

Atradius Country Report

Slovak Republic – January 2010



Overview

General information

| | |
|------------------|---|
| Capital: | Bratislava |
| Government type: | Republic |
| Currency: | Euro |
| Population: | 5.5 million |
| Status: | Upper middle income country (GDP/capita: US-\$ 16,569 in 2010) |

Most important sectors (% of GDP, 2009)

| | |
|--------------|------|
| Services: | 64 % |
| Industry: | 33 % |
| Agriculture: | 3 % |

Main import sources (2008, % of total)

| | |
|-----------------|--------|
| Germany: | 20.0 % |
| Czech Republic: | 17.7 % |
| Russia: | 10.6 % |
| Hungary: | 6.9 % |
| Austria: | 5.0 % |

Main export markets (2008, % of total)

| | |
|-----------------|--------|
| Germany: | 20.0 % |
| Czech Republic: | 13.1 % |
| France: | 6.7 % |
| Poland: | 6.6 % |
| Hungary: | 6.3 % |

Main expenses of foreign exchange

Machinery & transports (43 %), fuels (12 %)

Main sources of foreign exchange

Machinery & transports, especially cars: (53 %)

Key indicators

| | 2006 | 2007 | 2008 | 2009* | 2010** |
|--|--------|--------|--------|--------|--------|
| GDP (US-\$ million) | 55,878 | 75,030 | 94,966 | 85,890 | 98,468 |
| Real GDP growth (%) | 8.5 | 10.4 | 6.3 | -5.8 | 2.0 |
| GDP per capita (US-\$) | 10,367 | 13,920 | 17,586 | 15,906 | 16,569 |
| Inflation p.a. (%) | 4.4 | 2.8 | 4.2 | 1.6 | 2.3 |
| Fiscal balance (% of GDP) | -3.1 | -2.2 | -2.0 | -5.9 | -6.3 |
| Total foreign debt (US-\$ million) | 27,085 | 36,632 | 45,149 | 44,567 | n.a. |
| Foreign debt/GDP (%) | 48 | 49 | 48 | 52 | n.a. |
| Foreign debt/XGS (%) | 55 | 55 | 55 | 80 | 47 |
| Short-term debt/inter. reserves (%) | 125 | 118 | 142 | 2210 | n.a. |
| Debt service ratio (%) | 8 | 8 | 10 | 17 | 13 |
| Current account balance (US-\$ m.) | -3,937 | -4,103 | -6,187 | -3,061 | -3,696 |
| Current account/GDP (%) | -7.0 | -5.5 | -6.5 | -3.6 | -4.1 |
| Nom. exchange rate to US-\$ (average) | 29.70 | 24.69 | 21.36 | 0.73 | 0.71 |
| International reserves (US-\$ million) | 12,426 | 17,525 | 18,378 | 1,200 | 1,200 |
| In months of merchandise imports | 3.2 | 3.4 | 3.0 | 0.3 | 0.2 |

* estimate ** forecast

Source: Economist Intelligence Unit (EIU), International Monetary Fund (IMF)

Political situation: Stable

Head of state: President Ivan Gasparovic (since June 2004)
Head of government: Prime Minister Robert Fico (since July 2006)
Form of government: Three-party government led by the left-wing SMER, in coalition with the nationalist/populist LS-HZDS and the far-right SNS

Internal situation

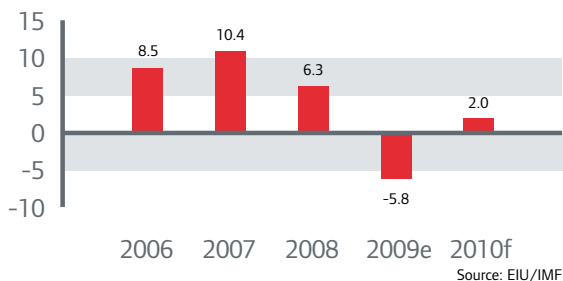
The early elections of June 2006 were won by the 'populist' SMER, HZDS and SNS. The three parties formed a coalition that has a comfortable majority in parliament (85 out of 150 seats). Despite its disparate makeup, the coalition has turned out to be more stable than expected and will hold together until the next parliamentary elections, scheduled for mid 2010.

International relations

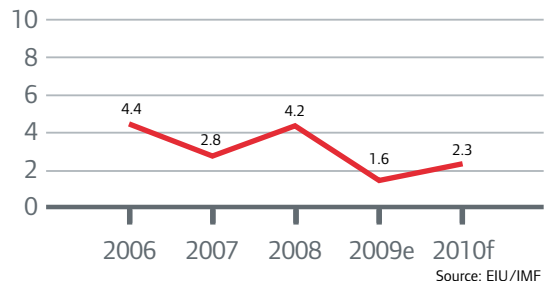
Relations with Hungary cooled considerably after the SNS entered the coalition government, as party leader Jan Slota has voiced some intemperate remarks about the Hungarian minority and Hungary itself in the past. Tensions with the Hungarian minority in Slovakia and with Hungary increased in 2009 because of a controversial amendment to the Slovakian language law, limiting the public use of minority languages.

Internal economic situation: Recession and high unemployment

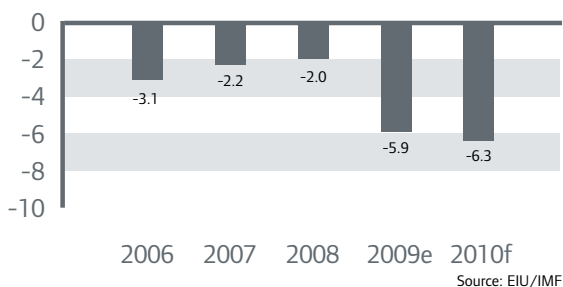
Real GDP growth (%)



Inflation p.a. (%)



Fiscal balance (% of GDP)



General situation

Slovakia is one of the success stories of Eastern Europe's economic transition. The country's once rigid economy, controlled by massive state intervention, has been transformed into an open economy with high foreign direct investment (FDI) inflows in recent years and export-oriented GDP growth. Slovakia has become the world's top supplier of cars per capita (VW, Kia, Peugeot, and Citroën) due to its favourable business climate (low wage costs, tax breaks, skilled workforce). These factors have also attracted FDI in electronics, IT and engineering.

That said, with its very open economy and export dependency, Slovakia has been hit hard by the global economic crisis. Real GDP is expected to shrink by almost 6 % in 2009, and production in major industries has fallen markedly. From January to August 2009, production in the automotive industry fell by 39.2 % year-on-year, the manufacture of machinery and equipment by 30 %, metals by 26.5 %, and chemicals by 24.9 %. Domestic demand has weakened and unemployment has increased to 12 %. Both wholesale and retail activity has deteriorated sharply, with weakening sales of household and durable goods. Concerns over rising consumer prices have proved wrong, mainly due to shrinking household spending. In 2009 inflation stood at 1.6 %.

Slovakia's banking sector is mainly privately (and foreign) owned. Because of a strong domestic deposit base, banks are less reliant on foreign funding than other Eastern European economies, but some banks are overexposed to real estate.

Private sector borrowing has decelerated, and corporate lending conditions are still a sensitive issue, as banks remain reluctant to provide new credit. Since June 2009, the volume of corporate loans has stalled and rates for new loans with longer maturity are rising, discouraging new investment. Unlike many other Eastern European markets, as a eurozone member, Slovakia and its companies have not been affected by the repercussions of currency fluctuations: for instance, the risen indebtedness of companies in hard currency due to a deteriorating exchange rate.

We expect insolvencies in Slovakia to have increased in 2009 by as much as 20-25 % - to about 650. The sectors mainly affected will be transport, construction, textiles and machinery manufacture.

Economic policy

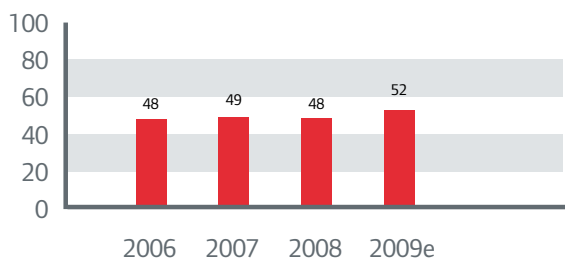
Slovakia entered the eurozone on 1 January 2009 and, consequently, the currency risk has disappeared as monetary policy is fixed by the European Central Bank (ECB). The entry followed years of fiscal discipline, leading to a public debt of only 32 % of GDP.

The government has tried to mitigate the impact of the economic slowdown with increased social spending. Together with decreasing tax revenues, this will lead to budget deficits of 5.9 % in 2009 and 6.3 % in 2010, exceeding the European Monetary Union (EMU) target rate (Stability and Growth Pact) of 3 %. However, EMU-membership will prevent any inclination to excessively step-up welfare spending and state intervention

We do not expect major changes to the free market reforms that have so far been achieved. The current government has reversed some of the economic reforms of the former, more market-friendly, administration (labour market, health care, pensions), but the bulk of the reforms have remained in place. The Fico administration has backed down from overhauling the flat direct (income and corporate) tax system. However, it has stopped the privatisation of state property deemed to be strategic (residual stakes in gas/oil/electricity, airport, and railways).

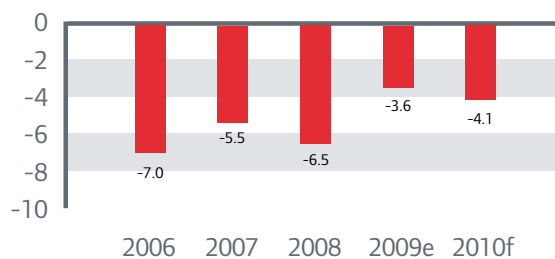
External economic situation: Good – public debt below 60 %

Foreign debt/GDP (%)



Source: EIU/IMF

Current account/GDP (%)



Source: EIU/IMF

Balance of payments

- Trade balance: A deficit of US-\$ 1.8 billion in 2009
Current account: Lower deficits: from 6.5 % of GDP in 2005 to 3.6 % in 2009 and 4.1 % in 2010
Capital account: Expected to be positive

Remarks:

From 2002 until the outbreak of the economic crisis, exports soared thanks to record sales of cars, metals, machinery and furniture, but FDI-related imports increased even faster, causing large current account deficits. The balance of payments is dependent on the dynamics in Slovakia's EU export markets.

Outlook: Depending on export performance

Political situation

The SMER party continues to hold a strong lead in the opinion polls, and is expected to win the 2010 general election. The large ethnic Hungarian minority could lose any parliamentary representation after 2010 as a result of a split in the Hungarian Coalition Party (SMK).

Economic situation

There have been tentative signs of a bottoming-out of the recession, mainly thanks to the modest recovery in some of the larger EU markets. In the short term, economic activity will probably not return to the high pre-crisis levels of growth. The EIU forecasts Slovakia's growth to rebound by 2.0 % in 2010 (the IMF by as much as 3.7 %). However, tighter credit conditions and excess capacity will persist for the time being. Some sectors with low added value and high staff costs, such as textiles, will continue to lose their competitiveness with producers in neighbouring countries whose exchange rates have weakened against the euro. Overall, a continued recovery in the major EU markets is crucial to Slovakia's performance in 2010.

Together with increasing exports, imports will also rise again, leaving the current account deficits more or less unchanged at 4 % of GDP in 2010. Inflation will remain low at 2 % in 2010, but this is still higher than the eurozone average. The public deficit will continue to be high until 2012, and there is a risk of relatively higher (public) debt servicing costs, as smaller issuers like Slovakia may be crowded out by the financing needs of larger EU countries, coupled with increased risk aversion by investors.

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