

ECONOMIC BULLETIN

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DEVELOPMENTS IN THE WORLD ECONOMY

The global economy remains on a gradual recovery path, although the growth momentum moderated somewhat in the first quarter of 2014. Global activity should gather pace in the period ahead, supported by both advanced and emerging market economies. Nevertheless, the underlying trends continue to suggest a shift in growth dynamics in favour of advanced economies, with the global economic recovery remaining modest overall. Global trade momentum has softened since the beginning of the year, in line with the slowdown in activity. Global inflation picked up slightly in the first quarter, but remains low, reflecting muted energy price developments and persistent economic slack.

Europe: The European Central Bank (ECB) Governing Council decided at its meeting on 5 June 2014 on a combination of measures to provide additional monetary policy accommodation and to support lending to the real economy. This package includes further reductions in the key ECB interest rates, targeted longer-term refinancing operations, preparatory work related to outright purchases of asset-backed securities and a prolongation of fixed rate, full allotment tender procedures. In addition, the Governing Council decided to suspend the weekly fine-tuning operation sterilizing the liquidity injected under the Securities Markets Programme. Regarding the individual measures announced on 5 June 2014, the Governing Council decided to lower the interest rate on the main refinancing operations of the Eurosystem by 10 basis points to 0.15% and the rate on the marginal lending facility by 35 basis points to 0.40%. The rate on the deposit facility was lowered by 10 basis points to -0.10%. These changes came into effect on 11 June 2014. The negative rate also applies to reserve holdings in excess of the minimum reserve requirements. Regarding the economic analysis, real GDP in the euro area rose by 0.20%, quarter on quarter, in the first quarter of this year. This confirmed the ongoing gradual recovery, while the outcome was somewhat weaker than expected. The most recent survey results signal moderate growth also in the second quarter of 2014. Looking ahead, domestic demand should continue to be supported by the accommodative monetary policy stance, ongoing improvements in financing conditions, the progress made in fiscal consolidation and structural reforms, and gains in real disposable income resulting from falls in energy prices. At the same time, although labour markets have shown some further signs of improvement, unemployment remains high in the euro area and, overall, unutilised capacity continues to be sizeable. Eurosystem staff macroeconomic projections for the euro area foresee annual real GDP increasing by 1.0% in 2014, 1.70% in 2015 and 1.80% in 2016. The risks surrounding the economic outlook for the euro area continue to be on the downside. Geopolitical risks, as well as developments in emerging market economies and global financial markets, may have the potential to affect economic conditions negatively. Other downside risks include weaker than expected domestic demand and insufficient implementation of structural reforms in euro area countries, as well as weaker export growth. Euro area annual Harmonised Index of Consumer Prices (HICP) inflation was 0.50% in May 2014, after 0.70% in April. On the basis of the information available to the Governing Council at its meeting on 5 June 2014, annual HICP inflation is expected to remain at low levels over the coming months, before increasing only gradually during 2015 and 2016. The projections foresee annual HICP inflation at 0.70% in 2014, 1.10% in 2015 and 1.40% in 2016.

United States: The Federal Open Market Committee (FOMC) announced the reduction of its monthly asset purchases by a further USD 10 billion, to USD 45 billion, starting from May. The FOMC reaffirmed that, in determining how long to maintain the 0% to 0.25% target range for the federal funds rate, it “will take into account a wide range of information, including measures of labour market conditions, indicators of inflation pressures and inflation expectations, and readings on financial developments”. Real GDP contracted in the first quarter of 2014, following a pick-up in activity in the second half of 2013. Real GDP declined at an annualized rate of 1.00%, after having increased by 2.60% in the fourth quarter of 2013. Available indicators for the second quarter are consistent with an acceleration in growth. Private consumption is expected to remain robust, supported by the solid momentum in retail sales and improving consumer confidence. The continued recovery in the job market is another factor supporting private consumption in the near term. Looking further ahead, the recovery is expected to accelerate during the second half of the year, on the back of a decline in fiscal drag, supportive financial conditions, continued accommodative monetary policy conditions, and a gradual recovery in housing and labour markets. Annual inflation excluding food and energy rose to 1.80% in April, from 1.70% in March.

United Kingdom: In the United Kingdom, the strong economic performance observed throughout 2013 has continued in 2014. Real GDP increased by 0.80% quarter on quarter in the first quarter of 2014. Growth has been driven by robust domestic demand, and by improvements in employment, low inflation and the sustained momentum of investment. Unemployment declined further, to 6.80%, in the three months to March 2014. Annual CPI inflation increased to 1.80% in April 2014 but remained below the central bank’s target of 2%. At its meeting on 5 June 2014 the Bank of England’s Monetary Policy Committee maintained the policy rate at 0.50% and the size of its asset purchase programme at GBP 375 billion.

Japan: During the first quarter of 2014 GDP surged by 1.50% quarter on quarter. Annual CPI inflation increased strongly to 3.40% in April from 1.60% in March, with the CPI increasing to 2.30% in April.

Energy News: Brent crude oil prices have been relatively stable in a range of USD 106-112 per barrel over the last couple of months. The price of Brent crude oil stood at USD 112 per barrel on 1 July, which is about 13% higher than the level one year ago.

CYPRUS ECONOMY AND MAJOR DEVELOPMENTS

The Troika (IMF, European Commission and ECB) completed their fourth review of the economic programme of Cyprus, concluding that the programme is on track with fiscal targets being comfortably met. Regarding the banking sector the priority set is to deal with the high level of non-performing loans. To this end, the Cypriot authorities agreed on the reform of the debt-restructuring legal framework. Regarding fiscal policy, the Government needs to continue reducing the fiscal deficit to reach the sustainability target of 4% of GDP primary surplus and at the same time implement structural reforms, like reforming the tax revenue and welfare administration and implementing the privatization plan. The Government has recently lifted domestic capital controls in line with the roadmap announced at the start of the programme. The GDP growth rate during the first quarter of 2014 was negative at -4% over the corresponding quarter of 2013. The rate of inflation for May 2014 decreased by -1.40% compared to -1.60% in April 2014 and -0.70% in May 2013. Unemployment reached the level of 15.3% in May 2014.

Main Economic Indicators

Period: First Quarter of 2014

	<i>Europe</i>	<i>United States</i>	<i>United Kingdom</i>	<i>Japan</i>	<i>Cyprus</i>
<i>Real GDP (year-on-year 2013-2012 %)</i>	-0.40	1.90	1.70	1.53	-5.40
<i>Forecasted Real GDP (year-on-year 2014-2013 %)</i>	1.10	2.20	3.00	1.50	-4.20
<i>Real GDP (1st quarter 2014 compared to 1st quarter 2013 %)</i>	0.90	-2.90	3.00	6.70	-4.00
<i>Unemployment (%)</i>	11.95	7.40	7.63	4.03	15.30 (*)
<i>Inflation (1st quarter 2014 compared to 1st quarter 2013 %)</i>	0.67	1.40	1.73	1.50	-2.58

* Data for May 2014

Sources:

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

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