

# ECONOMIC BULLETIN

Publication December 2015

## DEVELOPMENTS IN THE WORLD ECONOMY

Global economic activity remains on a gradual and uneven recovery path. The outlook for advanced economies is supported by low oil prices, still favourable financing conditions, improving labour markets, growing confidence and the receding headwinds of private sector deleveraging and fiscal consolidation. By contrast, growth prospects in emerging market economies continue to be restrained by structural impediments and macroeconomic imbalances. In some countries, this is amplified by a tightening in global financial conditions and the fall in commodity prices. Global inflationary pressures are expected to remain contained following the decline in oil prices and the still abundant global spare capacity.

**Europe:** At its monetary policy meeting on 3 December 2015, the Governing Council re-examined the degree of monetary policy accommodation: the analysis confirmed the need for further monetary stimulus in order to secure a return of inflation rates towards levels that are below, but close to, 2%. The December 2015 macroeconomic projections indicated continued downside risks to the inflation outlook and slightly weaker inflation dynamics than previously expected. As a result, the Governing Council took the following decisions in the pursuit of its price stability objective. First, as regards the key ECB interest rates, it decided to lower the interest rate on the deposit facility by 10 basis points to -0.30%. The interest rate on the main refinancing operations and the rate on the marginal lending facility will remain unchanged at their levels of 0.05% and 0.30% respectively. Second, as regards non-standard monetary policy measures, it decided to extend the asset purchase programme (APP). The monthly purchases of €60 billion under the APP are now 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 aim of achieving inflation rates below, but close to, 2% over the medium term. Third, the Governing Council decided to reinvest the principal payments on the securities purchased under the APP as they mature, for as long as necessary. This will contribute both to favourable liquidity conditions and to an appropriate monetary policy stance. The above measures will ensure accommodative financial conditions and further strengthen the substantial easing impact of the measures taken since June 2014, which have had significant positive effects on financing conditions, credit and the real economy. The economic recovery in the euro area is increasingly supported by domestic demand. Real GDP increased by 0.30%, quarter on quarter, in the third quarter of 2015, following a rise of 0.40% in the previous quarter, on account of a continued positive contribution from consumption. The most recent survey indicators point to ongoing real GDP growth in the final quarter of 2015. The December 2015 Eurosystem staff macroeconomic projections for the euro area foresee annual real GDP increasing by 1.50% in 2015, 1.70% in 2016 and 1.90% in 2017. Compared with the September 2015 ECB staff macroeconomic projections, the prospects for real GDP growth are broadly unchanged. Harmonized Index of Consumer prices (HICP) inflation has increased somewhat, but remains low. According to Eurostat's flash estimate, euro area annual HICP inflation was 0.10% in November 2015, unchanged from October but lower than expected. HICP inflation excluding food and energy declined to 0.90% in November after having increased to 1.10% in October. The December 2015 Eurosystem staff macroeconomic projections for the euro area foresee annual HICP inflation at 0.10% in 2015, 1% in 2016 and 1.60% in 2017.

**United States:** At its meeting on 16 December 2015, the Federal Open Market Committee (FOMC) decided to raise the target range for the federal funds rate by 0.25 percentage point, from 0% - 0.25% to 0.25% - 0.50%. The Committee is maintaining its existing policy of reinvesting principal payments from its holdings of agency debt and agency mortgage-backed securities, and it anticipates doing so until normalization of the level of the federal funds rate is well under way. This policy, by keeping the Committee's holdings of longer-term securities at sizable levels, should help maintain accommodative financial conditions. The US labour market has clearly shown significant further improvement toward the objective of maximum employment. The unemployment rate, at 5% in November, is down 0.60% from the end of last year. U.S. real gross domestic product is estimated to have increased at an average pace of 2.25% over the first three quarters of the year. Net exports have been restrained by subdued foreign growth and the appreciation of the dollar, but this weakness has been offset by solid expansion of domestic spending. Continued job gains and increases in real disposable income have supported household spending. Residential investment has been rising at a faster pace than last year, although the level of new homebuilding still remains low. Overall consumer price inflation—as measured by the price index for personal consumption

expenditures was only 0.25% over the 12 months ending in October. However, much of the shortfall from the 2% objective reflected the sharp declines in energy prices since the middle of last year, and the effects of these declines should dissipate over time. The appreciation of the dollar has also weighed on inflation by holding down import prices. As these transitory influences fade and as the labour market strengthens further, the Committee expects inflation to rise to 2% over the medium term. The projection for real GDP growth is 2.10% in 2015 and 2.40% in 2016. Inflation is projected at 0.40% in 2015, rising to 1.60% in 2016 and reaching 1.90% in 2017 and 2% percent in 2018.

**United Kingdom:** At its meeting ending on 9 December 2015, the Monetary Policy Committee (MPC) voted to maintain Bank Rate at 0.50%. The Committee voted unanimously to maintain the stock of purchased assets financed by the issuance of central bank reserves at £375 billion. UK real GDP growth rate in 2015 Q3 was 2.10%. Consumer Price Index (CPI) inflation remained at -0.10% in October, a little more than 2% below the inflation target of 2%. CPI inflation is expected to stay below 1% until the second half of next year. Prospects for domestic activity are also little changed on the month, with robust growth in private domestic spending continuing to counter-balance subdued demand growth overseas. The projected return of CPI inflation to the target depends on an increase in domestic cost growth sufficient to balance the drag on prices from very subdued global inflation and past increases in the value of sterling. Despite lower unemployment, nominal pay growth appears to have flattened off recently. All members agree that, given the likely persistence of the headwinds weighing on the economy, when Bank Rate does begin to rise, it is expected to do so more gradually and to a lower level than in recent cycles. However, the actual path Bank Rate will follow over the next few years will depend on the economic circumstances.

**Japan:** Stronger than expected dynamics in investment helped the Japanese economy avoid falling into recession in Q3. GDP expanded at an annualized rate of 1% in Q3, which contrasted the 0.80% decline initially reported. Growth in Japan remains constrained by weaker demand from overseas, in particular from China, although the country is also suffering from slow progress in the implementation of much-needed pro-growth reforms. On the upside, steady gains in the labour market are propping up consumer confidence, which hit a two-year high in November. Moreover, a weak yen is allowing Japanese businesses to sharply increase their profits, giving a boost to capital expenditure

**China:** Latest economic data suggest that the Chinese economy has slowly started to stabilize following the massive stimulus measures Chinese authorities had launched after the summer stock market crash. In November, retail sales continued to gain traction, while growth in all-important fixed-asset investment was stable for the first time since June. However, significant uncertainty exists as the Chinese economy loses its strength with a gradual slowdown in its growth rate.

**Energy News:** Brent crude oil spot prices decreased in December 2015 with the price on 31 December at \$37/barrel, recording a yearly decrease of 45% compared to one year before. Increases in global liquids inventories have put significant downward pressure on oil prices. Crude oil price forecasts remains subject to significant uncertainties as the oil market moves toward balance. The oil market faces many uncertainties heading into 2016, including the pace and volume at which Iranian oil re-enters the market, the strength of oil consumption growth, and the responsiveness of non-OPEC production to low oil prices.

## **CYPRUS ECONOMY AND MAJOR DEVELOPMENTS**

The Cyprus Economy expanded by 0.40% during the first quarter of 2015 (after 14 consecutive quarters of contraction) and by a further 1.20% and 2.30% during the second and third quarters of 2015 respectively. Inflation for December 2015 decreased at a rate of -1.20% compared to -2.10% in November 2015. The corresponding rate for December 2014 was -1.50%. The rate of unemployment stood at 15.80% in November 2015 (2015 projection at 16%). The Foreclosure Law, the Insolvency Framework and the relevant Regulations which are important for addressing the Non-Performing Loans issue, have been enacted by the House of Representatives on the 17th of April 2015, and are being implemented. Therefore, Cyprus became eligible for the ECB's, QE (Quantitative Easing) purchase programme. Until the end of November 2015 an amount of €285 million (with an average remaining maturity years of 5.91) Cyprus Government Bonds has been purchased by ECB. Despite of the above, further actions by the Cyprus authorities will be required to support the reduction of non-performing loans (NPLs), which stand between 58% and 62%. The securitization legislation and the implementation of the privatization legislation/plan are necessary prerequisites for the next Troika's assessment review on Cyprus.

## Main Economic Indicators

Period: Third Quarter of 2015					
	<i>Eurozone</i>	<i>United States</i>	<i>United Kingdom</i>	<i>Japan</i>	<i>Cyprus</i>
<i>Real GDP (year-on-year 2014-2013 %)</i>	0.90	2.40	2.90	0.00	-2.30
<i>Forecasted Real GDP (year-on-year 2015-2014 %)</i>	1.50	2.10	2.40	0.60	0.50
<i>Forecasted Real GDP (year-on-year 2016-2015 %)</i>	1.70	2.40	2.30	1.10	1.40
<i>Real GDP (3<sup>rd</sup> quarter 2015 compared to 3<sup>rd</sup> quarter 2014 %)</i>	1.60	2.25	2.10	1.00	2.30
<i>Unemployment (%)</i>	10.50	5.00	5.50	3.10	15.80 (*)
<i>Inflation (3<sup>rd</sup> quarter 2015 compared to 3<sup>rd</sup> quarter 2014 %)</i>	0.10	0.10	0.00	0.10	-1.80

\* Data for November 2015

### Sources:

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

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