

ECONOMIC BULLETIN

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DEVELOPMENTS IN THE WORLD ECONOMY

Global economic activity, albeit dampened by the economic weakness in the United States, by the global repercussions of the ongoing financial market tensions and by the elevated levels of energy and food prices, is expected to remain resilient. The slowdown in global growth concerns mainly developed economies, while economic growth remains sustained in emerging markets. In June headline consumer price inflation in OECD countries rose to its higher levels since March 2000 due to sharp rises in oil and non-energy commodity prices. On balance, the risks to the outlook for global growth continue to lie on the downside.

Europe: At its meeting on 4 September 2008, the Governing Council of the ECB decided, on the basis of its regular economic and monetary analyses, 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 4.25%. The interest rates on the marginal lending facility and the deposit facility were also left unchanged at 5.25% and 3.25% respectively. It has confirmed that annual inflation rates are likely to remain well above levels consistent with price stability for a protracted period of time and that risks to price stability over the medium term remain on the upside. With regard to price developments, annual HICP inflation has remained considerably above the level consistent with price stability since last autumn, reaching 4.0% in June 2008 and, according to Eurostat's flash estimate, 4.15 in July. This worrying level of inflation rates results of past sharp increases in energy and food prices at the global level. Looking ahead, on the basis of current futures prices for commodities, the annual HICP inflation rate is likely to remain well above a level consistent with price stability for quite some time, moderating only gradually in 2009. A cross-check of the outcome of the economic analysis with that of the monetary analysis clearly confirms the assessment of increasing upside risks to price stability over the medium term. Annual inflation rates are likely to remain well above levels consistent with price stability, and monetary aggregates continue to grow vigorously, with so far no signs of significant constraints on bank loan supply. The latest economic data point to a weakening of real GDP growth in mid-2008, which in part was expected after the exceptionally strong growth in the first quarter. Against this background, it remains crucial to avoid broadly based second-round effects in wage and price-setting.

United States: The Federal Open Market Committee (FOMC) decided, at its meeting on 5 August 2008, to leave the US borrowing costs unchanged at 2.0%. As regards price developments, annual CPI inflation increased to 5.0% in June from 4.2% in the previous month, reaching its highest level in 17 years. This increase was due to the recent pick-up in energy costs, which now account for about half of the annual rate of inflation. Annual core inflation remained broadly stable at 2.4% in June, which is the same as the average growth rate during the first half of 2008. Economic activity recovered somewhat in the second quarter of 2008, but growth remained below its long-term average. According to advance estimates, real GDP increase at a quarterly annualized rate of 1.9% compared with 0.9% in the first quarter of 2008.

United Kingdom: The Bank of England's Monetary Policy Committee, at its meeting on 4 September 2008, decided to keep its main policy rate unchanged at 5%. The preliminary estimate of output growth (0.2% quarter on quarter) in the second quarter of 2008 confirmed the ongoing slowdown. The weakening growth in retail sales in the same quarter points to a moderation in private consumption, thus reducing the gap between official statistics and survey indicators. Construction output declined and house prices continued to fall in the second quarter. Given the low and falling confidence indicators, especially for retail sales and construction, output growth is expected to remain subdued in the coming quarters. Food and



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energy price shocks continued to push up consumer and producer prices. In June annual HICP inflation rose to 3.8% and producer prices increased by 10.0% year on year.

Japan: At its meeting on 15 July 2008, the Bank of Japan decided to leave its target for the uncollateralised overnight call rate unchanged at 0.5%. Signs of a decline in economic activity were confirmed by recent data. Industrial production growth declined by 2% month on month in June, contributing to the negative industrial production growth recorded in the second quarter of 2008. CPI inflation in Japan has increased since the beginning of the year, mainly as a result of rising commodity prices. Annual CPI inflation went up to 2% in June from 1.3% in May, reaching the upper limit of the Bank of Japan's definition of price stability. This rise in inflation was driven in particular by increases in food prices and in oil prices. Prices excluding food and energy rose by 0.1% in annual terms.

Energy News: During the first two weeks of July, oil prices continued to surge, peaking at USD 145.7 on 4 July. Subsequently, they declined to approximately USD 104 on 2 September, which is still 25% higher than at the beginning of the year. This correction was triggered by better-than-expected figures for US inventories, which nevertheless remain at very low levels. Market participants expect medium-term prices of around USD 120 for USD 120 for December 2009. On the demand side, the slowdown in OECD imports is still being offset by the robust growth in demand from developing economies.

CYPRUS ECONOMY

GDP in total is forecasted at EUR 4,338 million for the second quarter of 2008. Economic growth is forecasted to 3.9% in the second quarter of 2008, compared with the corresponding quarter in 2007. Higher fuel prices pushed Cyprus's consumer inflation to 5.6% in July 2008. For the period January July 2008 CPI index rose by 4.95% compared to the corresponding period in 2007. Month on month CPI index decreased by 0.60% to 109.85 points in July compared to 110.51 in June. 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 June 2008 reaches 229.6 million compared with 207.4 million in June 2007, recording a decrease of 10.70%. For the period January July 2008 arrivals of tourists totaled 1,332,406 compared to 681,632 in the corresponding period of 2007, recording an increase of 1.21%.

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