

CYPRUS



GREECE



EUROLAND



View from the top

Cypriot economic growth decelerated in the second quarter of 2008, largely due to a fall in government spending. Growth in 2008 overall is forecast to fall significantly from the seven-year high achieved in 2007, with the economy stabilising in 2009.

Key metrics

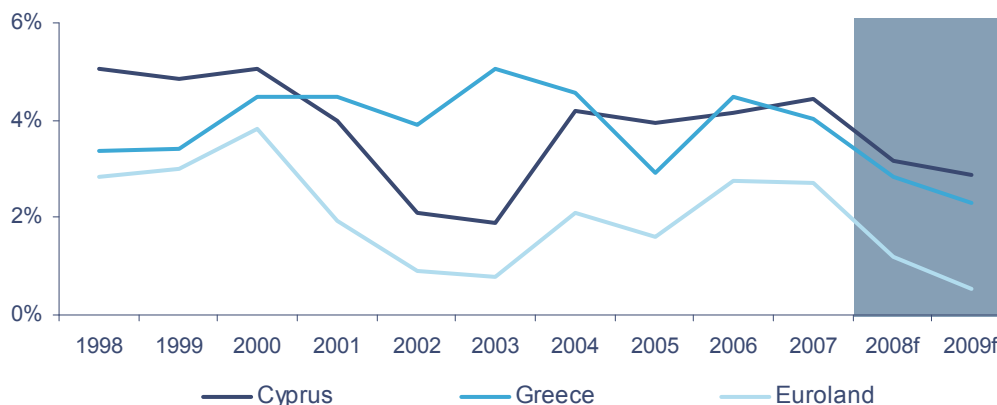
Indicator	2007	2008 ^f	2009 ^f
GDP growth	4.4%	3.1%	2.9%
Inflation	2.2%	4.4%	3.3%
Base interest rate (EOP)	4.0%	▼*	▼
General outlook		Negative	Stable

Source: Eurostat; European Central Bank; PricewaterhouseCoopers forecasts (f) * Interest rate as of October 2008 was 3.75% Inflation measure shown is the Harmonised Index of Consumer Prices (HICP)

Key trends

- Cypriot economic growth slowed in Q2 2008, largely due to a fall in government spending and stagnant consumer spending.
- The rate of Cypriot consumer price inflation eased to 5% in September 2008, as commodity prices began to fall from recent highs.
- The Cypriot unemployment rate fell to 3.6% in August, substantially lower than the Euroland average of 7.5% in the same period.

Economic growth profile



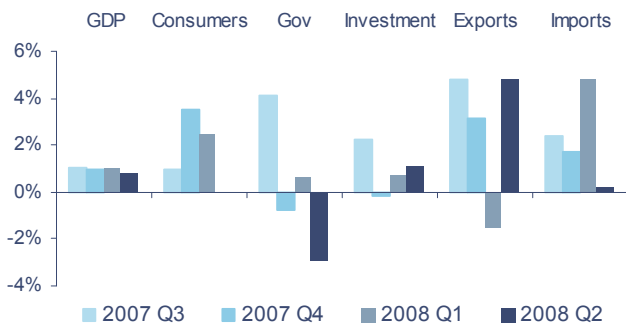
Source: Eurostat; PricewaterhouseCoopers forecasts (f)

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Cyprus

The Cypriot economy grew by 0.8% quarter-on-quarter in Q2 2008 (see Chart 1 below), a reduction of 0.2 percentage points compared to the previous quarter. With government spending contracting by 2.9% and consumer spending stagnant, growth in Q2 2008 was driven by a recovery in exports and a pick up in investment growth. Exports increased by 4.8% in Q2 2008 following a contraction of 1.5% in the previous quarter with imports growth decreasing from 4.8% to 0.2%.

Chart 1: Cypriot quarter-on-quarter growth rates

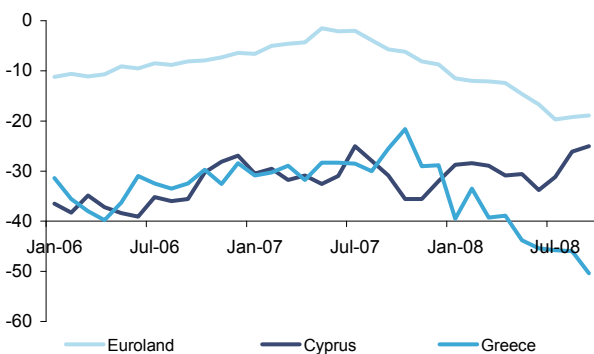


Source: Eurostat

The agricultural and fishery sector recorded the highest growth rate in Q2 2008, expanding by 1.5%. However, growth was subdued in other major sectors of the economy, with growth in the retail, tourism and transport sector decreasing from 1% in the previous quarter to 0.1% in Q2 2008. Growth in the mining and energy sector fell from 1.1% to 0.3% during the same period.

Consumer spending stagnated in Q2 2008, despite improving levels of consumer confidence which reached its highest point in September since July 2007 (see Chart 2 below).

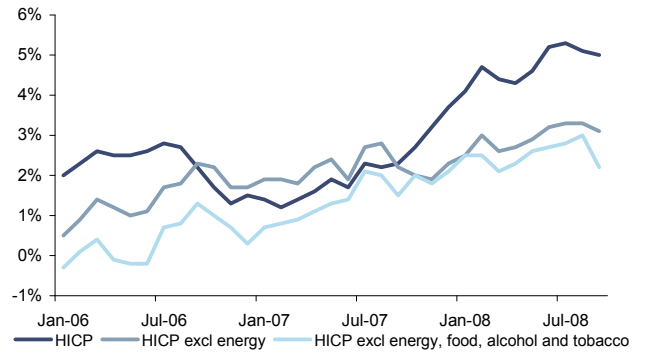
Chart 2: Consumer sentiment



Source: European Commission

After peaking at 5.3% in July, the Cypriot inflation rate fell slightly to 5% in September, remaining above the Euroland average (see chart 3 on the right). High international commodity prices and wage indexation have kept Cypriot inflation above the Euroland average. The Cypriot economy relies heavily on imported products and continues to be susceptible to inflationary pressures from abroad. Inflationary pressures are expected to ease in the short term amidst falling global food and energy prices.

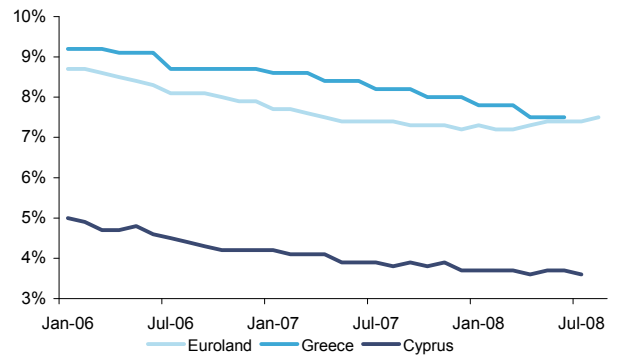
Chart 3: Cypriot inflation rates



Source: Eurostat

The Cypriot unemployment rate decreased slightly to 3.6% in August, and remains considerably below the Euroland average (see Chart 4 below). A large proportion of the unemployed (47%) were the short-term unemployed (between 15 days to 3 months). Only ten percent of the unemployed were individuals who have been out of work for more than 12 months.

Chart 4: Unemployment



Source: Eurostat

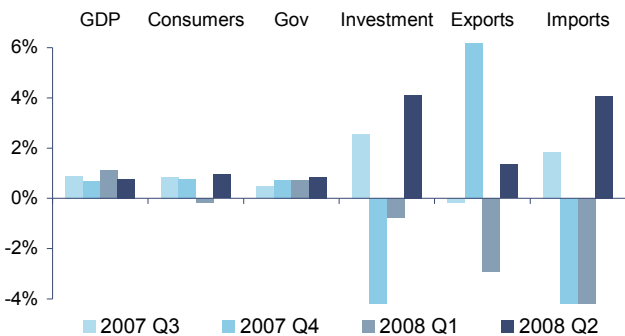
Consumer confidence unexpectedly picked up in Q2 2008, although overall economic sentiment continued on its downward trajectory. Businesses are becoming more pessimistic regarding the current economic environment. Falling commodity prices should provide some welcome news to Cypriot businesses as they seek to reduce costs.

Growth in the Cypriot economy is expected to slow in both 2008 and 2009 with the economy forecast to expand by 3.1% in 2008 and 2.9% in 2009. Domestic demand is expected to continue as the main driver of growth in the economy, with external demand easing due to worsening conditions among Cyprus's main trading partners which include the United Kingdom and Germany.

Greece

The Greek economy expanded by 0.8% q-o-q, down from the first quarter of 2008 when the economy grew by 1.1%. Economic growth in Q2 2008 was broad based with all components of GDP growing from the previous period (see chart 5 below).

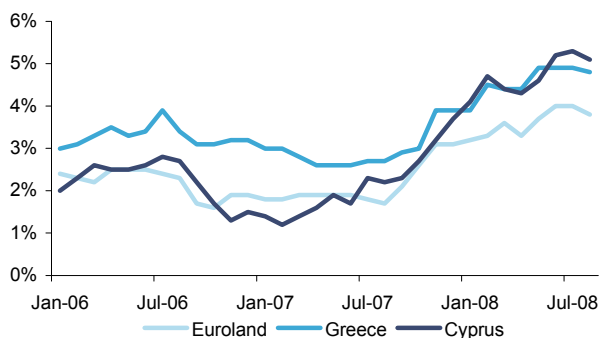
Chart 5: Greek quarter-on-quarter growth rates



Source: Eurostat

The rate of inflation is showing signs of improvement, falling slightly to 4.7% in September (see Chart 6 below). The highest price rises were recorded in housing, transport, education and food, alcoholic beverages and tobacco products. With the recent drop in energy and food prices it is probable that Greek inflation will continue its recent trend and fall further.

Chart 6: inflation rates



Source: Eurostat

Greek unemployment continued its downward trajectory, falling to 7.5% in July (see Chart 4 on the previous page). It is unlikely that the downward trend will continue over the coming months.

A significant risk to Greek economic growth prospects comes from the downturn which many of the country's main trading partners are facing. Tourism, which accounts for a substantial share of the Greek economy, is likely to weaken.

In September Greek consumer sentiment (chart 2 on the previous page) reached its lowest level since records began in January 1985. Should this be reflected in Greek consumer spending it will have a substantial impact on the Greek economy given that over 70% of Greek GDP is attributed to consumer spending.

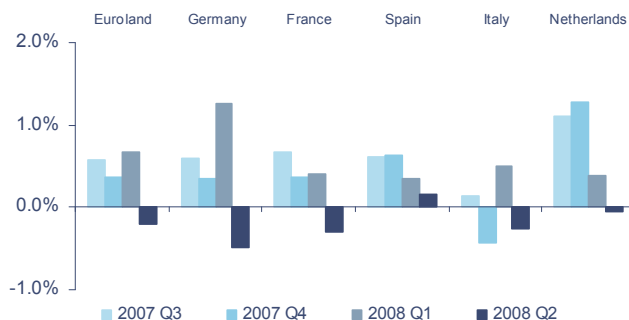
Greek economic growth is expected to decrease in both 2008 and 2009. Weakening domestic demand and the

appreciation of the euro together with the current global financial climate is expected to dampen future growth prospects. The Greek economy is forecast to expand by 2.8 % in 2008 and 2.3% in 2009.

Euroland

Economic activity in Euroland contracted in Q2 2008 by 0.2%, as shown in Chart 7 below. A contraction in consumer spending and investment, particularly in the residential sector, were the key causes behind the contraction in Q2.

Chart 7: Euroland quarter-on-quarter growth rates



Source: Eurostat

A combination of falling commodity prices and the anti-inflation focused monetary policy stance of the European Central Bank contributed to an easing of inflationary pressures in Euroland. The annual rate of change in the Harmonised Consumer Price Index – the preferred measure of consumer prices in Euroland – fell to 3.8% in August from record highs of 4% in July, as shown in Chart 6 on the left. However, inflation remains significantly above the ECB's medium-term target of 2%.

The President of the ECB, Jean-Claude Trichet, indicated in September that the ECB's primary focus will remain on ensuring medium-term price stability. However, conditions in the financial markets and their rising toll on economic activity in Euroland pushed the ECB to cut rates by 50 basis points in October. We expect that the downward trend in Euroland interest rates will continue.

Forward-looking indicators of economic prospects indicate expectations of a contraction in output. The Euroland economic sentiment indicator, which measures both business and consumer confidence, has continued to trend downward in recent months

Following a sustained fall in the rate of unemployment in Euroland between March 2005 and March 2008, there are now signs that the slowdown in economic activity is starting to feed its way into the labour market. The rate of unemployment in Euroland rose to 7.5% in August 2008, suggesting its downward trend in recent years has halted. It is likely that the labour market will soften further in the months to come, which would help contain wage increases, but could also dampen consumer spending further.

The real effective exchange rate index for Euroland – a measure of price competitiveness which weights the euro against the currencies of its main trading partners – fell to its lowest level in six months in August 2008, following a steady appreciation since the beginning of 2006, as shown in Chart 8 on the next page.

This will help the export sector at a time when domestic demand is sluggish. However, import demand in Euroland's main trading partners – the UK and the US – is likely to remain weak in the short term.

Chart 8: Euro real effective exchange rate index



Source: European Central Bank

The ongoing effects of high commodity prices, the credit crisis and corrections in residential housing markets in some of Euroland's largest economies will serve to constrain growth in both the domestic and external sectors. Growth in Euroland is forecast to slow to 1.3% [1.2% in table] in 2008. As the negative effects of the housing slump in Spain and Ireland continue and the German economy decelerates, the Euroland economy is forecast to grow by 0.8% [0.6%] in 2009 (see Table 1 below).

Table 1: Euroland and UK GDP growth outlook

GDP annual % change	2007	2008 ^f	2009 ^f
Euroland	2.6	1.2	0.6
Austria	3.1	2.1	1.7
Belgium	2.8	1.7	1.1
Cyprus	4.4	3.1	2.9
Finland	4.5	2.5	1.8
France	2.2	1.0	0.3
Germany	2.5	1.6	0.5
Greece	4.0	2.8	2.3
Ireland	6.0	-1.0	0.5
Italy	1.5	0.1	0.0
Netherlands	3.5	2.2	0.8
Portugal	1.9	0.8	0.5
Slovenia	6.8	4.4	4.3
Spain	3.7	1.1	0.6
UK	3.0	1.0	-0.3

Source: CSO, Eurostat; PricewaterhouseCoopers forecasts (f)

Cyprus: recent performance and forecasts

	2005	2006	2007	2008 ^f	2009 ^f
Real growth (annual % change)					
GDP	3.9	4.1	4.4	3.1	2.9
Consumer spending	4.0	4.5	6.9	6.1	2.3
Government	3.4	7.4	-0.1	-0.9	3.7
Investment	3.3	10.5	7.6	3.9	4.9
Exports	4.7	3.8	7.5	4.9	1.3
Imports	3.1	6.6	11.1	6.6	-0.2
Contribution to GDP growth (%)*					
Consumer spending	2.6	3.0	4.6	4.2	1.6
Government	0.6	1.2	0.0	-0.1	0.6
Investment	0.6	2.0	1.5	0.8	1.0
Exports	2.4	2.0	3.9	2.6	0.7
Imports	-1.7	-3.6	-6.2	-3.9	0.1
Domestic demand	4.5	6.6	5.4	4.3	3.7
Net Exports	0.7	-1.6	-2.3	-1.3	0.8
Economic structure (% of GDP)*					
Consumer spending	66.0	66.2	67.8	69.7	69.4
Government	16.8	17.3	16.5	15.9	16.0
Investment	18.8	19.9	20.5	20.7	21.1
Exports	52.1	52.0	53.5	54.4	53.5
Imports	54.3	55.6	59.1	61.1	59.3
Inflation					
HICP (annual % change, average)	2.0	2.2	2.2	4.4	3.3
HICP (annual % change, EOP)	1.4	1.5	3.7	3.9	3.0

Source: Eurostat; PricewaterhouseCoopers forecasts (f) *Component shares of GDP may not add up to 100% owing to stockbuilding and statistical discrepancy.

Size of the economy

	2005	2006	2007	Share of 2007 world total
Population (millions)	0.7	0.8	0.8	0.0%
GDP, market rates (US\$ billions)	16	17	18	0.0%
GDP, PPP rates (US\$ billions)	20	21	22	0.0%
GDP per capita, market rates (US\$)	21,343	22,378	23,676	
GDP per capita, PPP rates (US\$)	26,609	27,765	29,105	

Source: IMF

Report date: 16 October 2008

Definitions

Base interest rate – The policy interest rate for Euroland is the main refinancing operations minimum bid rate

Base interest rate forecasts – ▲ increase; ▼ decrease; ◀▶ no change

General outlook – In the Key Metrics table on page 1, the overall economic environment is assessed as being Positive, Stable or Negative

EOP – End of Period;

HICP – Harmonised Index of Consumer Prices

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