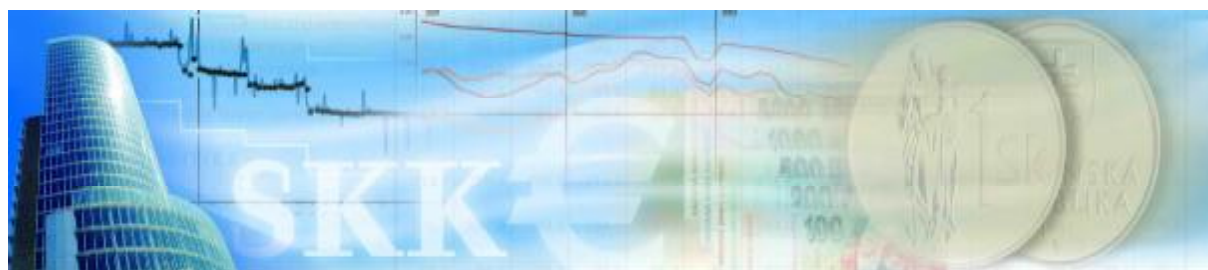




NÁRODNÁ BANKA SLOVENSKA

**MEDIUM-TERM FORECAST
(MTF-2007Q2)**

April 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). New information and data released on economic growth in 2006, especially the improved export performance in the second half of 2006, provided a rationale for the reassessment of the growth in the economy's potential output and consequently appreciation of the equilibrium real exchange rate in comparison with the January forecast (MTF-2007Q1). The trends in equilibrium real interest rates have remained unchanged.

The structure of economic growth in 2006 confirmed that the acceleration in GDP growth was caused first and foremost by an increase in the production capacity of the economy. The continuing inflows in foreign direct investment (FDI) and the related increase in export performance are likely to continue throughout the medium-term horizon. This should provide room for acceleration in the pace of non-inflationary economic growth. During 2007-2009, potential output is expected to grow by an average of approximately 8.0%. The strongest growth is expected in 2007, mainly in connection with the launch of production at new production plants in the automotive and electrical industries. In the following years, the growth in the economy's potential output is likely to moderate. Despite this, the rate of growth should remain above the long-term average even in 2009. The expected entry into the euro area is also likely to act as a stimulus for continuing investment demand.

The supply side of the economy recorded dynamic changes, which were, at the same time, the main reason for the reassessment of the equilibrium appreciation in real terms. In the current medium-term forecast, faster equilibrium real appreciation is expected in 2006 and 2007, compared with the January forecast. The change in its tendency is attributable to a marked increase in the productivity of production factors in this period.

Current position of the economy¹

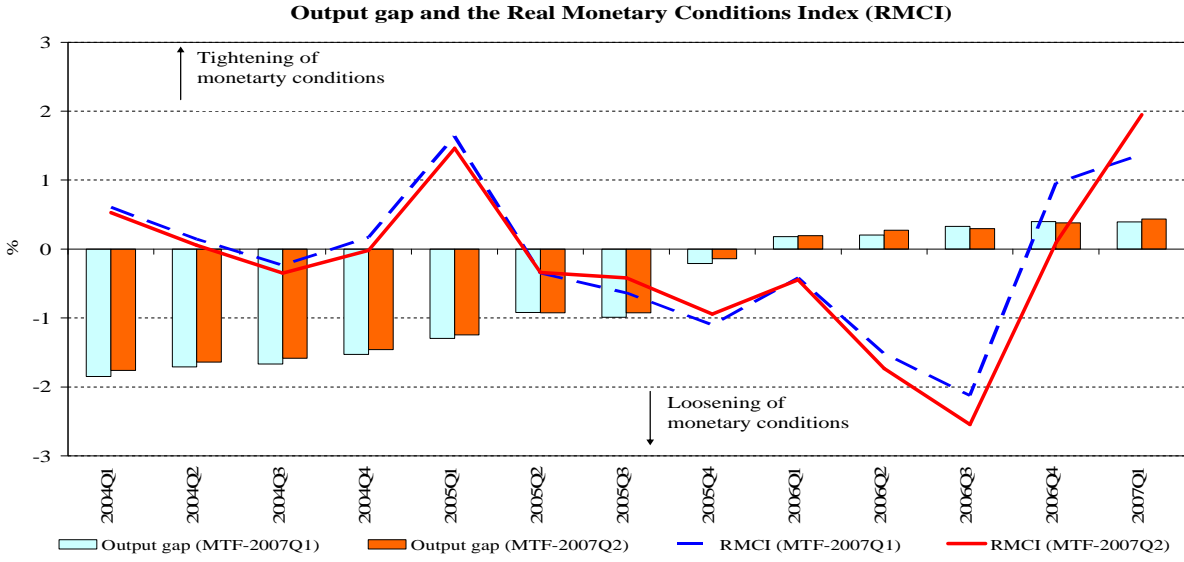
The estimate of the economy's current position is based on the estimated deviations of the key macroeconomic indicators from their equilibrium trends. The reassessment of the equilibrium real exchange rate gave rise to a change in the monetary policy stance, expressed in terms of the Real Monetary Conditions Index (RMCI) in 2006. The gradual acceleration in the appreciation of the equilibrium real exchange rate means that the exchange rate component of the monetary conditions had no dampening effect on the economy in 2006. Compared with the January forecast, the monetary conditions were on the whole looser in 2006. In the first quarter of 2007, the monetary conditions were tightened owing to an appreciation in the nominal exchange rate, mainly after the revaluation of the central rate. The marked appreciation of the exchange rate in such a short period, however, was not based on economic fundamentals. The persistence of the exchange rate at a level well above the central rate in 2007 may have a restrictive impact on the economy in the next quarters, despite the reassessment of the trend in equilibrium real appreciation. The interest rate component of the

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

monetary conditions fell somewhat below its equilibrium level as a result of reductions in nominal interbank market rates. This has, however, a negligible impact on the overall monetary conditions compared with the shift in the exchange rate component. In the first quarter of 2007, the monetary conditions maintained their restrictive character in line with the assumptions of the January forecast.

In the fourth quarter of 2006, real economic growth reached 9.6% and thus fulfilled the assumptions of the January forecast (MTF-2007Q1). As far as the structure of GDP is concerned, the MTF-2007Q1 was based on the assumption that overall economic growth was promoted by both domestic and foreign demand, while, concerning the relative contributions, GDP growth was largely expected to be stimulated by foreign demand. The year-on-year acceleration in the rate of real economic growth was mainly a consequence of net exports, which contributed 5.2 percentage points to the year-on-year rate of economic growth. The developments in domestic demand reflected the pro-growth effects of final consumption and fixed investments. The volume of inventories decreased in the fourth quarter (in line with expectations); this development had a dampening effect on the final pace of economic growth. The structure of GDP growth in 2006 indicates that the continuing dynamic economic growth in the fourth quarter of 2006 was caused by the economy’s increasing production capacity. This means that the strong economic growth is composed of non-inflationary GDP growth, while the estimate of the economy’s cyclical component has remained virtually unchanged in comparison with the January forecast.

With regard to real economic growth, the most significant factor in the first quarter of 2007 will probably be the expected increase in export performance, which will accelerate the rate of GDP growth. This development should result from dynamic value added creation in the manufacturing of transport equipment and is also indicated by receipts for own performances and goods in this sector, as well as in the entire manufacturing industry. In the first quarter of 2007, owing to the utilisation of the expanding production capacity in industry and increased production in construction (climatic conditions), the Slovak economy is likely to achieve the strongest growth ever recorded (at constant prices). The increase in net exports should be partly offset by a decline anticipated in inventories, mainly in the ‘finished products’ category.



Actual and projected data on GDP growth in the first quarter indicate that at the beginning of 2007 the economy remained in a slightly positive output gap, similar in size as in the fourth quarter of 2006 (+0.4% of GDP). The estimated current position of the economy corresponds to the loose monetary conditions to date and the gradual revival of foreign demand.

The growth in nominal and real wages over the fourth quarter of 2006 was in line with the figure predicted by the NBS in the January forecast. The strongest nominal wage growth in the fourth quarter of 2006 was recorded in public administration, defence and social security, real estate, agriculture, health care and industry. The dynamic wage growth is expected to continue in the first quarter of 2007 (as according to the previous forecast), which is also indicated by preliminary data on wage developments in the selected sectors in January and February, but their dynamics should be somewhat weaker than in the previous quarter. In the first quarter of 2007, real wage growth is likely to accelerate in comparison with the previous quarter as a result of a lower average inflation rate.

According to statistical reports as well as Labour Force Sample Survey (LFSS), employment continued to grow dynamically on a year-on-year basis in the fourth quarter of 2006, in line with the projections of the MTF-2007Q1. The trends in employment in selected sectors in January and February indicate that the dynamic employment growth is likely to continue in the first quarter of 2007 at a somewhat faster pace than according to the MTF-2007Q1. According to a LFSS, employment should remain at the level of the MTF-2007Q1 due to an anticipated slowdown in employment growth abroad and accelerated employment growth in the domestic part of the economy.

In 2006, the balance of payments on current account resulted in a deficit of Sk 135.6 billion, representing a year-on-year increase of Sk 8.7 billion. The deterioration in the b.o.p. current account was mainly caused by an increase in the trade deficit, which was only partly offset by an increase in the positive balance of services. The other two current account components recorded only a slight deterioration in comparison with 2005. The current account deficit exceeded the NBS estimate from the MTF-2007Q1 by more than Sk 20 billion, while the higher-than-expected figure was mainly caused by increased deficits in the income and current transfers balances, and developments in the trade balance in particular (in the MTF-2007Q1, the NBS assumed that non-standard imports for stocking-up would be gradually transformed into exports in the fourth quarter, which, however, was completed only in part). On the other hand, an improvement was achieved in the services balance, where the increased surplus resulted from non-standard receipts from the transit of gas (the non-standard receipts were connected with the remittance of withheld payments from 2004-2006). The increased deficit also affected the share of the b.o.p. current account deficit of GDP, which decreased year-on-year by only 0.3 of a percentage point in comparison with the January medium-term forecast (the original estimate was 1.6 percentage points) and reached 8.3% in 2006.

With regard to the fact that the beginning of 2007 saw an acceleration in both export and import growth, accompanied by an improvement in the trade balance, the trade balance is expected to improve in comparison with the previous forecast throughout the first quarter of 2007.

As expected, consumer prices, as measured by the Harmonised Index of Consumer Prices (HICP), recorded a slowdown in the year-on-year rate of increase over the first quarter of 2007. This development was influenced by the weakening year-on-year dynamics of prices for services as well as goods. Within the scope of goods prices the year-on-year rate of increase slowed in comparison with the previous quarter in energy prices in particular, due to the base effect of a marked energy price increase in the same period a year earlier. The prices of industrial goods, excluding energy, were affected by the January reduction in VAT on pharmaceuticals. Accelerated year-on-year increases in the first quarter (compared with the previous quarter) were recorded in food prices, where both processed (bread and bakery products, cigarettes) and unprocessed food prices (fruit and vegetables, including potatoes) showed increased dynamics. Prices for services recorded a slowdown in year-on-year dynamics, as a result of developments in prices for services related to housing, recreational and personal services, and other miscellaneous services.

Compared with the previous forecast (MTF-2007Q1), a higher inflation rate was recorded in the first quarter of 2007. This was mainly due to a steeper-than-expected rise in food prices and a slower-than-expected year-on-year decline in industrial goods prices, excluding energy prices. Compared with the assumptions of the MTF-2007Q1, however, slower year-on-year increases were recorded in energy prices (due to fuel price developments) and prices for services. In services, weaker dynamics compared with the forecast were reflected in the prices of housing-related services.

Medium-term forecast

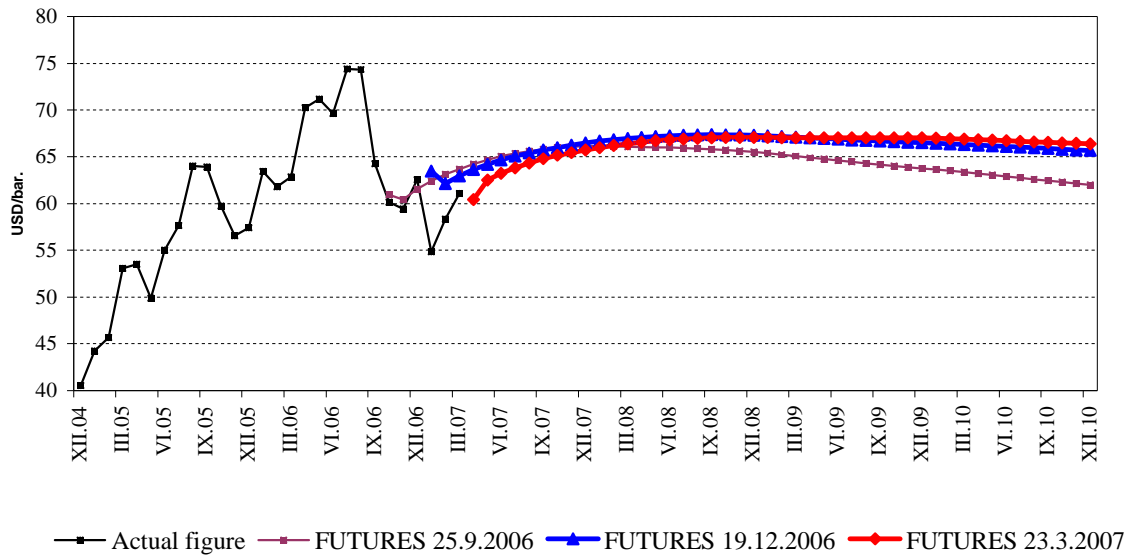
External environment

The medium-term forecast of exogenous indicators is based on the March issue of the Consensus Forecasts (CF)². The expected developments in oil prices are based on the prices of futures as of 23 March 2007.

Compared with the MTF-2007Q1, the oil price forecast predicts a drop to a lower level, while the projected increase until 2009 is maintained in line with the previous forecast. As from the middle of 2007, however, the increase in oil prices is likely to accelerate in comparison with the MTF-2007Q1. The USD exchange rate towards EUR is expected to appreciate throughout the projection horizon, but at a slower pace than predicted in the MTF-2007Q1.

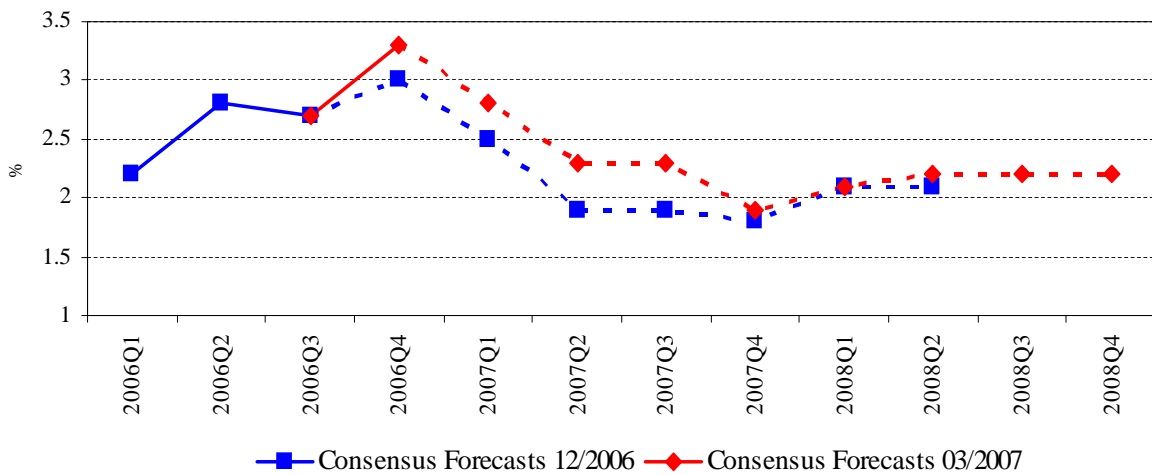
² A survey of forecasts made by international economic and financial institutions, from which an average is calculated. This ensures the most unbiased estimate of the trends in foreign sector indicators. With regard to the course and schedule of forecasting at the NBS, the values of input variables were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

Expected oil prices



In 2007, euro-area GDP is expected to grow at a faster pace (by 0.1 to 0.4 of a percentage point) than according to the MTF-2007Q1. However, the assumption of a slowdown in 2007 followed by a modest increase in dynamics in 2008 remains.

Euro-area GDP growth forecast based on Consensus Forecasts



In 2007, euro-area inflation should fluctuate below 2%, representing a fall in inflation of 0.2 of a percentage point compared with the MTF-2007Q1. As of the end of 2007, inflation is expected to return to the 2% level. Compared with the MTF-2007Q1, the EURIBOR interest rate is expected to rise more dynamically throughout the projection horizon, by approximately 0.2 of a percentage point, up to 4.1% in 2008.

	2006	2007	2008	2009
Euro-area inflation in %				
CF 12/06 (annual average)	2.2	2.1	1.9 (2Q)	
CF 03/07 (annual average)	2.2	1.8	2.0	2.0*
Euro-area GDP growth in %				
CF 12/06	2.7	2.0	2.1 (2Q)	
CF 03/07	2.7	2.3	2.2	2.0*
Oil prices in USD/barrel and EUR/barrel respectively (annual average)				
19 December 2006	66.2/52.9	64.7/49.1	67.2/51.7	
23 March 2007	66.2/52.9	62.5/47.5	66.7/51.0	67.1/51.3*
USD/EUR exchange rate (end of the relevant quarter)				
CF 12/06		1.323 (Q1)	1.308 (Q4)	1.291 (Q4)
CF 03/07		1.319 (Q2)	1.309 (Q1)	1.307 (Q1)

* NBS forecast.

The stronger economic growth in the euro area in 2007 (compared with the previous forecast) is expected to create conditions for foreign demand to have a stimulating effect on the Slovak economy. Compared with the previous forecast, price developments in Slovakia should be dampened by euro-area inflation in 2007. Upward effects in 2008 are mainly expected from a rise in oil prices and an appreciation in the dollar.

Forecast for 2007

The forecast for 2007 predicts a slowdown in the 12-month rate of HICP inflation over the next three quarters, below 2%, and a somewhat lower year-end inflation rate in comparison with the MTF-2007Q1. The lower headline inflation forecast in comparison with the previous forecast can primarily be ascribed to a slowdown in the year-on-year increase in prices for services in the next quarters. On the other hand, goods prices are expected to show slightly increased dynamics. They are likely to be affected by a steeper increase in food prices, caused by higher agricultural commodity prices. At the same time, the dynamics of energy prices are expected to weaken, due to a marked year-on-year fall in fuel prices and coupled with an anticipated steeper year-on-year decline in industrial goods prices, excluding energy prices (a fall in regulated prices in health services, the impact of lower foreign and imported inflation). In the previous forecast (MTF-2007Q1), the regulated prices of pharmaceuticals were not expected to fall as from April. The current forecast takes this fall into account, which represents a contribution of -0.1 of a percentage point to overall inflation.

As a result of these factors, the rate of headline inflation, excluding energy and unprocessed food prices, is likely to slow and remain until the end of the year at a lower level than was predicted in the MTF-2007Q1. At the end of 2007, HICP inflation is expected to reach 1.3%; the average annual rate could reach 1.5%.

Regulated prices (energy prices and other regulated prices) are projected by the NBS to rise by an average of 1.8% in 2007 (compared with 2.4% according to the MTF-2007Q1). They should contribute approximately 0.6 of a percentage point to headline inflation in 2007 (compared with 0.7 of a percentage point according to the MTF-2007Q1). At the end of

2007, the year-on-year increase in regulated prices is expected to reach 0.4% (compared with 1.0% according to the MTF-2007Q1), representing a contribution to headline inflation of 0.1 of a percentage point (compared with 0.3 of a percentage point according to the MTF-2007Q1). The current assumption of weaker regulated price dynamics results from the expected reduction in the prices of pharmaceuticals with effect from April. This fact was not taken into account in the previous forecast.

In the real GDP growth forecast for 2007, the growth rate is predicted to accelerate by 0.3 of a percentage point compared with the previous forecast. This change is connected with the expected utilisation of the Slovak economy's expanding production capacity, mainly in export-oriented sectors. On the basis of foreign trade figures for January and February 2007, the export performance of the economy (automotive and electrotechnical industries) is expected to increase, mainly in the first half of 2007, with exports growing year-on-year by more than 30% at constant prices.

Final consumption in the household and general government sectors has remained unchanged in comparison with the previous forecast. Household final consumption should be dampened by a slight slowdown in the rate of real wage growth (by 0.2 of a percentage point). Despite the unchanged LFSS-based employment forecast, employment is expected to have a stimulating effect on household final consumption (in terms of structure, stronger employment growth is expected in the domestic economy, accompanied by weaker growth abroad, compared with the previous forecast). The continuing growth in household final consumption is also indicated by the level of consumer confidence. According to information on the new investments of Samsung, the dynamics of gross fixed capital formation are 0.8 of a percentage point stronger than according to the January forecast.

In the MTF-2007Q2, compared with the January forecast, the NBS foresees no change in the rate of nominal wage growth in 2007. The NBS based its assumptions on wage developments from 2006, which were in line with the MTF-2007Q1 forecast. The NBS still assumes that the stronger growth in labour productivity will not be fully reflected in the nominal wage growth. Labour productivity growth, which is mainly expected in sectors with FDI inflows, should be mostly influenced by the increasing gross operating surplus. This assumption remains the most serious risk in the forecast.

In 2007, developments in employment should be in line with the January forecast. Employment growth is mainly expected to be promoted by the favourable economic environment reflected in the dynamic overall economic growth. These factors, stimulating growth in labour demand in the domestic part of the economy, should be dampened in part by the expected reductions in staffing levels in budgetary and subsidised organisations.

The unemployment rate (based on an LFSS) is expected to be somewhat lower in 2007 than according to the MTF-2007Q1.

The balance of payments on current account for 2006, as well as the new assumptions concerning the external factors, 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 previous trade balance developments. Exports grew year-on-year at an accelerating rate during 2006, and this trend continues at the beginning of 2007. This is reflected in the increasing dynamics and volume of exports in 2007; the growth in export performance is mainly mirrored in the growing exports of semi-finished goods and machines. Stronger exports led to increased import expectations in both semi-finished goods and machines. The growth in imports will also be supported by the construction of a new production plant for Samsung. The exports and imports of raw materials in 2007 are expected to be lower than according to the previous forecast, due to the anticipated fall in oil prices.

The total increase in exports resulting from the economy's increased export performance exceeds the increase in imports resulting from the import intensity of the economy and increased imports of investments. Thus, the expected deficit in the trade balance forecast for 2007 is reduced by a total of Sk 3.7 billion.

According to the latest data on the services balance in 2006, which confirmed the assumptions of the NBS from the previous forecast, there was no need to change the estimated surplus in the 2007 balance of services, compared with the previous forecast.

On the other hand, the projection of the total income balance deficit was adjusted in comparison with the previous forecast, mainly in view of the higher estimate of dividend payments (on the basis of the profits of companies reassessed according to the results for 2006). The increase in the income balance deficit, caused by a higher estimate of dividends paid to foreign investors, was only partly offset by a lower estimate of reinvested earnings and a higher estimate of income from the compensation of employees working abroad (due to the more favourable developments in 2006). In total, the income balance deficit deteriorated by more than Sk 6 billion, as a result of the actual developments in 2006.

The lower estimate of drawings from EU funds, coupled with a higher estimate of the deficit in the balance of other current transfers (compared with the previous forecast), contributed to the deteriorated estimate of the current transfers balance and was influenced by developments in 2006. On the basis of the latest estimates, the balance of transfers surplus predicted for 2007 was reduced by Sk 5.5 billion.

The changes in the estimates of individual current account components led to an increase of approximately Sk 8 billion in the deficit predicted for 2007; the share of the current account deficit of GDP is expected to increase by 0.5 of a percentage point, to 4.3%. Compared with the previous forecast, the degree of openness of the economy is expected to increase by 4.1 percentage points, to 178.4% of GDP.

Since FDI inflows in the form of equity participation in 2006 exceeded the projections from the MTF-2007Q1, the estimated inflow of equity capital was also increased somewhat for 2007. Similarly, the increased drawing of financial credits from foreign parent companies in the current developments in 2006 was reflected in an increase in estimated FDI inflows in the form of 'other capital'. The increased FDI inflows in the form of equity participation and other capital are exceeded in the April forecast by a lower estimate of reinvested earnings, which causes a slight decrease in the total FDI inflow.

Forecasts for 2008 and 2009

The current medium-term forecast foresees a year-end HICP inflation rate of 2.0% in 2008 (an average of 1.9%), followed by an acceleration in 2009, to 2.5% (an average of 2.2%). Compared with the MTF-2007Q1, the current medium-term inflation forecast predicts unchanged figures for 2008.

The inflation forecast for 2008 was influenced by the expectation of a weaker impact from the increased excise duty on cigarettes, due to an upward shift in the exchange rate and the fact that the best selling cigarettes were the more expensive brands³. The NBS currently assumes that the excise tax increase for cigarettes will represent a contribution of approximately 0.2 of a percentage point (compared with 0.3 of a percentage point according to the MTF-2007Q1). Another stimulus for a drop in inflation to a lower level in 2008, compared with the previous forecast, is the slowdown in inflation in 2007 and the resulting lower inflation expectations for 2008. These lower inflation stimuli will be offset by a steeper-than-expected increase in prices for services (compared with the MTF-2007Q1).

Within the basic structure of inflation, average price dynamics are expected to increase in 2008 (compared with 2007) for both goods and services. In 2008, the prices of services are likely to be affected by the increased cost stimuli resulting from a faster rise in regulated energy prices anticipated in 2008. After showing weaker year-on-year dynamics in 2007, energy prices should again accelerate from 2008 onwards, as a result of an increase in regulated energy prices and developments in fuel prices, which are likely to rise year-on-year in 2008. Food prices, which showed the strongest year-on-year dynamics at the beginning of 2007, are expected to slow from the second quarter of 2007 to the middle of 2008. In the second half of 2008, food prices are likely to reflect the effect of excise tax increase for cigarettes.

According to the assumption of the NBS, the dynamics of energy prices are likely to weaken in 2009 compared with 2008. Inflation is expected to accelerate in 2009, mainly as a result of factors outside the range of monetary policy. In 2009, energy taxes are planned to be introduced with a contribution to headline inflation of 0.1 of a percentage point. According to the Draft General Government Budgets for 2007-2009, another factor will be a further increase in the excise duty on cigarettes with effect from January 2009, which will have an upward effect on food prices. According to the NBS estimates, the increased excise duty on cigarettes should contribute 0.2 of a percentage point to overall inflation. The acceleration in inflation will also be influenced in the short term by the effect of rounding during the introduction of euro coins and notes (the so-called 'euro changeover effect'). According to Eurostat's estimates, the exchange of coins and notes denominated in the national currencies for euro coins and notes raised inflation in euro-area countries in 2002, by 0.12 to 0.29 of a

³ According to EU rules, the minimum tax rate is calculated for the best selling brand of cigarettes. The tax rates are calculated from the fixed and percentual parts, where the percentage is determined as a % share of the retail price. If the price of the best selling cigarettes is higher, the tax rate will also be increased, as well as its share of the selling price. In the previous year, the retail price of the best selling cigarettes was Sk 50 per packet (19 pcs) and the tax on these cigarettes (64.8% and EUR 45.5 per 1,000 pcs) was higher than the tax on the best selling cigarettes to date packed in 10-piece packets (49.8% and EUR 54.5 per 1,000 pcs), while the minimum tax rate was 57% and EUR 64 per 1,000 pcs.

percentage point⁴. According to Eurostat's first estimates, the euro changeover effect in Slovenia reached approximately 0.3 of a percentage point⁵. The Slovak Government and the NBS are preparing various measures for the protection of consumer prices from these effects. In the current forecast, the NBS expects, as a precaution, a contribution from the euro cash changeover in the range of 0.2 to 0.3 of a percentage point.

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 inflation expectations and the low imported inflation, due to the openness of the Slovak economy also simplified price comparison and trade after the introduction of the euro. A certain upward effect on inflation may also be expected from the lowering of interest rates to the level of the euro area, which may support consumption to the detriment of savings.

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

		2006	2007	2008	2009
TOTAL (HICP)	MTF-2006Q4	4.4	2.8	2.1	
	MTF-2007Q1	4.2	1.6	2.0	
	MTF-2007Q2	4.3	1.5	1.9	2.2

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

		2006	2007	2008	2009
TOTAL (HICP)	MTF-2006Q4	4.1	2.6	2.0	
	MTF-2007Q1	3.7	1.5	2.0	
	MTF-2007Q2	3.7	1.3	2.0	2.5

According to NBS estimates, regulated prices (energy prices and other regulated prices) are likely to rise by an average of 1.9% in 2008 (compared with 2.0% according to the MTF-2007Q1) and by 1.7% in 2009. Their contribution to overall inflation should be approximately 0.6 of a percentage point in 2008 (the same figure was predicted in the MTF-2007Q1) and approximately 0.5 of a percentage point in 2009. By the end of 2008, regulated prices should increase by 1.8% (the same figure was projected in the MTF-2007Q1) with a contribution of 0.5 of a percentage point to overall year-on-year inflation (compared with 0.5 of a percentage point in the MTF-2007Q1) and by the end of 2009, their year-on-year increase should reach 2.1% with a contribution to overall inflation of approximately 0.6 of a percentage point.

The current forecast also includes certain risks. The most serious inflationary risks are the developments in oil prices and their impact on fuel prices and regulated energy prices, which may change the course of inflation in comparison with the current forecast.

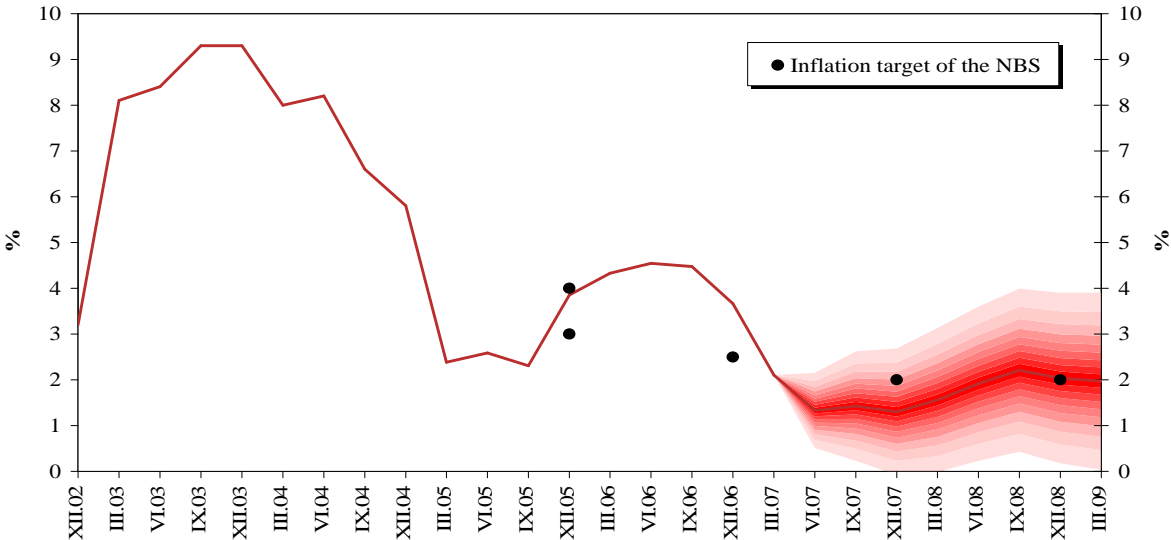
Food prices, which may be affected by weather conditions and developments in the prices of agricultural commodities on the European market, also pose persistent inflationary risks.

⁴ Source: News Release 69/2003 of 18/06/2003, with Annex on Euro changeover effect - Study 4, Eurostat, June 2003.

⁵ Source: Euro changeover and inflation in Slovenia, Eurostat, March 2007.

Prices for services are still influenced by the upward effects of growing employment, nominal and real wage growth, and household final consumption. At the beginning of the year, however, the secondary effects of modest increases in regulated prices were reflected in services prices to a lower extent than expected. This trend in the weaker than expected dynamics may persist in the coming period and represents a downward risk.

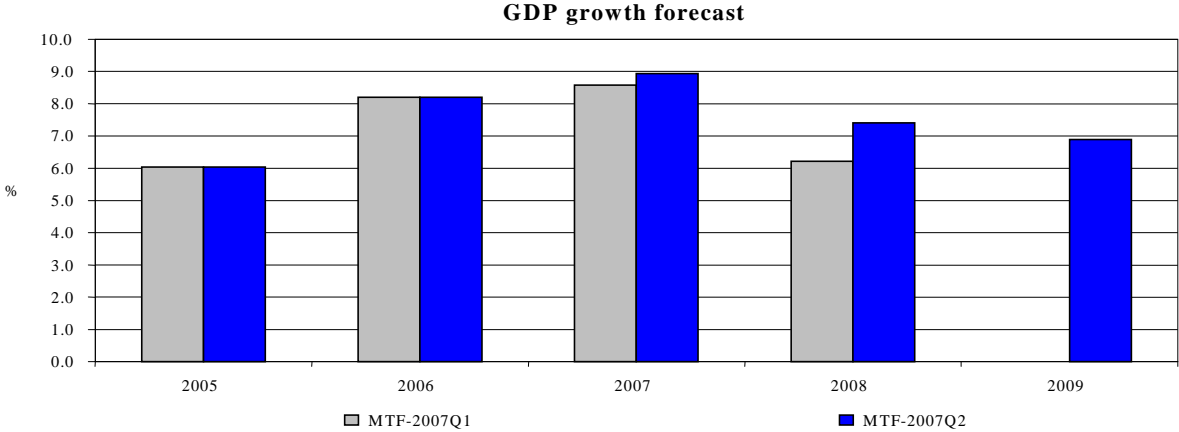
HICP inflation forecast



In the medium-term forecast of the real economy, export performance is predicted to accelerate in 2008 (compared with the MTF-2007Q1), which will also be reflected in the overall rate of real GDP growth. This change is connected with the gradual expansion in production capacities in the automotive industry and the announcement of a new investment by Samsung. Automobile production at the PSA plant is expected to increase in 2009. These developments should lead to increased value added creation and increased export performance. Thus, net export is expected to contribute approximately by 2.1 percentage points to real GDP growth in 2008. A risk to the forecast (upwards) is posed by the extension of the network of sub-contractors in the electrotechnical industry and the planned investments in the power industry. In the next period, additional foreign investments are expected in connection with the entry of Slovakia into the euro area, which should have a pro-growth effect on GDP in the coming years.

Within the structure of domestic demand, all its major components are expected to have a growth-promoting effect in 2008-2009. Household final consumption is likely to show increasing dynamics in 2008 (compared with the MTF-2007Q1) as a result of accelerated growth in real wages. In 2009, the growth in final consumption is expected to continue at a slightly accelerated pace. Developments in general government final consumption in the coming period will be connected with the fulfilment of the general government budget, overall economic development, and the drawing of funds from the structural funds; the assumptions have remained unchanged in comparison with the January forecast. Over the medium-term horizon, gross fixed capital formation is likely to reach an average year-on-year growth of 7.7% in real terms, which would slightly exceed the figure for 2006. The growth in fixed investments should be supported by the growing profits of companies, the stable business environment, and the increasing production activity in industrial sectors. 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, mainly due to the start-up of production at the Samsung plant and/or growth in production at the PSA plant (the impact of investment imports and their re-classification to fixed investments). In 2008-2009, the economy's production capacity is expected to expand still further, which indicates that, despite the projected increased dynamics of real GDP growth (compared with the MTF-2007Q1), such economic growth should have no inflationary effect.



Compared with the MTF-2007Q1, the current medium-term forecast predicts nominal wage growth at a somewhat faster pace in 2008. The stronger wage growth may be a result of dynamic employment growth, mainly in the automotive and electrotechnical industries. In these sectors, further FDI inflows may be expected, as well as a steady increase in production capacities in existing companies. This may result in a shortage of qualified labour. These factors will probably also stimulate wage growth in 2009, at a slightly accelerated rate in comparison with 2008. The growth in real labour productivity is expected to accelerate in 2008 in connection with the stronger GDP growth compared with the previous forecast, and is likely to exceed real wage growth throughout the projection horizon.

The medium-term forecast (MTF-2007Q2) predicts somewhat faster employment growth for 2008 (according to statistical reports) in comparison with the previous forecast, with a gradual slowdown until 2009. In 2008, employment growth (according to a LFSS) should be in line with the assumptions of the previous forecast, but the NBS expects a slight acceleration in employment growth in the domestic part of the economy, while the growth in the number of persons working abroad should slow somewhat in comparison with the MTF-2007Q1. The improvement in the domestic economy, coupled with dynamic nominal wage growth, will create conditions for making the domestic labour market more attractive, which may have a contra productive effect on the outflow of labour for work abroad. In 2008-2009, 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 somewhat lower than according to the MTF-2007Q1.

Within the balance of payments current account, the volume of exports as well as the rate of growth predicted for 2008 have been increased in comparison with the previous forecast. The increase in exports was mainly caused by the revaluation of export conditions at the KIA automobile assembly plant, where the planned level of production is expected to be achieved

more quickly, and by the calculation of the estimated output and exports of the new Samsung plant. On the basis of current developments, the conditions for export in smaller companies have also been reassessed. Since the strong growth in exports continues at the beginning of 2007, the economy's export potential is expected to increase further in the upcoming years. The higher estimate of exports for 2008 is reflected in the higher imports estimate in comparison with the previous forecast. The import intensity of exporting companies should be mainly reflected in the growing imports of semi-finished goods and machines. The construction of the new FDI plant also requires a temporary increase in imports, in the form of imported technology, machinery and equipment. On the other hand, the lower estimates of oil prices (compared with the MTF-2007Q1) are expected to cause a slight reduction in both exports and imports in comparison with the previous forecast.

In 2009, the year-on-year rates of export and import growth are expected to slow somewhat, since the positive effect of expanding production at the new plants is likely to be weaker than in the previous year. An increase in production and subsequently in exports may be expected in the automotive and electrotechnical industries (since export from the new Samsung plant in 2008 is expected to start in the second quarter whereas in 2009 the export will be carried out for the whole year). Through import intensity, the slowdown in export growth should also induce a slight year-on-year slowdown in import growth (mainly in semi-finished goods and machines). In connection with the assumed oil price stability, raw materials should also contribute to the slowdown in export and import growth.

Since the increase in exports is only partly offset by an increase in imports, resulting mainly from the existing import intensity and expanding production capacity of the economy, these changes should cause an accelerated improvement in the trade balance in 2008 (compared with the previous forecast). The continuing improvement in the 2009 balance will be supported by the expected consequences of Slovakia's entry into the euro area, which should gradually provide an additional stimulus for more intense trade with euro-area countries. Due to the absence of transaction costs, especially exports are expected to be influenced positively; this influence should cause an improvement in the trade balance in the long term. On the other hand, a negative impact on the trade balance in the period under review is likely to be exerted by the planned construction of new nuclear and steam power plants, which may cause a temporary deterioration in the trade balance through increased imports.

Similar to estimated balance of services for 2007, the estimate for 2008 has remained unchanged in comparison with the previous forecast. In 2009, the moderate year-on-year increase in the services balance surplus is expected to continue, mainly due to an improvement in the balance of other services.

The projection of the total income balance deficit for 2008 has been adjusted for the higher estimate of dividend payments. The increase in the income balance deficit, caused by a higher estimate of dividends paid to foreign investors, was only partly offset by a lower estimate of reinvested earnings and a higher estimate of income from the compensation of employees working abroad, caused the estimate of the income balance deficit to deteriorate by more than Sk 8 billion. In 2009, the total profits of companies with foreign participation are expected to increase more moderately; hence the deterioration in the income balance deficit is likely to be offset by the continuing growth in the surplus in compensation of employees abroad. Thus, the income balance deficit in 2009 should be roughly similar to that in 2008.

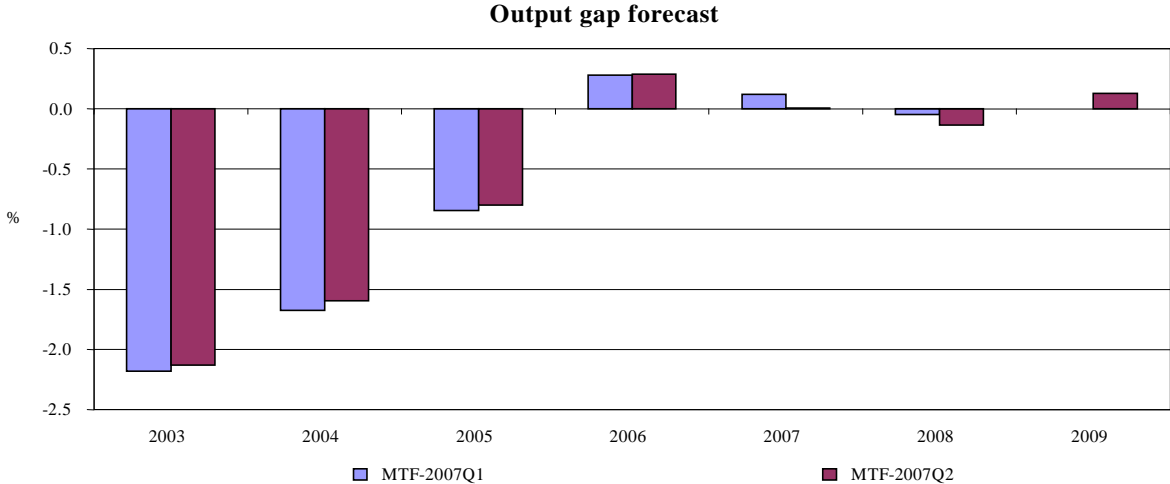
The increase in the estimated deficit in the balance of other current transfers in comparison with the previous forecast was the main reason behind the deterioration in the estimated balance of current transfers in 2008 (by more than Sk 4 billion). On the basis of the latest estimates, a marked increase is expected in 2009 in drawings from eurofunds, which is likely to cause a year-on-year increase in the positive balance of current transfers. A risk for the expected transfers balance surplus may be 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 changes in the estimates of individual current account components have led to an improvement in the deficit estimate for 2008 (by almost Sk 10 billion) and a decrease in the current account deficit as a share of GDP (by 0.6 of a percentage point, to 2.7%). According to the latest estimates, the b.o.p. current account deficit should shrink below 1% of GDP in 2009.

In 2008 (as in 2007), slightly increased FDI inflows are expected in the form of equity and other capital. The increased FDI inflows in the form of equity participation and other capital are also offset in the 2008 forecast by a lower estimate of reinvested earnings, which leads to a slight decrease in the estimate for the total FDI inflow. In 2009, a modest year-on-year increase is expected in FDI inflows, mainly as a result of an increased inflow in equity capital.

In 2008, the degree of economic openness is expected to increase both in comparison with the previous forecast and on a year-on-year basis. In 2009, this indicator is expected to increase year-on-year to 184.1% of GDP.

Monetary policy setting is still determined by the ongoing developments in the economy. There is a risk that the marked appreciation of the real exchange rate in the first quarter of 2007 may temporarily dampen economic activity. However, the continuing revival in foreign demand should have a pro-cyclical effect. By pursuing a prudent monetary policy aimed at eliminating the potential risk of overheating, the economy may move from a slightly positive output gap in 2006 through an equilibrium state in 2007 to a slightly negative output gap in 2008 (-0.1%). Compared with the MTF-2007Q1, in which a positive output gap was predicted for 2007, the monetary conditions are expected to have a more restrictive effect on the cyclical position of the economy. In 2009, however, a slight pro-growth stimulus is expected in connection with the country's entry into the euro area.



Annex

Medium-term forecast (MTF-2007Q2) of main economic indicators

Indicator	2006	2007	2008	2009	2007	2008	2009
	Actual	Forecast			Difference with previous forecast		
Prices (y-o-y change)							
HICP index (index 2005=100)	1.2	1.9	2.0	2.5	-0.1	0.0	-
LCPI index (average)	2.1	2.7	2.8	2.2	-0.1	0.1	-
HICP excluding energy and unprocessed food and grain	2.1	2.7	2.5	2.8	-0.1	0.2	-
HICP excluding energy and unprocessed food and grain (excl. tax)	1.7	1.6	2.2	2.4	-0.1	-0.1	-
GDP inflation (year-on)	-1.2	-0.5	-0.9	2.5	-0.1	0.2	-
Core inflation (year-on)	-0.5	0.2	0	2.3	-0.1	-0.1	-
Consumer inflation (year-on)	0	2.3	1.7	2.0	-0.1	-0.2	-
Core inflation (average)	2.3	2.7	2.8	2.1	-0.1	0.1	-
IPF (percentage)	3.4	2.1	2.5	1	-1.1	0.2	-
GDP (y-o-y change, unless otherwise indicated)							
Nominal GDP (BIL bn)	1 535.7	1 615.8	1 552.6	1 731.1	8.8	38.7	-
Hours of GDP	11.2	11.2	9.9	9.1	0.9	1.6	-
Real GDP	3.2	3.5	3.1	6.9	-0.3	1.2	-
Domestic demand	6.4	4.4	3.9	6.0	-0.1	-0.2	-
Final consumption of private households	6.3	6.9	6.0	6.1	-0.1	0.1	-
Final consumption of general government	-1.1	2.5	2.0	1.9	-0.1	0.0	-
Final consumption of non-profit institutions	-0.2	2.0	2.0	2.0	-0.1	0.0	-
Gross fixed capital formation	7.2	3.7	3.1	8.0	-0.2	0.6	-
Exports of goods and services	23.7	25.7	21.7	7.8	5.7	3.7	-
Imports of goods and services	19.9	19.1	17.9	2.1	6.1	2.1	-
Labour market							
Nominal wage (monthly average, year-on change)	3.0	3.1	4.8	7.3	-0.1	0.1	-
Real wage (monthly average, year-on change)	0.9	4.9	4.8	4.9	-0.1	0.6	-
Employment (BIL, y-o-y change)	3.8	2.0	2.3	1.9	-0.1	0.0	-
Employment (excl. agriculture, y-o-y change)	4.2	2.1	1.6	1.4	-0.1	0.2	-
Unemployment rate (LF5, %)	15.2	12.2	11.8	10.9	-0.1	-0.2	-
Labour productivity (Real GDP/employment, y-o-y change)	5.0	6.7	3.7	2.6	-0.1	0.3	-
Balance of payments							
Economic surplus (% GDP)	-175.2	-173.1	-221.6	-21.1	-1.1	8.6	-
Trade balance (BIL bn)	21.6	22.1	22.3	3.0	3.7	22.7	-
Trade balance (% GDP)	-5.6	-4.8	-4.6	0.1	0.2	1.2	-
Balance of services (BIL bn)	19.2	18.1	18.8	12.9	-0.1	0.6	-
Balance of services (% GDP)	1.2	1.0	0.9	0.2	-0.1	0.1	-
Current account (BIL bn)	-1 056	-922	-938	-121	-4.9	9.3	-
Current account (% GDP)	-6.2	-4.2	-4.7	0.9	-0.5	0.6	-
Current and capital account (BIL bn)	135.8	72.7	16.6	-2.5	8.5	3.8	-
Current and capital account (% GDP)	-4.4	-4.0	-2.9	-0.1	-0.5	0.1	-

Difference with previous forecast

Indicator	2006	2007	2008	2009	2007	2008	2009
	Actual	Forecast			Difference with previous forecast		
Deepening of employment (BIL bn, year-on change)							
Deepening of employment (BIL bn, year-on change)	3.6	2.0	4.2	2.1	0.6	0.2	-
Real gross disposable household income (year-on change)	6.6	2.0	1.8	7.3	1.3	0.6	-
Household saving rate (% of disposable income)	13.2	10.6	8.9	9.5	2.5	2.7	-
Employment (BIL bn) (y-o-y change)	2.7	2.2	2.7	1.7	-0.7	0.8	-
Labour productivity (BIL bn/Gross GDP/employment BIL bn, y-o-y change)	5.5	6.6	3.6	2.6	-1.1	0.8	-
LDU (consumption per employee hour of labour productivity BIL bn, y-o-y change)	1.2	0.1	1.1	1.3	0.7	0.2	-
Income balance (BIL bn)							
Income balance (BIL bn) (excl. taxes)	-63.2	-62.7	-60.8	-42.1	-13.2	-15.9	-
Income balance (BIL bn) (incl. taxes)	-3.9	-3.4	-3.0	-3.3	-0.2	-0.1	-
PII inflow (BIL bn)	11.9	24.0	23.8	26.5	-0.4	-0.2	-
PII inflow (% GDP)	5.5	4	3.7	3.5	-0.1	-0.1	-
Profit investment (BIL bn)	-3.1	21.1	22.3	17.1	2.1	23.2	-
Profit investment (% GDP)	-2.3	2.7	2.9	0.8	1.3	1.2	-
Other long-term investment (BIL bn)	18.6	1.1	6.0	3.2	11.1	32.2	-
Other short-term investment (BIL bn)	141.2	112.1	10.9	12.5	119.8	7.2	-
Financial account (BIL bn)	66.6	17.6	21.1	14.8	89.9	-11.0	-
Financial account (% GDP)	1.7	1.1	1.4	0.8	5.8	-1.0	-