ECONOMIC BULLETIN

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DEVELOPMENTS IN THE WORLD ECONOMY

Global trade growth remained robust in the second quarter, and prospects remain positive in the near term. The combination of strong trade indicators and surveys and the repeated surprises on the upside could suggest that there is more cyclical momentum in world trade than previously anticipated related to the cyclical upturn and the recovery in investment. However, medium-term downside risks prevail, such as an increase in trade protectionism, a sudden tightening in global financial conditions, disruptions associated with China's reform and liberalization process, and political and geopolitical uncertainties, including those related to the negotiations on the future relations between the United Kingdom and the European Union.

Europe: At its monetary policy meeting on December 14, 2017, the Governing Council of the ECB concluded that an ample degree of monetary accommodation is still needed to secure a return of inflation towards levels that are below, but close to, 2.00%. The Governing Council assessed that the strong cyclical momentum and the significant reduction of economic slack give grounds for greater confidence that inflation will converge towards its aim. At the same time, domestic price pressures remain muted overall and have yet to show convincing signs of a sustained upward trend. The Governing Council therefore concluded that an ample degree of monetary stimulus remains necessary for underlying inflation pressures to continue to build up and support headline inflation developments over the medium term. This continued monetary support is provided by the additional net asset purchases that the Governing Council decided on at the October monetary policy meeting, by the sizeable stock of acquired assets and the forthcoming reinvestments, and by the forward guidance on interest rates. Real GDP growth is supported by growth in private consumption and investment as well as exports benefiting from the broad-based global recovery. The latest survey results and incoming data confirm robust growth momentum. The global economy is also continuing to expand at a solid rate, and the recovery shows signs of synchronisation globally. Real GDP increased by 0.60%, quarter on quarter, in the third quarter of 2017, following growth of 0.70% in the previous quarter. The main driver continued to be domestic demand, notably fixed investment spending, and to a lesser extent net exports and changes in inventories. On the production side, activity was broad-based, with strong value added growth in industry (excluding construction) and slightly lower growth in the construction and services sectors. The euro area foresee annual real GDP increasing by 2.40% in 2017, 2.30% in 2018, 1.90% in 2019 and 1.70% in 2020. Euro area annual HICP inflation was 1.50% in November, up from 1.40% in October. Annual HICP inflation is foreseen at 1.50% in 2017, 1.40% in 2018, 1.50% in 2019 and 1.70% in 2020, mainly reflecting higher oil and food prices. Looking ahead, on the basis of current futures prices for oil, annual rates of headline inflation are likely to moderate in the coming months, mainly reflecting base effects in energy prices, before increasing again. Underlying inflation is expected to rise gradually over the medium term, supported by the ECB's monetary policy measures, the continuing economic expansion, the corresponding absorption of economic slack and rising wage growth. HICP inflation excluding food and energy was 0.90% in November 2017, unchanged from October but down from 1.10% in September. It is projected to be 1.00% in 2017, 1.10% in 2018, 1.50% in 2019 and 1.80% in 2020.

United States: At its meeting on December 13, 2017, the Federal Open Market Committee (FOMC) decided to raise the target range for the federal funds rate by 25 basis points, bringing it at 1.25% to 1.50%. The decision reflects the committee's assessment that a gradual removal of monetary policy accommodation will sustain a strong labour market while fostering a return of inflation to 2.00%, consistent with the maximum employment and price stability objectives assigned by law. Following a slowdown in the first quarter, economic growth stepped up to a solid 3.25% pace in the 2nd and 3rd quarters of the year. Household spending has been expanding at a moderate rate, business investment has picked up, and favourable economic conditions abroad have supported exports. Overall, the economy is expected to expand at a moderate pace. While changes in tax policy will likely provide some lift to economic activity in coming years, the magnitude and timing of the macroeconomic effects of any tax package remain uncertain. The unemployment rate has declined further in recent months to 4.10% in November, and it is projected to stand at 4.10% in the 4th quarter of this year and run close to 4.00% over the next three years, modestly below the median estimate of its longer-run normal rate. Inflation has continued to run below the FOMC's 2.00% longer-run objective, but it is expected to move up and stabilize around 2.00% over the next couple of years. The 12-month change in the price index for personal consumption expenditures was 1.60% in October. Core inflation--which excludes the volatile food and energy categories--has followed a similar pattern and was 1.40% in October. The projection of real GDP is 2.50% this year and next and moderates to 2.00% by 2020, a bit above its estimated longer-run rate. The median projection for the federal funds rate is 2.10% at the end of next year, 2.70% at the end of 2019, and 3.10% in 2020.

United Kingdom: At its meeting ending on December 13, 2017, the Monetary Policy Committee (MPC) voted unanimously to maintain Bank Rate at 0.50%. The Committee voted unanimously to maintain the stock of sterling non-financial investment-grade corporate bond purchases, financed by the issuance of central bank reserves, at £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. In the MPC's most recent economic projections, set out in the November *Inflation Report*, GDP is projected to grow modestly over the next few years, at a pace just above its reduced rate of potential. Consumption growth is projected to remain sluggish in the near term before rising, in line with household incomes. Net trade was bolstered by the strong global expansion and the past depreciation of sterling. Business investment, while affected by uncertainties around Brexit, and is projected to continue to grow at a modest pace, supported by strong global demand, high rates of profitability, the low cost of capital and limited spare capacity. GDP rose by 0.30% in the second quarter, although initial estimates of private final demand were softer than anticipated. As for 2017 Q3, GDP is expected at 0.30%. Twelve-month CPI inflation had risen by 10 basis points to 3.10% in November. It remains the case that inflation has been pushed above the target by the boost of import prices that resulted from the past depreciation of sterling. The MPC judges that inflation is likely to be close to its peak, and will decline towards the 2.00% target in the medium term. By contrast, The Committee continued to expect that the annual rate of pay growth would pick up in the early part of next year, though there remained uncertainties around that projection. Overall, the general assessment of demand growing at a pace just above its reduced rate of potential, generating a gradual pickup in domestic inflationary pressures, seemed intact.

Japan: Economic expansion is expected to remain firm, supported by domestic and external factors. While waning fiscal support is likely to act as a drag on growth, economic activity is expected to be supported by firming foreign demand, private investment gains associated with high profits and increasing labour and capacity shortages, and favourable financing conditions. The planned VAT hike in October 2019 is, however, expected to have a negative impact on economic activity after its implementation.

China: Activity continues to expand at a robust pace, supported by resilient consumption and a still robust housing market. The near-term outlook is dominated by the authorities' focus on stable growth, given the ongoing political transition, while the assumption over the medium term is that continued structural reforms will gradually be implemented, leading to an orderly slowdown.

Energy News: Brent crude oil prices rose from USD 50 per barrel in mid-August to over USD 64 per barrel recently. Higher prices were supported by geopolitical tensions in the Middle East and recent developments in Venezuela, firming expectations of an extension of the OPEC/non-OPEC agreement on supply cuts beyond March 2018, confirmed by the actual extension on 30 November 2017 to the end of 2018, and robust oil demand. Oil futures suggest that oil prices will fall below current levels, to around USD 61 per barrel in 2018 and USD 58 per barrel in 2019. By contrast, non-energy commodity prices have fallen slightly in the last few weeks, although iron ore quotations increased.

CYPRUS ECONOMY AND MAJOR DEVELOPMENTS

Cyprus' Real GDP (seasonally adjusted) recorded a positive rate of growth of 3.90% in the 3rd quarter of 2017 same as in the 2nd quarter of 2017, and 3.70% in 1st quarter of 2017. Growth is expected to reach the 3.80% in 2017 and 3.60% in 2018 (IMF's December projections). Inflation (HICP) decreased by 0.20% in November 2017 compared to November 2016. For the period January– November 2017, HICP recorded an increase of 0.80% compared to the correspondent period of the previous year. It is expected to be in the area of 0.80% in 2017 and 0.70% in 2018. Deposits in the banking system are on an upward trend since the second half of 2015. In October 2017, deposits amounted €49.5 billion, compared to €49.0 billion in September 2017 and at the end of 2016.

Main Economic Indicators

	Eurozone	United States	United Kingdom	Japan	China	Cyprus
Real GDP (year-on-year 2016-2015 %)	1.80	1.50	1.80	1.00	6.70	2.80
Forecasted Real GDP (year-on-year 2017-2016 %)	2.40	2.50	1.70	1.50	6.80	3.80
Forecasted Real GDP (year-on-year 2018-2017 %)	2.30	2.20	1.50	0.70	6.50	3.60
Real GDP 3rd quarter 2017 compared to 3rd quarter 2016 %)	2.50	3.25	0.40	2.50	6.80	3.90
Forecast Unemployment 2017 (%)	9.20	4.10	4.40	2.90	4.00	11.30
Forecast Inflation 2017 (%)	1.50	1.70	2.60	0.40	1.80	0.80

Sources:

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

USB BANK PLC

Treasury & Correspondent Banking   P.O. Box 28510, 2080 Nicosia, Cyprus   Telephone 22883344