

Monetary Developments



2 Monetary Developments

In 2007, NBS implemented its monetary policy in an environment of dynamic economic growth and continued pursuing an inflation-targeting strategy under ERM II in line with its Monetary Programme for the Period until 2008. In view of the commitments arising from EU membership, the task to create conditions for the adoption of the single European currency in January 2009, and the commitment of the Government to reduce the fiscal deficit, NBS set a target rate for year-on-year inflation, expressed in terms of the Harmonised Index of Consumer Prices (HICP), below 2% for December 2007 and 2008, so that the Maastricht criterion for the average 12-month inflation rate is met.

At the end of 2007, HICP inflation stood at 2.5%, representing a slowdown of 1.2 percentage points compared with the end of December 2006. Since August 2007, inflation had been below the Maastricht inflation criterion. The inflation target of NBS for end-2007 was exceeded, due to steep increases in food and oil prices in the last quarter of 2007. However, these causes represented exclusively inflation cost factors, which were defined as escape clauses.

Economic and monetary developments in 2007 were characterised by dynamic GDP growth, reaching 10.4% at constant prices. In comparison with 2006, the pace of economic growth accelerated by 1.9 percentage points. The continuing strong GDP growth in 2007 was partly reflected in an increase in wages and employment, a decrease in the number of unemployed, labour productivity growth, and an improvement in the financial results of corporations (profit growth). The deficit in the balance of payments current account decreased in comparison with the previous year, due mainly to a year-on-year improvement in the trade balance.

During 2007, NBS changed the setting of its monetary policy by lowering its key interest rates in March and April by 0.25 of a percentage point, i.e. by a total of 0.50 of a percentage point. NBS also reduced its overnight sterilisation rate by 0.75 of a percentage point in March and by 0.25 of a percentage point in April.

Due to positive developments in the basic macroeconomic indicators, the central parity of the koruna

against the euro was revalued by 8.5% with effect from 19 March 2007. The new central rate was set at SKK 35.4424 per euro (originally SKK/EUR 38.4550), the lower compulsory intervention rate at SKK/EUR 30.1260 and the upper rate at SKK/EUR 40.7588.

2.1 Economic developments

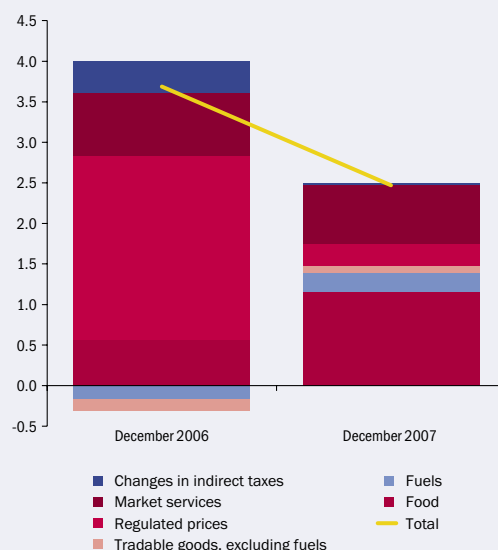
2.1.1 Price Developments

Consumer prices

Inflation as measured by the Harmonised Index of Consumer Prices

Consumer prices, expressed in terms of the Harmonised Index of Consumer Prices (HICP), had increased by 2.5% on year-on-year basis by the end of December 2007, representing a slowdown in dynamics of 1.2 percentage points in comparison with the end of 2006. The average inflation rate reached 1.9% in 2007 (compared with 4.3% in 2006), with the prices of goods and services rising by 1.4% and 2.9%,

Chart 13 **Structure of HICP inflation according to the breakdown of the national index (contributions to headline inflation by component) (p.p)**



Sources: Statistical Office of the SR and NBS calculations.



respectively. The year-on-year rate of core inflation (overall inflation, excluding energy and unprocessed food prices) averaged 1.9% in 2007 and was 0.2 of a percentage point lower than in the previous year.

In its Monetary Programme for 2005–2008 of December 2004, Národná banka Slovenska defined its monetary policy as inflation targeting in the conditions of ERM II. The main anchor of such monetary policy is the setting of an inflation target. For December 2007, the year-on-year inflation rate had been set at 2%, but the actual end-year figure was 0.5 of a percentage point above the target.

The inflation target was exceeded as a result of factors outside the control of monetary policy, i.e. global increases in food and energy prices, which were also reflected in the consumer prices of food and fuels in the last months of 2007. The year-on-year dynamics of oil prices expressed in Slovak koruna reached 25.7% in December 2007, and the average oil price was USD 72.5 per barrel in 2007 (forecast in the Monetary Programme of NBS until 2008, in which the inflation target was set, predicted USD 34.6/barrel for 2007). In 2007, compared with 2006, food prices were influenced by the prices of agricultural commodities in European and global markets in the second half of 2007, as a result of poor harvests in some countries and growing demand from Asian emerging economies. Raising demand as a result of bio fuel production increase was reflected in agro-commodity prices, too. The year-on-year increase in the prices of non-energy industrial goods was nearly in line with the expectations of the Monetary Programme of NBS until 2008, while services prices showed somewhat weaker dynamics.

All the listed factors were supply shocks in character and were on the list of exemptions from inflation target achievement, which are exactly defined in the Monetary Programme of NBS for the Period until 2008 and are as such beyond the scope of NBS's monetary policy. Hence, NBS focused first and foremost on the mitigation and/or elimination of the impact of second-round factors in order to prevent price contagion spreading to other components of the consumer basket.

Goods

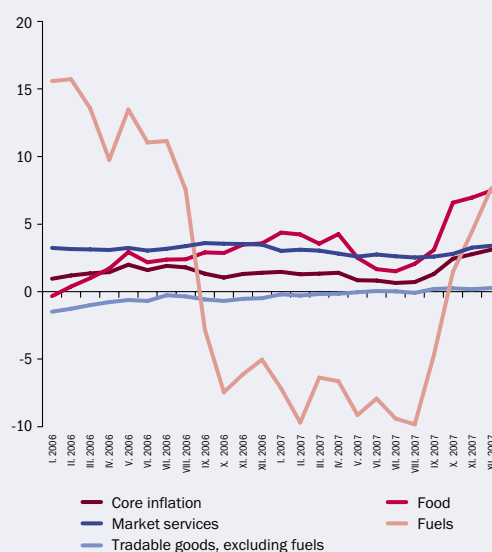
Energy prices had a dampening effect on the dynamics of goods prices in 2007, after acting as stimulants in the previous years. The average dynamics of regulated energy prices (electricity, gas, and other) weakened, from 14.9% in 2006 to 2.6% in 2007, as well as the dynamics of fuel prices, which recorded an average year-on-year fall of 4.9% in 2007 (compared with a rise of 5.5% in 2006). The prices of non-energy industrial

goods dropped by an average of 1.1 % in 2007, as a result of developments in the regulated prices of pharmaceuticals (VAT reduction from 19% to 10%, and the exclusion of an expensive medicament from production and its replacement in the consumer basket by a similar, but cheaper product). Even without this administrative measure, the average price of non-energy industrial goods would record a year-on-year fall in 2007, after a rise of 0.6% in 2006. Most exposed to the pressure of foreign competition was the sale of non-energy industrial goods, which recorded, despite the pronounced exchange rate appreciation in 2007 (by 9.3%), a much smaller year-on-year decline; this certifies that the exchange rate has a weak and limited influence on consumer prices. Within the structure of this sub-aggregate, the steepest increases occurred in the prices of semi-durable industrial goods (an average of 0.7%), while the prices of durable industrial goods dropped by 5.5%. Food prices rose by an average of 4.1%, due to increases in both processed and unprocessed food prices (4.7% and 3.0% respectively).

Services

In 2007, prices for services rose annually by an average of 2.9%, representing a slowdown in dynamics compared with 2006 (3.5%). The most dynamic increases were recorded in the prices of medical, dental, and financial services. However, these increases took place mostly in the last quarter of 2007. The dynamics of transport-related prices also accelerated (from 2.6% in 2006 to 3.8% in 2007). The only category of services to record a price fall was post and

Chart 14 Developments in the prices of core inflation components (year-on-year changes in %)



Source: Statistical Office of the SR.

Table 2 Consumer price developments in terms of HICP (average for the period)
(year-on-year changes in %)

	2006		2007				
	Dec.	Year	Mar.	June	Sep.	Dec.	Year
Total	3.7	4.3	2.1	1.5	1.7	2.5	1.9
Goods	4.0	4.6	1.7	0.9	1.0	1.8	1.4
Industrial goods	3.9	6.0	0.4	-0.1	-0.1	-0.2	0.0
Non-energy industrial goods	1.1	0.6	-0.4	-1.1	-1.4	-1.2	-1.1
Energy	7.4	13.1	1.5	1.2	1.8	1.2	1.3
Food	4.1	2.3	4.1	2.8	3.0	5.8	4.1
Processed food (including alcohol and tobacco)	3.5	1.4	3.9	4.5	3.8	7.4	4.7
Unprocessed food	5.3	4.0	4.4	-0.1	1.3	2.6	3.0
Services	3.1	3.5	2.8	2.6	3.2	3.7	2.9
Core inflation (excluding energy and unprocessed food prices)	2.5	2.1	1.9	1.7	1.8	2.8	1.9
Total, excluding energy	2.8	2.3	2.2	1.5	1.7	2.8	2.0

Source: NBS calculations based on data from the Statistical Office of the SR.

telecommunications, where prices dropped during the year by an average of 0.3%.

Inflation as measured by the national Consumer Price Index

Consumer prices had increased year-on-year by 3.4% by the end of December 2007, representing a slowdown in dynamics of 0.8 of a percentage point compared with the end of 2006. As a result of a steep

rise in prices for housing-related services (house maintenance services and imputed rent increases), consumer prices expressed in terms of the CPI ended the year 2007 with a larger year-on-year increase than the HICP (by 0.9 of a percentage point). The average rate of CPI inflation in 2007 reached 2.8% (compared with 4.5% in the previous year).

In 2007, the year-on-year dynamics of consumer prices weakened in comparison with the previous year, due mainly to a slowdown in regulated prices.

Table 3 Consumer price developments (year-on-year changes)

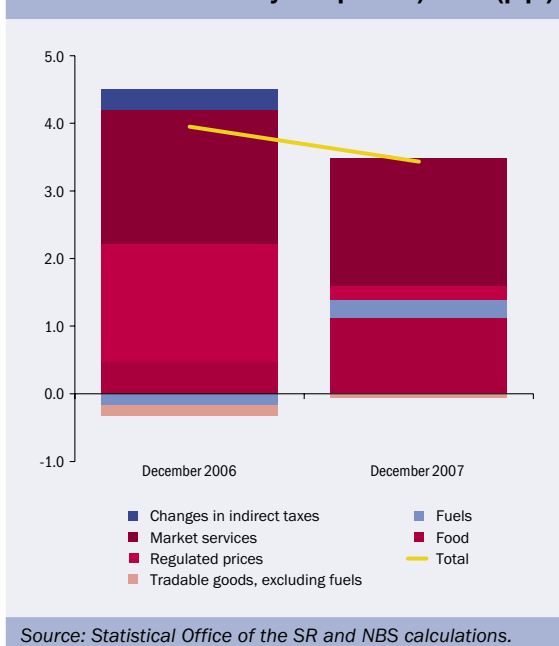
	2006		2007				
	Dec.	Year	Mar.	June	Sep.	Dec.	Year
Total in %	4.2	4.5	2.7	2.5	2.8	3.4	4.5
Regulated prices in %	7.5	10.5	2.3	1.5	2.1	0.9	1.7
<i>Impact of changes in indirect taxes on non-regulated prices – share of total in percentage points</i>	0.31	0.13	0.23	0.23	0.05	0.00	0.15
Core inflation in %	2.7	2.5	2.5	2.5	3.0	4.2	2.9
of which:							
Food prices in %	3.0	1.5	2.9	2.0	3.8	8.0	4.0
Tradable goods in % ¹⁾	-1.0	-0.1	-0.8	-1.0	-0.6	0.6	-0.7
Tradable goods, excluding fuels in % ¹⁾	-0.5	-0.8	-0.2	-0.2	-0.1	-0.2	-0.2
Fuels in %	-5.1	6.0	-6.4	-7.9	-4.7	7.6	-4.8
Market services in % ¹⁾	7.3	6.5	6.6	7.1	7.0	6.8	6.8
Net inflation (excluding the impact of changes in indirect taxes)	2.7	2.8	2.4	2.6	2.8	3.4	2.6
Net inflation, excluding fuels (excluding the impact of changes in indirect taxes)	3.2	2.6	3.0	3.3	3.3	3.1	3.1

Source: Statistical Office of the SR.

1) NBS calculations based on data from the Statistical Office of the SR.



Chart 15 Structure of CPI inflation (contributions to headline inflation by component) (p.p.)



Source: Statistical Office of the SR and NBS calculations.

Price levels in 2007 were determined mostly by external factors. Price developments were influenced by the global trends in commodity, oil, and energy prices, which, in turn, were reflected in regulated price changes and in fuel and food prices development. The rise in price level was mainly caused by increases in prices for market services (especially house maintenance services and imputed rents). The prices of tradable goods recorded an acceleration in the year-on-year rate of decline. This resulted from a marked year-on-year drop in fuel prices, despite a slowdown in the year-on-year decline in the prices of tradable goods, excluding fuels, at a time when the exchange rate strengthened to a significant extent.

Regulated prices

One of the determining factors in consumer price developments was, as in previous years, the adoption of administrative measures in the area of regulated prices. The year-on-year dynamics of regulated prices reached an average of 1.7% in 2007 (compared with 10.5% in 2006). Slowdown took place mainly in energy prices (heating, gas, electricity). Regulated prices reflected the impact of a VAT reduction for pharmaceuticals, from 19% to 10%, with effect from January 2007.

Changes in indirect taxes

In 2007, non-regulated prices were not affected by any changes in indirect taxes. In the first half of

2007, their year-on-year dynamics were influenced by the increase in excise taxes on tobacco and tobacco products from 2006 (0.15 of a percentage point of the year-on-year average CPI inflation rate).

Core inflation

In 2007, core inflation reached an average of 2.9%, representing a rise of 0.4 of a percentage point in comparison with the previous year. In December 2007, the year-on-year rate of core inflation stood at 4.2% (compared with 2.7% in December 2006).

Within the basic structure of core inflation, the determining factor in the accelerating price increase was food prices (their steep rise at the end of 2007, caused by the rising prices of agricultural commodities in world markets, affected food prices in all EU Member States differently in terms of intensity). Prices for market services recorded a modest increase in their average year-on-year dynamics (due to increases in house-maintenance prices and bank fees at the end of 2007). The year-on-year decline in tradable goods prices (excluding fuel prices) slowed in 2007, compared with 2006, and thus contributed to the higher average year-on-year rate of core inflation (steeper increases in the prices of non-alcoholic and alcoholic beverages).

Core inflation was dampened by fuel prices, which rose in 2006 by an average of 6.0% and dropped in 2007 by an average of 4.8% on a year-on-year basis. Their level reacted to changes in oil prices and the exchange rate of the Slovak koruna against the US dollar.

Developments in services prices showed no signs of excessive demand-based pressures. The steepest year-on-year increase during the year was recorded in the prices of housing-related services.

Producer prices

Producer price developments in 2007 were influenced by various factors, the most important being the price of oil, which caused a much slower year-on-year increase in refined oil products prices (falling under the category of manufacturing products) in the first nine months of 2007, compared with the previous year. This was connected with the slower rise in energy prices. In the final quarter, however, oil prices began to accelerate in the world markets and the prices of basic food commodities increased as well. As a result of these factors, the dynamics of industrial producer prices weakened considerably in 2007, compared with 2006.

Table 4 Year-on-year developments in producer prices (average for the period, %)

	2006	2007				
		Q1	Q2	Q3	Q4	Q1-Q4
Industrial producer prices	8.4	3.4	1.6	1.1	2.2	2.0
Raw materials prices	38.4	-0.5	-3.4	-5.2	-3.8	-3.3
Manufacturing products prices	2.1	0.9	-0.3	-0.7	1.4	0.3
Prices of electricity, gas, steam, and hot water	14.5	7.0	4.2	3.8	3.6	4.6
Construction prices	3.9	4.1	4.1	3.7	4.0	4.0
Building materials prices	3.0	5.2	5.4	6.7	5.1	5.6
Agricultural products prices	-0.2	0.8	-2.1	8.3	10.6	5.4
Prices of plant products	1.1	21.9	15.9	23.9	25.8	24.0
Prices of animal products	-0.7	-2.8	-3.9	-1.6	0.3	-2.0

Source: Statistical Office of the SR.

The combination of the effects of various, mostly external factors (drought in Australia, growing demand for food in China and India, increased use of cereals for bio fuel production), also caused a rise in agricultural products prices in Slovakia.

In 2007, construction prices continued to rise virtually at the same rate as in 2006, but the prices of building materials increased more rapidly than a year earlier.

In 2007, industrial producer prices recorded a substantially slower year-on-year increase than in the past year, mainly as a result of a marked year-on-year slowdown in electricity, gas, steam, and hot water prices (by an average of 10 percentage points, to 4.6%). The slowdown in energy prices took place in virtually all the basic components. The only prices that rose at the same rate as a year earlier (9.0%) were prices for electricity production and distribution. Prices for gas production and the distribution of gaseous fuels by pipeline dropped by an average of 3.6% in 2007, after rising in 2006 by an average of 22.7%. The year-on-year dynamics of prices for steam and hot water production and supply weakened in comparison with the previous year by 11.1 percentage points, to 7.3% in 2007, and prices for water treatment and supply slowed by 8.9 percentage points, to 0.7 %.

The year-on-year slowdown in manufacturing products prices in 2007 (by 1.8 percentage points, to 0.3%) was mainly the result of a fall in the prices of refined oil products (7.5%, compared with a rise of 13.1% a year earlier), though they began to increase again in the final quarter. Year-on-year drops in 2007 were also recorded in the prices of transport vehicles (3.3%, after stagnation a year earlier), electrical and optical equipment (0.5%, compared with a rise of 1.7% in 2006). The prices of base metals and finished metal

products increased at a slower rate than in 2006 (by 0.5 of a percentage point, to 2.5%). On the other hand, the prices of food products increased more rapidly than a year earlier (by 3.5%, after falling a year earlier by 0.4%), other non-metal mineral products (by 3.1 percentage points, to 4.9%), and wood products (by 3.9 percentage points, to 5.9%).

2.1.2 Gross domestic product

In 2007, gross domestic product (GDP) increased year-on-year by 10.4% at constant prices (according to a revised estimate of the Statistical Office of the SR). Compared with 2006, the pace of economic growth accelerated by 1.9 percentage points, due mainly to increased net exports and, in part, to the effect of stocking-up on cigarettes and tobacco products.

In terms of use, economic growth in 2007 was influenced by both domestic and foreign demand. In terms of production, real economic development was mostly influenced by value added growth in manufacturing and in public administration, education, health care, and other services. The nominal volume of GDP created in the period under review amounted to SKK 1,851.8 billion, which was 11.6% more than a year earlier.

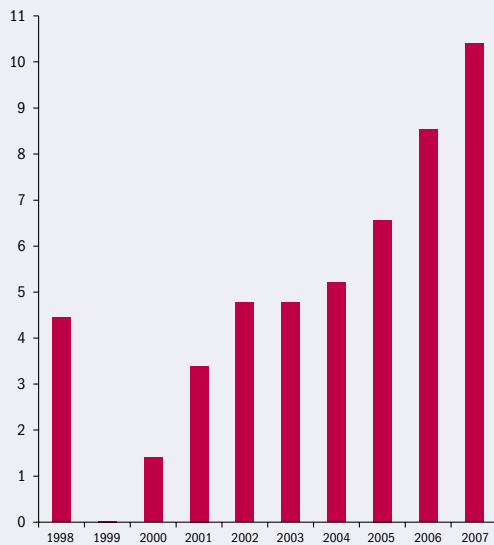
Broken down by quarter, real economic growth accelerated during 2007 from 8.3% in the first quarter to 14.3% in the fourth quarter.

Supply side of GDP

GDP generation in 2007 was influenced by value added creation, which grew year-on-year by 10.2% at constant prices (compared with 10.2% in 2006), as well as by net taxes (value added tax, excise duty,

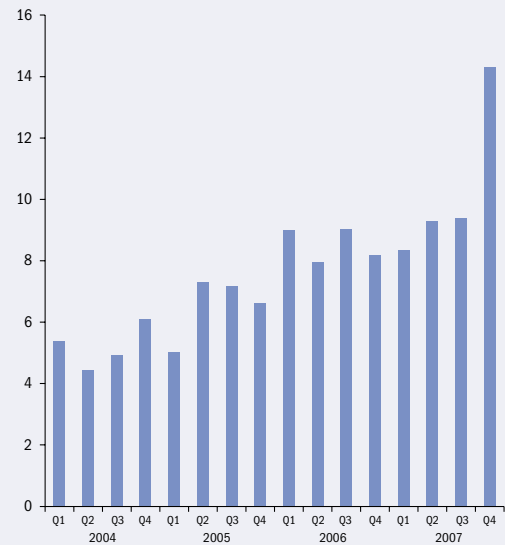


**Chart 16 Annual real GDP growth
(year-on-year growth in %)**



Source: Statistical Office of the SR.

**Chart 17 Quarterly real GDP growth
(year-on-year growth in %)**



Source: Statistical Office of the SR.

Table 5 GDP creation by component

(index, same period a year earlier = 100, constant prices 2000)

	2006	2007				
		Q1	Q2	Q3	Q4	Q1-Q4
Gross output	112.0	112.9	109.4	105.8	113.2	110.4
Intermediate consumption	113.2	114.7	108.9	102.5	115.3	110.4
Value added	110.2	110.1	110.2	110.7	109.9	110.2
Net taxes on products ¹⁾	95.4	92.6	101.8	97.8	160.9	111.8
Gross domestic product (GDP)	108.5	108.3	109.3	109.4	114.3	110.4

Source: Statistical Office of the SR.

1) Including value added tax, excise tax, and import tax, minus subsidies.

Table 6 GDP growth by sector

(index, same period a year earlier = 100, constant prices 2000)

	2006	Q1 07	Q2 07	Q3 07	Q4 07	2007
	2005	Q1 06	Q2 06	Q3 06	Q4 06	2006
Gross domestic product (GDP)	108.5	108.3	109.3	109.4	114.3	110.4
of which:						
Agriculture, hunting, forestry, and fishing	112.6	84.9	80.6	81.3	72.6	79.8
Industry	110.2	117.2	122.0	118.1	121.2	119.7
Construction	115.2	111.6	107.8	101.4	98.3	104.0
Trade, hotels and restaurants, transport	112.4	119.0	110.8	104.1	105.5	109.4
Financial intermediation, real estate business	111.6	89.2	93.6	119.1	108.4	101.5
Public administration, education, health care, other community, social, and personal services	102.0	117.4	116.0	116.3	111.9	115.2
Other ¹⁾	95.4	92.6	101.8	97.8	160.9	111.8

Source: Statistical Office of the SR.

1) Value added tax, excise tax, import tax, minus subsidies and imputed production of banking services (FISIM).

Table 7 GDP development by use
(index, same period a year earlier = 100, constant prices 2000)

	2006	2007				
		Q1	Q2	Q3	Q4	Q1-Q4
Gross domestic product (GDP)	108.5	108.3	109.3	109.4	114.3	110.4
Domestic demand	106.6	103.3	105.2	105.0	109.7	105.9
Final consumption	106.7	105.7	105.0	106.9	104.5	105.5
households	105.9	106.3	107.8	108.3	105.9	107.1
general government	110.1	103.5	96.5	102.2	100.8	100.7
non-profit institutions serving households	89.6	102.2	107.2	108.7	109.5	106.8
Gross capital formation	106.6	96.9	105.6	101.1	125.6	107.1
Gross fixed capital formation	108.4	111.0	105.9	106.5	108.9	107.9
Exports of goods and services	121.0	122.7	118.1	108.5	116.0	116.0
Imports of goods and services	117.7	114.5	113.2	103.0	111.6	110.4

Source: Statistical Office of the SR.

import tax, minus subsidies), which increased by a total of 11.8% (after decreasing by 4.6% in 2006).

In 2007, value added growth was recorded in all sectors, except in agriculture; stronger real growth than in 2006 was achieved in industry (19.7%) and in public administration, education, health care, and other community, social and personal services (15.2%).

Demand side of GDP

Economic growth in 2007 was influenced by both domestic and foreign demand. Foreign demand grew

in real terms by 16.0%, and thus increased the export performance of the economy. Economic growth was also stimulated by domestic demand, but its pace lagged behind the figure recorded a year earlier.

Turning to domestic demand, the most rapid growth in 2007 was recorded in investment demand (7.1% in real terms), which was 0.5 of a percentage point faster than in the previous year. The growth in the 'consumption' component of demand was 1.2 percentage points slower than a year earlier, which was mainly the result of a sharp slowdown in the growth of general government final consumption (0.7% in real terms, compared with 10.1% a year earlier). The dy-

Table 8 Structure of gross fixed capital formation in 2007

	Gross fixed capital formation (SKK million)	Proportion (%)	Index 2007/2006	Index 2006/2005
Economy of the SR in total	476,285	100.0	109.2	110.6
of which (by sector):				
Non-financial corporations	335,733	70.5	110.5	110.3
Financial corporations	6,825	1.4	140.8	83.1
General government	37,596	7.9	103.5	117.0
Households	95,097	20.0	105.4	111.2
Non-profit institutions	1,034	0.2	105.4	107.8
of which (by production):				
Machinery	201,067	42.2	109.1	95.0
of which: metal products and machines	148,494	31.2	107.3	87.1
transport equipment	52,573	11.0	114.2	130.7
Buildings and structures	247,943	52.1	107.5	133.6
of which: residential buildings	43,881	9.2	113.3	88.8
other structures	204,062	42.8	106.3	148.7

Source: NBS calculations based on data from the Statistical Office of the SR.



Table 9 Investments and savings

(% , current prices)

	2006	2007
Savings ratio ¹⁾	24.2	26.5
Gross investment ratio ²⁾	28.0	27.2
Fixed investment ratio ³⁾	26.3	25.7
Coverage of investments by savings ⁴⁾	86.3	97.3

Source: NBS calculations based on data from the Statistical Office of the SR.

1) Ratio of gross savings (GDP less final consumption in total) to GDP.

2) Ratio of gross capital formation to GDP.

3) Ratio of gross fixed capital formation to GDP.

4) Ratio of gross savings to gross investments.

namics of household final consumption strengthened year-on-year by 1.2 percentage points.

Domestic investment demand

Gross capital formation increased by 7.1% (at constant prices), due to growth in fixed investments (by 7.9% year-on-year) and growth in inventories (by SKK 16.6 billion at constant prices). Within the structure of inventories, all components increased in 2007, with the most rapid increases recorded in goods and materials inventories.

Gross fixed capital formation was mostly affected by the purchase of new fixed assets (a growth of 4.4% at constant prices). Looking at the breakdown of fixed assets by national accounts sector, their increases were most significantly influenced by the investment activities of non-financial corporations, which comprised both foreign and domestic investments.

Most investments were made by entrepreneurial entities in manufacturing. The growth in gross fixed capital formation in real terms was also supported by the investment activities of households (a growth of 4.2% at constant prices) and the general government sector (a growth of 2.3% at constant prices).

According to revised data from the Statistical Office of the SR, investments increased in both machines and construction, but the most rapid growth took place in investment in transport equipment. In construction, investment grew most dynamically in residential buildings.

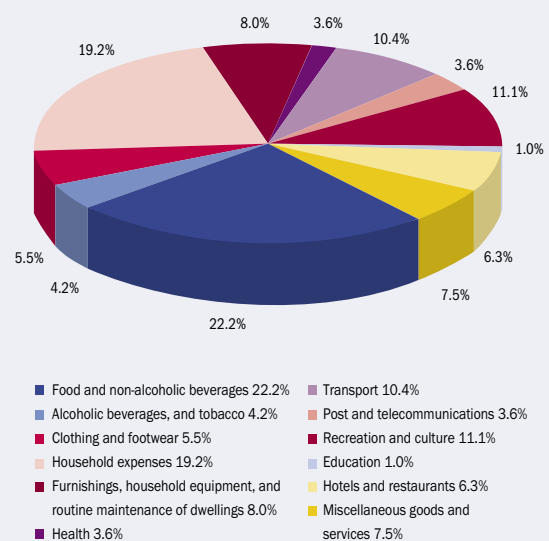
The share of domestic savings in the financing of investment demand increased in 2007. There were almost 86 haliers worth of gross savings in the national economy for one koruna worth of gross investments in 2006; this ratio increased to 97 haliers in 2007. This increase was a consequence of accelerated year-on-year growth in savings, accompanied by slower growth in gross investments.

Domestic consumer demand

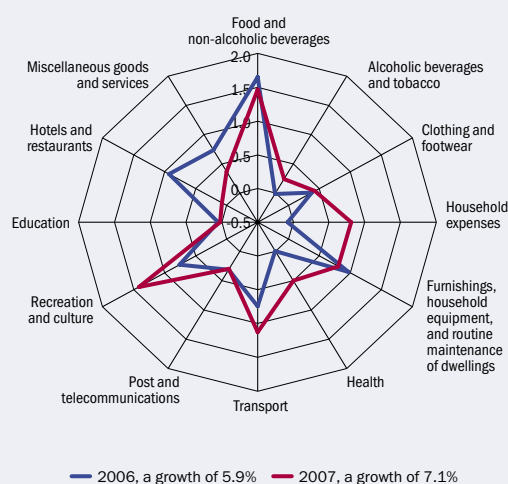
In 2007, final consumption expenditure increased year-on-year by 5.5%, due to growth in all sectors. Within the structure of final consumption, the dynamics of general government final consumption weakened in 2007 (compared with the previous year), whereas the dynamics of household final consumption strengthened.

Final consumption by households increased in real terms by 7.1% year-on-year in 2007, and its share of total GDP reached 52.0% (compared with 53.6% in 2006). Private household consumption growth was connected with the growth of wages, employment, gross mixed income (remuneration for work and profits earned by sole traders), and with the utilisation of credit resources. The total receivables of monetary financial institutions from households as a share of

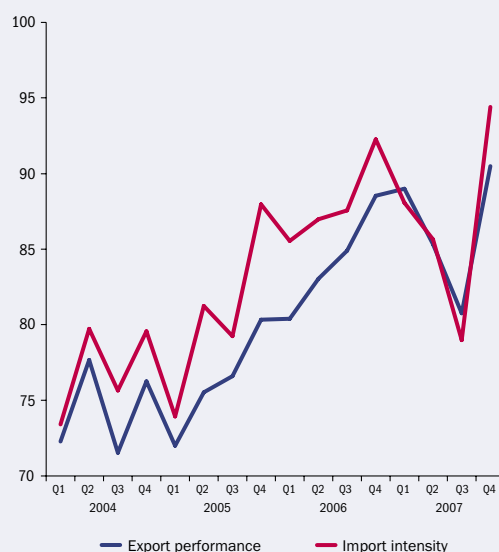
Chart 18 Structure of household final consumption



Source: Statistical Office of the SR.

Chart 19 Contributions of individual consumer expenses to growth in household final consumption (p.p.)


Source: NBS calculations based on data from the Statistical Office of the SR.

Chart 20 Export performance and import intensity (%)


Source: Statistical Office of the SR.

their final consumption continued to increase during 2007, by 4.1 percentage points, to 29.3% (compared with 25.2% at the end of 2006).

An analysis of household final consumption in 2007 shows that the most significant year-on-year increases occurred in the expenditures of households on health care (23.8% at constant prices), recreation and culture (13.4% at constant prices), and transport (11.3% at constant prices). In percentage terms, the largest consumption component (22%, as in 2006) was spending on food and non-alcoholic beverages. The second largest component was expenditure related to housing (19%), whose proportion to household consumption decreased by 0.6 of a percentage point in comparison with 2006.

The year-on-year growth in household final consumption was based primarily on consumer expenditures on food and non-alcoholic beverages, recreation and culture, and transport.

Exports and imports of goods and services showed weaker dynamics in 2007 than a year earlier. Exports grew by 14.2% and imports by 9.8% at current prices.

In nominal terms, net exports resulted in a deficit of SKK 8.7 billion (SKK 63.5 billion in 2006).

The export performance of the Slovak economy improved year-on-year by 2 percentage points in 2007, when the exports of goods and services as a share of GDP at current prices reached 86.4%. Import intensity weakened on a year-on-year basis, to 86.8% (from 88.2% in 2006). The openness of the Slovak economy, expressed in terms of the ratio of exports and imports of goods and services to nominal GDP, reached 173.2%, representing a year-on-year increase of 0.6 of a percentage point.

Income and expenditure of households¹

According to preliminary data from the Statistical Office of the SR, the current income of households reached SKK 1,458.5 billion in 2007, representing a year-on-year increase of 10.4% in nominal terms (7.4% in real terms). Compared with 2006, the rate of growth slowed in nominal terms by 0.2 of a percentage point. Within the scope of current income, the most rapid growth occurred in property income received (21.4%) and gross mixed income² (11.2%). In current income,

1 Income from property received (interest, dividends, income from rented land, and other), other current transfers received (insurance compensation paid to households, lottery winnings, etc.), income from property paid (interest paid to households for loans and other payments of this type), other current transfers paid (payments for various types of non-life insurance, life and health insurance), social security contributions (direct taxes and fees paid to the State budget, contributions paid to health insurance companies, the Social Insurance Agency, and the employment fund, etc.).

2 Gross mixed household income includes the earnings and incomes of small entrepreneurs, including the value of agricultural products grown by households for own consumption, imputed rents, and the contribution of households to individual housing construction.



Table 10 **Generation and use of income in the household sector** (current prices)

	Volume in SKK billions		Index ¹⁾		Share in %	
	2006	2007	2006 2005	2007 2006	2006	2007
Compensation of employees (all sectors)	656.4	720.7	109.9	109.8	49.7	49.4
of which: gross wages and salaries	512.5	566.2	109.3	110.5	38.8	38.8
Gross mixed income	384.5	427.6	112.9	111.2	29.1	29.3
Property income – received	31.8	38.6	106.7	121.4	2.4	2.6
Social benefits	206.2	226.6	107.2	109.9	15.6	15.5
Other current transfers – received	41.7	45.0	121.2	107.9	3.2	3.1
Current income in total	1,320.6	1,458.5	110.6	110.4	100.0	100.0
Property income – paid	20.9	23.3	244.1	111.6	6.0	6.1
Current taxes on income, property, etc.	50.6	55.7	110.2	110.2	14.4	14.5
Social contributions	244.7	267.8	113.5	109.4	69.7	69.9
Other current transfers – paid	34.9	36.3	104.6	104.0	9.9	9.5
Current expenditure in total	351.1	383.2	115.7	109.1	100.0	100.0
Gross disposable income	969.5	1,075.3	108.8	110.9	-	-
Adjustment for changes in the net equity of households in pension funds	30.4	28.4	250.0	93.4	-	-
Final consumption of households	928.5	1,020.1	111.0	109.9	-	-
Gross savings of households	71.4	83.6	106.9	117.0	-	-
Gross savings as a share of gross disposable income (%)	7.4	7.8	-	-	-	-

Source: Statistical Office of the SR.

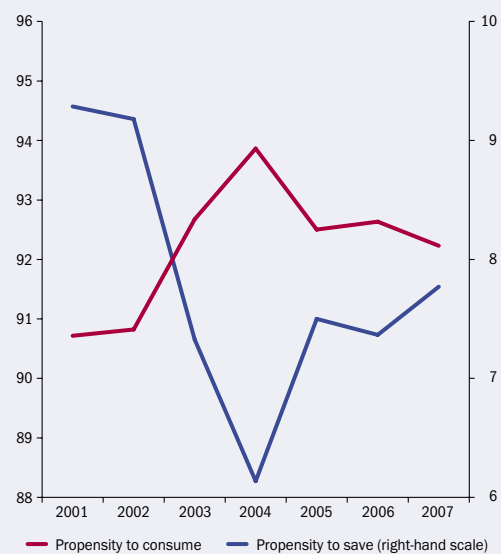
1) Indices calculated from values expressed in millions of SKK.

the largest component was the compensation of employees, which increased year-on-year by 9.8%.

The current expenditure of households (paid to other sectors and not used for direct consumption) increased year-on-year by 9.1% (in real terms by 6.1%), to SKK 383.2 billion. In 2006, current expenditure increased by 15.7%. The year-on-year growth in current expenditure was mainly connected with increases in expenses related to property income and current taxes on income. The smallest year-on-year increase was recorded in other current transfers.

With current expenditure being deducted from current income, the gross disposable income of households amounted to SKK 1,075.3 billion, representing a year-on-year increase of 10.9% (compared with 8.8% a year earlier). Of the disposable income, 94.9% was used for final consumption; the remainder went to gross savings, which increased year-on-year by 17%. The total increase in the dynamics of gross savings, which exceeded the dynamics of gross disposable income, was reflected in the ratio of gross household savings (7.8%), which was 0.4 of a percentage point higher than a year earlier (7.4%).

Chart 21 **Propensity of households to save and to consume** (%)



Sources: Statistical Office of the SR, NBS calculations.

2.1.3 Labour market

Employment

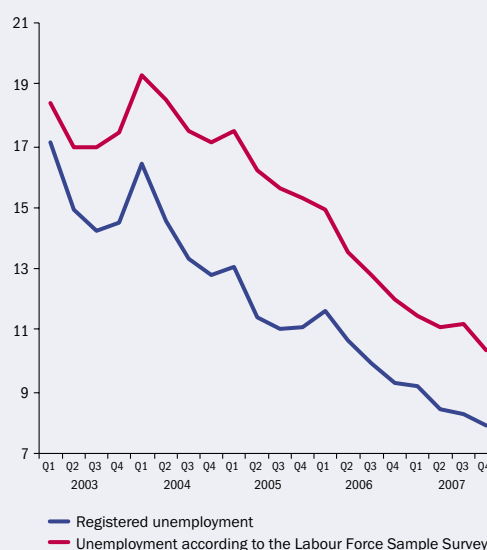
The favourable economic development in 2007 was also reflected in the level of employment. Employment according to the methodology of national accounts (ESA 95) grew year-on-year by 2.1% (in 2006 by 2.3%). Looking at the breakdown of employment by sector, the year 2007 witnessed growing demand for labour in services, which led to dynamic growth in employment, mainly in real estate, renting, and business activities; health and social services. On the other hand, employment remained below the previous year's level in education, other community services, public administration and defence, and in financial intermediation. In production sectors, employment grew dynamically in construction, while employment in agriculture, forestry, and fishing declined.

Unemployment

The persistent demand for labour was also reflected in the level of unemployment. On the basis of the Labour Force Sample Survey, the number of people out of work decreased year-on-year by 17.4% in 2007. This decrease was also mirrored in the annual unemploy-

Chart 22 Unemployment rate

(%)



Sources: Centre for Labour, Social Affairs and Family and the Statistical Office of the SR.

ment rate, which reached 11.0% in 2007, representing a drop of 2.3 percentage points compared with 2006. The falling trend in unemployment was also confirmed by data on registered unemployment. Ac-

Table 11 Labour market indicators

	2006	2007				
		Q1	Q2	Q3	Q4	Q1-Q4
Nominal wage (SKK)	18,761	18,511	19,598	19,514	22,925	20,146
Nominal wage (index)	108.0	107.1	106.7	106.8	108.0	107.2
Real wage (index)	103.3	104.2	104.1	104.2	104.5	104.3
Compensation per employee in nominal terms, ESA 95 (index)	107.9	108.7	106.8	107.6	109.9	108.2
Compensation per employee in real terms, ESA 95 (index)	103.5	106.4	105.1	106.1	107.4	106.2
Labour productivity of GDP (index, current prices)	109.3	109.2	108.1	109.1	109.1	108.9
Labour productivity of GDP (index, constant prices)	106.2	105.6	106.6	106.6	111.8	107.7
Labour productivity of GDP, ESA 95 (index, current prices)	109.2	109.7	108.6	109.8	109.0	109.3
Labour productivity of GDP, ESA 95 (index, constant prices)	106.1	106.0	107.2	107.2	111.7	108.1
Employment according to statistical records (index)	102.2	102.6	102.5	102.6	102.2	102.5
Employment according to ESA 95 (index)	102.3	102.2	102.0	102.0	102.3	102.1
Registered unemployment rate (%)	10.4	9.2	8.4	8.3	7.9	8.4
Unemployment rate according to LFSS ¹⁾ (%)	13.3	11.5	11.1	11.2	10.3	11.0
Unit labour costs in nominal terms ²⁾ (ULC)	101.7	102.5	99.6	100.3	98.4	100.2
Consumer prices (average index)	104.5	102.8	102.5	102.5	103.3	102.8

Sources: Statistical Office of the SR and NBS calculations based on data from the Statistical Office.

1) Labour Force Sample Survey (LFSS).

2) Ratio of growth in compensation per employee at current prices to growth in labour productivity according to ESA95 (at constant prices).



According to the registers of Offices for Labour, Social Affairs and Family, the average unemployment rate in 2007 stood at 8.4%, representing a fall of 2 percentage points compared with 2006.

The continuing year-on-year growth in labour supply (i.e. persons at productive and post-productive age) was mostly reflected in the increased number of economically inactive persons (i.e. persons outside the labour market) in 2007. As a result of this development, the rate of economic activity reached 58.8%, representing a year-on-year fall of 0.3 of a percentage point. Among the economically active population, the increasing share of persons in employment led to a rise in the employment rate, by 1.1 percentage points year-on-year, to 60.7% in 2007.

Wages and labour productivity

In 2007³, the average monthly nominal wage in the Slovak economy increased year-on-year by 7.2%, to SKK 20,146. Compared with 2006, the rate of wage growth slowed by 0.8 of a percentage point. The strongest nominal wage growth in 2007 occurred in health and social care (15.6%); mining and quarrying (10.6%); and agriculture, forestry, and fishing (10.3%). The smallest increases in nominal wages were recorded in hotels and restaurants (6.2%), real estate and renting (5.7%).

Compared with 2006, real wage dynamics increased in 2007 by 1 percentage point (from 3.3% to 4.3%), which was the result of lower average inflation than a year earlier. Real wages increased in all sectors of the economy in 2007.

Labour productivity (GDP per employee) increased more dynamically than in 2006, in nominal terms by

8.9% and in real terms by 7.7%. Labour productivity followed a positive trend in relation to wages, when the dynamics of real labour productivity exceeded the rate of real wage growth by 3.4 percentage points.

Unit labour costs increased year-on-year by 0.2% in 2007, while the annual HICP inflation rate stood at 1.9%. This represented a considerable slowdown in comparison with 2006.

2.1.4 Financial results of corporations

According to preliminary data from the Statistical Office of the SR, financial and non-financial corporations generated a total profit of SKK 328 billion in 2007. The profit achieved was 22.2% higher than in 2006, which was attributable to increased earnings reported by financial/non-financial corporations and to the reduced negative financial result of NBS.

The increased profits of non-financial corporations were due largely to year-on-year increases in earnings in wholesale as well as retail trade; transport, storage, post and telecommunications; and in real estate, renting, and business activities. The year-on-year growth in earnings in manufacturing production (4.4%) lagged behind the overall year-on-year growth in the profits of non-financial corporations (a year-on-year increase of 10.1%). In 2007, the year-on-year growth in the profits of non-financial corporations was slower than in the previous year (profits in 2006 grew year-on-year by 25.8%), due mainly to a slowdown in the year-on-year growth of profits in the production and supply of electricity, gas, and water; metal and metal products; chemicals and chemical products; rubber and plastic goods.

Table 12 **Financial results of corporations** (SKK million, current prices)

	2006	2007	Index 2005/2004	Index 2006/2005	Index 2007/2006
Financial result (before taxation)					
Non-financial and financial corporations in total	268,380	327,980	141.3	106.7	122.2
Non-financial corporations	280,350	308,606	117.4	125.8	110.1
Financial corporations	-11,970	19,374	-	-	-
of which: NBS	-45,128	-19,464	-	-	-
Financial corporations, excluding NBS	33,158	38,838	149.3	113.0	117.3

Sources: Statistical Office of the SR and NBS.

³ With effect from 2007, a methodological change was made in the reporting of average monthly wages; on the basis of this change, the incomes of professional soldiers are now also included in the wages and the year-on-year indices are calculated from comparable data.

2.2 Balance of payments

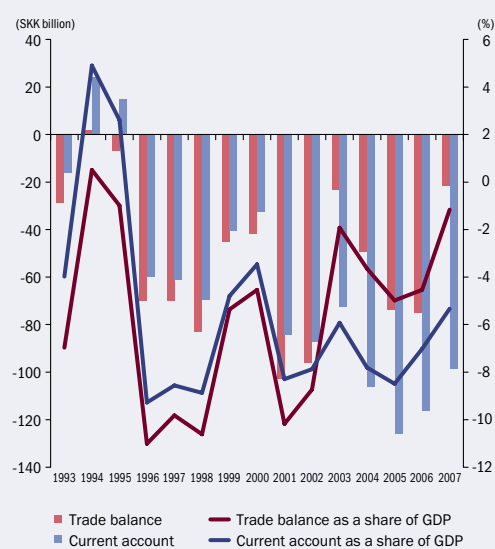
2.2.1 Current account

In 2007, the balance of payments on current account resulted in a deficit of SKK 98.7 billion, which was SKK 17.8 billion less than in the previous year. The main factor behind the year-on-year reduction in the current account deficit was an improvement in the trade balance. On the other hand, year-on-year deterioration occurred in the income balance and, to a lesser extent, in the balances of current transfers and services. The current account deficit as a share of GDP at current prices reached 5.3%, representing a year-on-year decrease of 1.7 percentage points (the share of the current account balance, excluding dividends and reinvested earnings, was positive (0.3%), while 2006 saw a deficit of 1.8%). The trade balance deficit as a share of GDP dropped to 1.2% in 2007 (the value of this ratio stood at 4.5% in 2006).

The trade balance resulted in a deficit of SKK 21.4 billion, representing a year-on-year improvement of SKK 53.9 billion. The improvement in foreign trade can be ascribed to the stronger dynamics of exports compared with imports, while the growth of imports, as well as exports, slowed in comparison with the previous year, as a result of developments in the koruna exchange rate, since exports and imports in euro showed approximately twofold dynamics (in US dollars almost threefold dynamics).

The year-on-year improvement in the trade balance resulted from the fact that exports recorded a larger year-on-year increase (SKK 187.9 billion) than imports (SKK 134.0 billion). The most significant increase in exports took place in 'machinery and transport equipment', in virtually the same amount as in

Chart 23 Trade balance and current account developments



Sources: NBS and the Statistical Office of the SR.

2006. Within the scope of this category, transport equipment recorded a larger year-on-year increase in exports, which was offset by a smaller increase in machinery exports. In imports, a smaller year-on-year increase was recorded in 'machinery and transport equipment' (reduced import of investment goods); the smaller increase in imports compared with 2006 was attributable to a year-on-year change in the growth of raw materials imports (owing to the exchange rate and lower oil prices).

According to preliminary data from the Statistical Office of the SR, goods were exported during 2007 in the total amount of SKK 1,420.7 billion, which

	2007	2006
Balance of trade	-21.4	-75.3
Exports	1,420.7	1,232.9
Imports	1,442.1	1,308.2
Balance of services	13.1	22.5
Balance of income	-79.3	-62.1
of which: investment income	-114.0	-92.9
of which: reinvested earnings	-23.3	-23.8
Current transfers	-11.1	-1.6
Current account in total	-98.7	-116.5
Current account as a share of GDP in %	-5.3	-7.0
Current account (excluding dividends and reinvested earnings) as a share of GDP in %	0.3	-1.8

Sources: NBS, Statistical Office of the SR.



Table 14 Exports from January to December

	Year-on-year changes in billions of SKK		Contribution to the year-on-year change in percentage points	
	2007	2006	2007	2006
Raw materials	-5.2	10.7	-0.4	1.1
Chemicals and semi-finished goods	15.4	58.7	1.3	5.9
of which: Chemical products	1.7	16.5	0.1	1.7
Semi-finished goods	13.7	42.2	1.1	4.3
Machinery and transport equipment	168.0	169.5	13.6	17.1
of which: Machinery	72.5	98.7	5.9	10.0
Transport equipment	95.5	70.8	7.7	7.2
Finished products	9.7	4.0	0.8	0.4
Exports in total	187.9	242.8	15.2	24.5

Source: NBS calculation based on data from the Statistical Office of the SR.

Table 15 Imports from January to December

	Year on-year changes in billions of SKK		Contribution to the year-on-year change in percentage points	
	2007	2006	2007	2006
Raw materials	-14.5	38.8	-1.1	3.6
Chemicals and semi-finished goods	32.7	51.9	2.5	4.9
of which: Chemical products	7.5	19.8	0.6	1.9
Semi-finished goods	25.2	32.1	1.9	3.0
Machinery and transport equipment	91.1	123.7	7.0	11.6
of which: Machinery	56.0	93.7	4.3	8.8
Transport equipment	35.1	30.0	2.7	2.8
Finished products	24.7	29.7	1.9	2.8
of which: Agricultural and industrial products	20.6	12.0	1.6	1.1
Passenger cars	7.1	5.6	0.5	0.5
Machines and electrical consumer goods	-3.0	12.0	-0.2	1.1
Imports in total	134.0	244.1	10.2	22.9

Source: NBS calculation based on data from the Statistical Office of the SR.

was 15.2% more than in 2006 (38.6% in USD and 27.1% in EUR).

The increase in the volume of exports in 2007 was mostly influenced by the exports of machinery and transport equipment (accounting for almost 90% of the total increase in exports). In contrast with 2006, when machinery exports accounted for more than half of the increase in the 'machinery and transport equipment' category, almost 57% of the year-on-year increase in 2007 took place in the exports of transport equipment, as a result of growth in the exports of automobiles and components.

The volume of goods imported in 2007 amounted to SKK 1,442.1 billion, representing a year-on-year increase of 10.2% (in USD 32.6% and in EUR 21.5%).

In goods imports, 2007 saw the strongest growth in the imports of machinery and transport equipment. In this category of goods, accelerated growth was recorded in the imports of transport equipment (motor vehicle parts and components), in connection with the expansion of production in the automotive industry. On the other hand, the strong year-on-year growth in machine imports from 2006 slowed gradually over the course of 2007. In the 'machinery' sub-category, the most rapid growth took place in the

imports of components for the electrical industry. The year-on-year increase in imports in 'chemicals and semi-finished goods' also contributed significantly to the year-on-year growth in total imports, despite a certain slowdown in comparison with 2006. The imports of raw materials, whose year-on-year decline significantly reduced the total year-on-year increase in imports, were affected by a year-on-year fall in oil prices, which was mainly reflected in the lower imports of oil and natural gas.

Trade in services during 2007 resulted in a surplus of SKK 13.1 billion, which was SKK 9.4 billion less than in the previous year. The fall in the balance of services surplus was mainly the result of developments in transport services and, to a lesser extent, services related to tourism, while the balance of 'other services in total' improved on a year-on-year basis. The surplus in transport services diminished significantly on a year-on-year basis, mainly as a result of lower receipts from the transit of oil and natural gas (the fall in transit receipts was caused in part by the non-standard settlement of retained payments for 2004 – 2006 last year and in part by the appreciation of the Slovak koruna against the US dollar) and increased trade costs of importing goods, whose growth was associated with the expansion of foreign trade. At the same time, the balance of transport services was positively influenced by passenger air transport services, the receipts for which grew at a faster pace than the expenses of Slovak residents on services rendered by non-residents, owing to the development of air transport in the SR. Positive effects on the overall balance were also produced by insurance, legal, and advisory services, where the growth in receipts was accompanied by a fall in expenses.

Table 16 Balance of services (SKK billion)

	2007	2006
Transport	10.2	21.3
Tourism	12.0	13.6
Other services	-9.1	-12.4
Balance of services	13.1	22.5

Source: NBS.

In 2007, the income balance resulted in a deficit of SKK 79.3 billion, representing a deterioration of SKK 17.2 billion compared with the previous year, when a modest year-on-year decrease in receipts (SKK 0.5 billion) was accompanied by a marked increase in payments (SKK 16.7 billion). The increase in the deficit was caused mainly by increased dividend payments to foreign investors (by SKK 16.8 billion) in 2007, when foreign investors received dividends in the total amount of SKK 81.1 billion. Within the overall income

balance, the increased deficit was moderated to some extent by an increase in the incomes of Slovak residents from abroad, coupled with an increased surplus in the compensation of employees.

Table 17 Income balance (SKK billion)

	2007	2006
Compensation of employees	34.7	30.8
Direct investment	-109.2	-90.9
of which: reinvested earnings	-23.3	-23.8
Portfolio and other investments	-4.8	-2.0
Income balance	-79.3	-62.1

Source: NBS.

The balance of current transfers produced a deficit of SKK 11.1 billion in 2007. This represented a year-on-year deterioration of SKK 9.5 billion and was mainly the result of a methodological change concerning

Table 18 Balance of current transfers (SKK billion)

	2007	2006
Government	0.5	8.3
Other	-11.6	-9.9
Balance of current transfers	-11.1	-1.6

Source: NBS.

Box 1 Reclassification of part of the receipts from EU funds, from current to capital transfers

In 2007, a methodological change was introduced in respect of the recording of receipts from the EU budget. Originally, all receipts were recorded within the balance of current transfers, since receipts from EU funds could not be identified and classified as current or capital transfers. According to an analysis of the structure of receipts from EU funds, based on partner data supplied to Eurostat by the European institutions concerned, the individual receipts from EU funds could be divided into current and capital transfers. The new classification takes into account the character of the individual funds through which money is drawn from the EU budget, i.e. distinguishes between funds set up for common and/or investment purposes. This led to the shift of part of the receipts (intended for investment purposes) from the balance of current transfers to the balance of capital transfers, with a consequent negative impact on the current account balance. The methodological change had no effect on the external equilibrium, since the lower current account receipts were fully offset by the higher inflow into the capital and financial account.



Table 19 Balance of payments capital and financial account		(SKK billion)
	2007	2006
Capital account	11.4	-1.2
Direct investment	71.2	112.9
SR abroad	-9.5	-10.9
of which: equity capital abroad	-6.0	-9.5
reinvested earnings	-1.2	-1.2
In the SR	80.7	123.8
of which: equity capital in the SR	27.4	56.0
of which: FDI other than privatisation ¹⁾	27.4	25.0
Reinvested earnings	24.5	25.0
Portfolio investment and financial derivatives	-16.2	43.4
SR abroad	-19.7	-18.1
In the SR	3.5	61.5
Other long-term investment	18.9	18.6
Assets	-6.4	5.3
Liabilities	25.4	13.3
Short-term investment	100.4	-141.3
Assets	-29.3	-38.4
Liabilities	129.7	-102.9
Capital and financial account in total	185.7	32.4
Source: NBS.		
1) Foreign direct investment.		

the reclassification of part of the funds drawn from the EU budget, from current to capital transfers (the balance of current transfers was negatively affected, by SKK 16.2 billion).

2.2.2 Capital and financial account

The b.o.p. capital and financial account resulted in a surplus of SKK 185.7 billion, which was SKK 153.3 billion more than in the previous year. The structure of financial flows also changed during the year. In 2006, capital inflows were dominated by direct and portfolio investments, which were partly offset by an outflow of short-term capital. In 2007, the dominant inflow took place in short-term capital for the banking sector. Thus, the structure of the b.o.p. capital

and financial account changed in comparison with the previous year, but, with regard to the marked improvement in the current account balance, only a small part of the deficit was covered by an inflow of short-term funds.

The balance of payments on capital account resulted in a surplus of SKK 11.4 billion in 2007, while the previous year saw a deficit of SKK 1.2 billion, which was influenced by the aforementioned methodological change.

From January to December 2007, foreign direct investment (FDI) recorded an inflow of SKK 71.2 billion, representing a decline of SKK 41.7 billion compared with 2006. The year-on-year change in the balance of direct investments was mainly caused by privatisa-

Table 20 Capital inflows in other investment by sector			(SKK billion)
	2007	2006	Year-on-year changes
Banks	88.4	-150.6	239.0
Enterprises	36.1	26.5	9.6
Government + NBS	-5.2	1.4	-6.6
Total	119.3	-122.7	242.0
Source: NBS.			



tion receipts from 2006, since 2007 witnessed no privatisation. While the total equity capital of foreign investors invested in Slovakia decreased by SKK 28.6 billion in 2007 (compared with the previous year), the equity capital of foreign investors in Slovakia, adjusted for privatisation receipts, increased by SKK 2.4 billion. The lower inflow of capital in form of FDI compared with 2006 was also supported by developments in 'other capital', where there was a decrease in export claims exceeding the increase in import liabilities.

Portfolio investment resulted in a net outflow of SKK 16.2 billion, compared with a net inflow of SKK 43.4 billion in the previous year. The year-on-year change from an inflow to an outflow of SKK 59.6 billion was influenced on the assets side by an increase in demand for long-term foreign bonds among Slovak residents. On the liabilities side, there was a smaller inflow than a year earlier, as a result of lower demand for long-term government debt securities among investors and a new issue of government eurobonds with a lower koruna equivalent. In the corporate sector, there was a larger outflow than in the previous year, resulting from an increase in the repayment of liabilities in respect of bond issues.

In 'other investment', 2007 saw an inflow of funds in an amount of SKK 119.3 billion, compared with an outflow of SKK 122.7 billion in the same period a year earlier. Virtually the entire year-on-year change (SKK 239.0 billion) was associated with developments in the banking sector, while the main factor was again (after an outflow in 2006) an inflow of short-term capital into Slovak banks (bank deposits) in 2007.

This capital inflow was, to a large extent, the result of interbank foreign exchange market developments in March and April, which led to the appreciation of the Slovak koruna and subsequent NBS interventions.

2.2.3 Foreign reserves

At the end of December 2007, the foreign reserves of Národná banka Slovenska reached USD 18.98 billion (EUR 12.91 billion), representing an increase of USD 5.61 million since the beginning of the year. The total foreign reserves of NBS were influenced by several factors during the year. The key factor positively affecting revenues was income arising from NBS interventions in the foreign exchange market in the first half of the year. Expenditures were mainly determined by debt service payments made on behalf of the Government. The Bank's foreign reserves were also affected during the year by movements in the exchange rates of fully convertible currencies in global financial markets. The surplus in the balance of revenues and expenditures (USD 3.77 billion) was accompanied by positive exchange rate differentials (USD 1.84 million), which resulted from movements in the euro exchange rate against the US dollar in international financial markets.

At the end of 2007, the foreign reserves of NBS were 3.5 times greater than the volume of average monthly imports of goods and services to Slovakia during 2007. The ratio of foreign reserves to the amount of payments for goods and services, recorded in banking statistics, reached 4.6 times the volume of average monthly imports of goods and services in 2007.

Table 21 External debt of the SR

	In millions of USD		In millions of EUR	
	1.1.2007	31.12.2007	1.1.2007	31.12.2007
Total external debt of the SR	32,205.9	44,308.7	24,448.9	30,156.2
Long-term external debt	16,649.7	20,709.7	12,639.5	14,094.9
Government and NBS ¹⁾	7,702.1	9,502.4	5,847.0	6,467.3
Commercial banks	1,559.2	2,150.8	1,183.6	1,463.8
Entrepreneurial entities	7,388.4	9,056.5	5,608.9	6,163.8
Short-term external debt	15,556.2	23,599.0	11,809.4	16,061.3
Government and NBS	0.0	0.0	0.0	0.0
Commercial banks	6,148.8	12,095.6	4,667.8	8,232.2
Entrepreneurial entities	9,407.4	11,503.4	7,141.6	7,829.1
Foreign assets	26,718.4	37,017.4	20,283.2	25,193.8
Net external debt	5,487.5	7,291.3	4,165.7	4,962.4
SKK/USD and SKK/EUR rates	26.246	22.870	34.573	33.603
EUR/USD cross exchange rate	-	-	1.317	1.469

Source: NBS.

1) Including government agencies and municipalities.



The foreign reserves of commercial banks reached USD 3.0 million (EUR 2.0 billion) at the end of 2007. The volume of foreign reserves in the banking sector, including NBS, stood at USD 21.9 billion (EUR 14.9 billion) at the end of the year.

2.2.4 External debt of the SR

At the end of December 2007, Slovakia's total gross external debt reached USD 44.3 billion (EUR 30.2 billion). Total per-capita gross external debt was at the level of USD 8,237 in the period under review. The share of short-term debt in the country's total gross external debt reached 53.3% at the end of December 2007.

In 2007, the total gross external debt of Slovakia increased by USD 12.1 billion, of which long-term foreign debt accounted for USD 4.1 billion and short-term foreign debt for USD 8.0 billion. The most significant increase was recorded in the short-term foreign liabilities of commercial banks (USD 6.0 billion). This increase was partly due to interbank market developments. Total per-capita gross external debt increased during the year by USD 2,250; the proportion of short-term foreign debt to the country's total gross external debt increased year-on-year by 5 percentage points.

The net external debt of Slovakia, expressed as the difference between gross foreign debt, i.e. USD 44.3 billion (liabilities of NBS and the Government, commercial banks, and the corporate sector – except for equity participation), and foreign assets, i.e. USD 37.0 billion (foreign reserves of NBS, foreign assets of commercial banks and the corporate sector – except for equity participation), increased over the course of 2007 by USD 1.8 billion, to USD 7.3 billion (debtor position) at the end of December 2007.

According to preliminary data, Slovakia's total gross external debt as a share of GDP at current prices reached 54.7% in 2007, representing an increase of 3.8 percentage points compared with 2006.

2.2.5 Nominal and real effective exchange rates of the Slovak koruna

The average year-on-year appreciation of the nominal effective exchange rate (NEER) of the Slovak koruna accelerated in 2007 to 10.2%, from 2.4% in the previous year. To the accelerated appreciation of the NEER index contributed mostly the strengthening of the koruna against the euro (5.6 percentage points), followed by the contribution of an appreciation in relation to the Czech koruna (1.6 percentage points).

The faster appreciation of the Slovak koruna in 2007 (in nominal terms) led to an accelerated appreciation in the real effective exchange rate (REER). The average year-on-year appreciation of the REER index, defined on the basis of consumer prices, accelerated in comparison with the previous year by 5.6 percentage points, to 9.8%. In the case of the REER index, defined on the basis of industrial producer prices, the rate of appreciation accelerated by 1.2 percentage points, to 7.8%. The appreciation of the REER index, defined on the basis of manufacturing products prices, accelerated by 5.5 percentage points, to 5.9%. The slower appreciation of the individual real effective exchange rate indices in comparison with the nominal effective exchange rate resulted from the ongoing disinflation process in the Slovak economy, mainly in the first half of 2007. The main factors in this process were a slower rise in regulated prices and raw materials and energy prices, but also an economic growth not exceeding markedly the dynamics of potential output and exerting no excessive demand-based inflationary pressures.

2.3 General government sector

Budgetary performance in the general government sector during 2007 resulted in a deficit corresponding to 2.2% of GDP. Compared with the approved deficit (2.9% of GDP), the actual outcome was much more favourable. This result is mainly attributable to the central government budget performance. Though the reduction in the central government budget deficit can partly be ascribed to saving on the expenditure side, the determining factor was the higher than expected tax revenues. In addition to better than expected macroeconomic developments, tax revenues were significantly influenced by the effect of pre-stocking-up on tobacco products, as a result of an excise tax increase with effect from 1 January 2008.

Apart from the State budget, the overall result was also influenced favourably by the budgetary performance of the Social Insurance Agency and public universities. On the other hand, budgetary performance at the level of local governments was unfavourable in comparison with the central government budget. A negative contribution also came from the higher than projected payments under Pillar II of the pension insurance system. The budgetary performance of health insurance companies also showed a slightly unfavourable tendency in comparison with the budget. The additional inclusion of the Slovak Television and Slovak Radio in the general government sector (upon the recommendation of Eurostat) had a neutral effect on the sector's overall budget deficit.

Funds drawn from the EU budget reached 88% of the figure planned for 2007.

In 2007, the gross debt of the general government sector reached 29.4% of GDP, which was less than the budgeted figure (31.8% of GDP).

The parameters of the sector's deficit and debt in 2007 reached the values required for meeting the Maastricht criteria and the conditions of the Stability and Growth Pact.

2.4 Monetary developments

2.4.1 Monetary aggregates

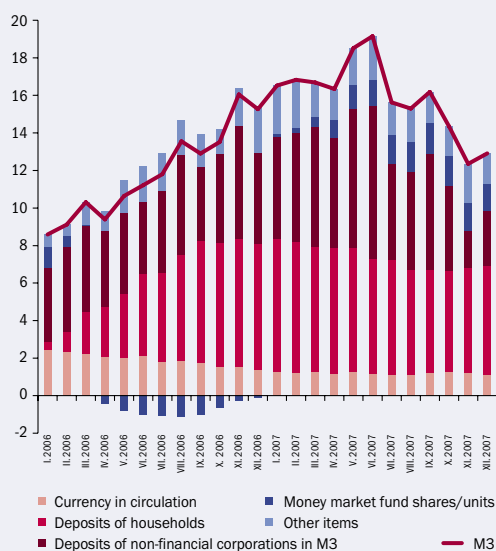
The M3 monetary aggregate followed different trends in the two halves of 2007. Its year-on-year dynamics showed a slightly increasing tendency over the first six months (the strongest dynamics were recorded in June: 19.2%). The second half of the year saw a gradual slowdown, to 12.8% in December 2007. The volume of M3 reached SKK 1,082.7 billion at the end of 2007. Among the money supply components, the largest contributions to M3 growth were made during the year by the less liquid components, mainly household deposits and received loans with an agreed maturity of up to 2 years, though their contributions diminished in the second half of the year. The opposite trend was recorded in deposits and received loans repayable on demand. Their growth accelerated in the second half of the year, due to developments in household deposits, while the deposits of non-financial corporations grew at a slightly slackening pace throughout the year. Among the counterparts of M3, the growing trend continued in the monetary financial institutions (MFIs) loans to the private sector, mainly to non-financial corporations.

Main components of M3

After diminishing in the first half of the year, the contribution of deposits and received loans repayable on demand was growing steadily over the second half. The contribution was, however, positive throughout the period under review. Contributions from the most liquid types of deposits to M3 growth reflected developments in household deposits and received loans repayable on demand. The deposits of non-financial corporations recorded a slowdown in dynamics throughout 2007. This trend was also supported by increased dividend payments abroad by the corporate sector. After decelerating in the previous year, the year-on-year rate of growth in currency in circulation was stagnant (at 8.5% on average), which was also reflected in its stagnating contribution to the money supply growth.

Developments in the less liquid money supply components (M2 minus M1), mainly in fixed-term house-

Chart 24 Contributions of individual M3 components to its year-on-year dynamics (p.p.)



Source: NBS.

hold deposits, were also connected with the trend in deposits repayable on demand, which represented their main substitutes. During the first half of the year, they followed the trends from the previous year and their contributions reached a relatively high level. This trend came to a halt in the second half of the year, when the contributions of household deposits with an agreed maturity of up to 2 years began to diminish. The deposits and received loans of non-financial corporations repayable within 2 years recorded stable growth virtually throughout the year, which, however, slowed in the final quarter. Deposits redeemable at notice of up to 3 months continued to decrease and thus made a negative contribution to the money supply growth.

The smallest increase in the money supply was generated by marketable instruments (M3 minus M2). They represent the least liquid components and are formed mostly by money market fund shares/units. In 2007, households' interest in investment in money market fund shares/units recovered, at the expense of a slight fall in the volume of fixed-term household deposits and, towards the end of the year, a similar recovery was recorded with regard to the shares/units of investment funds other than money market funds. As a result of this growth, they made a positive contribution to the year-on-year dynamics of M3 throughout the year. Other marketable instruments were repo operations and debt securities issued with a maturity of up to 2 years, whose share in the money market stagnated around the level of 0.7%. Consequently, their contributions to M3 growth remained virtually unchanged during the year.

Table 22 **Developments in the main M3 components and counterparts**

	Changes since the beginning of the year (SKK billion)		Changes since the beginning of the year (%)		Volume as at 31.12.2007 (SKK billion)
	2006 ¹⁾	2007 ¹⁾	2006 ¹⁾	2007 ¹⁾	
Currency in circulation	11,3	10,5	9,5	8,0	141,7
Deposits and received loans repayable on demand	53,6	61,3	14,6	14,4	480,9
M1	64,9	71,9	13,4	12,9	622,6
M2	123,2	106,9	15,7	11,7	1 015,0
M3 monetary aggregate	127,0	124,4	15,3	12,9	1 082,7
Main counterparts of M3					
Loans and securities of MFIs	100,5	151,2	13,4	17,8	1 046,9
of which: general government	-18,7	6,8	-6,3	3,1	261,6
other residents (private sector)	119,2	144,3	23,6	23,6	785,3
Net foreign assets	-5,5	6,2	-2,8	-0,7	262,2
Long-term financial liabilities (excluding capital and reserves)	19,7	19,3	19,0	15,7	141,9
Other items net (including capital and reserves) ²⁾	51,6	-13,8	-54,8	-11,5	-84,5

Source: NBS.

1) Since the components and counterparts of the M3 monetary aggregate are not compiled for 1 January of the given year (in line with ECB methodology), the initial values for these years as stated in the table and the text below are values for 31 December of the previous years.

2) Other items net, including the deposits of the central government. The values are calculated as follows: M3 = loans to the general government + loans to other residents + net foreign assets – long-term financial liabilities + other items net.

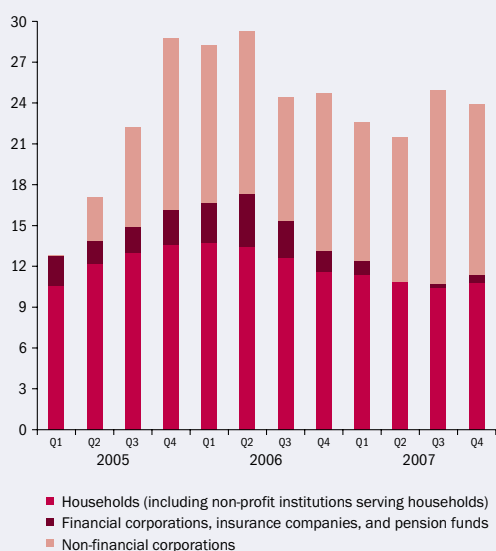
Main counterparts of M3

Among the main M3 counterparts, the decisive factor was loans to the resident private sector, which consisted of loans to enterprises and households (both being virtually equal). The annual increase in long-term financial liabilities (excluding capital, reserves, and provisions) diminished somewhat in 2007, due mainly to a smaller increase in deposits and received loans with an agreed maturity of over 2 years. Developments in 'other items net' were substantially influenced by a fall in capital, reserves, and provisions, which was much smaller than in 2006.

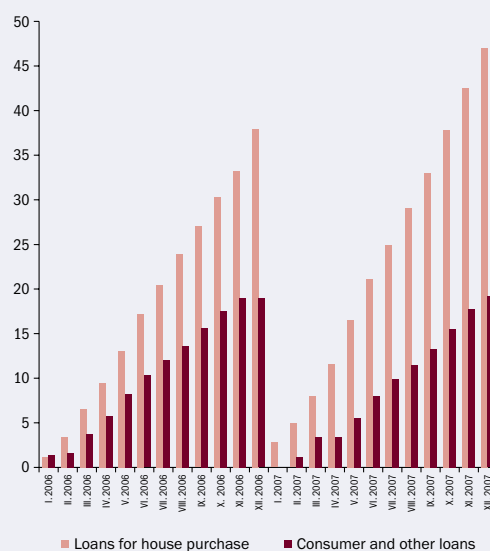
The volume of MFI loans to residents (including securities issued by clients and held by MFIs) increased during 2007 by SKK 151.2 billion, which was 50% (SKK 50.7 billion) more than in the previous year. The growth in MFI loans took place mostly in the private sector (SKK 144.3 billion), but its year-on-year dynamics remained unchanged, at the level of 2006. The increase in MFI loans to the general government sector was positive (unlike in 2006). Their contribution to the total growth in MFI loans was roughly the same as that of MFI loans to the private sector.

MFI loans to the private sector

The MFI loans to the private sector (excluding securities) reached SKK 770.0 billion at the end of December 2007, representing an increase of SKK 142.7 billion since the end of 2006 (compared with SKK 119.8 billion in the previous year). Broken down by sector, the most significant contribution to credit growth came from non-financial corporations, with slightly increasing dynamics, mainly in the second half of 2007. Loans to households recorded a slowdown in the rate of growth over the first three quarters, which were followed by a period of stagnation. This development took place partly in loans denominated in Slovak koruna (an increase of SKK 104.9 billion) and partly in euro-denominated loans (an increase of SKK 34.9 billion) and loans in other foreign currencies (SKK 2.8 billion). The structure of loans by currency had remained virtually unchanged until the end of 2007. The share of koruna loans in the total volume decreased somewhat, to 78.8%, while the share of euro loans increased to 19.8%, and loans in other currencies accounted for 1.4%. At the end of 2006, koruna loans accounted for 80.0%, euro loans for 18.8%, and loans in other foreign currencies for 1.2% of the total volume of loans. Most loans in foreign currencies were concentrated in the non-financial

Chart 25 Contributions to the year-on-year growth in MFI loans to the private sector (p.p.)


Source: NBS.

Chart 26 Increases in loans to households (cumulative data since the beginning of the year) (SKK billion)


Source: NBS.

corporations sector (an average 34.8% of the total corporate loans), while households tended to borrow funds in Slovak koruna (foreign-currency loans accounted for only 2.6 %).

MFI loans to households

During 2007, the MFI loans to households followed the growing trend from the previous year, and closed the year with an absolute year-on-year increase of SKK 66.2 billion; they reached a year-on-year growth rate of 28.5%. The dynamics of bank lending to households were weakening slightly until September, when this trend came to a halt; the final quarter of 2007 was marked by stagnation. Compared with December 2006, the rate of growth slowed by 4.0 percentage points.

In 2007, as in the previous year, households used credit resources mostly for long-term investment. Within the structure of loans by purpose, the steepest year-on-year increase was recorded in loans for house purchase⁴ (SKK 47.0 billion, compared with SKK 37.9 billion in 2006), which contributed 19.9 percentage points to the year-on-year growth in loans to households. Consumer and other loans recorded an absolute year-on-year increase of SKK 19.2 billion, which was similar to the figure for 2006 (SKK 18.9 billion). Their contribution to the growth dynamics of loans to households diminished gradually during the year,

to 8.6 percentage points in December. Consumer and other loans represented one of the sources of growth in household final consumption. Their share in household final consumption slightly increased in 2007, by 1.1 percentage points compared with the previous year, to 9.7% (2006 saw an increase of 1.3 percentage points, to 8.6%). It was, however, lower than in the euro area and the other V4 countries.

The growth in monetary financial institutions loans to households was accompanied by a rise in the level of indebtedness (expressed in terms of the ratio of loans to households to GDP), which increased year-on-year by 2.1 percentage points and reached 16.4% at the end of 2007. Similar developments in connection with the process of real convergence were also recorded in the other new EU Member States, while household indebtedness in these countries was much lower than in the euro area (54.4% in 2007).

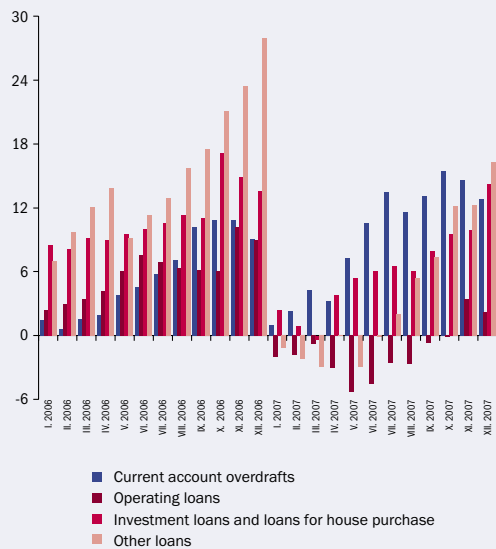
MFI loans to non-financial corporations

Loans to the non-financial corporations sector showed less dynamic development than those to the household sector. After moderating over the first half of the year, the year-on-year rate of growth accelerated again and reached an average of 22.4% in 2007. In terms of purpose, the increase in loans to non-financial corporations was concentrated in investment loans and loans for house purchase throughout the year,

⁴ Loans to households (including non-profit institutions serving households) broken down by purpose comprise house purchase loans, consumer loans, and other loans.



Chart 27 Increases in loans to non-financial corporations (year-on-year growth) (SKK billion)



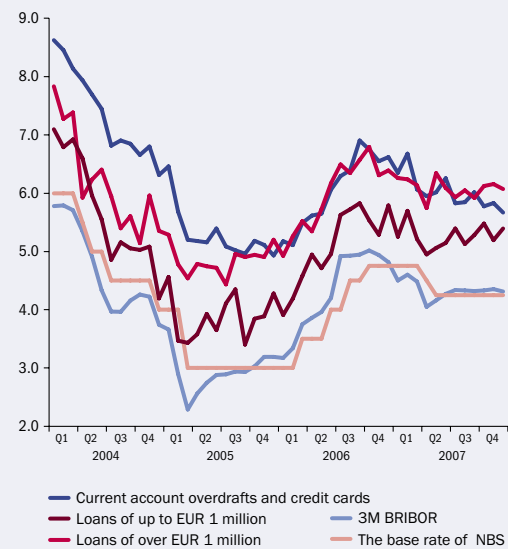
Source: NBS.

even if these increases were much smaller than in the previous year. Current account overdrafts grew significantly almost throughout the year. Regarding the time structure of loans, the growth in MFI loans to non-financial corporations took place mostly in short-term loans (up to 1 year), which recorded a gradual increase in dynamics. Concerning long-term loans, the contributions of loans from 1 to 5 years and those over 5 years were virtually equal, while their dynamics were stagnant during the year. The dynamics of loans with the longest maturities weakened somewhat at the end of the year.

2.4.2 Factoring, leasing and consumer credit companies loans

In 2007, NBS began to collect data from financial corporations granting loans (leasing companies, factoring companies, and consumer credit companies, personal or business finance companies) that according to ESA95 methodology form the S.123 sector "Other financial intermediaries, except for insurance corporations and pension funds". By definition, this sector is formed also by investment funds, except for money market funds, financial corporations providing credit and loans (leasing, factoring, instalment financing, personal or business financing), dealers in securities and derivatives, financial holding companies, and financial vehicle corporations. These statistics provide a more comprehensive picture of developments in the Slovak financial market, on the basis of balance-sheet data reflecting the activities

Chart 28 Interest rates on loans to non-financial corporations, 3-M BRIBOR, and the NBS base rate (%)



Source: NBS.

of financial intermediaries outside the sector of monetary financial institutions.

The factoring, leasing and consumer credit companies (FLCC) loans to the private sector reached SKK 124.1 billion at the end of 2007. About 71% of these loans were loans to non-financial corporations, and 28.5% were loans to households.

The volume of loans to non-financial corporations increased throughout the year and reached SKK 88.4 billion at the end of December. Broken down by purpose, loans to enterprises were dominated by financial leasing (SKK 65.8 billion). The share of FLCC loans in total loans to corporations (MFI and FLCC loans) reached an average of 18.1% in 2007.

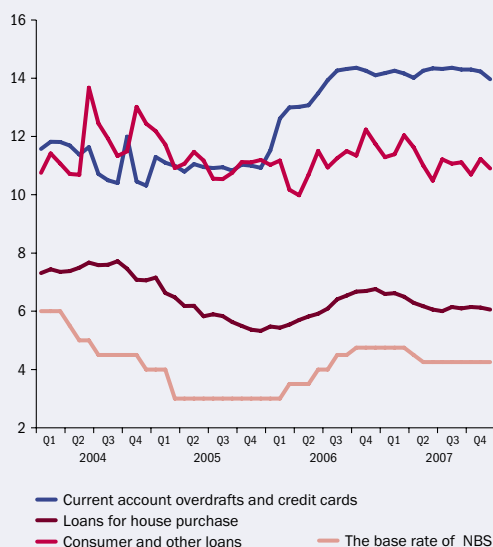
2007 also saw a gradual increase in the volume of loans in the household sector (totalling SKK 35.3 billion at the end of the year). The main components were instalment loans and consumer loans; they accounted for two thirds of the total FLCC loans to households. The growth in their volume was accompanied by an increase in their share in household final consumption, which reached 3.4% at the end of the year. This form of household financing accounted for 10.3% of the total loans to households (MFI and FLCC loans).

2.4.3 Customer interest rates

Customer interest rates were influenced in 2007 by reductions in the key NBS rates at the end of March

Chart 29 Interest rates on loans to households by type

(%)



Source: NBS.

and April (by 0.50 of a percentage point in total) and by developments in interbank market rates. Banks reacted to changes in the key interest rates of NBS relatively flexibly in the case of loans to non-financial corporations and households, and less flexibly in the case of deposits from non-financial corporations and households. In the case of certain types of loans and deposits, the effects of interbank market developments prevailed. Customer interest rates fell mostly in the first few months of 2007, later in the year they were relatively stable.

Interest rates on loans to non-financial corporations

Developments in interest rates on loans to non-financial corporations were dominated at the beginning of the year by a slightly falling trend, resulting from a cut in the base interest rate of NBS coupled with low interbank market rates attributable to a liquidity surplus. In the following period, interest rates were relatively stable, showing only small fluctuations. The changes in the base interest rate of NBS and the low interbank market rates were mostly reflected in short-term customer interest rates; long-term rates reacted very mildly. Most loans to non-financial corporations were provided with a short fixation period or without initial rate fixation, hence their interest rates reacted relatively sensitively to changes in the key rates. Interest rates on loans for small and medium-sized enterprises (up to EUR 1 million) and loans for large enterprises (over EUR 1 million) behaved in the same way. They

fell somewhat in the first few months, and followed a slightly rising trend in the following period. The falling trend in rates for current account overdrafts for non-financial corporations persisted throughout 2007, which was partly the result of developments in interbank market rates.

Interest rates on loans to households

Developments in interest rates on loans to households were characterised, as in the case of non-financial corporations, by a slightly falling trend in 2007, which reflected the cuts in the key NBS rates in the first months of the year.

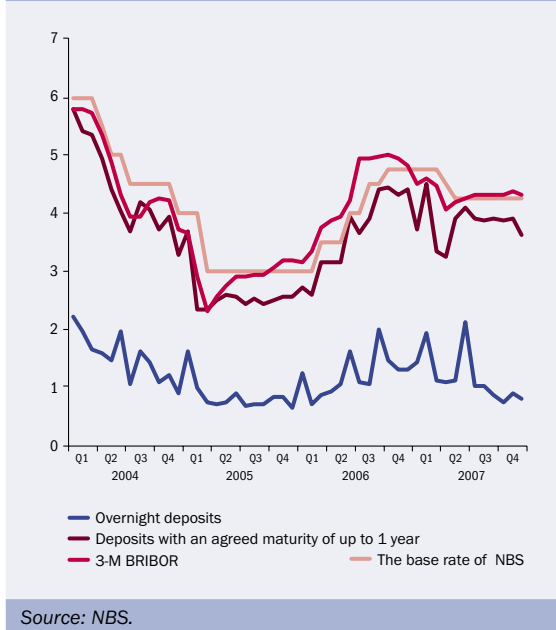
Interest rates on current account overdrafts and credit cards were stable throughout the year, and showed no reactions to the cuts in the key NBS rates.

The rising trend in interest rates on loans for house purchase, which persisted throughout 2006, came to a halt at the beginning of 2007. After NBS had lowered its key rates, customer interest rates on loans for house purchase began to fall slightly. This trend continued until July, when the decline came to a halt. From that time, interest rates on loans for house purchase were more or less stable, at the level of approximately 6.1%. This represented a fall of 0.70 of a percentage point compared with December 2006. Within the scope of loans for house purchase, interest rates dropped considerably on mortgage loans and other loans for house purchase. Interest rates on home savings bank loans showed different tendencies. Interest rates on intermediate loans dropped somewhat, while the rate for building loans rose slightly. Interest rates on home savings bank loans reacted to changes in the key NBS rates and market rates in a minimum extent, which can be explained by the different character of these products (compared with bank loans).

Interest rates on loans for consumption (consumer and other loans) were relatively volatile during the year, and showed a slightly falling tendency. This development was mostly influenced by drops in rates for non-specific loans and other loans. On the other hand, the opposite trend was recorded in rates for consumer loans granted for specific purposes, which increased.

Interest rates on deposits from non-financial corporations

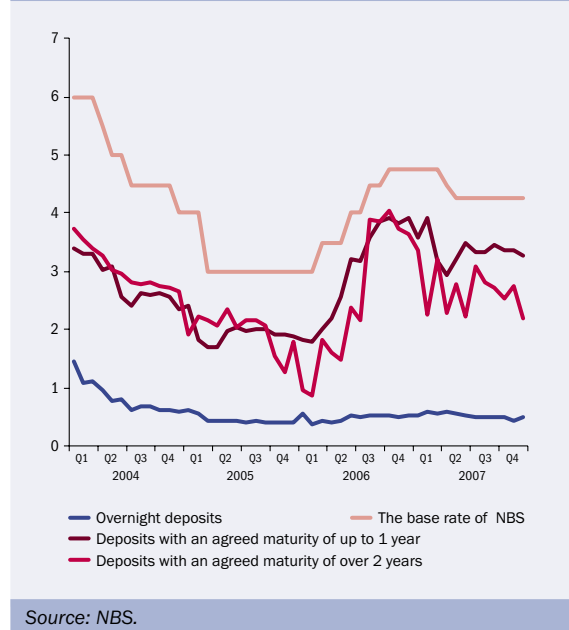
Interest rates on deposits from non-financial corporations followed a slightly falling trend in 2007. The most significant drops were recorded in interest rates on deposits with agreed maturity. Among these rates,

**Chart 30 Interest rates on deposits from non-financial corporations (%)**

the sharpest drop occurred in the rate for short-term deposits (deposits with an agreed maturity of up to 7 days and up to 3 months). A fall was also recorded in the price of overnight deposits, which reacted to changes in interbank rates relatively sensitively. Interest rates on long-term deposits were rather volatile, owing to the small share of these deposits.

Interest rates on household deposits

Interest rates on household deposits were characterised by a slight fall in 2007 (except for overnight deposits). Rates for overnight deposits remained unchanged throughout the year, though a significant drop was recorded within this category in the price of one day deposits. A slight fall was also recorded in rates for deposits with an agreed maturity of up to 1

Chart 31 Interest rates on household deposits (%)

year (mainly for deposits fixed for up to 7 days). This occurred in the first half of the year as a result of a reduction in the key NBS rates. The sharpest drops were recorded in rates for long-term deposits (fixed for over 2 years), which fell by as much as 1.4 percentage points. Interest rates on deposits redeemable at notice dropped only slightly in 2007.

Real interest rates, calculated by deflating the average interest rate on new one-year household deposits by HICP inflation, showed a slightly rising tendency until August 2007, mainly as a result of a slowdown in inflation coupled with a slight fall in interest rates on household deposits. In the following months, the inflation rate accelerated somewhat, while deposit rates were at a standstill, which led to a modest fall in real interest rates.