ECONOMIC BULLETIN

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DEVELOPMENTS IN THE WORLD ECONOMY

Global activity improved in the second half of last year and growth is expected to remain sustained in the first quarter of 2017, albeit at a modest pace when seen in historical perspective. Global headline inflation has increased in recent months, following the rebound in oil prices, while slowly diminishing spare capacity is expected to give some support to underlying inflation over the medium term. However, uncertainty remains elevated owing to a number of factors, including the design of the new US administration's policies and their effects on the US economy and any spillovers to global activity; the strength of the recovery in commodity exporters; the gradual rebalancing of the Chinese economy; and future relations between the United Kingdom and the European Union.

Europe: At its monetary policy meeting on 9 March 2017, the Governing Council decided to keep the key ECB interest rates unchanged and continues to expect them to remain at present or lower levels for an extended period of time, and well past the horizon of the net asset purchases. Regarding non-standard monetary policy measures, the Governing Council confirmed that it will continue to make purchases under the asset purchase programme (APP) at the current monthly pace of €80 billion until the end of March 2017 and that, from April 2017, the net asset purchases are intended to continue at a monthly pace of €60 billion until the end of December 2017, or beyond, if necessary, and in any case until the Governing Council sees a sustained adjustment in the path of inflation consistent with its inflation aim. The economic recovery in the euro area is steadily firming**.** Euro area real Gross Domestic Product (GDP) increased by 0.40 %, quarter on quarter, in the fourth quarter of 2016, following a similar pace of growth in the third quarter. Looking ahead, the pass-through of the ECB's monetary policy measures is supporting domestic demand and facilitates the ongoing debt-reduction process (deleveraging). The recovery in investment continues to be promoted by very favourable financing conditions and improvements in corporate profitability. Moreover, rising employment, which is also benefiting from past structural reforms, is having a positive impact on households' real disposable income, thereby providing support for private consumption. In addition, there are signs of a somewhat stronger global recovery and increasing global trade. However, economic growth in the euro area is expected to be dampened by a sluggish pace of implementation of structural reforms and remaining balance sheet adjustment needs in a number of sectors. The March 2017 ECB staff macroeconomic projections for the euro area foresee annual real GDP increasing by 1.80 % in 2017, by 1.70 % in 2018 and by 1.60 % in 2019. Euro area annual Harmonised Index of Consumer Prices (HICP) inflation increased further to 2.00 % in February, up from 1.80 % in January 2017 and 1.10 % in December 2016. This reflected mainly a strong increase in annual energy and unprocessed food price inflation, with no signs yet of a convincing upward trend in underlying inflation. Looking ahead, headline inflation is likely to remain at levels close to 2.00 % in the coming months, largely reflecting movements in the annual rate of change of energy prices. The March 2017 ECB staff macroeconomic projections for the euro area foresee annual HICP inflation at 1.70 % in 2017, 1.60% in 2018 and 1.70 % in 2019.

United States: At its meeting on 15 March 2017, the Federal Open Market Committee decided to raise the target range for the federal funds rate by 25 basis points, bringing it to 0.75 % to 1.00 %. The decision reflects the economy's continued progress at a moderate pace toward the employment and price stability objectives. Solid income gains and relatively high levels of consumer sentiment and wealth have supported household spending growth. Business investment, which was soft for much of last year, has firmed somewhat, and business sentiment is at favourable levels. The unemployment rate was 4.70 % in February, near its recent low. Turning to inflation, the 12-month change in the price index for personal consumption expenditures rose to nearly 2.00 % in January, up from less than 1.00 % last summer. That rise was largely driven by energy prices, which have been increasing recently after earlier declines. Core inflation—which excludes volatile energy and food prices and tends to be a better indicator of future inflation—has been little changed in recent months at about 1.75 % and it is expected to move up and overall inflation to stabilize around 2.00 % over the next couple of years, in line with the longer-run objective. The projection of GDP is 2.10 % this year and next, and edges down to 1.90 % in 2019, slightly above its estimated longer-run rate. The median inflation projection is 1.90 %

this year and rises to 2.00 % in 2018 and 2019. The median projection for the federal funds rate is 1.40 % at the end of this year, 2.10 % at the end of next year, and 3.00 % at the end of 2019, in line with its estimated longer-run value.

United Kingdom: At its meeting ending on 15 March 2017, the Monetary Policy Committee (MPC) voted by a majority of 8-1 to maintain Bank Rate at 0.25%. The Committee voted unanimously to continue with the programme of sterling non-financial investment-grade corporate bond purchases, financed by the issuance of central bank reserves, totalling up to £10 billion. The Committee also voted unanimously to maintain the stock of UK government bond purchases, financed by the issuance of central bank reserves, at £435 billion. The economic activity has been surprisingly resilient in the aftermath of the referendum on EU membership. While investment stagnated in the last quarter of 2016 amid the "Brexit"-related uncertainty, private consumption contributed significantly to GDP growth, its slowdown compared with the previous quarter notwithstanding. However, economic activity is expected to slow down over the course of 2017. The exchange-rate driven increase in consumer prices is expected to curtail private consumption, while firms' investment decisions are likely to be affected by the uncertainty surrounding Brexit. CPI inflation increased to 1.80% in January, and the MPC expects it to rise above the 2.00 % target over the next few months, before peaking at around 2.75 % in early 2018 and drifting gradually back down towards the target thereafter. The projected overshoot entirely reflects the expected effects of the drop in sterling. Pay growth has remained subdued, while measures of inflation expectations remain at levels broadly consistent with the achievement of the inflation target. The annual real GDP is projected to be 1.70 % in 2017, and 1.30 % in 2018. A slowing in household demand had been a central feature of the MPC's February projections. Household consumption was estimated to have grown by around 3.00 % in 2016, the highest rate since 2004, but this is projected to fall to around 2.00 % in 2017 in response to a marked weakening in real income growth. Several indicators had been consistent with such a slowdown.

Japan: Real GDP decelerated in the last quarter of 2016, as domestic demand weakened. Net exports supported by a weaker yen and recovering activity abroad contributed more to real GDP growth than did domestic demand. In the short-term horizon, growth should be supported by significant fiscal and monetary policies stimuli as well as foreign demand. Looking further ahead, as support from last year's fiscal stimulus package gradually vanishes, economic activity is expected to decelerate over time towards the potential output growth rate.

China: China's growth strengthened in the last quarter of 2016, supported by strong consumption and the recovery in private investment. The near-term outlook is dominated by the extent of the policy stimulus, but in the medium term economic growth is expected to remain on a gradual downward trend. In particular, investment growth will continue to moderate as overcapacity is gradually cut back.

Energy News: Brent crude oil prices have fluctuated in the range of USD 52 to USD 56 per barrel since the agreement of the Organization of the Petroleum Exporting Countries (OPEC) on 30 November 2016 to cut output. Global oil production dropped in January, mirroring declines in both OPEC and non-OPEC countries. While OPEC production recorded one of the largest output cuts in its history, non-OPEC members participating in the output deal also contributed to what was the biggest month-on-month decline in global oil supply since September 2008. However, looking forward, non-OPEC output is set to increase in 2017 driven mainly by countries outside the output deal (the United States, Canada and Brazil), with US shale production already showing production increases in December 2016. Non-oil commodity prices have increased by around 1.00 % (in US dollar terms) over the past few weeks, mainly driven by a rise in the price of iron ore to a near three-year high, which was partly offset by a fall in food prices.

CYPRUS ECONOMY AND MAJOR DEVELOPMENTS

Cyprus' Real GDP growth rate is expected to grow by 2.20 % in 2017(IMF's October projections). The actual growth for 2016 was 2.80 %. Unemployment reached the level of 13.30 % in 2016 (2017 IMF projection at 11.60 %). Inflation (HICP) averaged at -1.20 % in 2016 (2016 IMF projection at -1%). HICP is expected to be in the area of 0.50 % in 2017. Deposits in the banking system are on an upward trend during the recent months, recording an increase of €3 billion during 2016, reaching the amount of €49 billion.

Main Economic Indicators

	Eurozone	*United States*	*United Kingdom*	*Japan*	*China*	*Cyprus*
Real GDP (year-on-year 2016-2015 %)	1.70	1.60	1.80	1.00	6.70	2.80
Forecasted Real GDP (year-on-year 2017-2016 %)	1.80	2.10	1.70	1.10	6.50	2.20
Forecasted Real GDP (year-on-year 2018-2017 %)	1.70	2.10	1.30	1.00	6.20	2.10
Real GDP (4^{th} quarter 2016 compared to 4^{th} quarter 2015 %)	1.70	1.90	2.00	1.60	6.80	2.90
Unemployment (%), 2016	9.60 (*)	4.80	4.90	3.10	4.00	14.10 (*)
Inflation (4^{th} quarter 2016 compared to 4^{th} quarter 2015 %)	0.70	1.80	1.20	0.30	2.20	-1.40

** Data for January 2017*

Sources:

1) *European Central Bank 2) Bank of England 3) Federal Reserve 4) Statistical Service of Cyprus (CYSTAT) 5) Bloomberg Statistics, 6) IMF*

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