

# ECONOMIC BULLETIN

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## DEVELOPMENTS IN THE WORLD ECONOMY

Moderate global growth continued in the first half of 2016. Looking ahead, global growth is expected to recover gradually. Low interest rates, improving labour markets and growing confidence support the outlook for advanced economies, although the uncertainty generated by the referendum in the United Kingdom on EU membership will weigh on demand in that country. As regards emerging market economies, economic activity in China is expected to slow, while the outlook for large commodity exporters remains subdued, despite some tentative signs of stabilization. Risks to the outlook for global economic activity remain on the downside.

**Europe:** At its monetary policy meeting on 8 September 2016 the Governing Council decided to keep the key ECB interest rates unchanged and continued to expect these rates to remain at present or lower levels for an extended period of time, and well past the horizon of the Eurosystem's net asset purchases. Regarding non-standard monetary policy measures, the Governing Council confirmed that the monthly asset purchases of €80 billion are intended to run until the end of March 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. Looking ahead, the Governing Council expects the economic recovery to proceed at a moderate but steady pace. Euro area real GDP increased by 0.30%, quarter-on-quarter, in the second quarter of 2016, after 0.50% in the first quarter. Growth was supported by net exports as well as a continued positive contribution from domestic demand. Incoming data point to ongoing growth in the third quarter of 2016, at around the same rate as in the second quarter. Domestic demand remains supported by the pass-through of the monetary policy measures to the real economy. Favourable financing conditions and improvements in the demand outlook and in corporate profitability continue to promote a recovery in investment. Sustained employment gains, which are also benefiting from past structural reforms and still relatively low oil prices provide additional support for households' real disposable income and thus for private consumption. In addition, the fiscal stance in the euro area is expected to be mildly expansionary in 2016 and to turn broadly neutral in 2017 and 2018. However, the economic recovery in the euro area is expected to be dampened by still subdued foreign demand – partly related to the uncertainties following the UK referendum outcome – the necessary balance sheet adjustments in a number of sectors and a sluggish pace of implementation of structural reforms. The September 2016 ECB staff macroeconomic projections for the euro area expect annual real GDP to increase by 1.70% in 2016, by 1.60% in 2017 and by 1.60% in 2018. Regarding inflation, September 2016 ECB staff macroeconomic projections for the euro area foresee the annual Harmonised Index of Consumer Prices (HICP) inflation at 0.20% in 2016, 1.20% in 2017 and 1.60% in 2018.

**United States:** At its meeting on 22 September 2016, the Federal Open Market Committee (FOMC) decided to maintain the target range for the federal funds rate at 0.25% to 0.50%. The Committee judges that the case for an increase in the federal funds rate has strengthened but decided, for the time being, to wait for further evidence of continued progress toward its objectives. The stance of monetary policy remains accommodative, thereby supporting further improvement in labour market conditions and a return to 2% inflation. The labour market has continued to strengthen and growth of economic activity has picked up from the modest pace seen in the first half of this year. Although the unemployment rate is little changed in recent months, job gains have been solid, on average. Household spending has been growing strongly but business fixed investment has remained soft. Inflation has continued to run below the Committee's 2% longer-run objective, partly reflecting earlier declines in energy prices and in prices of non-energy imports. Market-based measures of inflation compensation remain low; most survey-based measures of longer-term inflation expectations are little changed, on balance, in recent months. The projection for real GDP growth is 2% in 2016 until 2018. Inflation is projected at 1.70% in 2016, rising to 1.90% in 2017 and reaching 2.00% in 2018.

**United Kingdom:** Following UK's vote last June to leave the European Union and the interest rate cut from 0.50% to 0.25% in August, the Bank of England's Monetary Policy Committee (MPC) voted unanimously on 14 September to maintain the Bank Rate at 0.25%. The Committee voted unanimously to continue with the programme of sterling non-financial investment-grade corporate bond purchases totalling up to £10 billion, financed by the issuance of central bank reserves. The Committee also voted unanimously to continue with the programme of £60 billion of UK government bond

purchases to take the total stock of these purchases to £435 billion, financed by the issuance of central bank reserves. The heightened uncertainty seen in the United Kingdom is expected to weigh on economic growth. The institutional and political uncertainty surrounding the negotiations to leave the European Union is expected to dampen domestic demand, particularly investment (although recent data suggest that the short-term impact of the referendum has been relatively modest thus far). Looking further ahead, monetary accommodation and a reduction in the pace of fiscal consolidation should help to support economic activity. A number of indicators of near-term economic activity have been somewhat stronger than expected. The Committee now expects less of a slowing in UK GDP growth in the second half of 2016. Twelve-month CPI inflation remained at 0.60% in August, well below the 2% inflation target. As the unusually large drags from energy and food prices attenuate, CPI inflation is expected to rise to around its 2% target in the first half of 2017, consistent with the August Inflation Report, albeit with the projection a little lower over the remainder of 2016 than had been anticipated in August.

**Japan:** Weak wage growth, an uncertain global economic outlook and a strong yen limited growth in the second quarter, with GDP expanding at a 0.20% quarter-on-quarter seasonally-adjusted annualized rate. Against this backdrop, the government unveiled a JPY 28.1 trillion (USD 269 billion) stimulus package in an attempt to jumpstart the economy. The plan mainly targets Japan's challenging demographics, infrastructure projects and reconstruction in earthquake-hit areas. While the program represents the largest fiscal stimulus since 2009, analysts warn that fresh spending only amounts to JPY 7.5 trillion. More recent data suggest that the strong yen is hurting the external sector as exports contracted at the fastest pace since 2009 in July. The Bank of Japan at its 21 September meeting statement committed itself to its expansionary monetary policy 'until inflation exceeds the 2% target and stays above the target in a stable manner'.

**China:** The growth rate of the Chinese economy is expected to moderate gradually. In the short term, resilient consumption and improvements in housing demand, combined with continued monetary accommodation and fiscal stimulus, should support the economy. Looking further ahead, however, continued emphasis on rebalancing the economy – including reductions in overcapacity in some heavy industries and action to address non-performing loans – is expected to result in a decline in the pace of economic growth.

**Energy News:** Despite the recovery of oil and many other commodity prices in the second quarter of 2016, most commodity indexes are expected to decline this year. This trend is due to persistently elevated supplies, and in the case of industrial commodities – which include energy, metals, and agricultural raw materials - weak growth prospects in emerging market and developing economies. However, most of the declines are projected to be smaller than originally expected. Over the coming months, oil prices will be supported by the rebalancing of supply/demand conditions. Brent crude oil spot prices on 23 September stood at \$47.6/barrel, while the one-year futures contract price for September 2017 at around \$51/barrel.

## **CYPRUS ECONOMY AND MAJOR DEVELOPMENTS**

The GDP growth rate in real terms during the second quarter of 2016 is positive and estimated at 2.90% over the corresponding quarter of 2015. Based on seasonally and working day adjusted data, GDP growth rate in real terms is estimated at 2.70%. The increase of the GDP growth rate is mainly attributed to the sectors: Hotels and Restaurants, Professional, Scientific and Technical Activities, Retail and Wholesale Trade, Manufacturing, Construction and Transport. Negative growth rates were recorded by the sectors: Financial Service activities, Information and Communication and Agriculture, Forestry and Fishing. The rate of unemployment stood at 11.60% in July 2016. On Sept. 16, 'Standard and Poor's' (S&P) Global Ratings raised its foreign and local currency long-term sovereign credit ratings on the Republic of Cyprus to 'BB' from 'BB-'. The upgrade reflects views of Cyprus' stronger-than-expected economic growth and its further debt reduction, as well as steady improvement in the banking sector's asset quality. Cyprus's major challenges include: the public administration wage bill legislation (a legislation that is pending for approval by Parliament) and the privatization of the Cyprus Telecommunications Authority (CYTA) which will have a positive impact on the country's high public debt. In addition, major challenges are the reduction of the banks' high Non-Performing Loans and the effective management of the potential economic impacts of the UK's decision to leave the EU.

## Main Economic Indicators

Period: Second Quarter of 2016					
	<i>Eurozone</i>	<i>United States</i>	<i>United Kingdom</i>	<i>Japan</i>	<i>Cyprus</i>
<i>Real GDP (year-on-year 2015-2014 %)</i>	2.00	2.60	2.20	0.60	1.60
<i>Forecasted Real GDP (year-on-year 2016-2015 %)</i>	1.70	2.00	1.70	0.60	1.50
<i>Forecasted Real GDP (year-on-year 2017-2016 %)</i>	1.60	2.00	0.70	0.80	2.00
<i>Real GDP (2<sup>nd</sup> quarter 2016 compared to 2<sup>nd</sup> quarter 2015 %)</i>	1.60	1.20	2.20	0.70	2.70
<i>Unemployment (%), June 2016</i>	10.10	4.90	4.90	3.00	11.60 (*)
<i>Inflation (2<sup>nd</sup> quarter 2016 compared to 2<sup>nd</sup> quarter 2015 %)</i>	-0.10	1.00	0.40	-0.40	-2.00

\* Data for July 2016

### 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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