

ECONOMIC BULLETIN

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DEVELOPMENTS IN THE WORLD ECONOMY

Against the background of high financial market volatility and incoming data suggesting more pronounced weakness in US economic activity, the external environment of the euro area has weakened over the past quarter. While global economic activity still continues to be supported by robust economic conditions in emerging markets, country-specific factors, as well as repercussions of the US slowdown, are having more of a dampening effect on the pace of economic expansion in other advanced economies. At the same time, the protracted upward momentum of commodity prices continues to place upward pressure on headline consumer price inflation in OECD countries. On balance, the risks to the outlook for growth are judged to lie on the downside.

Europe: On the basis of its regular economic and monetary analyses, the Governing Council of the ECB decided at its meeting on 10 April 2008 to leave the key ECB interest rates unchanged. They decided to leave the minimum bid rate on the main refinancing operations of the Eurosystem at 4.00%. The interest rates on the marginal lending facility and the deposit facility were also left unchanged at 5.00% and 3.00% respectively. The information that has become available since the previous meeting of the Governing Council, on 7 February, has confirmed the existence of strong short-term upward pressure on inflation. It has also confirmed the assessment that there are upside risks to price stability over the medium term, in a context of very vigorous money and credit growth. The economic fundamentals of the euro area are sound. Incoming macroeconomic data point to moderating but ongoing real GDP growth. Yet the level of uncertainty resulting from the turmoil in financial markets remains high. Against this background, the Governing Council emphasizes that maintaining price stability in the medium term is its primary objective in accordance with its mandate. The latest information on economic activity confirms the picture of moderating growth around the turn of the year. According to Eurostat's first estimate, the quarter-on-quarter growth rate of euro area real GDP in the fourth quarter of 2007 was 0.4%, following 0.8% in the previous quarter. Annual real GDP growth is projected to lie in the range of 1.3% to 2.1% in 2008, and be between 1.3% and 2.3% in 2009. With regard to price developments, annual HICP inflation rate was 3.2% in February 2008, unchanged from January. This confirms the strong upward pressure on inflation in the short term, stemming mainly from the increases in energy and food prices in recent months. Looking ahead, the Governing Council expects a more protracted period of relatively high rates of inflation than it did a few months ago. The annual HICP inflation rate will most likely remain significantly above 2% in the coming months. The March 2008 ECB staff macroeconomic projections foresee annual HICP inflation of between 2.6% and 3.2% in 2008, and between 1.5% and 2.7% in 2009.

United States: After having cut its target for the federal funds rate by 25 basis points on 11 December 2007, the US Federal Open Market Committee (FOMC) lowered the target again on three occasions in early 2008. First, at an unscheduled meeting on 22 January, it decided to cut its target by 75 basis points to 3.5%. Subsequently, at its regular meeting on 30 January, the target was lowered by an additional 50 basis points to 3% and finally, on 18 March, it decided to cut its target by 75 basis points to 2.25%. As regards price developments, headline consumer price inflation stood at 2.8% in 2007, down from 3.2% in 2006. The year-on-year rate of change in the CPI increased in the course of 2007, with the exception of a brief decline in the summer. The annual rate of inflation excluding energy and food moderated over most of 2007, although it has increased again in the past few months. In 2007 as a whole it stood at 2.3%, 0.2 percentage point lower than in 2006. Following several years of strong growth in economic activity, real GDP growth slowed somewhat in 2007, standing at 2.2% in that year, down from 2.9% in 2006. This slowdown mainly reflects adverse developments in the housing market, which continued trends observed in 2006 and resulted in a sharp contraction in residential investments. Looking ahead, the outlook for the US economy has deteriorated in recent months, suggesting that economic growth in economic activity will slow substantially further by comparison with the rates observed in 2007. Real GDP growth is expected to lie in the range of 1.3-2.0% in 2008, 2.1-2.7% in 2009 and 2.5-3.0% in 2010. Annual “core” inflation is projected to stand between 2.0% and 2.2% in 2008 and to lie in the range of 1.7-2.0% and 1.7-1.9% in 2009 and 2010 respectively.

United Kingdom: On 10 April 2008 the Bank of England’s Monetary Policy Committee cut its main policy rate by 25 basis points to 5%. GDP growth has moderated and HICP inflation has remained relatively stable in recent months. The quarterly rate of output growth gradually moderated in 2007, and in the fourth quarter of 2007 it stood at 0.6%, just below the long-term average of 0.7%. HICP inflation remained more or less unchanged in the four months to January 2008, standing at 2.2% in that month. Looking ahead, growth momentum is expected to decelerate further on the back of tighter credit conditions, negative wealth effects stemming from the weakness in house and equity prices, and weaker foreign demand. In the short run, inflation is expected to increase significantly owing to increases in the prices of gas, electricity, fuel and imports.

Japan: The Bank of Japan’s target for the uncollateralised overnight call rate remains at 0.5%. In Japan, economic activity has continued to expand and output has been supported by resilient business investment and solid export growth, while the contribution of private consumption to GDP growth has remained moderate. In the fourth quarter of 2007, according to the first preliminary data released by the Cabinet Office, real GDP grew by 0.9% quarter on quarter. For the year as a whole, real GDP grew by 2.1%, down from 2.4% in 2006. Consumer price inflation has remained subdued, owing to persistent downward pressures, especially on wages. In recent months, however, as a result of the rise in the price of imported raw materials, general CPI inflation has returned to positive territory. In December 2007 the annual rate of change in the CPI was 0.7%, having stood at 0.6% in November, while the annual rate of change in the CPI excluding fresh food was 0.8%, having stood at 0.4% in November. Excluding food and energy, the annual rate of change in the CPI was –0.1%, the same as in November.

Energy News: After surging throughout most of 2007, oil prices entered a period of very high volatility at the end of the year and have since remained volatile at historically high levels, standing at USD 99.6 ON 5 March. At the beginning of 2008 market concerns regarding a global economic downturn resulting in subdued global oil demand placed downward pressure on oil prices. In its February assessment the International Energy Agency revised downwards its 2008 forecast for global oil demand growth from 2.3% to 1.9%. This downward revision reflects weaker demand growth in OECD countries, mainly the United States, while non-OECD demand is expected to remain robust. Looking ahead, future prices indicate that oil price will remain at elevated levels in the medium run.

CYPRUS ECONOMY

As from 1st January 2008, when Cyprus joined the Eurozone, the official interest rates are set by the ECB. GDP in total is forecasted at 15.5 million Euros for 2007. Economy is expected to expand by 4.4% in 2007, and 4.1% in 2008. Higher fuel prices pushed Cyprus's consumer inflation to 4.7% in March 2008. For the whole year, 2007, the CPI index rose by 2.4%, down from 2.5% in 2006. For the period January – February 2008 CPI index rose by 4.63% compared to the corresponding period in 2007. Month on month CPI index increased by 0.49% to 107.11 points in February compared to 106.58 in January. Turning to the labour market, unemployment for 2007 was at 3.9%, that is lower than the corresponding figure in 2006 which stood at 4.5%. The unemployment rate fell in the fourth quarter of 2007 to 3.5% from 4.0% in the third quarter. For the period January-March 2007 the fiscal deficit reached to 0.8% of the GDP. As regards receipts from tourism for the period January – February 2008 reaches 75.9 million compared to 72.2 million in the corresponding period of 2007, recording an increase of 5.2%. For the period January – February 2008 arrivals of tourists totaled 50,658 compared to 51,848 in the corresponding period of 2007, recording a decrease of 2.3%.

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