ALPHA BANK

Greece and Southeastern Europe Economic and Financial Outlook

Economic Research Division

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Executive Summary

1. Greece

- Greek growth to slow down to 2.1% in 2009 from 3.2% in 2008, given the deterioration in consumer confidence and business prospects, with tourism, shipping, construction and SE European business all declining as the global economy enters in a recession.
- The Greek government's Economic Stimulus Plan to provide € 28 billion in capital, liquidity and guarantees so that economic activity may be sustained at appropriate levels.
- Given the high current account deficit and international indebtedness and with capital inflows slowing down, the prospects for a fiscal stimulus plan are rather remote given the widening of the spreads of Greek Government bonds. Nevertheless, the budget deficit target for 2009 of 2% of GDP may be off-the-mark given the expected decline of tax revenue growth in an environment of reduced economic activity.

2. Romania

- Economic activity surged passed all previous estimates with full year GDP growth of 8.5% expected in 2008. However, in tandem with the global recession, GDP growth is expected to decline to 3.7% in 2009.
- The current account deficit has stabilised at around 14.0% of GDP on the back of slower import and faster export growth. The forecast decline in private consumption, easing pressure on import demand, will allow for a modest correction in the current account in 2009.
- With both headline and core HICP inflation eased in August and September of this year, prices once again inched higher in October, with headline HICP of 7.4%. A combination of base-effects and lower commodity prices will help alleviate pressure on prices moving into the final months of 2008. Disinflation will continue in 2009, aided by lower food prices and weaker domestic demand.
- The Central Bank has embarked on a series of interest rate increases which have seen the key policy rate rising to 10.25% (up 325bps since June 2007) to contain domestic demand and rising inflation. Following the recent financial crisis, the Central Bank decided to leave rates unchanged, signalling that weaker global growth would aid the disinflation process.

3. Bulgaria

- GDP growth remained strong in the first half of 2008, increasing by 7.1%. A slight moderation in private consumption is expected to reduce GDP growth to around 6.5% for 2008. Uncertainty in the global financial markets will lead to lower growth of 3.5% in 2009, as lower credit growth constrains private consumption.
- Supply-side shocks in the form of rising food and oil prices have played havoc with the authorities' attempts at continued disinflation. However, in recent months, HICP inflation has eased to 11.2% in October, from a high of 14.7% in June 2008. HICP inflation is forecast to decline to 10.5% by year-end, aided by positive base effects, a decline in international energy prices and increased agricultural production.
- The current account deficit has stabilised at 21.5% of GDP. This was assisted by the activation of new export related production facilities and solid external demand which boosted export growth in H1 2008. Lower economic activity in 2008 will constrain import growth, facilitating a correction in the deficit to below 20.0% of GDP

4. Cyprus

- Economic activity has begun to moderate, with GDP growth declining from 4.1% in Q1, to 3.5% in Q3. We currently forecast full year GDP growth of 3.7%. Positive contributions were once again recorded by private consumption (6.8% Q1 and 7.4% Q2 2008) and investment (5.5% Q1 and 3.7% Q2 2008).
- Determined fiscal policy has facilitated a substantial shift in the general government balance from a deficit of -1.2% of GDP in 2006 to a surplus of 3.3% in 2007, primarily due to unsustainably high tax revenues related to robust business sector profitability. The budget surplus is forecast at 1.0% of GDP in 2008.
- A combination of base effects in the last quarter of 2008 and the recent decline in oil prices will help reign in inflation, which is expected to average 4.5% in 2008 and then decline to 2.9% in 2009.

5. Serbia

- Economic activity has remained robust, registering GDP growth of 8.4% in Q1 and 6.2% in Q2. However, in 2008 a growth deceleration in the final quarter of the year, will constrain GDP growth to 6.5% in 2008. Growth is expected to slow further, to 3.5% in 2009 as the economy adjust to reduced external finance and tighter credit markets.
- Supported by persistent wage and credit growth, the current account deficit widened by 62.0% in the first nine months of 2008. The deficit is now expected to reach 18.6% of full year GDP, from the 15.9% recorded in 2007. However, weaker domestic demand will alleviate the pressure on the current account deficit, although this will be offset somewhat through weaker export growth.

6. Albania

- Being one of the least integrated economies in Southeastern Europe, economic growth has remained robust. Current IMF forecasts call for GDP growth of 6.1%, increasing to 6.3% in 2009. However, the growth outlook remains contingent on developments in the energy sector, but early indications (strong seasonal rainfall) bode well, both for the energy sector and the overall economy.
- Inflation has been heavily influenced by the combination of the domestic energy crisis and global rise in energy prices. While inflation accelerated in the early months of 2008, price pressure has since eased on the back of lower commodity prices. Inflation is expected to average 4.0% in 2008 before easing back to 3.1% in 2009.

7. Former Yugoslav Republic of Macedonia

- Economic activity remained strong in the first half of 2008, with GDP growth of 6.1% in Q1 and 6.5% in Q2. Nonetheless, following the indirect effects of the global slowdown, we expect growth to ease in second half of 2008 and as well as in 2009.
- Consumer price inflation has started to decelerate, with average inflation having declined to 9.3% in September 2008, although it remains higher than average inflation of 1.4% September 2007. Average annual inflation is expected to decline to around 7.0% by year-end.

8. Ukraine

- Following the spread of the global financial crisis to Ukraine, GDP growth forecasts have been significantly cut. The sharp deterioration in economic performance is expected to be felt in the final quarter of 2008, which will lower growth for 2008 to an estimated 5.3%, from the 6.5% reported for the first six months of the year.
- Inflation is likely to remain over 20% year on year at the end of 2008, despite the fact that CPI inflation slowed to 23.2% in October, with average annual inflation remaining in double digits, at around 12% for 2008.

9. Turkey

- The slowdown in the Turkish economy that started in Q2 is likely to deepen in 2009 as the impact of the global recession is felt by the local economy. GDP growth is expected to slow to 3.4% in 2008 and 1.5% in 2009.
- While the monetary and fiscal policy mix in combination with falling energy and commodity prices will support the disinflation process, this may be partially mitigated by the exchange rate pass-through stemming from the TRY depreciation in 2008-2009. Consumer price inflation is currently forecast to average 10.2% in 2008, with year-end inflation remaining high at 10.7%.

1. GREECE

Table 1. Basic Conjunctural Indicators (% change from previous period)	2005	2006	2007	2008	
Retail Sales					
Turnover Index	6.0	10.8	5.7	3,4	Jan-Aug
Volume Index	3.0	8.0	2.3	-0,3	Jan-Aug
Automobile sales	-3	0.5	4.3	-3,5	Jan-Sep
Tax on Mobile telephony	10.8	11.8	106.5	6,0	Jan-Aug
VAT Receipts	2.8	12.0	9.8	8,7	Jan-Jun
Consumption Tax on Fuels	0,7	5,4	10,0	23,3	Jan-Jun
Total Consumption	3.7	3.3	3.0	2,4	H1 2008
Building activity (Permits)	35.2	-19.5	-5	-15,8	Jan-Aug
Cement Production	2.4	3.1	-9.2	-0,4	Jan-Aug
Public Investment	-21.0	8.9	7.6	0,3	Jan-Sep
Total Investments	0.7	14.8	4.4	-4,8	H1 2008
Industrial Production					
Composite Index	-0.9	0.5	2.2	-2,2	Jan-Sep
Manufacturing Production	-0.8	0.8	1.8	-2,6	Jan-Sep
PMI (Manufacturing)	51.5	52.4	53.7	48,1	Oct
Turnover in Industry	7.6	12.6	4.2	19.1	Jan-Sep
New Orders in Industry	-1.8	12.3	1.7	-2.5	Jan-Sep
Exports goods & services	2.7	5.1	5.9	4,4	H1 2008
Imports goods & services	0.5	8.7	7,0	-5,9	H1 2008
GDP	**3.8**	**4.2**	**4,0**	**3,3**	**Jan-Sep**
Current Account (% of GDP)	-6,4	-9,7	-12,2	-8,8	Jan-Sep

Note: Growth rates are calculated on a cumulative basis

ECONOMIC DEVELOPMENTS: The Greek economy has been slowing down since the beginning of 2008 on the back of rising international prices for oil, food and raw materials and the deepening of the financial crisis. Nevertheless, growth in Jan-Sep 2008 has been a solid 3.3%. Under the influence of the post-Lehman dismal external economic and financial environment, growth in Q4 2008 is expected to decelerate further to 2.9%. The prevailing heightened uncertainty has proven to be detrimental to consumer and business confidence, undercutting economic activity and prospects as we move into 2009.

Credit crunch conditions have worsened as Greek banks intensified their re-pricing customer loans, following a period of working with negative term deposit spreads and in view of the post-Lehman abrupt deterioration in funding conditions in the international markets. In this environment, on the 20th November 2008, the Greek government, in line with prevailing international practice, adopted an Economic Stimulus Plan amounting to € 28 billion. The measures included bank capital injections through the issue of preference shares of € 5 billion, guarantees for bank borrowing in the markets of € 15 billion, and direct liquidity injection through the issue of € 8 billion special government bonds, to be used in repos.

The slowdown in economic activity was, so far, mainly due to weaker demand with exports growth remaining robust in the first nine months of 2008. Moreover, the deceleration of domestic demand growth was also reflected in the fall of imports of goods and services, with net exports set to exert a sizable positive contribution to GDP growth in 2008.

The weakening of domestic demand in Jan-Sep 2008 was mainly due to the surge in energy and food prices to record levels, which, combined with the overvalued Euro, has exerted substantial negative effects on domestic demand and activity in the main tradable goods sectors of the economy, including tourism. In fact, the deceleration of growth of private consumption in the first nine months of 2008, took place despite the robust 20.7% growth of credit expansion to households until end-September 2008. However, the malfunctioning interbank and corporate bond markets have increased the cost of capital for Greek banks, as well as domestic deposits and lending rates. Moreover, lending rules by Greek banks to both households and businesses have tightened, implying a substantial slowdown of domestic credit expansion in Q4 2008 onwards.

Therefore, final consumption growth decelerated to an estimated 2.3% in Jan-Sep 2008, down from 4.5% in Jan-Sep 2007. This is comprised of private and government consumption growth of 2.2% and 2.6% respectively, compared with 3.2% and 11.1% respectively in Jan-Sep 2007. Thus, the contribution to GDP growth of final consumption fell to 2.1 pp in Jan-September 2008, from 3.9 pp in Jan-Sep 2007. **Overall, growth of final consumption in 2008 is now expected to reach 2.2% compared with 3.9% in 2007 and 3.3% in 2006.**

Investment also declined by an estimated -3.5% in Jan-Sep 2008, following a -4.8% fall in H1 2008, compared to the sizable increase of 7.9% in Jan-Sep 2007. This fall in total investment was mainly due to the fall of housing investment, by more than -29,0% in H1 2008, compared with a -6.8% fall in 2007. In fact this negative growth of housing investment continued in Q3 2008 and is now expected to continue in Q4 2008 as well, implying a negative growth of -13.5% of this investment in 2008 as a whole. These developments coincide with a deceleration in mortgage credit growth to 15.1% in September 2008.

On the other hand, general government investment registered positive growth in Jan-Sep 2008, as the absorption of funds under the Public Investment Budget was slightly higher (0.3% yoy) in the first nine months of 2008, while for the year as a whole the government has budgeted for a 6.9% increase (+2.7% in constant prices). Finally, business investment (that is total investment minus general government and housing investment) has registered a positive 4.0% real growth in H1 2008, while for 2008 as a whole, growth of this investment is expected to reach 4.5% in constant prices.

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Overall, growth of total investment is now expected to decline -2.2% in 2008, compared with 4.9% in 2007 and 12.9% in 2006.

An important characteristic of the present domestic demand slowdown is related to the fact that it is reflected by a substantial fall of total imports of goods and services. This fall reached -5.8% in real terms in H1 2008 and is estimated at -3.5% in Jan-Sep 2008 and at 2.2% in 2008 as a whole. This is in combination with the continued robust growth in exports of goods and services, which is estimated at 4.6% in Jan-Sep 2008 and 3.4% in 2008, from 4.4% in H1 2008 and 3.1% in 2007. These developments imply a sizable positive effect of net exports on GDP growth, of roughly 1.8pps in 2008, from -1.3 p.p. in 2007.

Coming to the end of 2008, we find the Greek economy operating in a dismal international economic and financial environment, with the main advanced economies in a deep and, according to all indications, prolonged recession, coupled with a substantial deceleration of growth in the rapidly growing developing countries as well. In this dire economic environment, international trade growth is expected to decelerate to 1.9% in 2009 from 4.7% in 2008, while international tourism traffic will also fall below 2008 levels. These developments have already had a depressing effect on the international shipping industry in the last two months, in which industry the Greek ship-owners play a leading rule. Performance of this industry is expected to stay at low levels in 2009, with Greek current account receipts from international shipping expected to fall substantially next year, from their record level in 2008. This is one of the factors which will negatively affect domestic consumption and investment in 2009, especially investment in the housing sector. Moreover, negative effects are expected in the following year for Greek tourism and exports of goods and services in general, following again their positive performance in 2008.

The above adverse conditions for the operation of the Greek economy in 2009 are further enforced by the continuing high growth of domestic unit labour costs, which has contributed to a gradual erosion of domestic cost competitiveness, especially in periods of Euro appreciation. However, this erosion of competitiveness has not as yet dented Greek export growth, as domestic supply of exportable goods and services has been substantially boosted by rapidly increasing domestic production capacity as a result of the high rate of investment in the last ten years. Moreover, Greek exports have a boost by the rapidly growing SE European countries, Russia, and various other developing countries. These supply side and market growth effects are also expected, ceteris paribus, to support Greek exports of goods and tourism in 2009, despite the expected deceleration of growth in the main countries of destination of Greek exports or of origin of Greek tourists.

In fact, following the depreciation of the Euro from July 2008, onwards we may now expect slightly improved cost competitiveness for Greece and other Eurozone countries, despite the substantial depreciation of the currencies of Turkey, Hungary, Romania, S. Korea and other developing countries competing with Greek products in the international markets.

Overall however, we now expect exports of goods and services to loose their growth momentum in 2009 and register a fall of -4.8% in real terms, with imports falling even further due to the substantial slowdown of domestic demand, by -5.8%. Therefore, the contribution of net exports to GDP growth will be still positive at around 0.8pp in 2009, compared with the expected bigger positive contribution of 1.8pp in 2008. As shown in Table 2, **this leads to GDP growth of 2.1% in 2009,** compared with 3.2% growth in 2008 and 4.0% in 2007. Moreover, there is a strong basis for healthy growth above 2.5% to continue in 2010 onwards assuming a gradual recovery of the world economy.

Concerning the operation of the Greek economy given the new adverse economic environment, the following points need to be considered. The slowdown of GDP growth in Greece in 2008 and 2009 may be seen as a needed step towards the rationalization of its, recently robust, domestic demand growth. Higher interest rates could be an opportunity to boost domestic savings in Greece, as well as in other SE European countries, which in turn is the most effective way to improve their current account deficit position and contain domestic inflationary pressures. Moreover, higher interest rates on servicing the public debt may again bring home the message of the great advantages arising from a sound management of the Greek public finances.

The Greek banking system has been a strong pillar supporting growth in Greece and the SEE region as a whole in the last ten years. In the current period, despite the severe tensions in international financial markets, banks remain fundamentally sound, safe and stable. Their leverage is lower than in the Eurozone, with loans to GDP at 100%, compared with 122.4% in the Eurozone and above 170% in some "problematic" economies. Write-offs by Greek banks related to the international crisis are insignificant. Their profitability is still relatively robust and their capital base remains relatively strong. Over 90% of bank lending in Greece is financed by customer deposits, minimising Greek banks' exposure to financing in the international markets. Therefore, despite the expected significant slowdown, domestic credit expansion may still exceed 10.0% in 2009, given the utilization of the aforementioned Economic Stimulus Plan.

The Greek housing sector undergoes slowdown in 2007-2009 was in response to the extraordinarily high level of

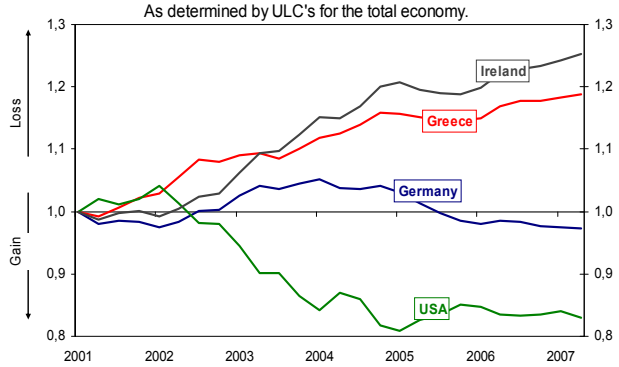
residential investment in 2006, following a building permit explosion in 2005 due to impending changes in the tax law affecting real estate transactions. However, it is now evident that this sector has also been negatively affected by uncertainty and tightening credit conditions due to the international financial turmoil. Therefore, housing investment is now expected to fall further in 2009, by about -14.0%, from its already low level of 2008. Housing price growth has also slowed down to around 1.5% in 2008, barely enough to compensate for the substantial increase in the cost of housing construction this year, as compared with the 3.5% increase in 2007 and a 12.2% growth in 2006. On the other hand, the abrupt fall in housing investment in 2007-2009 imply a substantial absorption of the number of unsold houses, reducing excess supply in the market. This is the main factor that may contribute to a recovery of housing investment from 2010, in combination with the beneficial effects expected from an improved international economic environment. Moreover, Greece's improved status as a favoured tourist destination, in combination with its increasing attractiveness as a destination for the establishment of second or summer homes, may enable both tourism and the housing sector to benefit from the expected recovery of the European economies.

Greece's net merchant shipping and international tourist receipts remain buoyant in the middle of the current economic slowdown. Net merchant shipping receipts which reached € 9.2 billion in 2007, a 25.0% increase on 2006, has continued to grow at a rapid pace increasing 22.3% in Jan-Sep 2008. These substantial net current account receipts constitute a considerable boost to domestic demand, investment and consumption in the Greek economy contributing to GDP growth. We expect these receipts to fall substantially, by around 35% (or by about 1.2% of GDP), in 2009 affecting negatively both private consumption and developments in the housing sector. Also, **international tourist receipts** were up by 4.0% yoy in Jan-Sep 2008 and are expected to register a positive growth for the year as a whole. This is mainly attributed to the substantial increase of tourist arrivals from Russia and SE European countries, which compensate for a possible slowdown of growth of arrivals from more traditional tourist origin countries (e.g. Germany and United Kingdom). However, we now expect a fall in tourist arrivals exceeding 10% in 2009, with earnings from foreign tourism falling by about 13%, contributing to the assumed fall of exports of goods and services by -4.8% in real terms.

Following the above developments, private consumption growth may also support GDP growth in the following years, despite being expected to ease to 2.2% in 2008 and 1.8% in 2009, from 3.2% in 2007 and 4.2% in 2006. In 2010, private consumption growth is expected to recover to 2.2%, as the negative factors affecting private consumption growth in 2008 and 2009 will have subsided. On the other hand, growth in government consumption, which accelerated to 7.4% in 2007 from 0.3% in 2006 (mainly due to the implementation of relief measures for households, businesses and local government affected by the summer 2007 fires, as well as to additional expenses related to the September 2007 general elections). This is expected to fall to the still high 2.9% growth in 2008 and to reach 3.5% in 2009 as the government will try to support to some extent domestic demand growth. However, government consumption growth is expected to be constrained from 2010 onwards due to the increasing pressure for maintaining the general government deficit bellow 3.0% of GDP. Thus, overall domestic demand growth will not exceed 1.1% in 2009, contributing to a sizable improvement of the goods and services deficit (national accounts basis) to 9.2% of GDP from 10.2% of GDP in 2008 and 12.4% in 2007.

Investment's function as the primary growth driver is constrained in 2008-2009 by the abrupt fall of investment in housing, while non-general government investment excluding housing will still register positive growth of 3.6% in 2008, 4.5% in 2009 and 4.9% in 2010. Absorption of EU funds by government and private sector business is expected to continue in the final year of the CSF III implementation period (2009), as well as in the initial implementation period of CSF VI (2007-2013). More than € 12 billion should be absorbed from the EU during the 3-years from 2008 to 2010. The Government has now been promoting most of the public sector projects through Public Private Partnerships (PPPs), implying a fall of general government investment by 13.2% in 2009, following the 2.6% and 2.7% real growth in 2007 and 2008 respectively, from the high 9.1% growth in 2006.

Diagram 1. Real Effective Exchange Rate
As determined by ULC's for the total economy.

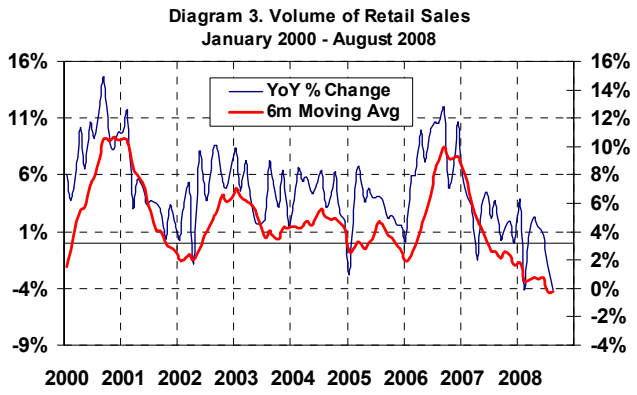


Business investment is also expected to be boosted in the following years by: (a) The rapidly expanding activity of project development via PPPs. Following a relatively long gestation period, a number of important infrastructure projects (budgeted at more than € 5.0 billion) were awarded to consortia of construction companies (domestic and foreign) in 2007 and 2008 to be implemented mainly in 2009 onwards. (b) The large number of investment projects under the investment incentives law (3299/2004) in the period 2005-2008. About 6.543 projects were submitted, of which 4.300 were approved. Total budgeted value of investment in

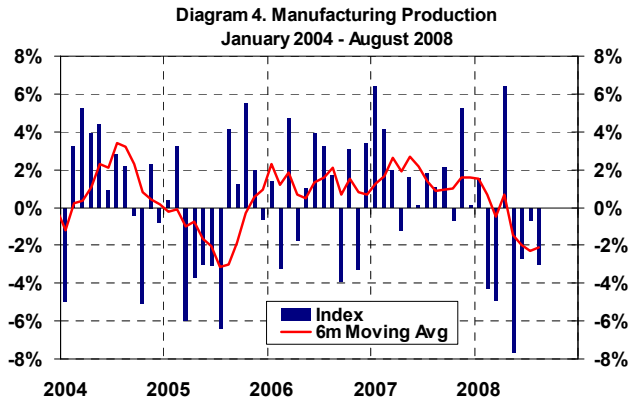
these projects reached € 8.9 billion, in which a government subsidy of € 3.7 billion is included. In fact, most of these investment projects are expected to be implemented and completed in the period 2008-2009 boosting business investment in this period.

However, the continuation of Greece's solid growth, within a crisis environment and recession in the international economy, is constrained by the gradual erosion of Greece's international competitiveness in terms of unit labour costs (ULC). Data from the IMF, the European Commission and the Bank of Greece indicate that since 2001, Greece's ULC-based real effective exchange rate had appreciated by as much as 17.0% relative to its main trading partners and by nearly 30% against emerging market economies (Diagram 1). Deteriorating competitiveness is constraining Greek export growth (including tourism), while at the same time contributing to the high growth rate of imports and, as a result, to the high current account deficit. This appreciating trend of Greece's real effective exchange rate may be reversed in H2 2008 due to the depreciation of the Euro since July 2008. This reversal could be more pronounced with: (1) an acceleration of structural reforms, which would facilitate the continued high rate of productivity growth and (2) adjusting the wage policy so that wage-growth trends below productivity growth, in combination with the successful implementation of reform measures of the social security system recently adopted.

ECONOMIC INDICATORS: Retail sales volume in Jan-Aug 2008 posted a slight fall of -0.3% yoy, following a 3.4% growth in Jan-Aug 2007. Registrations of private new passenger vehicles fell by -4.0% in Jan-Oct 2008, following a 4.3% increase in 2007. The retail business confidence index fell abruptly to 88.7 in October , from 101.3 in July, 119.7 in April 2008 and 117 in January 2008, mainly as a result of the surge in uncertainty produced through the extended publicity of the international financial crisis provided by Greek media in recent months.



Residential construction activity – as measured by the volume (m^3) of building permits – registered negative growth of -15.8% in Jan-Aug 2008, compared with the decline by -5.2% in Jan-Aug 2007 and -5.0% for 2007 as a whole. Also, growth in residential investment is set to register a decline of around -13.5% in 2008, following the fall by -6.8% for 2007, which in turn followed the 21.5% surge in 2006. Nevertheless, demand for housing investment was supported by the still high growth of mortgage lending (15.1% end-Sept 2008, 17.0% end-June 2008, 21.4% end-Dec 2007). A further deceleration in the growth of mortgage lending to around 12% is now expected by year end, following the recent surge in the cost of borrowing and the stricter credit rules applied by Greek banks since Sept. 2008. This unfavourable turn of events because of the international financial turmoil, is also reflected in the substantial deterioration of the construction business confidence index, which fell to 90.9 in Oct. 2008, from 105.2 in July 2008 and 110.5 in April 2008, but fluctuating still higher than the 84.2 in January 2008 and slightly lower than the 92.5 for 2007 as a whole.



Manufacturing production recorded also negative growth of -2.6% in Jan.-Sept 2008, following 1.9% growth in Jan.-Sept 2007. This fall was mainly due to the -26.6% fall of production of textiles and the -11.9% fall in the production of clothing. One of the main textiles firms in Greece was forced to go out of operation in May-Sept 2008 due to its inability to compete with cheap imports and aggressive competitors in its main exporting markets given labour costs prevailing in Greece. Moreover, production of non metallic minerals, of office machinery and computers and of radio, TV and telecommunications equipment was down by -5.9%, -24.6% and -25.4% respectively. On the other hand, production of food and beverages was up by 2.5% in Jan.-Sept 2008, on top of a 4.5% increase in Jan.-Sept 2007 and positive growth was also registered in the production of tobacco, leather products and footwear, chemical products, electrical machinery and equipment and recycling. The prospects ahead are again affected negatively by the current international financial turmoil, with the PMI index falling bellow 50, from 51.6 in July 2008 and 54.4 in April 2008. Also, manufacturing business confidence fell substantially to 83.9 in Oct. 2008, from 92.2 in Sept., 93.7 in July 2008, 101.4 in April 2008 and 97.5 in December 2007, while in 2007 it averaged at 102.8, compared with 101.5 in 2006.

Finally, the general index of industrial production also fell by -2.2% yoy in Jan.-Sept 2008, from 2.2% yoy in Jan.-Sept 2007, following an increase of 2.2% in 2007, 0.5% in 2006 and a -0.9% decline in 2005. Mining and quarrying production fell by -5.3% in Jan.-Sept 2008, compared with a fall of -0.6% in Jan.-Sept 2007. The production of electricity also fell by -1.7% in Jan.-Sept 2008, following a 2.6% increase in the same period of 2007. Natural gas and water production rose by 15.8% and 1.9% respectively in Jan.-Sept 2008, from 28.7% and 0,9% in Jan.-Sept 2007.

FISCAL POLICY: Regarding the implementation of the 2008 Budget as estimated in the 2009 Budget: **(a)** Net current revenues reached € 54.14 billion in 2008, up 10.1% compared with a budgeted increase of 13.0%. Tax rebates surged by 22% on top of a 9.7% increase in 2007, compared with a budgeted decrease of -2.8%. It is important to notice that total net revenues shortfall from the budgeted level reached € 1.38 billion, while the shortfall of only the VAT tax on items excluding petroleum products reached € 1.56 billion. This indicates that the main factor contributing to the systematic below target growth of net revenues in 2003-2008 period is the increasing tax evasion in small and medium size businesses. In fact revenues from property taxes are now expected to exceed the already high budgeted level, reaching € 1.12 billion, from € 0.43 billion in 2007.

Table 2. Implementation of the B2008 and the B2009

	B2002	B2007	B2008		B2008: Estimated Outcome		B2009	
	Billion €	Billion €	Billion €	% Change	Billion €	% Change	Billion €	% Change
Net Current Revenues	37,08	49,15	55,52	13,0%	54,14	10,1%	62,27	15,0%
Special Accounts Revenues							0,97	
Revenues from bank support plan							0,40	
Current Primary Expenditure	-28,30	-44,82	-48,56	8,4%	-49,16	9,7%	-53,10	8,0%
Interest payments	-9,13	-9,80	-10,50	7,2%	-11,30	15,4%	-12,00	6,2%
Special Accounts Paymenets							-0,88	
Non-recurrent expenditure		-1,10						
Public Invest. Budget: Revenues	2,56	4,88	4,53	7,0%	5,13	5,2%	3,70	-27,9%
Public Invest. Budget: Expenditure	-7,01	-8,81	-9,30	5,6%	-9,65	9,5%	-8,80	-8,8%
Central Government Deficit	-4,81	-10,50	-8,31	-20,9	-10,84		-8,81	
As % of GDP	***-3,1%***	***-4,6%***	***-3,4%***		***-4,4%***		***-3,4%***	
Local Govern.& Social Sec.Surplus		3,46	7,17		8,41		4,93	
Financing Social Security		-0,47	-3,01		-3,45		-0,58	
Defence Equipment		-1,32	-1,40		-1,80		-2,20	
National Accounts Adjustment		1,00	1,53		1,55		1,39	
General Government Deficit		-7,83	-4,03		-6,13		-5,27	
As % of GDP		***-3,4%***	***-1,6%***		***-2,5%***		***-2,0%***	
GDP, at matket prices	***157,3***	***228,2***	***244,2***	***7,0%***	***245,8***	***7,7%***	***260,2***	***5,9%***

The relatively high growth target for net revenues in 2008 was based on the expectation that it would be possible to further increase revenues through: a) the needed improvement of the tax revenue collection system by effectively tackling tax and social security contribution evasion and b) a successful effort to take in at least a small part of overdue tax liabilities, which are currently estimated at € 18 billion, of which about € 8.5 billion are deemed to be collectable.

In this regard, the government passed a new tax bill in 2007 aimed at: (i) The restructuring of the heating oil taxation and distribution system, which was expected to substantially reduce tax evasion and thereby raise additional revenue from the specific tax on oil of € 1.17 billion. In practice, however, additional revenue from this source reached only € 850 million. (ii) The simplification and rationalization of property taxation through the introduction of a unified property tax. The new real estate tax regime, encompassing the possession, transfer and inheritance of property in Greece, was recently brought in line with European Union standards. As a result, the new tax regime not only increases transparency and simplicity but will also reduce the overall tax burden. It is estimated that the new real estate tax regime will result in a small annual tax burden for more than 2.5 million of taxpayers, while relieving a large potential tax burden for a relatively small number of large property owners. The overall result was estimated to be an increase of tax revenues from the property tax of € 545 million, with the actual increase reaching the level of € 686 million.

(b) Current primary expenditure reached € 49.16 billion in 2008, up again 9.7% yoy (following the 8.4% increase in 2007) and much higher than the budgeted increase of 8.3%. This increase of current primary expenditure is not in keeping with the need for a more determined move towards fiscal adjustment that is, achieving a zero general government deficit in 2010 and maintaining surplus thereafter. In fact, the surge in current primary expenditure during 2008 was mainly due to: (i) the 10.2% increase of public sector wage payments and pensions, (ii) the 21.3% increase of subsidies to the main social security funds needed to cover their operational deficits (2007: 15.5%), (iii) the 13.7% increase of social benefits' expenses (2007: 19,6%), and (iv) the 7.9% increase of public revenues transferred to local government and other organizations.

Public sector wage policy, restraining wage increases to 3.5% and pension increases to 4.0%, should have contributed to a lower growth of wage payments in 2008. However, a multitude of additional high wage and pension increases awarded to specific categories of employees or pensioners in the public sector imply a much higher increase in the wage bill as a whole. Moreover, a tighter control on the spending of public sector businesses and entities, and in particular hospitals, could also have contributed towards the needed containment of current primary expenditure. However, intentions expressed repeatedly towards this end by policy makers do not seem to materialize in practice as yet. Finally, it is now evident that without a substantial improvement of pension funds finances, the needed sustainable containment of current primary expenditure growth and a more general improvement of Greek public finances may not be possible.

(c) Interest payments reached € 11.3 billion in 2008, exceeding by € 800 million the budgeted level. This is mainly the result of the higher cost of borrowing of the Greek state implied mainly by the increased spread of Greek government bonds in the four final months of 2008.

(d) In the Public Investment Budget (PIB), expenditure reached € 9.65 billion in 2008, up 9.5%, compared to the planned 5.6% increase. PIB revenues also reached

higher to € 5.13 billion, up 5.2%, compared with the budgeted fall of -7.0%.

The above brought the Greek general government deficit to 2.5% of GDP in 2008, compared with a budgeted deficit of 1.65% of GDP. This deficit is mainly due to inadequate tax revenue generation in view of the continuing excessive growth of primary expenditure due mainly to rapidly increasing transfers to pension funds. Therefore, the long-term sustainability of public finances requires that additional measures are taken to effectively contain the rate of growth of primary expenditure and combat tax and social security contribution evasion. Fiscal adjustment, aimed at achieving a general government surplus even before 2010, is a prerequisite to increasing domestic savings, to containing (i) the excessive growth of domestic demand, (ii) the deteriorating international competitiveness and (iii) the rising current account deficit.

INFLATION: CPI inflation fell, as expected, to 3.9% in Oct. 2008, from 4.9% in May-July 2008, 4.4% in April - March 2008 and 3.9% in January 2008. Core inflation (which in Greece excludes unprocessed food and energy products) also fell to 3.5% in Oct. 2008, from 3.7% in July 2008, reflecting the weakening domestic demand. Inflation in both Greece and the Eurozone is expected to fall substantially in the following months, mainly due to the continuing fall in the international price of oil, which in early Nov. 2008 has reached the level of $ 55/barel from above $ 145/barrel in July 2008. However, Greek CPI inflation remains higher than the Eurozone, as Greece is still experiencing higher growth in both domestic demand and unit labour costs relative to the majority of Eurozone countries. **Following the substantial fall of the price of oil and basic food prices from July 2008, it is now expected that inflation will fall further to 3.3% in Nov 2008 and, finally, to 3.3% in December 2008.** Therefore, the average annual rate of inflation will reach 4.3% in 2008, up from 2.9% in 2007. However, inflation will decelerate faster in 2009, assuming a stabilization or decline in the price of oil given the substantial slowing down of growth in the world economy.

BALANCE OF PAYMENTS: In Jan-Sep2008, the current account deficit (which includes net capital transfers) increased by € 3.1 billion over the same period of 2007 reaching € 21.6 billion or 8.8% of 2008 GDP. The higher current account deficit was reflected in an almost equally higher surplus in the capital account of the Greek balance of payments, which also reached € 21.64 billion. The increasing, until Sept 2008, net capital inflows in the Greek economy (for direct and portfolio investment as well as through the banking system) contributed to the high growth of domestic demand and to the increasing deficits on the current account.

In fact, the current account deficit in Jan.-Sept 2008 was 16.5% higher than in Jan.-Sept 2007, despite: a) the substantial growth of exports of goods by 20.4% and services by 13.3%, and b) the substantial increase of the surplus of the balance of income and capital transfers by € 1,3 billion. Concerning these developments, of particular importance is the high growth: a) of exports of goods excluding ships and fuels by 17% in Jan.-Sept 2008, from 4.9% in Jan.-Sept 2007, b) of external tourist receipts by 4.0% in Jan.-Sept 2008, from -0.5% in Jan.-Sept 2007, c) of earnings from international shipping by 22.5% in Jan.-Sept 2008, from 13.7% in Jan.-Sept 2007 and d) of the surplus of net capital and income transfers by 29.2%. Therefore, the increasing current account deficit in Greece is not due to the inadequate growth of exports from the Greek economy or to its inability to generate valuable income and capital transfers (to a great extent due to the European Union contribution in the financing of CSF III & IV).

Instead, the high growth of domestic demand, which is also facilitated by the fast increasing net capital inflows into the Greek economy, in combination with the abnormal increase in oil and food prices and the erosion of Greece's international competitiveness, have, in recent years, led: a) A high growth of imports of goods by 16.3%, which is mainly due to the surge of payments for fuel imports by 55.1%, as well as to the high (but decelerating) growth of imports of goods excluding ships and fuels by 8.1%. b) A high growth of payments for imports of services by 19.2% (tourism: 12.5%, international transportation (shipping): 27.2%, and other services: 9.1%). c) A high growth of payments for interest, dividends and profits to foreign investors of 20.5% yoy in Jan.-Sept 2008, on top of a 29.7% yoy growth in Jan.-Sept 2007, which is mainly the result of fast growing net capital inflows and the implied build up of the country's net international indebtedness.

The above developments have led to the structure of the Greek current account balance shown in Table 4. Overall, the substantial increase in the surpluses of the services balance (by € 1.19 billion), the income and capital transfers balance (by € 1.3 billion) and the capital account (by € 2.34 billion) have been used in order to finance the considerable increase in the deficit of the trade balance (by € 4.33 billion) and the increased deficit of the incomes balance (by € 1.2 billion).

Table 4. Greek Balance of Payments (€ Billions)

	2005	2006	2007	Jan-Sept 2008	Jan-Sept 2007
Trade Balance (TB)	-27,56	-35,29	-41,50	-34,19	-29,86
Exports	14,20	16,15	17,45	14,99	12,46
Imports	-41,76	-51,44	-58,94	-49,18	-42,30
Services Balance	15,39	15,34	16,72	14,86	13,68
Tourism Receipts	10,84	11,39	11,41	10,35	9,95
Shipping Receipts	13,87	14,32	16,94	14,88	12,16
Income Balance	-5,68	-7,12	-9,08	-8,05	-6,83
Payment of Interest, Divid. & Profits	-8,23	-10,46	-13,37	-12,07	-10,01
Transfers' Balance	5,15	6,45	5,92	5,74	4,44
Current Account (CA)	-12,70	-20,62	-27,93	-21,64	-18,57
CA (% of GDP)	6,3%	9,6%	12,2%	-8,78%	-8,14%
Capital Account	12,61	20,36	27,36	21,64	19,30

Source: Bank of Greece

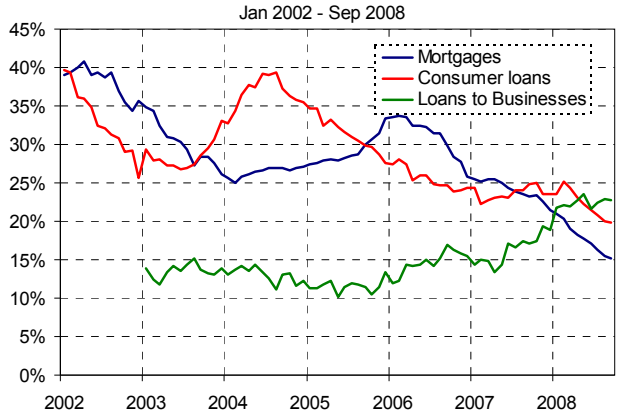
With respect to the structure of the capital account of the Greek balance of payments the most important developments in Jan-Sept 2008 could be summarized as follows: a) Net capital inflows increased significantly to €

21.64 billion in Jan-Sept 2008 from € 19.30 billion in Jan-Sept 2007. This increase was mainly due: a) To the substantial increase of net capital inflow through foreign direct investment (FDI), which reached € 1.12 billion in Jan.-Sept 2008, from -€ 2.5 billion in Jan.-Sept 2007. b) To the significant fall of capital outflow for portfolio investment abroad by Greek residents to € 2.1 billion in Jan-Sep 2008, from € 14.35 billion in Jan.-Sept 2007. On the other hand, Jan.-Sept 2008 witnessed a big fall of net capital inflows from foreign residents for portfolio investment in Greece to € 20.0 billion in Jan.-Sept 2008, from € 30.7 billion in Jan.-Sept 2007. Finally, net inflow of bank capital fell to € 2.55 billion in Jan.-Sept 2008, from € 5.43 billion in Jan.-Sept 2007.

High net capital inflows have contributed to the build up of the country's net international indebtedness, as well as to the rapid increase in payments of interest, dividends and profits, contributing to the growing current account deficit. On the other hand, net capital inflows have helped to finance the high growth of investment which has taken place in recent years in a period during which the domestic saving rate remained at particularly low levels. This situation is expected to change from Oct 2008 onwards. The volumes of capital inflows and outflows going through the Greek capital account will be reduced substantially, as well as the capital account surplus and the current account deficit.

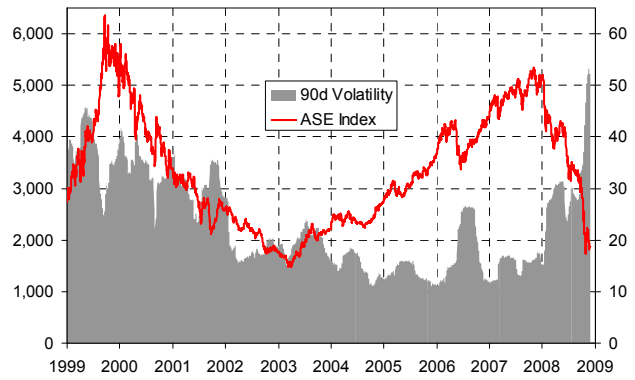
MONEY & FINANCIAL MARKETS: (Credit data provided by the Bank of Greece are adjusted for securitisation, which leads in turn to higher growth and penetration rates). Credit expansion to businesses and households remains robust at 19.7% from 20.9% of end-Dec 2007. In particular, mortgage and consumer lending growth reached 15.1% and 19.9% respectively by end-Sep 2008, from 21.4% and 23.5% of end-Dec 2007.

Diagram 5. Credit Expansion on a 12-Month Basis
Jan 2002 - Sep 2008



Loans to domestic households reached 47.3% of GDP in end-Aug 2008, from 45.5% of GDP in end-Dec 2007, compared to 59.0% of GDP in the Eurozone (Aug 2008). Overall, credit expansion to the private sector is expected to decelerate to 15.0% by year-end, mainly as a result of the intensifying international credit crisis raising interest rates and tightening credit rules applied by Greek banks. For 2009, the application of the aforementioned € 28 billion Economic Stimulus Plan may sustain credit expansion at about 10%, given the expected slowdown of activity in the Greek economy.

Diagram 6. Athens Stock Exchange
1 Jan 1999 - 24 November 2008



By the 24th of November 2008, the main ASE composite index was down by -63.9% since the start of 2008 (FTSE-20 stocks: -64.7%, mid-cap FTSE-40: -64.4% and small caps FTSE-80: -59.3%). Greek Shares are trading at 12.5 and 10.4 times the estimated earnings for 2008 and 2009 respectively, at a 6.0% premium and a 2.0% discount respectively compared with European Shares. According to Bank of Greece data, the ASE saw € 8.1 billion of net inflows from abroad in 2007, or 3.5% of GDP. These inflows helped to boost trading volumes and stock prices. At the end of 2007, 51.8% of the total stock exchange value of listed firms (€ 196.4 billion) was in the hands of foreign institutional investors, up from 36.4% end-2004 and 40.3% end-2005. In fact, total stock exchange value by end-2007 was up by 24.3% from end-2006.

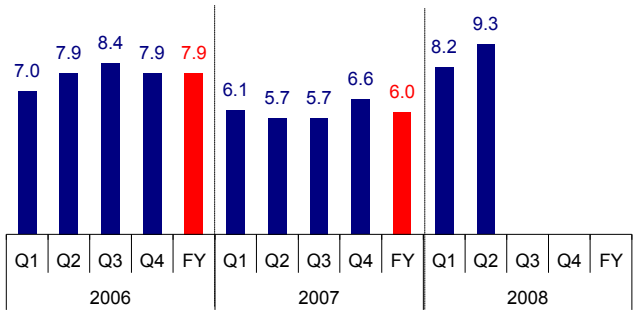
SOUTHEASTERN EUROPE

2. ROMANIA

ECONOMIC OVERVIEW: Due to the improved outlook for agricultural output in Q3 and the continued strong growth of household consumption and fixed investment, GDP growth is forecast to reach 8.5% in 2008. In the first half of 2008 GDP growth accelerated to 8.8% on the back of high real wage growth, the continued boom in domestic credit and sustained FDI inflows, all of which continue to drive growth in private consumption and investment. Growth was also boosted by an improvement in trade performance, the result of significant investment in the manufacturing sector in recent years as well as the near 15% depreciation of the RON/€ since August 2007. In the second quarter, the services sector contributed 4.3pps to headline growth, while private consumption, which increased 12.2%, contributed 10.1pps to GDP growth. Investment remained strong at 30.0% in Q2 while the agriculture sector remained weak, registering growth of 0.0% in Q1 and 0.2% in Q2. However, initial indicators point to a rapid recovery in agricultural output in the second half of the year. Growth in exports

remained strong at 26.9% and growth in imports eased to 24.4%. Recent flash estimates have indicated that GDP growth might remain above 9.0% in Q3, due in large part to a recovery in the agricultural sector. However, domestic demand is expected to slow in the second half of 2008 and in 2009 due to tighter credit conditions induced by monetary policy and the general global financial situation. As such, growth is expected to decline to 3.7% in 2009.

Real GDP (%Δ YoY)

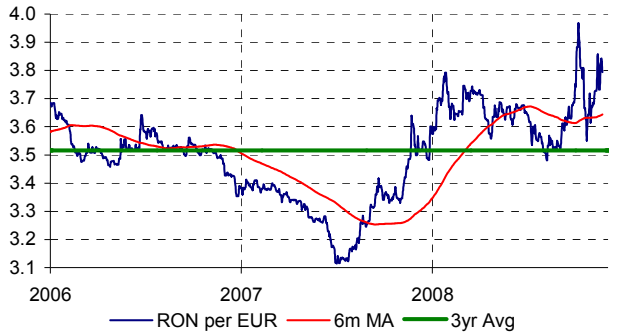


FISCAL POLICY: The government has yet to reign in fiscal spending; the budget deficit is now expected to deteriorate from 2.6% of GDP in 2007 to around 3.0% in 2008. The upside risk that the deficit might move beyond 3.0% is high, more so given the recent spate of pre-election promises to increase spending on public wages, subsidies and social transfers. Public wages are set to increase dramatically if the recent decision to increase teachers' wages by 50% is actually implemented, triggering similar wage claims in the rest of the public sector. Risks are compounded further by the fact that government revenues could turn out lower, especially given the forecast growth slowdown at a time when there could be even further pressure to increase public spending ahead of the forthcoming elections in 2008 and 2009.

INFLATION: In 2008 inflation was driven by the steep rise in food prices (following the severe drought in 2007 and increased in international agricultural product prices), the depreciation of the Leu since the international financial crisis begun unfolding July 2007, rapid wage growth, and rising energy costs. The domestic consumer price index increased from 3.7% in March 2007 to 9.04% in Jul 2008. Since then, it declined in both August (8.02%) and September (7.3%) before increasing to 7.39% in October. A combination of increased agricultural output lowering food prices, positive end year base-effects and the decline in commodity prices should see a small fall in inflation in the fourth quarter of 2008. However, the recent rapid depreciation of the Leu will mitigate these benefits to a certain degree. Inflation is projected to decline to around 6.0% by the end of the year and to around 5.0% in 2009.

BALANCE OF PAYMENTS: The current account deficit is expected to increase to 14.0% of GDP in 2008, compared with 13.9% in 2007. However, weaker domestic demand should lead to a contraction of the deficit in 2009-10. In the first nine months of this year the current account deficit widened by 15.0% yoy to € 12.7 or 9.4% of the projected full-year GDP, compared to 9.2% of GDP during the same period of 2007. The gap for the 12m period ending September was €18.5 billion, or 13.8% of the projected GDP full-year, versus 12.7% for the 12m ending September 2007. The trade deficit increased by 40.2% yoy in September and by 11.1% in Jan-Sep. Net FDI increased by 44.7% yoy to € 7.2 billion in Jan-Sep covering 57% of the CA gap versus 45% coverage in the same period of last year. Although FDI flows covered 57% of the current account deficit in the first nine months of 2008, the reliance on short-term debt has increased over recent years, putting an additional premium on policies that strengthen investor confidence.

Exchange Rate Developments



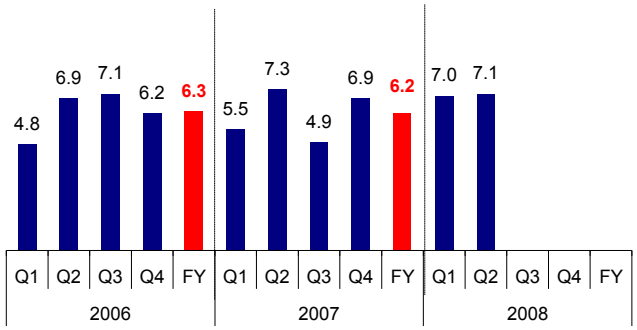
MONEY & FINANCIAL MARKETS: For the first 7-8 months of 2008, the Leu had been trading at a range of between RON3.45-3.75/€1. However, as the current financial crisis unfolded, the Leu dropped close to 14.0%, from RON3.48/€1 to RON3.96/€1. This forced the central bank intervene, albeit unofficially and indirectly, in the forex market, bringing the Leu back to RON3.55//€1. Since then, the Leu has proven to be highly volatile, losing between 5-10% in any given day and is currently trading around RON3.97/€1.The currency will remain subject to bouts of volatility until a degree of stability returns to the international markets. The National Bank of Romania was forced to intervene in the forex market following the almost 9.0% decline versus the euro in under a month. Currency reserves (excluding gold) increased €1.3 billion in October to €27.3 billion. Inflows were €4.4 billion, coming mainly from changes in the minimum reserve requirement on hard currency liabilities for commercial banks, transactions on the interbank market and funds deposited in the European Commission account. Outflows totalled €3.1 billion, largely reflecting interbank transactions, payments to service Romania's public external debt and changes in the minimum reserve requirement. Following the drop of 1pp in year-on-year inflation, to 8.0%, inflation dropped to 7.3% yoy in September before accelerating to 7.39% yoy in October. The National Bank of Romania (NBR) is unlikely to relax monetary policy for some time, given persistent excess demand supported by lax budgetary

and incomes policies. The NBR raised its main policy rate by 25 basis points in July to 10.25% and has since left the rate unchanged, indicating that interest rates may have peaked after a total increase of 325 basis points since October 2007.

3. Bulgaria

Economic Overview: Driven by buoyant domestic demand and strong investment, GDP growth accelerated to slightly above 7.0% in the first half of 2008. Growth in private consumption has remained strong, increasing 4.7% in Q1 and 4.8% in Q2, while investment growth accelerated from 15.5% in Q1 to 28.6% in Q2. Although the pace of growth has been stronger than expected, it has also been highly unbalanced: the rate of import growth was 3pps higher than the rate of export growth in the first half of the year, which has led to the widening of the current-account deficit to around 23.0% of GDP. Attesting to this development, export growth eased from 9.1% in Q1 to 5.1% in Q2 while import growth accelerated from 5.8% in Q1 to 13.7% in Q2.

Real GDP (%Δ YoY)

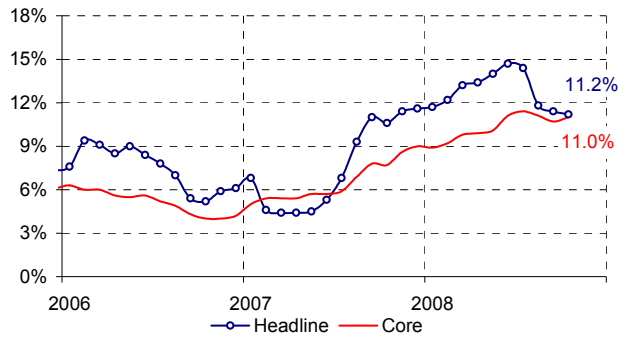


Looking ahead, a combination of uncertainty on the international financial markets and global recession will serve to constrain domestic demand in the final quarter of 2008 and in 2009. As credit growth moderates, interest rates rise and some deceleration in wage and employment growth occurs, private consumption expenditure is expected to slow from 5.3% in 2007, to 5.0% this year and 4.4% in 2009. Driven by FDI inflows and surging credit growth, investment will remain strong, and is expected to register growth of 19.0% in this year before declining to 9.0% in 2009 (21.7% in 2007). This decline in domestic demand will, to some extent, help correct the external imbalance, reducing the current account deficit to below 21% of GDP in 2009.

Fiscal policy: The currently better-than-targeted general government surplus of around 3.5% of GDP is mainly due to higher-than-expected revenue due to favourable economic growth, higher inflation and improved collection of direct taxes. However, on the expenditure side, there may be some slippages as additional social and infrastructure spending has been approved. This leads us to believe the end-year surplus will be around 3.3% of GDP. In line with strong nominal GDP growth and continued high primary fiscal surpluses, general government gross debt is expected to drop well below 10% of GDP by the end of 2010.

Inflation: Following the surged in the first half of 2008 the rate of HICP inflation eased back again in October, dropping to 11.2% from 11.14.7 in June. The year-on-year growth in food prices, which was the main factor behind the surge in inflation in 2007, remained at just over 10% in October. The main factor pushing up prices in October was the roughly 11.0% rise in the price of educational goods and services as suppliers used the start of the school year to push through large increases in prices. Nonetheless, the global economic downturn and the resulting fall in domestic demand should help to slow inflation to below 8.0% in 2009.

HICP Inflation - October (%Δ YoY)



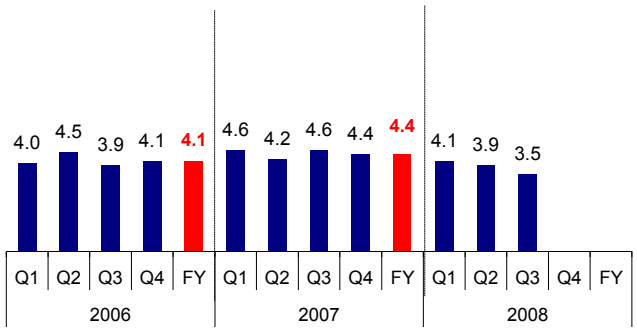
Balance of Payments: In 2007, the current account deficit increased to -21.5% of GDP while remaining comfortably financed by FDI inflows which covered 98.2% of the deficit. Looking to the present and taking into account the continued strength of domestic demand and the earlier surge in energy and commodity prices, a substantial reduction in the current account deficit is not expected this year. Encouragingly though, the deficit does appear to have stabilised, remaining around 21.5% in the 12-months to August 2008. This stabilisation has come about due to a rapid rise in export growth, while import growth continues unimpeded. During Jan-Aug 2008 export growth accelerated to 21.7% (9.4% Jan-Aug 2007) while import growth increased to 24.3% (18.9% Jan-Jun 2007). FDI inflows are forecast at € 7.0 billion in 2008, with € 2.9 billion of inflows recorded during the first eight months.

Money & Financial Markets: Bulgaria's currency board arrangement means that the Bulgarian National Bank (BNB) has limited discretion in adjusting monetary conditions. Early in 2008 the BNB announced an increase in the minimum reserve ratio to 12%, from 8% in the hopes of putting a brake on rapid growth in bank lending. Bank lending has since slowed only modestly from the peak growth rate of 62.7% at the end of 2007, to 46.7% yoy in September. This pace of lending growth is substantially faster than could be covered by the growth

in domestic deposits, forcing the Bulgarian banks to borrow heavily from abroad to finance their domestic lending. At the end of September, the ratio of loans to deposits was 135%, and total external debt of the banking system had risen to €7.8 billion at the end of July. Over 70% of the total of this foreign borrowing takes the form of loans to Bulgarian banks from their foreign parents. Following the financial turmoil in October and November, the rate of credit growth is now expected to slow sharply in 2009-10.

4. CYPRUS

Real GDP (%Δ YoY)



ECONOMIC OVERVIEW: Economic activity remained strong in the first half of 2008, with GDP growth of 4.1% in Q1, slowing marginally to 3.9% in Q2. Growth of overall domestic demand accelerated to 5.6% in the second quarter, from 5.2% in the first quarter, because of strong consumer spending that has been fuelled by still-high rates of credit growth. While investment has decelerated from the unusually high levels of last year, it still remains dynamic. In the second quarter of 2008, investment growth slowed to 3.7% from 5.5% in the first quarter owing to a contraction in housing construction. This is the first time that there has been a contraction in housing construction since 2001, when residential construction was affected by the immediate aftermath of the bursting of the Cyprus stock market bubble. Net exports of goods and services lifted GDP growth, contributing 1pp to GDP growth in Q2 (-9.9pp in Q1 2008). This role-reversal was due to the rapid slow down in import growth, from 16.8% in Q1 to 8.3% in Q2, while export growth accelerated from -0.6% in Q1 to 11.1% in Q2. We expect GDP growth to decelerate somewhat in the second half of the year, which should lead to an annual rate of 3.7%.

FISCAL POLICY: In 2007 the general government budget recorded a surplus equal to 3.3% of GDP reflecting an exceptional rise in revenues due to higher tax receipts arising from the strong profitability in the financial sector and booming real estate market. For 2008, the government surplus is forecast to decline 1.0%. This is the result of a decline in government revenue due largely to moderate property tax receipts. However, government expenditure also increased on the back of higher contractual salary increases and transfers to disadvantaged social groups as well as spending related to the drought. On account of a somewhat less optimistic macroeconomic scenario and a more prudent assessment of measures on the revenue side, the government surplus is expected to decline to 0.75% in 2009.

INFLATION: Following the developments in oil and commodity markets, HICP inflation accelerated in the first eight months of 2008 to 4.75%. After reaching a high of 5.3% in July, HICP inflation has since declined to 4.8% in October. However, the index continues to record month-on-month increases, especially for food and non-alcoholic beverages and utilities. Cyprus relies on imported oil for more than 90% of its electricity production and has only a small public transport system, causing changes in oil prices to have a significant impact on overall inflation. Transport prices fell by 0.9% mom in October, but the annual rate of increase was still 7.1% (albeit down from 7.9% in August and 9.7% in July). Looking forward, a combination of base effects in the last quarter of 2008 and the recent decline in oil prices will help reign in inflation. As such, inflation is expected to average 4.5% in 2008 and then decline to 2.9% in 2009.

BALANCE OF PAYMENTS: The current account deficit rose to 10.1% of GDP in 2007, reflecting high international oil prices and strong import demand. In the first six months of 2008, the current account deficit increased a further 146.2% to € 1.5 billion. During the same period, the trade deficit increased 21.5% to € 2.7 billion. Merchandise export growth remained weak, increasing 0.2% yoy while merchandise import growth increased 17.1% yoy. The surplus on the services balance declined 5.3% yoy, from € 1.48 billion in H1 2007 to € 1.40 billion. FDI inflows remained muted, increasing 16.2% yoy to € 394 million. However, during H1 2008 FDI outflows increased 122% to € 653 million. As a result, Net FDI registered a six-fold decline from the € 44.7 million in H1 2007 to € -260 million in H1 2008. We estimate that the deficit will increase to 10.6% of GDP in 2008, reflecting strong consumer demand and a surge in commodity prices in the first half of the year. Import demand is also expected to weaken gradually in combination with the decline in oil prices. This will help to offset weak growth in the exports of goods and modest performances by the tourism and financial services sectors, which are likely to be negatively affected by the sharp downturn in the UK and Russian economies and the global credit crunch.

MONEY & FINANCIAL MARKETS: In late August the Central Bank of Cyprus cut the foreign-exchange reserve requirement for commercial banks from 75% to 70% of total foreign-currency deposits. Non-euro bank deposits amounted to €14.7 billion in July 2008, which suggests that the amount available for lending rose by around €733 million. This is equivalent to 1.5% of total outstanding loans, which amounted to €48.9 billion in July 2008. Total deposits in the same month were €55.6 billion, well over three times annual GDP. The Central

Bank appears to have been reacting to a slowdown in demand.

5. Serbia

Economic Developments: Thus far, economic activity has remained robust, registering GDP growth of 8.4% in Q1 and 6.2% in Q2. This means that the economy expanded by an estimated 7.3% in the first half of the year. In the second quarter, the strongest performing sectors were, once again, transportation and telecommunications which registered growth of 17.6% and financial intermediation which registered growth of 16%. The pace of growth in the wholesale and retail trade sector slowed to 5.8% from 11.4% in Q1 2008, indicative of a slow down in consumption on the back of a moderation in real wage growth, deceleration of credit activity and the weakening of the local currency against the Euro. Growth also slowed in the agricultural (3.4% Q1 and 6.4% Q2), and utilities sectors (-3.6% Q1 and 11.0% Q2). Growth in the industrial sector rebounded in Q2, registering a 4.4% expansion (3.9% in Q1).

Following the international financial instability, a slowdown is now expected in the second half of this year which will limit GDP growth to around 6.5% in 2008 and around 3.5% in 2009. The global liquidity squeeze will exacerbate external financing pressures and place a strain on the banking system. Difficulties in obtaining finance and worries about the effects of rapidly growing wages on profitability will deter investment, leading to a significant slowdown in domestic demand growth in 2009-10. There is a further downside risk to the forecast, as a prolonged global liquidity squeeze, could have a strong negative impact on Serbia because of its large external financing requirement, and could necessitate a sharper policy tightening in order to reduce external imbalances, causing growth to slow more sharply in 2009-10.

The Serbian government has announced that it reached an agreement with the IMF on a 15-month stand-by arrangement which is aimed at maintaining macroeconomic and financial stability. The agreement, which envisages budget deficit target of 1.5% of GDP for 2009, will require the government to freeze pensions in 2009 (that is to abolish the regular annual adjustments), while public sector payments will be increased by 8%. In addition, subsidies for agriculture, tourism, state enterprises and social assistance will be reduced by roughly 25%. In return, Serbia may withdraw up to 75% of its quota in the Fund equal to SDR351 million or € 412.3 million.

Fiscal Policy: Under the new government, fiscal policy has remained loose and pro-cyclical with current spending rising rapidly. The cabinet recently approved a one-off, 10% increase in pensions, which took effect in October. However, following the recently agreed IMF deal, it is unlikely that there will be any further budget revisions in 2008, with a general government deficit of around 1.8% expected this year. As part of the IMF deal, the government will reduce the deficit to 1.5% of GDP in 2009 and will aim to run a general government surplus by 2010.

Inflation: While headline CPI inflation surge from a low of 3.1% in May 2007 to 15.9% in June 2008 there are signs that headline inflationary pressures may have peaked or at least stabilised. The consumer price index declined to 10.6% in September before accelerating to 12.1% in October. Likewise, retail price inflation declined to 9.9% in September, after reaching a high of 12.1% in June, but has once again accelerated in October to 12.1%. In the final months of 2008, inflation should benefit from positive base effects as well as the recent decline in international commodity prices. As such, we expect average inflation of 10.8% in 2008. However, inflationary pressures will remain strong. This reflects continued rapid wage growth and high inflationary expectations; the oversized public sector; the existence of monopolies in parts of the private sector; and the need for further increases in administered prices. There is a risk that inflation will be much higher if the dinar continues to weaken.

Balance of Payments: The current account deficit is expected to increase from 15.9% of GDP in 2007 to 18.6% of GDP in 2008. During Jan-Sep 2008, as rapid wage and credit growth continued to fuel an import-oriented consumption boom, the deficit increased by 62.0% reaching € 4.7 billion. The trade deficit increased 41.8% to € 5.8 billion as export growth of 37.7% continued to underperform import growth of 39.8%. This apparently small growth differential underlies the significant deterioration in the trade balance given the Import-to-Export ratio of 2.01. Net current transfers increased by 8.3% to € 1.8 billion. During the first nine months, the financial account registered a 56.9% increased, with Net FDI having increased 76.0% to € 1.6 billion. Net portfolio inflows turned negative, registering an outflow of $ -61.8 million as compared to the net inflows of $ 511 inflow during Jan-Sep 2008. The other investments category registered growth of 42.0% increasing to € 3.0 billion from € 2.1 billion during the same period of 2007. The current account deficit is expected to fall in 2009-10, as external financing constraints force a reduction of external deficits. Falling oil prices will also contribute to reducing the import bill, while a recession in the Eurozone raises the risk that export growth will slow. The current account deficit is therefore forecast to decline to 13.2% of GDP in 2009.

Money & Financial Markets: Fuelled by historically low interest rates and strong capital inflows, private sector credit growth (as measured in Euros) reached 39.1% in September 2008 from 31.9% in December 2007. Household credit growth continues to accelerate from 19.7% in December 2007 to 21.6% in September 2008, with mortgage growth of 39.7% in September. Corporate credit increased by 54.5% in September from 44.1% in 2007.

6. Albania

Economic Outlook: Albania's relatively low level of financial intermediation and well capitalised banking sector, being largely financed through household deposits, will help mitigate the risks to the economy from the international financial crisis. However, the continued widening of the current account deficit requires increased capital inflows which might prove challenging given the current economic environment. Forecast economic activity is expected to remain robust, with GDP growth of 6.1% in 2008. The main drivers of growth remain buoyant domestic demand benefiting from the continued pace of domestic credit expansion and solid public investment. Growth was aided further by buoyant construction and trade and increased export activities – e.g. textiles, footwear and mining. Moving into the end of 2008 and looking towards 2009, the risks to growth remain to the downside. Private consumption will ease as domestic credit expansion continues to moderate, while weaker foreign demand with impact on export growth

While the IMF recently emphasised the need for continued structural and institutional reform, as well as for improvements to Albania's business environment, progress has been achieved. In the World Bank's recently published report, Doing Business 2009, Albania ranked among one of the best performers in Southeastern Europe. The ranking of Albania's business environment improved to 85 up from 135 last year. Albania has worked to simplify procedures for starting a business, opening the national registry centre and has worked to improve protection of investors.

Despite the international financial crisis, privatisation of large-scale enterprises has remained unaffected. In August an 85% stake in the oil refinery ARMO was sold for € 127.75 million. The government has also confirmed that four companies have met the tender requirements for the privatisation of up to 76% of the distribution division of power corporation KESH. Additionally, 10 companies filed bids for 61% of the state-owned stake in insurance firm INSIG.

Fiscal Policy: In line with IMF recommendations, the 2008 budget deficit has been revised downwards to 5.2% of GDP from an earlier 7.9% of GDP. Based on the supplementary budget, government revenues are projected to reach 28.2% of GDP (up from 26.4% from the previous projection) while government expenditures will reach 33.4% of GDP (down from 34.3%). The higher than expected revenue projection has been ascribed to improved collection of value added tax, profit tax, and personal income tax. On the expenditure side, previously planned large-scale capital expenditures (mainly on road construction) were reduced to 8.8% of GDP (down from 9.8%).

Inflation: Consumer price inflation accelerated to 2.7% in September after having decline to 2.5% in August. In previous months, inflation had declined from a peak of 4.6% in March 2008 and fell to below 4.0% in July 2008. The main contributors to inflation were the prices of bread and edible oil, which surged by 19% and 13% respectively. The prices of fuel and electricity increased 15% in September. This resulted in the hike in prices of transportation services, which increased by almost 11%. Inflation is expected to average 4.0% this year, before declining to 3.1% in 2009

Balance of Payments: The current account deficit increased further to close to 13% of GDP in H1 2008, up from close to 11% in 2007. The higher deficit resulted mainly from a worsening of the services balance and from a decline in remittances. The trade deficit increased 17.3% in H1 reaching close to 28% of GDP, after a slight reduction in the first quarter of 2008. Merchandise exports and imports increased 18.7% and 17.8% respectively in H1 2008. The services deficit deteriorated further, from € 14 million in H1 2007 to € 83 million adding close to 0.6pp to the current account deficit. The services deficit was due to increased expenditures on tourism and transport services, and the decline in income from transport services. Net current transfers, while remaining high and benefiting from continued inflows of remittances, declined 5.5% in H1 2008 to around 12% of GDP, down from 13% in 2007. Remittances covered roughly 45% of the merchandise trade deficit. From a financing perspective, net capital inflows remained relatively strong. Net FDI increased 74% in H1 2008 reaching close to 7% of GDP and included receipts from the privatisation of Albtelecom in 2007. Net inflows of other capital increased significantly, reaching close to 4% of GDP.

Money & Financial Markets: The central bank has maintained its key monetary policy rate at 6.25%, arguing that the risks to price stability were contained as the average consumer price inflation (12-months moving average) remained within the target range of +/-1pp 3.0%. Economic activity continued to be fuelled by fast credit growth, with the private sector credit growth accelerating to 45.3% in September 2008 (measured in domestic currency), after decelerating for three consecutive months. Credit expansion to business (which constitutes 65% of total outstanding credit) increased 48.2% while credit to households remained strong at 40.2%.

7. Former Yugoslav Republic of Macedonia

Economic Outlook: GDP growth in 2007 was revised to 5.9% from a previous 5.1%. This represents a significant acceleration from previous years and was driven by improved activity in the manufacturing, construction and financial sectors; robust consumer spending and investment. Growth was also aided in-part by the introduction of a flat-tax system and a reduction in the bureaucratic obstacles to running a business. Remaining largely domestic demand driven, economic activity remained strong in the first half of 2008, with

GDP growth of 6.1% in Q1 and 6.5% in Q2. Nonetheless, following the indirect effects of the global slowdown, we expect growth to ease in second half of 2008 and as well as in 2009. Weaker external demand implies a more difficult export environment while lower capital inflows will affect private consumption, investment growth. Private consumption is forecast to register growth of 8.0% in 2008 from 4.0% in 2007. Investment is forecast to register growth of 25.0% in 2008 from 20.0% in 2009. Public consumption is expected to have surged with growth of 10.0% in 2008 from 4.0% in 2007. The contribution from domestic demand to GDP growth is therefore forecast to have increased to 13.1pps in 2008 from 7.5pps in 2007. The negative contribution to GDP growth from the foreign balance is also expected to increase, from -2.3pp in 2007 to -7.6pp by the end of 2008. There has been a surge in imports due to increased expenditures for energy and machinery. Furthermore, weaker external demand has led to a reduction in export growth forecasts. As such, exports of goods and services are expected to record growth of 12.0%, down from 22.9% in 2007, while imports of goods and services are forecast to have remained steady with growth of 19.0% for 2008 versus 20.0% in 2007. This divergence in growth patterns will lead to a widening of the current account deficit to around -12.1% of GDP from -3.4% of GDP in 2007.

Looking forward, FYROM will not escape the global slow-down, which will most likely reduce GDP growth by around 1pp in 2009. A more protracted slowdown internationally could lead to further growth downgrades. Nonetheless, progress has been made with regards to structural reforms and the benefit of being an EU accession candidate should help to sustain a domestic driven growth momentum, benefitting from increased employment and consumer confidence.

FISCAL POLICY: Public finances have been put on a sound footing by successive governments, while increased tax receipts have facilitated higher spending through supplementary budgets. Due to a strong revenue performance the first half of 2008, the central government accounts registered a significant surplus of around 2.0% of GDP. In June and October of this year, the parliament adopted supplementary budgets, earmarking additional expenditures of around 2.5% of GDP. The funds will be used to cover losses at the state owned electricity authority, for additional social and labour market related measures and for construction and renovation. The government is targeting a general budget deficit of around 1.5% of GDP for 2008.

INFLATION: Consumer price inflation surged in the first half of 2008 as higher food and energy prices brought inflation close to 10.0%. While consumer price inflation has started to decelerate, with average inflation having declined to 9.3% in September 2008, it remains higher than average inflation of 1.4% September 2007. Average annual inflation is expected to decline to around 7.0% by year-end as the impulse of higher prices for food, energy and basic materials fade. However, there remains upside risk to the inflation forecast if the consumer price spike caused by higher food and energy costs proves to be more persistent.

BALANCE OF PAYMENTS: While current account data in FYROM is prone to large and often unpredictable revisions of trade flows, the current account deficit is expected to increase around 12.0% of GDP in 2008 from 3.5% in 2007. The main factor driving this strong increase is higher expenditures for energy and machinery. During Jan-Aug 2008 the current account deficit increased 200% to € 564.6 million. Meanwhile, the trade deficit increased 93.0% to € 1.18 billion in Jan-Aug (or 18.3% of the projected full-year GDP) as exports stagnated with growth of 12.4% while import growth remained strong at 34.6%. In August alone, the trade deficit increased by 164% yoy to €170.8mn from a 40% yoy increase in July. However, net FDI increased 220% in August to € 60.5mn, covering 73.9% of the current account deficit, an increase from the 68.1% coverage a month ago. As the Economist Intelligence Unit reports, the increase in FDI reflects in part the government's efforts to improve the business climate. That purpose has been served by the road-shows held in potential investor countries (mainly EU members) during 2008. Macedonia has attracted new investors to its free economic zone, the Technological Industrial Development Zone (TIDZ), at Bunardzik, outside the capital, Skopje. In September 2008 TriView (South Korea) announced a €4.0 million investment in an LCD monitor plant, and a Turkish company, Borteknik Otomotiv, announced a € 20 million investment in an automotive parts factory.

MONEY & FINANCIAL MARKETS: The current IMF agreement with FYROM sees the current exchange-rate regime, in which the Dinar is informally pegged to the euro, continuing to underpin monetary policy. The Dinar has proven to be highly volatile in recent months, strengthening to MKD58.4/€1 in mid October 2008, only to decline to MKD63.4€1. On a 12m moving average basis, the Dinar is trading at MKD61.1/€1. The central bank has decided to maintain the de facto exchange-rate peg as part of its monetary policy strategy, and is unlikely to make any changes in 2009-10. Although growing foreign capital inflows have raised the cost of the Central Banks sterilisation operations, they have brought about a strong accumulation of foreign reserves.

8. UKRAINE

ECONOMIC OVERVIEW: Following the spread of the global financial crisis to Ukraine, GDP growth forecasts have been significantly cut. The sharp deterioration in economic performance is expected to be felt in the final quarter of 2008, which will lower growth for 2008 to an estimated 5.3%, from the 6.5% reported for the first six months of the year. Private consumption has already slowed down, registering growth of 13.3% in Q2 (22.0%

in Q1), while investment growth almost halved to 6.3% in Q2 (14.7% in Q1). Private consumption is forecast to contract even further, owing to the expected tightening of fiscal policy and credit conditions while investment will be severely affected by reduced credit and poor investor confidence. On the back of high commodity prices, growth in exports of goods and services increased to 8.9% in Q2 from 0.9% in Q1, while import growth remained high, increasing from 20.2% in Q1 to 25.6 in Q2. Exports will be hit by reduced external prices and demand for steel, as well as for other export goods. Meanwhile, lower domestic consumption and a substantially weaker exchange rate will lead to a drop in imports, but this will only partly offset the contraction in overall GDP growth.

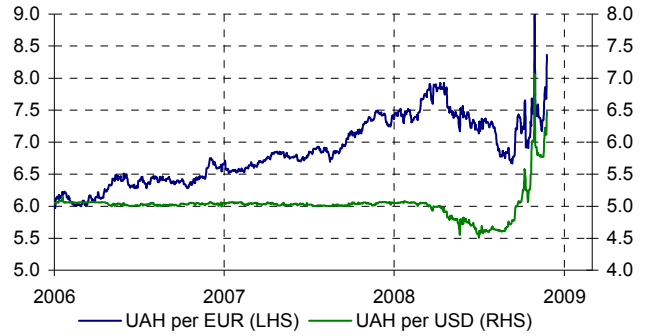
FISCAL POLICY: Owing to the need to restore financial and economic stability, the draft 2009 budget approved by the government in September 2008 incorporates a reduction in the budget deficit target to 1.4% of GDP in 2009, from the expected 2.1% in 2008. Additional fiscal tightening is likely to come through reining in social expenditure (essentially public-sector wages and benefits), strong growth of which has contributed to economic overheating in recent years. However, in the light of the expected decline in economic activity in 2009-10, which will impact budget revenues, the budget is expected to post a modest deficit in 2009-10, equivalent to 0.5% of GDP each year, against an estimated deficit of 1.5% of GDP in 2008.

INFLATION: Inflation is likely to remain over 20% year on year at the end of 2008, despite the fact that CPI inflation slowed to 23.2% in October from 24.6% in September and a high of 31.1% in May 2008. The gradual decline in inflation is due largely to significant base-effects, as inflation accelerated from a low of 9.5% in February to 16.6% in December 2007. In October 2008, prices for foods and non alcoholic beverages increased by 22.9%; alcohol and tobacco increased 17.4%; housing, water, electricity, gas and other fuels increased 18.2%. Under pressure from the IMF, the authorities are likely to pass on the increased cost of gas imports to households to a greater extent than in the past. Overall, while inflation should slow fairly quickly during 2009, average annual inflation is expected to remain in double digits, at around 12%, remaining at around this level in 2010 as the economy slowly begins to recover.

BALANCE OF PAYMENTS: During the first six months of 2008, the current account deficit increased almost three-fold to € 4.5 billion. The trade deficit increased by 132% to € 5.8 billion, while export growth of 29.6% was eclipsed by import growth of 42.7%. The deficit on the incomes account increased 72.2% to € 425 million, while the current transfers balance increased 5.5% to €1.2 billion. From a financing perspective, the financial account recorded a 34.4% increase reaching € 5.8 billion. Net FDI remained solid, increasing 39.7% during the six month period, reaching €3.7 billion. As was to be expected, Net portfolio inflows declined by 90% to the € 235 million from € 2.4 billion during the same period in 2007. The other investment category turned from a € 741 million deficit in 2007, to a € 1.8 billion surplus in 2007. The current account is forecast to increase to 9.2% of GDP in 2008 from 7.2% of GDP in 2007.

MONEY & FINANCIAL MARKETS: The intensification of the global financial crisis in recent months has led to a sharp drop in steel prices and has sharply reduced Ukraine's access to external borrowing. The hryvnia has fallen sharply on the interbank market and at HRN6.55/$1 remains well outside the trading band of HRN4.95/US$1 (±8%) which was announced by the NBU in early October. Under pressure from the IMF, and with limited foreign-exchange reserves of its own, the NBU is likely to adopt a significantly freer exchange-rate policy over the forecast period. Although the gap between the interbank and the official exchange rates remains large, the NBU has already begun to narrow it.

Exchange Rate Developments



Following the recent market turmoil, which saw a significant depreciation of many emerging market currencies, the Ukraine approached the IMF for assistance after it was forced to intervene heavily in the forex market. An agreement was reached which will see the Ukraine gaining access to about €11.0 billion worth of loans. The IMF agreement followed declines in central bank reserves from €25.0 billion to €21.0 billion after heavy currency market intervention. The first tranche worth USD 4.5bn was channelled after the agreement was signed.

The effectiveness of monetary policy has been constrained in recent years by the maintenance of a de facto exchange-rate peg against the US dollar. The greater exchange-rate flexibility that the authorities are now expected to introduce will help to develop a more effective monetary policy. Having been negative in recent years, real interest rates are expected to turn positive in 2009-10. The National Bank of Ukraine (NBU, the central bank) will also be assisted in controlling the domestic money supply by the expected drop in steel prices and in domestic demand.

9. TURKEY

ECONOMIC OVERVIEW: While improved macroeconomic fundamentals and a stronger financial sector have helped to ensure that the economy is in a better position than in the past to weather the global financial crisis, large external financing needs increase the vulnerability to shocks. The slowdown in the Turkish economy that started in Q2 is likely to deepen in 2009 as the impact of the global recession is felt by the local economy. Economic activity slowed in Q2 2008 as growth in private consumption declined to 2.8% in Q2 from 7.6% in Q1, which was compounded by the -1.5% decline investment growth from the 9.5% recorded in Q1 2008. As a consequence, GDP growth eased to 1.9% in Q2 from the stronger growth of 6.7% recorded in Q1. Looking forward, domestic spending will remain weak, constrained both by tighter credit conditions and the deteriorating consumer and investor confidence. However, large external financing needs increase the country's vulnerability to shocks. The current account deficit, which is forecast to increase to 6.7% of GDP in 2008, and which has had been comfortably financed by FDI inflows in the past, now faces the prospect of a sharp decline in foreign financing. As a result of the increasingly difficult external financing environment Standard & Poor's revised the country's outlook to negative from stable. GDP growth is forecast to fall to 3.4% in 2008 and to 1.5% in 2009.

Since the international crisis has unfolded, Turkey has been in negotiations for funding with both the IMF and the World Bank. A deal was concluded with the World Bank which will see € 2.8 billion loans to the country next year. The country partnership strategy envisages World Bank financing equivalent to €4.2 billion loans between 2008 and 2011 to support the country's export-oriented sectors and small & medium sized companies. Meanwhile, the government is preparing to sign a precautionary stand-by deal with the IMF. As part of the deal, under which anywhere between €15-30 billion in loans will be made available for the government, the IMF requires the government to revise its primary surplus target upwards to 3.5-4% of GDP.

FISCAL POLICY: The government is expected to keep public finances under control, under the binding constraints of IMF assistance and because of the likely negative impact a sharp deterioration might have on investor sentiment. Despite some government expenditure being brought forward and some revenue being delayed, the budget deficit for the first nine months of 2008 was only YTL4.8 billion, compared with a deficit of YTL12.2 billion in the first nine months of 2007. The improved nine-month budget performance was, however, partly the result of the inclusion of some one-off revenue such as privatisation receipts as well as a fall in interest payments. As such, the general government deficit is expected to increase only modestly to -1.3% of GDP in 2008. While the deficit was initially forecast to increase in 2009, the recently concluded World Bank deal and soon to be concluded IMF deal will ensure that Turkey maintains a general government surplus in 2009.

INFLATION: Since 2007, consumer price inflation increased significantly due to rising price pressures of energy and foodstuffs. Consumer price inflation rose from around 9.0% in 2007 to 11.0% in the third quarter of 2008. However, in October the consumer price index ended two months of consecutive declines, increasing by 11.9% yoy from 11.1% in September. As prices of energy raw materials, foodstuffs and other international commodities continue to fall, inflation may begin to ease. While the monetary and fiscal policy mix in combination with falling energy and commodity prices will support the disinflation process, this may be partially mitigated by the exchange rate pass-through stemming from the TRY depreciation in 2008-2009. Consumer price inflation is currently forecast to average 10.2% in 2008, with year-end inflation remaining high at 10.7%

BALANCE OF PAYMENTS: Although domestic demand growth has slowed sharply in 2008, high international commodity prices and high levels of imported intermediate goods for exports have kept Turkey's import bill high, which accounts for the fact that the current account deficit increased by 35.6% in Jan-Sep 2008. During this period merchandise exports registered growth of 36.2%, reaching € 74.8 billion while imports increased 35.0% to €104 billion. Consequently, the foreign trade balance ran a deficit of €29.9 billion, up 32.4%. Foreign direct investments declined by 28% to € 8.2 billion and portfolio investments totalled to only €105 million in Jan-Sep, compared with €2.6 billion recorded a year ago. Other investments items soared 140% to € 23.2 billion in Jan-Sep. Weaker external demand is expected to offset any positive effect from the depreciation of the Lira versus the Euro and US Dollar, leading to weaker export growth in Q3 and Q4 of 2008 and for 2009 as a whole. Factoring in the additional deterioration in the income balance, reflecting larger interest-rate differentials and rising dividend payments, the current account deficit is expected to rise to about 6.7% of GDP in 2008.

MONEY & FINANCIAL MARKETS: A steady rise in inflation since August 2007 forced the Central Bank of Turkey to tighten monetary policy between May and July, partly reversing interest rate cuts. However, on 20th November, the central bank's monetary policy committee cut the overnight borrowing and lending rates by 50bps and 100bps respectively to 16.25% and 18.75%. The central bank maintains that the ongoing problems in international credit markets and the global economy will continue to restrain domestic and external demand for an extended period, limiting the pass-through from exchange rates to domestic prices. The bank also expects the sharp decline in oil and other commodity prices to have a favourable impact on disinflation and inflation to display a more rapid fall than envisaged before.

10. Economic Data – Greece

(% change unless otherwise noted)

Yearly Data	2003	2004	2005	2006	2007	2008*
Real GDP Growth	5.0	4.6	3.8	4.2	4.0	3.5
Gross Fixed Total Investments	15.4	6.0	0.7	14.8	4.4	0.1
- Construction	11.0	3.7	-1.0	21.6	11.4	-3.5
- Equipment	22.9	8.0	1.7	6.5	7.7	4.0
Manufacturing production	-0.4	1.2	-0.8	1.4	1.8	1.0
Unemployment (percent)	9.4	10.2	9.5	8.6	8.0	7.5
Employment	1.9	0.9	1.5	2.5	1.2	1.2
Consumer Price Index (year average)	3.5	2.9	3.5	3.2	2.9	4.4
Producer Price Index (year average)	2.3	3.5	5.9	6.9	3.3	7.0
Unit Labor Cost	2.4	1.8	3.7	4.6	4.3	5.2
Credit Expansion (Private Sector)	19.5	19.5	21.8	20.6	20.0	18.0
Government Deficit (as % of GDP)	-5.6	-7.4	-5.1	-2.6	-2.8	-2.6
Current Account (as % of GDP)	-13.2	-13.3	-13.4	-14.4	-15.8	-11.5

Source: Official National Accounts, 2007 and Alpha Bank Research

Quarterly Data	2006	2007		2008		2008	
		III	IV	I	II	(disposable period)	
Economic Activity (period average)							
Retail Sales Volume	8.0	2.3	1.0	-0.1	1.5	-0.3	(8month)
Construction Activity	-19.5	-5.0	-3.5	-21,7	-6.8	-15.8	(8month)
Industrial Production (Manufacturing)	0.8	1.8	1.5	-2,7	-2.3	-2.6	(9month)
PMI (manufacturing)	52.4	53.7	54.1	52,2	54.0	48.1	(10th)
Economic Sentiment Indicator	102.3	108.0	106.6	100,7	94.0	72.9	(10th)
Index of Business Expectations in Manufacturing	101.5	102.8	99.3	98,8	98.9	83.9	(10th)
Consumer Sentiment Index	-33.0	-28.0	-26.7	-37,7	-42.7	-57.0	(10th)
Credit Expansion (end of period)							
Private Sector	20.6	20.9	20.9	21.8	20.1	20.1	(8th)
Consumer Credit+Other	23.9	22.4	22.4	23.5	21.4	20.6	(8th)
Housing	25.8	21.4	21.4	19.0	17.1	15.5	(8th)
Business	16.6	19.9	19.9	22.8	21.6	22.9	(8th)
Tourism	3.7	9.8	9.8	11.7	15.2	18.4	(8th)
Prices (end of period)							
Consumer Price Index	3.2	2.9	3.6	4.3	4.8	3.9	(10th)
Core Inflation	2.7	2.9	2.8	2.9	3.6	3.5	(10th)
Producer Price Index	6.9	3.3	8.0	10.6	11.2	10.0	(9th)
Dwelling Price Index (17 urban areas)	13.0	3.8	1.5	1.7	3.0	2.3	(1st semester)
Interest Rates (period average)							
Savings	0.98	1.14	1.17	1.16	1.17	1.18	(8th)
Short-term Business Loans	7.18	7.54	7.61	7.52	7.61	7.78	(8th)
Consumer Loans (up to 1 year)	10.37	10.39	10.67	10.49	11.07	11.16	(8th)
Housing Loans (over 10 years)	4.64	4.61	4.56	4.70	4.68	5.09	(8th)
3 month Euribor	3.72	4.68	4.69	4.73	4.95	5.27	(9th)
10 year Bond Yield	4.07	4.50	4.51	4.39	4.82	5.51	(9th)
National Accounts							
Real GDP	4.5	4.0	3.6	3.6	3.5	3.5	(Q2/08)
Final Consumption	3.9	3.9	4.6	2.3	2.5	2.5	(Q2/08)
Investment	9.2	4.9	-4.7	-6.8	-2.7	-2.7	(Q2/08)
Exports	10.9	3.1	7.1	4.1	4.6	4.6	(Q2/08)
Imports	9,7	6,7	0,7	-7.8	-3.9	-3.9	(Q2/08)
Balance of Payments (in € mn - Cumulative)							
Exports of Goods	16.2	17.5	17.5	4.7	9.5	15.0	(9month)
Imports of Goods	51.4	58.9	58.9	15.0	32.3	49.2	(9month)
Trade Balance	-35.3	-41.5	-41.5	-10.4	-22.8	-34.2	(9month)
Invisibles Balance	14.6	13.5	13.5	3.6	5.9	12.6	(9month)
Invisibles Balance / Trade Account	41.4%	32.5%	32.5%	34.6%	25.9%	36.7	(9month)
Current Account	-20.6	-27.9	-27.9	-6.8	-17.0	-21.6	(9month)
Direct Investments	0.9	-2.5	-2.5	-0.3	1.6	1.1	(9month)
Portfolio Investments	8.1	17.4	17.4	7.0	0.3	18.0	(9month)
Athens Stock Exchange (end of period)							
Composite Index	4,394.1	5,123.4	5,178.8	3,985.0	3,439.7	2,060.3	(10th)
% change	19.9	17,9	17,9	-14,2	-29.0	-61.4	(10th)
Market Capitalization ASE (% of GDP)	74,1	85,7	85,7	66,5	54.6	32.2	(10th)

Source: National Accounts, 2007 Official and Alpha Bank Research

11. Economic Data – Southeastern Europe

Romania	2006	2007	2008 (f)	2009 (f)	2010 (f)
Real Economy					
Real GDP	8.2	6.0	8.5	3.7	4.7
Private Consumption	12.8	11.1	9.5	3.7	4.0
Government Consumption	6.5	5.2	3.5	3.5	3.3
Gross Fixed Investment	23.5	28.9	21.3	10.1	10.8
Exports (Goods & Services)	10.4	8.7	9.2	6.4	7.2
Imports (Goods & Services)	22.4	26.1	22.4	11.2	15.3
HICP Inflation (Avg)	6.6	4.9	7.8	5.7	4.0
Unemployment	7.3	6.4	6.1	5.9	5.9
General Government (%GDP)					
Overall Balance	-2.2	-2.5	-2.7	-2.7	-2.7
Gross Debt	12.4	13.0	13.6	14.9	14.9
Monetary					
Credit to Private Sector	54.5	60.4	28.0	15.0	22.0
Balance of Payments (% GDP)					
Current Account Balance	-10.4	-13.9	-13.5	-13.0	-12.6
Trade Balance	-12.1	-14.6	-15.5	-14.0	-12.5

Source: IMF. Economist Intelligence Unit, Central Bank. Eurostat. Alpha Bank Economic Research

Cyprus	2006	2007	2008 (f)	2009 (f)	2010 (f)
Real Economy					
Real GDP	4.1	4.4	3.7	2.9	3.2
Private Consumption	4.5	6.9	5.7	3.9	4.2
Government Consumption	7.4	-0.1	5.2	5.9	3.6
Gross Fixed Investment	10.5	7.6	4.2	1.3	1.9
Exports (Goods & Services)	3.8	7.5	5.5	2.4	3.2
Imports (Goods & Services)	6.6	11.1	7.1	3.8	4.0
HICP Inflation (Avg)	2.2	2.2	4.8	3.0	
Unemployment	4.6	4.0	3.9	3.8	3.7
General Government (%GDP)					
Overall Balance	-1.2	3.5	1.0	0.7	0.6
Gross Debt	64.6	59.5	48.2	44.7	41.3
Monetary					
Credit to Private Sector	12.2	31.9	28.0	18.0	20.0
Balance of Payments (% GDP)					
Current Account Balance	-5.9	-9.7	-10.5	-10.3	-9.8
Trade Balance	-27.2	-29.6	-31.7	-32.1	-32.3

Source: IMF. Economist Intelligence Unit, Central Bank. Eurostat. Alpha Bank Economic Research

Bulgaria	2006	2007	2008 (f)	2009 (f)	2010 (f)
Real Economy					
Real GDP	6.3	6.2	6.5	3.5	4.3
Private Consumption	9.5	5.3	5.0	4.0	4.7
Government Consumption	-1.3	3.1	4.1	4.0	4.0
Gross Fixed Investment	14.7	21.7	19.0	9.0	7.0
Exports (Goods & Services)	8.7	5.2	6.5	4.6	5.6
Imports (Goods & Services)	14.0	9.9	9.0	6.3	6.1
HICP Inflation (Avg)					
Unemployment	9.0	6.9	6.0	5.8	5.7
General Government (%GDP)					
Overall Balance	3.0	0.1	3.3	2.9	2.9
Gross Debt	22.7	18.2	13.8	10.6	7.9
Monetary					
Credit to Private Sector	24.7	62.7	30.0	16.0	20.0
Balance of Payments (% GDP)					
Current Account Balance	-18.6	-22.5	-23.8	-22.3	-21.5
Trade Balance	-22.0	-25.5	-26.6	-26.0	-25.8

Source: IMF. Economist Intelligence Unit, Central Bank. Eurostat. Alpha Bank Economic Research

Serbia	2006	2007	2008 (f)	2009 (f)	2010 (f)
Real Economy					
Real GDP	5.7	7.5	6.5	3.5	4.5
Private Consumption	7.0	7.5	6.0	3.0	4.0
Government Consumption	2.5	2.0	1.0	1.0	1.5
Gross Fixed Investment	9.0	8.6	10.0	6.0	7.0
Exports (Goods & Services)	5.8	5.7	5.4	5.0	5.6
Imports (Goods & Services)	8.4	8.0	7.3	5.0	5.7
Retail Price Inflation (Avg)	12.7	6.5	10.8	7.3	5.1
Unemployment	19.5	18.8	17.4	15.9	
General Government (%GDP)					
Overall Balance	-1.5	-1.0	-1.8	-1.5	-0.5
Gross Debt	48.0	36.3	33.2	31.4	29.3
Monetary					
Credit to Private Sector	16.3	39.2	25.0	16.0	23.0
Balance of Payments (% GDP)					
Current Account Balance	-10.1	-15.6	-18.6	-16.3	-15.8
Trade Balance	-19.7	-21.1	-21.3	-17.2	-18.0

Source: IMF. Economist Intelligence Unit, Central Bank. Eurostat. Alpha Bank Economic Research

Turkey	2006	2007	2008 (f)	2009 (f)	2010 (f)
Real Economy					
Real GDP	6.9	4.6	3.4	1.5	3.9
Private Consumption	4.6	4.1	3.5	1.0	4.5
Government Consumption	8.4	6.5	2.3	2.8	3.4
Gross Fixed Investment	13.3	5.5	3.8	2.2	4.9
Exports (Goods & Services)	6.6	7.3	6.6	3.8	6.8
Imports (Goods & Services)	6.9	10.7	6.5	3.6	7.4
HICP Inflation (Avg)	9.3	8.8	10.3	9.1	7.0
Unemployment	9.9	8.5	8.8	9.5	9.1
General Government (%GDP)					
Overall Balance	-0.1	-1.2	-1.3	3.5	3.0
Gross Debt	46.1	38.9	35.1	34.3	33.2
Monetary					
Credit to Private Sector	40.1	31.2	18.0	25.0	28.0
Balance of Payments (% GDP)					
Current Account Balance	-5.8	-5.8	-6.7	-5.8	-6.0
Trade Balance	-7.5	-7.2	-7.8	-6.8	-7.3

Source: IMF. Economist Intelligence Unit, Central Bank. Eurostat. Alpha Bank Economic Research

FYROM	2006	2007	2008 (f)	2009 (f)	2010 (f)
Real Economy					
Real GDP	4.0	5.1	5.5	4.6	5.0
Private Consumption	6.0	4.0	8.0	3.0	3.5
Government Consumption	1.8	4.0	10.0	8.0	8.0
Gross Fixed Investment	11.6	20.0	25.0	6.0	8.0
Exports (Goods & Services)	8.4	22.9	12.0	6.0	8.0
Imports (Goods & Services)	11.0	20.0	19.0	5.0	7.0
CPI Inflation (Avg)	3.2	2.3	6.0	2.7	
Unemployment	36.0	34.6	33.3	32.3	31.0
General Government (%GDP)					
Overall Balance	-0.5	0.6	-1.0	-2.7	-2.4
Gross Debt	38.7	25.4	23.2	23.0	22.8
Monetary					
Credit to Private Sector	27.2	36.8	29.0	20.0	30.0
Balance of Payments (% GDP)					
Current Account Balance	-0.9	-3.0	-12.1	-10.0	-8.4
Trade Balance	-20.2	-21.9	-29.6	-29.2	-28.9

Source: IMF. Economist Intelligence Unit, Central Bank. Eurostat. Alpha Bank Economic Research

Ukraine	2006	2007	2008 (f)	2009 (f)	2010 (f)
Real Economy					
Real GDP	7.9	7.7	5.3	-2.5	1.5
Private Consumption	16.9	15.3	8.0	-3.5	0.7
Government Consumption	2.4	2.9	3.3	0.0	0.8
Gross Fixed Investment	26.1	24.9	5.0	-12.0	-3.0
Exports (Goods & Services)	-7.6	2.8	2.0	0.0	2.0
Imports (Goods & Services)	13.2	20.2	8.0	-4.9	-1.6
CPI Inflation (Avg)	11.6	12.8	25.1	11.6	11.3
Unemployment	2.7	2.3	2.2	3.5	3.7
General Government (%GDP)					
Overall Balance	-0.7	-1.1	-1.5	-0.5	-0.5
Gross Debt	13.9	11.7	10.0	10.8	10.0
Monetary					
Credit to Private Sector	71.0	74.1	-	-	
Balance of Payments (% GDP)					
Current Account Balance	-1.5	-4.2	-6.7	-4.0	-2.7
Trade Balance	-4.9	-7.3	-7.0	-3.5	-2.0

Source: IMF. Economist Intelligence Unit, Central Bank. Eurostat. Alpha Bank Economic Research

Albania	2006	2007	2008 (f)	2009 (f)	2010 (f)
Real Economy					
Real GDP	5.4	6.0	6.1	6.3	6.3
Private Consumption	-	-	-	-	
Government Consumption	-	-	-	-	
Gross Fixed Investment	-	-	-	-	
Exports (Goods & Services)	-	-	-	-	
Imports (Goods & Services)	-	-	-	-	
CPI Inflation (Avg)	2.4	2.9	4.0	3.1	2.8
Unemployment	-	-	-	-	
General Government (%GDP)					
Overall Balance	-3.2	-3.3	-5.4	-4.8	-3.0
Gross Debt	55.0	54.5	NA	NA	NA
Monetary					
Credit to Private Sector	56.8	50.4	42.0	25.0	30.0
Balance of Payments (% GDP)					
Current Account Balance	-5.6	-9.2	-10.5	-7.1	-6.6
Trade Balance	-24.1	-26.5	-26.8	-23.4	-21.2

Source: IMF. Economist Intelligence Unit, Central Bank. Eurostat. Alpha Bank Economic Research

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