

## **Newsletter issue 15 – October 2008**

The 15th issue of 'Economics Research' contains articles on the evolution of the housing market in Cyprus, the evolution of consumer prices in countries that recently entered the Euro zone, the impacts of climate change on electricity consumption in Cyprus and the convergence of interest rates in Cyprus with those of the Euro zone.

The ERC is conducting research on the housing market in Cyprus for the period from 1988-2008. From the sample data we observe an increase in housing prices over the last two decades, with the increase being particularly pronounced during the last five years. However, robust results and a clearer picture on the behaviour of the housing market in Cyprus will be obtained with the use of econometric analysis

Regarding the evolution of the price index the period following the accession of Cyprus in the Eurozone in 2008, the rate of inflation in Cyprus was compared to the weighted average rate of inflation of the three EU countries outside the Eurozone (UK, Sweden and Denmark). Estimating an autoregressive model for inflation that controls for unemployment, oil prices and the exchange rate, we find that general inflation in Cyprus was higher than the average of the three non-Eurozone countries in the period after the introduction of the Euro. However, after analysing the individual categories of the general price index, we find that inflation in food, clothing and footwear and education was actually lower in Cyprus during that period.

A forecast of electricity consumption in Cyprus based on econometric estimation of past data shows that, if past trends continue, electricity use is expected to triple in the coming 20-25 years, with the residential and commercial sectors increasing their already high shares. According to projections by international organisations, the average temperature in the Eastern Mediterranean is expected to rise by about 1°C by the year 2030. Using our econometrically estimated model, we calculated that electricity consumption in Cyprus will be 2.9% higher in 2030 than in the reference scenario, causing welfare losses of the order of over 200 million Euros for the entire period 2008-2030.

Interest rates in Cyprus were compared to those of the Euro area and to the interest rates prevailing in other new EU member states. The comparison revealed that Cypriot rates converged toward the Euro area rates by mid-2006 for all interest rate groups. The convergence process was disturbed by exogenous shocks in 2004. Interest rates in Malta, a country that joined the Euro area on the same date as Cyprus, also converged to the Euro area rates during the same period. Rates in the remaining eight countries that joined the EU at the same time as Cyprus and Malta, but did not enter the Euro area at the same time, did not converge fully to the Euro zone rates over the period studied.