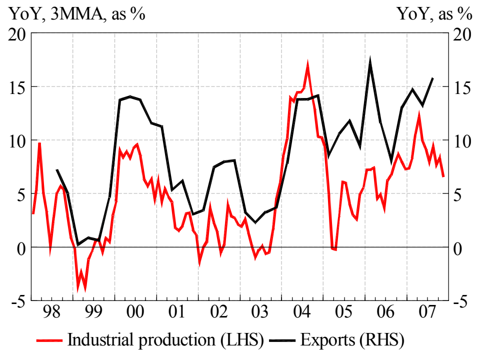
Industrial activity is set to slow in 2008, in tandem with exports...

Slovenia's manufacturing industry faces a steady deterioration in the international trading environment. Exports to the euro area represent its biggest market: Germany, France, Italy and Austria account for almost 50% of Slovenian exports and Germany alone accounts for 20%. The problem is that the volume growth of German imports is set to decrease sharply: +3.50% estimated for 2008 vs. +5.9% in 2007. Until now, the slowdown in demand from leading euro area countries has waned since the beginning of 2007 has been offset by stronger demand from Austria and Croatia. This has enabled continued dynamic growth in exports, but 2008 will be a different story. Moreover manufacturing output has been showing signs of running out of steam since the high point reached in spring 2007: yoy growth rates slumped from more than 12% to approximately 6.50% at the end of the year. In a similar vein, the ESI manufacturing industry index has lost considerable ground since the middle of 2007 largely due to a contraction in order books – export orders in particular.

THE SLOWDOWN IN INDUSTRIAL PRODUCTION LOOKS SET TO CONTINUE



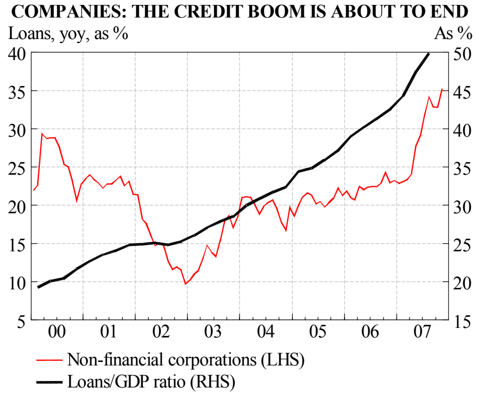
Sources: Datastream, SG forecasts

Mainly as a result of lower demand from EMU countries, export growth will slow considerably this year: estimated increase of 9.5% vs. +15.9% in 2007.

... and slacker investment

Productive investment will lose momentum

COMPANIES: THE CREDIT BOOM IS ABOUT TO END



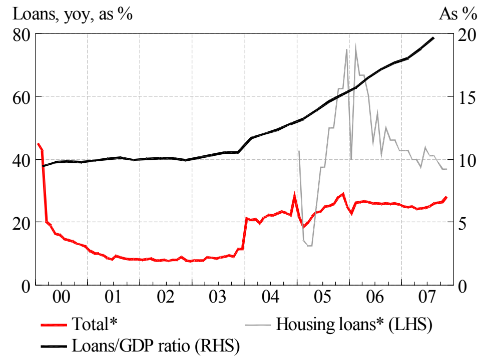
Sources: Eurostat, ECB

Investment in capital goods (31.4% of total investment in volume terms) enjoyed explosive growth rates in the first half of 2007: +13% in Q1 and +22% in Q2. Companies were faced with an unprecedented production capacity squeeze: utilisation rates had been holding up at record levels (approximately 86%) since the end of 2006. However, the pace of investment decelerated to +10% in Q3, due to the slowdown in industrial production and less encouraging trading prospects. This trend looks set to continue as the business climate becomes less propitious for p...ctive investment.

The combined impact of the fresh production capacity b...t on-stream following previous investment outlay (+9.1% in ... and +10.8% in 2007) and the deterioration in market cond... has eased pressure on production capacity. This sugge... that utilisation rates will fall back in line with long-term avera...vels. Moreover, companies had massive recourse to borrowi... order to finance their development programmes. After stagnatin... around 20% per annum until 2006, growth in lending ...non-financial companies surged dramatically in 2007, escalatin... 35.3% last November. The borrowing/GDP ratio is ... an exponential trend: almost 50% in Q3 2007 compared t...3% a year earlier. The explosive growth in borrowing was fa...ed by interest rate convergence towards the euro area avera... From now on, the tightening-up of lending conditions will curb growt... loan approvals considerably, after the bumper year recorde... 2007. To make matters worse, one third of Slovenia's ...king system is controlled by pan-European groups and the l... might well start adopting a more cautious stance. All things c...ered, growth in investment in capital goods is likely to consoli... at an annual average rate of around 5% this year.

The residential investment boom is over

HOUSEHOLD INDEBTEDNESS IS STILL LOW



Sources: Eurostat, ECB
** break in series in 2004*

Growth in investment in construction (64% of total investme... 2006, three quarters of which was accounted for by ...non-residential sector) has been in excess of 10% p.a. since ... . The performance of this sector has been defying gravity ... the middle of 2006 with growth rates in excess of 25%. The...n has been fed by massive recourse to borrowing both by com...es (to finance non-residential investment) and by househol...ome loans, most of which were taken out at variable rates).

Annual average growth in home loans outstanding pic...up to 40.4% in 2005 and to 51.5% in 2006. The pace slackene... 2007 but nonetheless remained vigorous: +36.8% yoy in N...ber, which represents an average increase of 40% for th...t 11 months of the year. Whilst household borrowing w... also underpinned by interest rate convergence towards e... area average levels, other factors came into play: the initially low leve... household indebtedness (the household borrowing/GDP ... was still standing at only 19.3% at the end of 2007) and the b...ncy o... the property market. The horizon is nonetheless cloudi...ver – which points to severe loss of momentum in inves...t in construction in 2008. Access to credit will be more difficult, bot... property developers and for households, due to the upw...move in interest rates and the tightening-up of lending conditions. ... result, the property sector has already started to run out ...eam. After peaking at 24 points last March, the ESI construct...ector index retreated to 18 points in December 2007.

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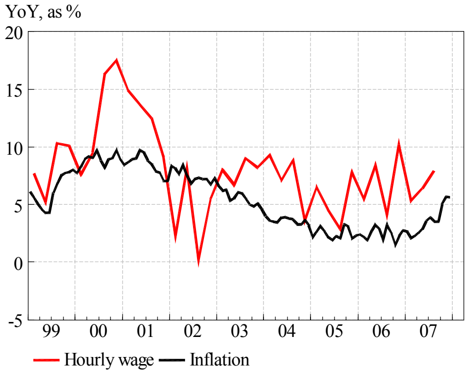
A hard landing can nonetheless most probably be ruled out over the short term. Residential building permits were standing sharply ahead in Q3 2007: +40.1% yoy. Moreover, the fact that economic growth is still robust will provide the non-residential sector with leeway. However, the property sector's heavy dependence on borrowing will start to rock the boat from the second half of 2008 onwards

The inflation differential with the euro area is considerable

INFLATION SURGES, WAGES TREND DOWNWARDS



Source: Eurostat

Standards of living in Slovenia are still substantially below the euro area average, even though the country has outpaced Portugal in terms of per capita GDP (PPP). The catching-up process is well underway. The vigour of economic growth has been driving prices sharply higher since the middle of 2007. The inflation rate was standing in excess of 5% in Q4 2007 (+5.7% in December), compared with 3.1% in the euro area. The adoption of the single currency at the beginning of 2007 is not the sole explanation for the acceleration in inflation, despite the fact that the rounding-up effect probably added an extra 0.3 to 0.6 points to the figures. As is the case in the rest of the euro area, surging inflation is mainly the result of the escalation in prices of energy (+9.8% yoy in December) and food products (+12% yoy). Stripping out energy, food, tobacco and alcohol, the inflation rate emerged at "only" 3.1% in December.

That said, prices of industrial goods – consumer non-durables in particular – have picked up sharply. Consumer non-durables goods are mostly imported because industry in Slovenia is heavily geared to the capital goods and intermediate goods sectors.

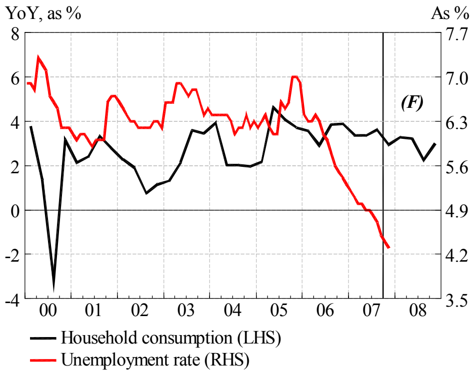
A minor deceleration in inflation can be expected in 2008, due to the softer trend in energy and agricultural commodity prices. Extreme vigilance is nonetheless required mainly because of the risk of second round effects linked to the price-wage spiral engendered by increasingly tight job market conditions.

Households knuckle under

Household confidence has been in freefall since the ESI index hit an all-time high last summer and fell back to levels in line wi long-term average in less than 4 months. Tumbling confiden attributable to mounting fears over economic growth and also to the acceleration in inflation at the end of 2007. The busin climate will nonetheless remain broadly favourable to househ Disposable income will continue to receive a boost from creations and from substantial wage increases.

The unemployment rate (calculated using Eurostat methodology) has fallen considerably since 2005: 4.3% in August 2007 vs. July 2005. Employment, which was rising at a modest pace a beginning of 2006, started rebounding vigorously in Q3 2006 yoy growth rates were standing at 3.7% in Q3 2007. Wages also picked up following the slowdown witnessed at the beginning of 2007: +7.9% yoy in Q3, with particularly strong increases i business services sector. Inflation is the only blot on landscape. Gains in spending power have been substantia attested by growth in consumption of approximately 3.3% volume terms) in 2007.

CONSUMPTION REMAINS VIGOROUS



Sources: Eurostat, SG forecasts

Households have also had recourse to consumer credit, though growth rates in this segment pale into comparison with thos home loans. An acceleration in this trend was palpable towar end of 2007: +21.7% yoy in November. Growth in lo outstanding is expected to average nearly 17% in 2007.

Employment is likely to decelerate in 2008. Given the heady growth rates attained at the end of 2007 and the strong bargaining p of waged-workers, wage increases will probably stabilise between 6% and 7%. As inflation will remain at high levels (+3 in annual average terms) household spending power will no as vigorously as it did in 2007. Growth rates in consumption are consequently set to slide to 2.9%, which is the lowest leve record since 2004.

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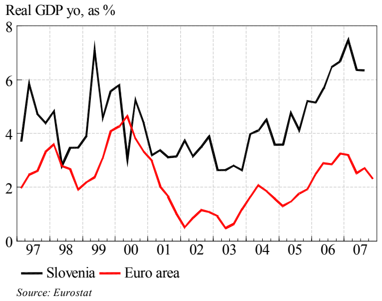
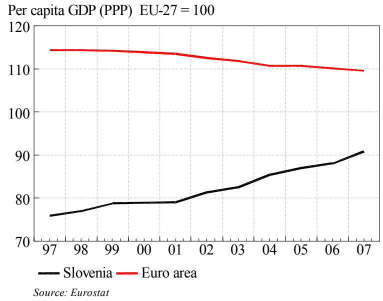
Annual growth rate (volume)	2003	2004	2005	2006	2007 (f)	2008 (f)
Private sector consumption	3.3	2.0	4.0	3.5	3.3	2.9
Public sector consumption	1.5	3.1	2.5	3.8	0.3	1.2
Total investment	6.7	7.4	1.9	12.0	19.0	8.1
Stock effect (contribution to growth)	1.1	1.3	-0.8	0.6	0.1	0.3
Total domestic demand	4.8	4.8	2.3	6.2	6.9	4.3
Exports	2.5	10.9	11.7	11.1	15.9	9.5
Imports	6.1	11.9	8.1	11.4	17.0	10.4
Real GDP	2.7	4.0	4.4	6.0	6.3	3.2
Current account (% of GDP)	-0.8	-2.5	-1.9	-2.6	-4.2	-5.0
Public balance (% of GDP)	-2.7	-2.7	-1.5	-1.1	-0.8	-1.5
Consumer prices	5.6	3.6	2.5	2.5	3.6	3.6
Harmonised unemployment rate	6.6	6.3	6.5	5.6	4.5	4.4

GROWTH WELL IN EXCESS OF THE EURO AREA AVERAGE...



... PAVES THE WAY FOR RAPID CONVERGENCE IN STANDARDS OF LIVING



SOVEREIGN RATINGS OF SLOVENIA

	Short	Long
S&P	A-1+	AA
Moody's		Aa2
Fitch	F1+	AA

Source: Reuters

FOREIGN TRADE STRUCTURE OF SLOVENIA BY TYPE OF GOODS AND COUNTRIES

TYPE OF GOODS	Export 2003	Export 2006	Imports 2003	Imports 2006
Total (EUR bn)	11,3	16,8	12,2	18,3
As % of total				
Food	3,1	2,5	4,8	5,0
Intermediate goods (excl. food)	36,9	38,7	46,2	49,7
Capital goods (excl. transport)	18,3	18,7	20,7	18,0
Transport equipment	16,4	18,6	14,6	14,9
Consumer goods	25,3	21,4	13,6	12,2

Source: Statistical Office of the Republic of Slovenia

BY COUNTRIES As % of total	Export 2003	Export 2006	Imports 2003	Imports 2006
Europe	91,5	92,7	93,7	92,2
Croatia	8,9	8,7	3,7	4,0
UE-27	69,5	71,1	85,8	82,6
Hungary	2,0	2,3	3,2	3,7
Euro area	54,4	53,9	71,0	68,3
Germany	23,1	19,7	21,1	20,4
Italy	13,1	12,9	19,0	18,6
Austria	7,3	8,7	13,6	12,2
France	5,7	6,8	8,7	6,2
Netherlands	1,7	1,4	3,2	3,7
Americas	4,2	2,9	1,8	2,1
United states	3,6	2,3	1,1	1,1
Asia	3,4	3,3	3,9	5,0
Others	0,9	1,0	0,7	0,8

Source: Statistical Office of the Republic of Slovenia

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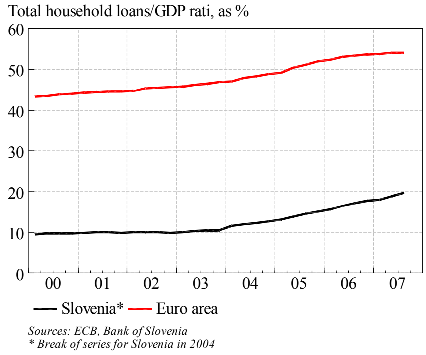
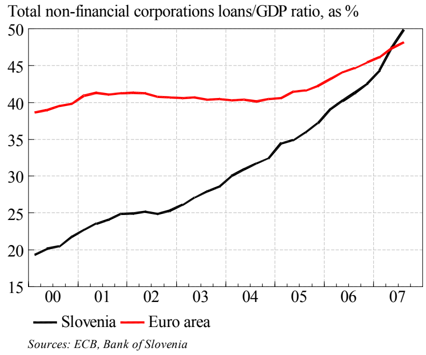
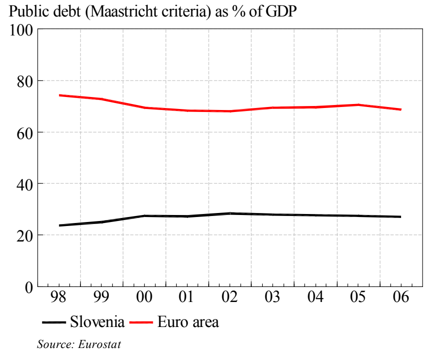


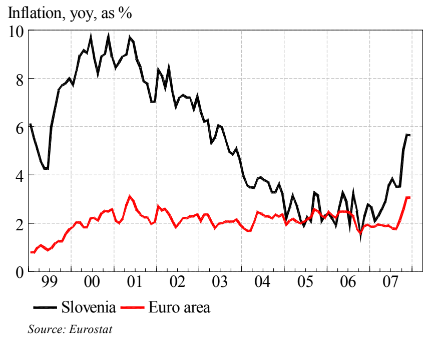
FAST GROWTH IN COMPANY BORROWING



PUBLIC DEBT IS LOW



AFTER A PERIOD OF RAPID CONVERGENCE, LEVELS OF INFLATION ARE DIVERGING AGAIN



RAPID CATCHING-UP OF WAGES

SLOVENIA HAS ACHIEVED FULL EMPLOYMENT