

ECONOMIC BULLETIN

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DEVELOPMENTS IN THE WORLD ECONOMY

The recovery of the world economy remains fragile. Over the past few months there has been a gradual pick-up in global activity. In most major non-euro area advanced economies there has been further evidence of a modest expansion, but structural impediments continue to restrain the medium-term growth outlook. In emerging economies growth has recently moderated somewhat, but it remains solid overall, thereby contributing significantly to global growth. In most countries, inflation has continued to ease in the last few months, mainly reflecting developments in energy prices.

Europe: Based on its regular economic and monetary analyses, the ECB Governing Council decided at its meeting on 6 June to keep the key ECB interest rates unchanged. Economic growth in the euro area remains weak, with heightened uncertainty weighing on confidence and sentiment. On a quarterly basis, euro area real GDP growth was flat in the first quarter of 2012. The June 2012 macroeconomic projections for the euro area foresee annual real GDP growth in a range between -0.50% and 0.30% for 2012 and between 0% and 2% for 2013. In the Governing Council's assessment, the economic outlook for the euro area is subject to increased downside risks relating, in particular, to a further increase in the tensions in several euro area financial markets and their potential spillover to the euro area real economy. Downside risks also relate to possibly renewed increases in commodity prices. Ongoing tensions in some euro area sovereign debt markets and their impact on credit conditions together with high unemployment are expected to continue to dampen the underlying growth momentum. With regard to price developments, euro area annual inflation was 2.40% in May 2012, according to Eurostat's flash estimate, after 2.60% in the previous month. Inflation is likely to stay above 2% for the remainder of the year, mainly owing to developments in energy prices and indirect taxes. The June 2012 projections for the euro area foresee annual inflation in a range between 2.30% and 2.50% for 2012 and between 1% and 2.20% for 2013. The Governing Council continues to view the risks to the medium-term outlook for price developments as broadly balanced. Upside risks pertain to further increases in indirect taxes, owing to the need for fiscal consolidation, and higher than expected commodity prices over the medium term. The main downside risks relate to the impact of weaker than expected growth in the euro area. With regard to fiscal and economic policies, the ECB Governing Council stresses the importance of restoring sound fiscal positions and competitiveness which are pre-conditions for stable economic growth, considering necessary the implementation of the new macroeconomic EU surveillance framework. In several euro area countries, excessive imbalances exist and need to be corrected. To this end, comprehensive product, labour and financial sector reforms will help foster sustainable growth. These growth-enhancing reforms would accelerate the necessary adjustment process and enhance job creation.

United States: On 20 June 2012 the Federal Open Market Committee (FOMC) decided to keep the target range for the federal funds rate at 0% to 0.25% and anticipated that economic conditions are likely to warrant exceptionally low levels for the federal funds rate at least until late 2014. US real GDP increased at an annual rate of 1.90% (0.50% quarter-on-quarter) in the first quarter of 2012, down from 3% in the previous quarter. Survey-based indicators point to an ongoing moderate expansion in the second quarter of 2012. While industrial production and consumer spending have continued to advance, the slowdown in the pace of job creation in April and May has raised some concerns about the momentum of the recovery, compounded by persistent uncertainties in global financial markets. Looking ahead, in a context of stimulative macroeconomic policies and gradually easing lending conditions, the recovery is expected to continue at a moderate pace. In particular, housing activity appears to have stabilised, the labour market has generally turned more supportive over recent quarters, despite some loss of momentum as of late, and energy prices have moderated. At the same time, the vigour of consumer spending will continue to be restrained as households try to rebuild their savings in the context of weak income growth. Reflecting sluggish global demand, export growth is likely to remain subdued in the near term. Price pressures have continued to ease. In April annual Consumer Price Index (CPI) inflation slowed further to 2.30%, down from 2.70% in the previous month and well below a peak of 3.90% in September 2011. The deceleration continued to reflect the easing in the annual rate of change in both energy and food prices. In the medium term, abundant spare capacity is expected to keep underlying price pressures contained.

United Kingdom: On 7 June, the Bank of England's Monetary Policy Committee maintained the official Bank Rate paid on commercial bank reserves at 0.50% and the stock of asset purchases financed by the issuance of central bank reserves at a total of GBP 325 billion. Real GDP declined by 0.30% quarter-on-quarter in the first quarter of 2012, with both investment and household consumption making a negative contribution to growth. The labour market situation has shown signs of stabilisation, but the unemployment rate is still relatively high (8.20%) and employment growth has been

subdued. Looking ahead, the economic recovery is likely to gather pace only gradually, as domestic demand is expected to remain constrained by tight credit conditions, ongoing household balance sheet adjustments and substantial fiscal tightening. Annual CPI inflation slowed to 3% in April from 3.50% in March but relatively high inflation is likely to remain persistent in the short term. However, looking further ahead, the existence of spare capacity and the sluggish recovery in economic activity should contribute to a dampening of inflationary pressures.

Japan: In Japan, real GDP growth expanded by 1% quarter-on-quarter, after stagnating in the previous quarter (0.20%). The main contributions to growth came from private consumption and public spending. Reconstruction-related spending is expected to continue to support growth in the near term, mainly through rising public spending and private investment. Annual CPI inflation in April stood at 0.40% (compared with 0.50% in the previous month). At its latest monetary policy meeting on 14 June, the Bank of Japan decided to maintain its target for the uncollateralised overnight call rate at around 0% to 0.10%.

Greece: Following the Greek elections, which took place on 17 June, a coalition government (between 3 parties) has been formed. The new government will seek changes to some of the terms in Greece's bailout deals. Greece will press for an extension of at least two years in the deadline, which would alleviate the immediate impact of new cutbacks and is seen as a likely concession by its creditors.

Energy News: Oil prices have declined strongly since late March, thereby more than offsetting the strong gains posted in the first quarter of 2012. Brent crude oil prices stood at USD 92.7 per barrel on 20 June, a level 15% lower compared with the beginning of the year and 24.7% below this year's peak on 14 March 2012. Looking ahead, market participants expect slightly lower oil prices over the medium term, with futures contracts for December 2013 trading at USD 94.60 per barrel. This recent downward correction is due to heightened uncertainty over global growth prospects, which is amplified by renewed tensions in some euro area sovereign debt markets.

CYPRUS ECONOMY

The GDP growth rate of the Cypriot economy in real terms during the first quarter of 2012 is negative and estimated at -1.60% over the corresponding quarter of 2011. Negative growth rates were recorded by the secondary sector of the economy (Construction, Manufacturing, Electricity), as well as in the sectors of Trade and Transport. Positive growth rates were presented by the sectors of Banking and Services (Public Administration, Education, Health and other services). The rate of increase of the Consumer Price Index, and therefore the rate of inflation, for May 2012 decreased to 2.90% compared to 3.10% in April 2012 and 3.90% in May 2011. Decreases have been recorded in the prices of petroleum products. For the period January-May 2012, the CPI recorded an increase of 3.10% compared to the corresponding period of 2011. The number of registered unemployed for May 2012 increased to 36.313 persons in comparison to 35.402 in the previous month. In comparison with May 2011, an increase of 8.112 persons or 31,10% was recorded which was mainly observed in the sectors of construction, trade, manufacturing, public administration, accommodation and food service activities, as well as to newcomers in the labour market.

Main Economic Indicators

Period: First Quarter of 2012					
	<i>Europe</i>	<i>United States</i>	<i>United Kingdom</i>	<i>Japan</i>	<i>Cyprus</i>
<i>Real GDP (year-on-year 2011-2010 %)</i>	1.50	1.70	0.68	-0.78	0.50
<i>Estimated Real GDP (year-on-year 2012-2011 %)</i>	-0.40	2.20	0.20	2.49	-0.80
<i>Real GDP (1st quarter 2012 compared to 1st quarter 2011 %)</i>	-0.10	1.90	-0.10	4.70	-1.60
<i>Unemployment (%)</i>	10.90	8.27	8.30	4.53	10.0
<i>CPI (year-on-year %)</i>	2.70	2.83	3.50	0.30	2.90

Sources:

- 1) *European Central Bank*
- 2) *Statistical Service of Cyprus (CYSTAT)*
- 3) *Bloomberg Statistics*

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