price development.

