

CYPRUS



GREECE



EUROLAND



View from the top

Cypriot economic growth continued to decelerate in the third quarter of 2008, largely due to a worsening balance of trade. Growth is expected to decelerate in 2009 as the effects of the global slowdown and weakening domestic demand take effect.

Key metrics

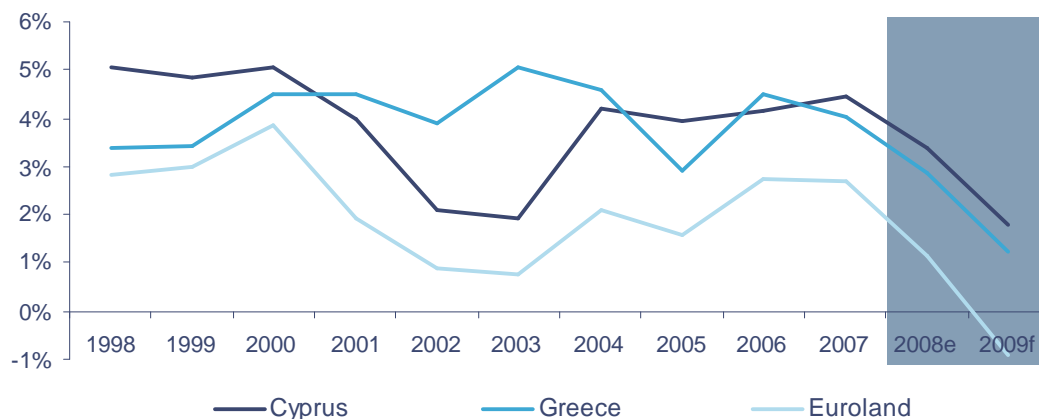
Indicator	2007	2008 ^e	2009 ^f
GDP growth	4.4%	3.3%	1.8%
Inflation	2.2%	4.4%	2.5%
Base interest rate	4% [^]	◀▶ [*]	▼
General outlook		Negative	Negative/Stable

Source: ECB; Eurostat; PricewaterhouseCoopers forecasts (f) [^]End of period. ^{*}Rate as of December 2008 is 2.5%.

Key trends

- Cypriot economic growth slowed in Q3 2008, largely due to a worsening balance of trade and stagnant consumer spending.
- Cypriot inflation eased to 3.1% in November 2008, but remained higher than the Euroland average.
- Cypriot economic sentiment fell to its lowest level in over six years in November 2008.

Economic growth profile



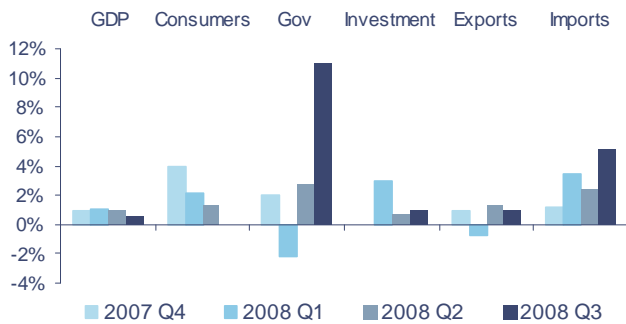
Source: Eurostat; PricewaterhouseCoopers estimates (e) and forecasts (f)

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Cyprus

The Cypriot economy expanded by 0.6% quarter-on-quarter in Q3 2008 (see Chart 1 below), a reduction of 0.3 percentage points compared to the previous quarter. Growth in the period was largely attributable to a surge in government spending which increased by 11.1%, following from the previous quarter's expansion of 2.7%. Export growth slowed to 0.9% while import growth picked up to 5.2%.

Chart 1: Cypriot quarter-on-quarter growth rates



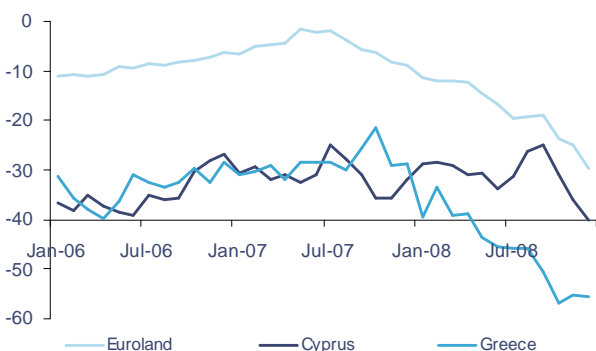
Source: Eurostat

Economic activity decelerated in key sectors of the Cypriot economy in the third quarter of 2008. Growth in the largest sector, which consists of retail, tourism and transport activities, fell from 1.1% in the previous quarter to 0.3% in Q3 2008. The second largest sector, comprising of financial and business services including real estate activities, also saw decelerated growth in Q3 2008 of only 0.4% in the quarter compared with 1.1% in Q2 2008. Growth in the construction sector remained relatively strong at 1% over that period.

The tourism sector is expected to face difficult times ahead especially as the UK, Cyprus's biggest source of visitors, is entering into a relatively prolonged recession. The impact of the deteriorating sterling exchange rate is likely to reduce the number of UK nationals investing in the Cypriot holiday home market. This could dampen real estate activity on the island as well as hit the construction industry.

Consumer confidence dropped considerably during the quarter, reaching its lowest level in December since August 2005 (see Chart 2 below). Consumer spending was stagnant in Q3 2008.

Chart 2: Consumer sentiment

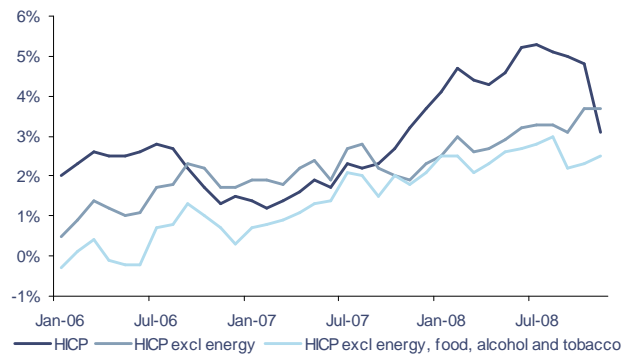


Source: European Commission

Overall economic sentiment carried on its recent downward trajectory reaching its lowest level in November since September 2002. The impact of the global slowdown and weaker consumer spending has made businesses more pessimistic regarding the current economic environment.

Cypriot inflation continued to fall, reaching 3.1% in November 2008, although it remains above the Euroland average. Inflation decreased due to a significant price drop in key commodities including energy and food. The price of liquid fuels, gas and vegetables all fell sharply in November.

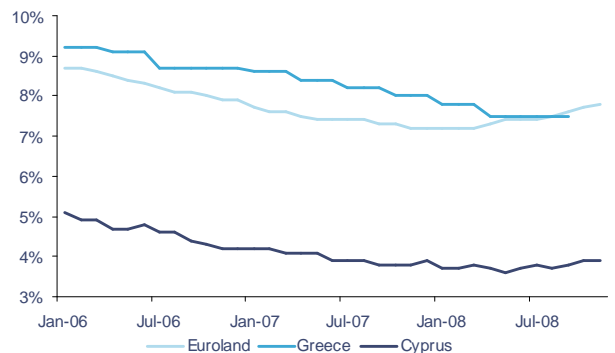
Chart 3: Cypriot inflation rates



Source: Eurostat

The Cypriot unemployment rate increased slightly to 3.9% in November, but remains considerably below the Euroland average (see Chart 4 below). Unemployment in the retail and tourism industry is expected to increase as the effects of the global slowdown and weaker domestic demand take their toll.

Chart 4: Unemployment



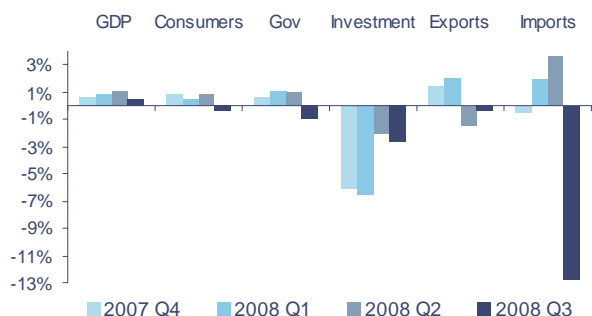
Source: Eurostat, Greek data only available up to June 2008.

Due to the impact of the global slowdown and the significantly low levels of consumer confidence in Cyprus, we are likely to see a significant deterioration in the economic outlook. Consequently we expect the Cypriot economy to expand by only 1.8% in 2009, following an estimated 3.3% growth in 2008.

Greece

In the third quarter of 2008 the Greek economy expanded by 0.4% q-o-q, down from 1.1% in Q2 2008. Economic growth in Q3 2008 was driven largely by an improvement in the balance of trade, with imports falling by 12.7%. Investment contracted for the fourth consecutive quarter while consumer spending fell by 0.4% (see Chart 5 below).

Chart 5: Greek quarter-on-quarter growth rates

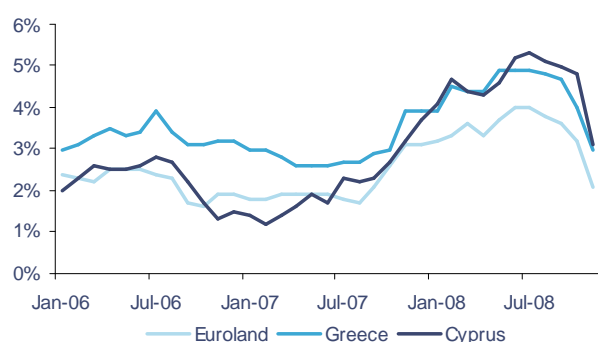


Source: Eurostat

The economic sentiment indicator for Greece reached its lowest level in December since records began in January 1985. This is likely further to dampen prospects for investment growth, which contracted for the fourth consecutive quarter in Q3 2008. Consumer spending fell by 0.4% q-o-q, the first drop in over eight years, echoing the low levels of economic sentiment.

Despite falling to 3% in November, Greek inflation remains higher than the Euroland average of 2.1% (see Chart 6 below). Persistent higher inflation is eroding the Greek economy's competitiveness.

Chart 6: inflation rates



Source: Eurostat

Greek exports fell for the second consecutive quarter and with two of Greece's main export markets – Germany and Italy – in recession, export growth is not expected to pick up in the short term.

Greece has one of the Euroland's most indebted economies, with public debt accounting for over 90% of GDP. This has placed a burden on the economy and is likely to restrict the fiscal policies available to the government as the country faces a difficult year ahead.

The Greek unemployment rate has remained stable during the first half of the year at around 7.5%. However, the level of unemployment among younger Greeks remains high. Greek unemployment in the under 25 age group reached

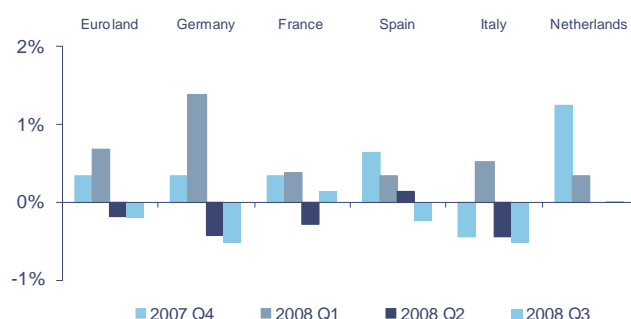
21.4% in June while the corresponding figure for Euroland was 15.1%. Fewer employment prospects for young Greeks was argued as one of the factors fuelling the riots in late 2008.

The combination of the global slowdown and low levels of Greek economic sentiment is expected to dampen Greek economic activity. Consequently we expect the Greek economy to grow by 2.8% in 2008 and 1.2% in 2009.

Euroland

The Euroland economy is now in a technical recession after contracting for the second consecutive quarter in the third quarter of 2008. GDP fell by 0.2%, the same rate as that in Q2 2008 (see Chart 7 below). Investment continued to fall during the quarter, down by 0.6%, and was a key driver of the overall contraction.

Chart 7: Quarter-on-quarter GDP growth rates



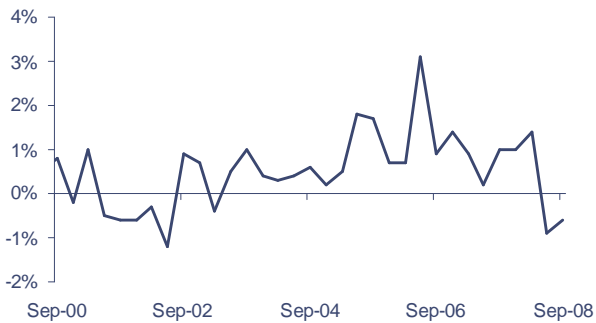
Source: Eurostat

Several Euroland economies are also now officially in technical recession. The German and Italian economies both contracted by 0.5% in Q3, while output in Spain was down 0.2% as the global downturn in activity took its toll.

Retail sales continued to fall in October, down by 0.8%, as consumers became increasingly cautious about spending. Prospects for the crucial Christmas sales season are also looking poor. Euroland's retail Purchasing Manager's Index, an indicator of retail managers' views on economic conditions and prospects, hit its lowest level in November since it was established in 1998, falling by 8.4%. Overall, conditions in the sector remain gloomy.

In contrast to movements earlier in the year, total investment fell by 0.6% in Q3, as illustrated in Chart 8 below. Over the past year, investment has been increasingly hit by sharply lower business confidence, tighter credit conditions and markedly weaker final demand. Looking forward, it is likely that investment will remain weak in the coming quarters, thereby further dampening economic growth.

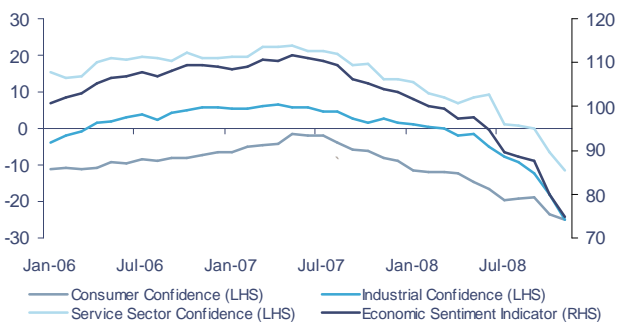
Chart 8: Quarter-on-quarter investment



Source: Eurostat

Consumer and business confidence indicators have further deteriorated in recent months. As shown in Chart 9 below, the Euroland economic sentiment indicator, measuring both business and consumer confidence, fell by 6.4% in November to hit a new record low since it was first produced in 1985. Specifically, consumers appear to be becoming more pessimistic about labour market conditions, with the sub-index measuring fears about unemployment jumping in November to its highest level in almost 15 years.

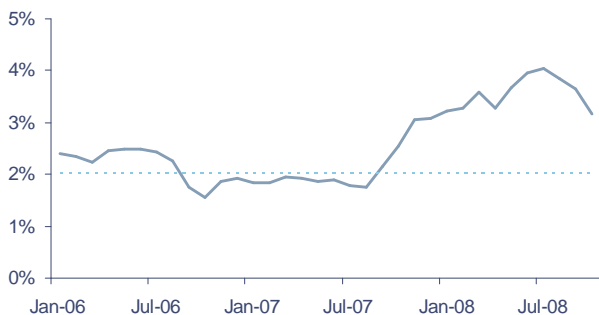
Chart 9: Economic Sentiment Indicator



Source: European Commission

The annual rate of inflation has continued to decline over recent months, retreating from its mid-July peak of 4%. A flash estimate of the annual inflation rate for November was 2.1%, down from 3.2% in October. Falling commodity and food prices have contributed to an easing of inflationary pressures across the region.

Chart 10: Inflation



Source: Eurostat

Easing inflationary pressures have provided greater scope for additional monetary stimulus by the ECB. The bank's key interest rate has been cut by 175 basis points since

September and currently lies at 2.5%. As economic conditions worsen in 2009, this trend in interest rate reductions is expected to continue in order to stimulate consumption and investment.

The ongoing effects of financial market instability, tighter credit conditions, weaker external demand and still volatile equity prices will continue to constrain economic activity in Euroland. Consequently, we have revised down our forecasts for economic growth in Euroland to 1.2% in 2008 and -0.9% in 2009.

Cyprus: recent performance and forecasts

	2005	2006	2007	2008 ^e	2009 ^f
Real growth (annual % change)					
GDP	3.9	4.1	4.4	3.3	1.8
Consumer spending	4.0	4.5	8.2	7.1	1.3
Government	3.4	7.4	0.1	6.9	10.0
Investment	3.3	10.5	7.6	5.6	1.8
Exports	4.7	3.9	7.2	2.8	1.7
Imports	3.1	6.6	12.5	12.0	3.8
Contribution to GDP growth (%)*					
Consumer spending	2.6	3.0	4.6	4.9	0.9
Government	0.6	1.2	0.0	1.1	1.7
Investment	0.6	2.0	1.5	1.2	0.4
Exports	2.4	2.0	3.9	1.5	0.9
Imports	-1.7	-3.6	-6.2	-7.2	-2.4
Domestic demand	4.5	6.6	5.4	10.7	3.3
Net Exports	0.7	-1.6	-2.3	-5.7	-1.5
Economic structure (% of GDP)*					
Consumer spending	66.0	66.2	67.8	71.1	70.8
Government	16.8	17.3	16.5	17.2	18.5
Investment	18.8	19.9	20.5	21.0	21.0
Exports	52.1	52.0	53.5	53.1	53.1
Imports	54.3	55.6	59.1	64.9	66.2
Inflation					
HICP (annual % change, average)	2.0	2.2	2.2	4.4	2.5
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: 14 January 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

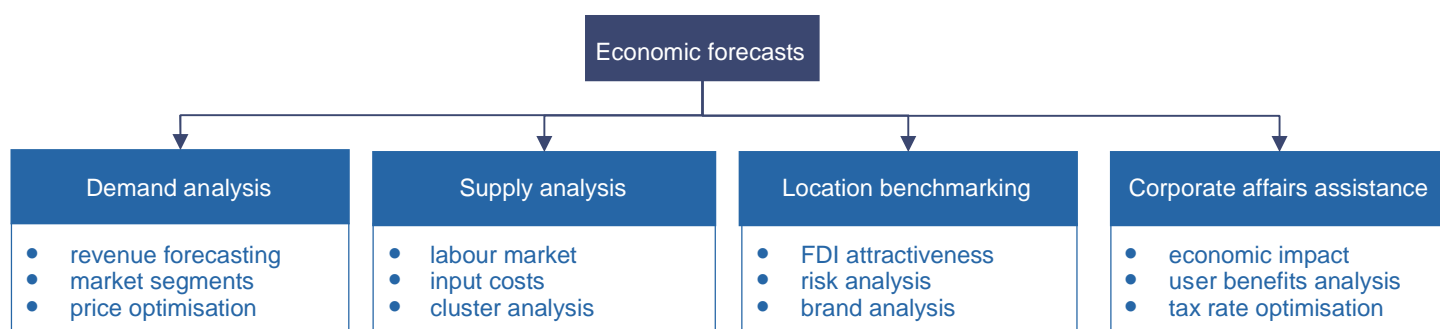
EOP – End of Period;

HICP – Harmonised Index of Consumer Prices

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