

# ECONOMIC BULLETIN

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## DEVELOPMENTS IN THE WORLD ECONOMY

Financial market strains have continued to weigh on global economic activity over the last few months. Broadening economic weakness in the United States and the global repercussions of the financial turmoil have translated into a slowdown in economic growth in major developed economies, while relatively resilient domestic demand in emerging economies is supporting overall global growth. At the same time, global inflationary pressures have remained high, boosted by strong rises in oil and non-energy commodity prices. On balance, the risks to the outlook for global growth continue to be tilted to the downside.

**Europe:** At its meeting on 3 July 2008, the Governing Council of the ECB decided, on the basis of its regular economic and monetary analyses, to increase the key ECB interest rates by 25 basis points. The minimum bid rate on the main refinancing operations of the Eurosystem increased from 4.00% to 4.25%, the interest rate on the marginal lending facility increased from 5.00% to 5.25% and the deposit facility rate increased from 3.00% to 3.25%. At the same time, the Government Council noted that risks to price stability over the medium term have increased further. Inflation rates have risen significantly since the autumn of last year, owing mainly to strong increases in energy and food prices. HICP inflation is now expected to remain high for a more protracted period than previously thought. Upside risks to price stability over the medium term are also confirmed by the continuing very vigorous money and credit growth and the absence of significant constraints on bank loan supply up to now. At the same time, the economic fundamentals of the euro area are sound. Against this background, the Governing Council emphasizes that maintaining price stability in the medium term is its primary objective in accordance with its mandate. According to Eurostat's first estimate, the quarter-on-quarter growth rate of euro area real GDP in the first quarter of 2008 was 0.8%, well above expectations. Average annual real GDP growth is projected to lie in the range of 1.5% to 2.1% in 2008, and between 1.0% and 2.0% in 2009. With regard to price developments, annual HICP inflation has remained above 3% for the past seven months. According to Eurostat's flash estimate, it was 3.6% in May 2008. This confirms the more persistent current upward pressure on inflation, resulting largely from sharp increases in energy and food prices at the global level in recent months. Looking ahead, on basis of current futures prices for these commodities, the annual HICP inflation rate is likely to remain above 3% for some time to come, before moderating only gradually in 2009. The Eurosystem staff projections foresee average annual HICP inflation at between 3.2% and 3.6% in 2008 and between 1.8% and 3.0% in 2009. Compared with the March 2008 ECB staff projections, the ranges projected for inflation in 2008 and 2009 are markedly higher, reflecting mainly higher oil and food prices and increasingly inflationary pressures in the services sector.

**United States:** The Federal Open Market Committee (FOMC) decided, at its meeting on 25 June 2008, to leave the US borrowing costs unchanged at 2.0%. As regards price developments, annual CPI inflation has remained at elevated levels, reflecting recent energy and food price developments. Annual headline inflation declined slightly to 3.9% in April, down from a six-month average of 4.1%. The decline observed since the beginning of 2008 reflects some moderation in the annual increase in energy prices, partly as a result of base effects. The annual rate of consumer price inflation excluding food and energy stood at 2.3% in April, 0.1 percentage point lower than in March. Real GDP increased at a quarterly annualized rate of 0.9% according to preliminary estimates, compared with 0.6% in the final quarter of 2007. Looking ahead, economic activity is expected to remain subdued over the course of 2008. At the 29-30 April meeting of the FOMC, Federal Reserve governors and Reserve Bank presidents revised down their projections for real GDP growth in 2008 to a central tendency of 0.3-1.2%. FOMC participants projected overall inflation to



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remain elevated over the near term due to the run-up of oil and other commodities prices, and viewed a possible increase in inflation expectations as a key upside risk to the inflation outlook.

**United Kingdom:** The Bank of England's Monetary Policy Committee, at its meeting on 5 June 2008, decided to leave its main policy rate unchanged at 5%. GDP growth has moderated and HICP inflation picked up. The quarterly rate of output growth gradually slowed over the past year. In first quarter of 2008 it stood at 0.4%, well below the long-term average of 0.7%. Since the beginning of 2008 HICP inflation has increased, reaching 3.0% in April. Looking ahead, growth momentum is expected to decelerate further on the back of tighter credit conditions, weaker growth in real income, negative wealth effects stemming from the weakness in house and equity prices, and softer foreign demand. At the same time, inflation is expected to increase in the short run, owing to a rise in the prices of energy and imports.

**Japan:** As in previous meetings this year, the Bank of Japan decided to leave its target for the uncollateralised overnight call rate unchanged at 0.5% at its most recent meeting on 12 June 2008. According to the first preliminary data release by the Cabinet Office, real GDP grew by 0.8% quarter on quarter in the first quarter of 2008. In Japan, economic activity was supported by a strong expansion of exports, and by sustained private consumption, which grew by 0.8%. Consumer price inflation, which has picked up at the beginning of the year as a result of increases in price of imported raw materials, declined more recently. Consumer price inflation decreased from 1.2% in March to 0.8% in April following the abolishment of a temporary higher rate of gasoline tax. The annual change in the CPI excluding fresh food also decreased to 0.9% in April, down from 1.25% in March. At the same time, the CPI excluding food and energy declined by 0.1% year on year in April. Looking ahead, signs of weakness in the industrial sector and falling confidence together with the decline in business investments growth and a moderation in global trade suggest that the economy could slow down in the coming quarters.

**Energy News:** Oil prices continued their surge to unprecedented levels, peaking at approximately USD 145 on 3 July. At the beginning of 2008 market concerns regarding a global economic downturn resulting in subdued global oil demand placed downward pressure on oil prices. On the demand side, the International Energy Agency has significantly revised down its forecasts for global demand, although demand in developing economies is growing vigorously, sustained in part by the strong growth of Chinese imports of refined products. On the supply side, OPEC has maintained that overall global supplies are sufficient, no extra meeting is envisaged before the one scheduled for September. Looking ahead, oil prices are likely to remain at elevated levels by historical standards in the near to medium term and very sensitive to small changes in the supply-demand balance and the geopolitical environment.

#### **CYPRUS ECONOMY**

GDP in total is forecasted at 15.5 million Euros for 2007. Economy is expected to expand by 4.1% in 2008. Higher fuel prices pushed Cyprus's consumer inflation to 5.5% in June 2008. For the period January - June 2008 CPI index rose by 5.47% compared to the corresponding period in 2007. Month on month CPI index increased by 0.29% to 110.51 points in June compared to 110.19 in May. Turning to the labour market, unemployment for the first quarter of 2008 was at 4.6% that is lower than the corresponding figure in 2007, which stood at 4.8%. The unemployment rate increased in the first quarter of 2008 to 4.6% from 3.5% in the fourth quarter of 2007. As regards receipts from tourism in April 2008 reaches 107.8 million compared with 123.7 million in April 2007, recording a decrease of 12.85%. For the period January - May 2008 arrivals of tourists totaled 682,614 compared to 681,632 in the corresponding period of 2007, recording an increase of 0.14%.

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