

A MAJOR MILESTONE: ADMISSION TO THE EMU

On January 1st, Slovakia became the 16th member to join the euro area. This event follows a period of sustained economic expansion fuelled by massive foreign investments in industry. The resulting new production capacity triggered a surge in exports accompanied by a strong increase in the standard of living and spending. This rapid economic expansion was achieved without creating major imbalances, which facilitated EMU membership. However, the country has been impacted by the global crisis and growth will mark a significant slowdown in 2009 and 2010.

The euro rewards rapid economic convergence... though considerable work remains to be done

With per capita GDP in PPP terms slightly less than US \$20,000 in 2007, Slovakia is the euro area's least wealthy country. However, its pace of economic convergence with Western European standards has been rapid.

Following a small dip in 1999-2000, activity gained momentum on domestic demand and sharply accelerated from 2004 onwards, with economic growth exceeding 5% per year and reaching 10.4% in 2007.

Progressive improvements in governance and admission to the European Union in 2004 contributed to an important inflow of foreign capital. In response, investments took off, particularly with the construction of automobile assembly plants in 2005-2006 by PSA-Peugeot Citroën and Kia Motors, followed in 2007-2008 by the installation of Sony and Samsung LCD screens manufacturing plants. Thus, Slovakia succeeded in developing a competitive export sector, supplementing its historical metallurgy activity. Exports achieved average annual growth of 12% over 2004-2008, with surges of 21% in 2006 and 13.8% in 2007. Consequently, the contribution of international trade to growth in these two years was particularly significant, representing 2.2% and 4.6% respectively.

Already robust, with average annual growth of 5% since 2001, consumer spending benefited significantly from the combined stimulus of investments and exports. Very rapid development, *inter alia*, of the automobile and electronic equipment sectors contributed to a sharp drop in unemployment from 19.3% in 2001 to 9.6% in 2008, accompanied by a significant increase in wages. The resulting increase in disposable income, combined with access to credit and controlled inflation (2% in 2007, 4% in 2008) boosted household spending that expanded 7% in real terms in 2007.

Initially, this period of strong growth significantly increased Slovakia's current account deficit as direct foreign investment fuelled sharp growth in imports. The current account deficit consequently reached 8.6% of GDP in 2005. The completion of major industrial projects in the automobile and electronics sectors and the resulting increase in exports nevertheless contributed to a significant reduction in the current account deficit which narrowed to 5.1% of GDP in 2007.

Finally, public debt rapidly fell to levels compatible with the Stability and Growth Pact. Between 2003 and 2008, Slovakia's government deficit remained below the threshold of 3% of GDP (with an exception in 2006 following reforms of the tax system); in 2007 it had fallen to -1.9% of GDP. Robust economic growth and effective management of public spending contributed to a significant reduction in public debt that fell from 43.4% of GDP in 2002 to 29.4% of GDP in 2007.

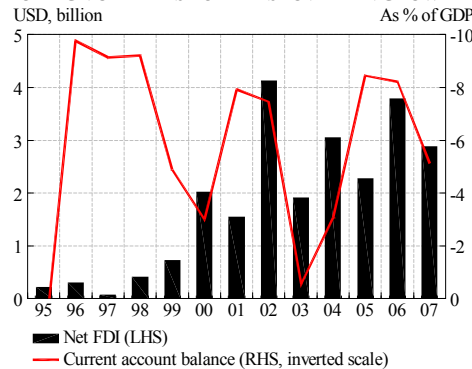
Significant challenges remain for the medium term: the labour force does not yet benefit from sufficient training; a significant percentage of the working age population remains unemployable as a consequence of being unemployed for too long (the very long-term – more than 4 years – unemployment rate was 4.5% in 2007); and Slovakia must increase its efforts in R&D so that its companies can rise in the value creation chain as Slovakian wages catch up with the average EMU level.

Industrial output to be hard hit in 2009

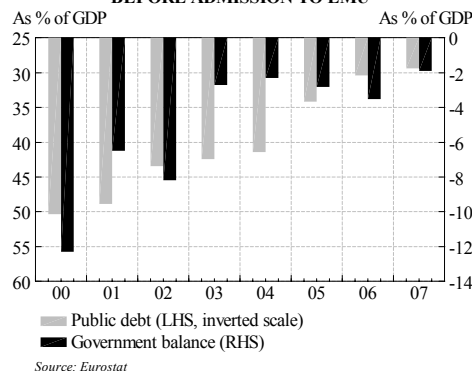
Slovakia's excellent economic performances have nevertheless not shielded it from the current economic crisis, the country being affected through the impact on the export sector. Indeed, Slovakia's major trade partners have been seriously hit and are set to reduce importantly their demand addressed abroad. Germany, which represented a fifth of Slovakian exports in the first three quarters of 2008 is expected to see its GDP decline by

Slovakia: Key data (in parentheses: euro area)	
Population	5.5m (329m)
Nominal GDP 2007 (EUR bn)	55 (8,931)
GDP per capita PPP 2007 (USD)	19,913 (32,670)
Unemployment rate (Nov. 08)	9.1% (7.8%)
Breakdown of VA:	
Industry, incl. construction	38% (26.7%)
Services	64% (71.4%)

FOREIGN CAPITALS FUELED SLOVAKIAN GROWTH



PUBLIC FINANCES IMPROVED BEFORE ADMISSION TO EMU



2.3% in 2009. More generally, half of Slovakian exports are destined to the euro area which is currently in the midst of a major recession, with GDP expected to decline by 1.8% this year. In addition, Slovakia's international specialisation increases its vulnerability, its exports consisting in large part of industrial goods particularly affected by the downturn in business investment and household durables. Indeed, electrical equipment accounts for approximately one third of exports (notably television sets), automobiles approximately one quarter and metals 14.3%.

The manufacturing industry has already felt the initial effects of weakening external demand, with output having contracted significantly in November; it is currently 8.3% lower than at the same month of the previous year. The deterioration in opinion surveys among Slovakian manufacturers since November suggests a continuation of the contraction of output, recently further aggravated by disruptions in gas supplies following tensions between Russia and Ukraine that forced many plants to temporarily shut down. Somewhat unsurprisingly, the ESI survey indicator for the industrial sector reached a record low in January, at -32 points, a fall explained by the drop in domestic and foreign orders accompanied by increasingly large inventories.

Domestic demand will weaken with rising unemployment

In response to the deteriorating employment prospects – unemployment started to move up in November 2008 –, Slovakian households are expected to significantly rein in consumer spending in 2009-2010. The subcomponent of the ESI survey on consumer confidence highlights a drop in intentions to make major purchases over the coming 12 months, which is consistent with opinion anticipating a significant deterioration in economic activity. In contrast, real income has been sustained by the decline in inflation, down from 4.5% in September to 3.5% in December. Total consumer spending is consequently expected to expand at its slowest pace since 2003, advancing 2½% in 2009 (compared with 6.8% in 2008),

Domestic demand will also benefit from the adoption of the euro as the single currency provides a degree of protection from strong financial turbulence that has contributed to instability in other countries of the region. Slovakia will thus reap the full benefits of the monetary easing policy of the ECB. Accordingly, investments in construction activity are expected to continue, boosted by past strong growth in consumer income and low interest rates. In January the ESI index in this sector was still above its long-term average because of satisfactory order books levels.

Business investment, notably FDI, is expected to increase marginally even if the major projects to expand production capacity in the automobile sector have been postponed. Finally, infrastructure investments in the energy sector, which are to be launched in 2009-2010 will underpin total investment, the latter increasing by 2% in real terms in 2009.

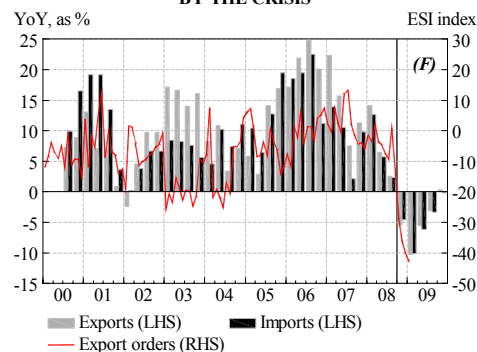
2009-2010: sharp slowdown of growth and rise in public deficit

The deceleration in domestic and external demand will impact growth in 2009 and 2010, which should fall to 2½% and 3½% respectively, the slowest growth pace since 2003.

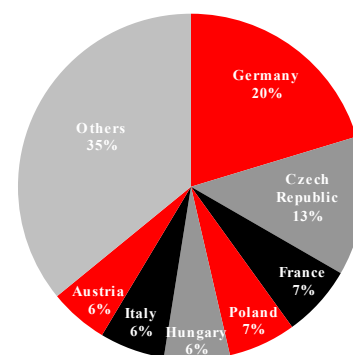
This still represents the best performance in the euro area for this year. The rapid consequences of the slowdown in activity, particularly industrial output, on the labour market, will increase the rate of unemployment to an average of 10.7% in 2009 following a low of 9% in October 2008. Consequently, the budget balance is expected to deteriorate significantly and fall to -3% of GDP in 2009 and -3.6% in 2010, notably in response to the adoption of more generous welfare benefits for retirement and family allowances.

François LETONDU +33 1 42 14 27 96

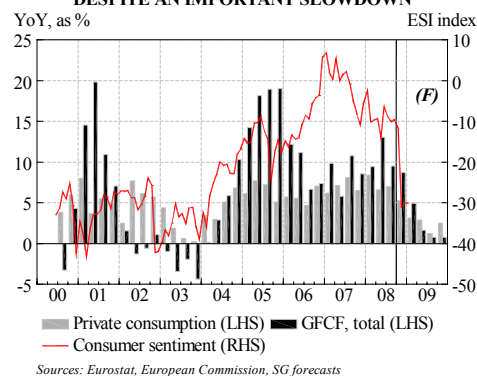
FOREIGN TRADE WILL BE SEVERELY AFFECTED BY THE CRISIS



SLOVAKIA'S MAIN EXPORT MARKETS



DOMESTIC DEMAND WILL SUPPORT GROWTH DESPITE AN IMPORTANT SLOWDOWN



WORTH WATCHING

The downside risks in relation to our main scenario are significant and depend notably on trends in neighbouring non-euro countries, particularly the Czech Republic, as the depreciation of their currencies could result in a sharper-than-expected slowdown for Slovakian exports.

As %	2005	2006	2007	2008(f)	2009(f)
Real GDP	6.5	8.5	10.4	7.4	2.5
Consumer prices (CPI)	2.8	4.3	1.9	3.9	2.0
Unemployment rate	16.3	13.3	11.2	9.6	10.7
Current account (% GDP)	-8.6	-7.4	-5.1	-6.0	-5.5
General govt. bal. (% GDP)	-2.8	-3.4	-1.9	-2.3	-3.0

All opinions and estimations included in the report represent the judgment of the sole Economics Department of Société Générale and do not necessarily reflect the opinion of the Société Générale itself or any of its subsidiaries and affiliates. These opinions are subject to change without notice. It does not constitute a commercial solicitation, a personal recommendation or take into account the particular investment objectives, financial situations.

Although the information in this report has been obtained from sources which are known to be reliable, we do not guarantee its accuracy or completeness. Neither Société Générale nor its subsidiaries/affiliates accept any responsibility for liability arising from the use of all or any part of this document.

Société Générale may both act as a market maker or a broker, and may trade securities issued by issuers mentioned in this report, as well as derivatives based thereon, for its own account. Société Générale, including its officers and employees may serve or have served as an officer, director or in an advisory capacity for any issuer mentioned in this report.

Additional note to readers outside France: The securities that may be discussed in this report, as well as the material itself, may not be available in every country or to every category of investors.