ECONOMIC BULLETIN

Publication: March 2018

DEVELOPMENTS IN THE WORLD ECONOMY

The global economy expanded at an even faster rate in the second half of 2017 and is providing further impetus to euro area exports. Global economic activity is expected to remain strong going forward, although the pace of growth will gradually moderate. Global trade growth is expected to remain sustained in the near term, while inflation is expected to rise slowly as spare capacity at the global level diminishes. However, corporate bond spreads have remained broadly stable and average sovereign bond spreads over the overnight index swap rate have decreased somewhat overall. Equity prices have declined in an environment of heightened volatility. In foreign exchange markets, the euro has appreciated in nominal effective terms.

Europe:

At its monetary policy meeting on 8 March 2018, the Governing Council 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. The information that has become available since the previous monetary policy meeting in January, including the new ECB staff projections, confirmed a strong and broad-based growth momentum in the euro area economy, which is projected to expand in the near term at a somewhat faster pace than previously expected. This outlook for growth confirmed the Governing Council's confidence that inflation will converge towards the inflation aim of below, but close to, 2% over the medium term. At the same time, measures of underlying inflation remained subdued and have yet to show convincing signs of a sustained upward trend. In this context, the Governing Council will continue monitoring developments in the exchange rate and financial conditions with regard to their possible implications for the medium-term outlook for price stability. The continued monetary support required for a sustained return of inflation rates towards levels that are below, but close to, 2.0% is provided by the ongoing net asset purchases, by the sizeable stock of acquired assets and the forthcoming reinvestments, and by the forward guidance on interest rates. Real GDP increased by 0.6%, quarter on quarter, in the fourth quarter of last year. Real GDP growth was driven by net trade and private consumption and investment as well as exports benefitting from the broad-based global recovery. The euro area foresee annual real GDP increasing by 2.4% in 2018, 1.9% in 2019 and 1.7% in 2020. Euro area annual HICP inflation declined to 1.2% in February 2018, from 1.3% in January. Looking ahead, on the basis of current futures prices for oil, annual rates of headline inflation are likely to hover around 1.5% for the remainder of the year. Measures of underlying inflation remained subdued but are 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. Annual HICP inflation is foreseen at 1.4% in 2018, 1.4% in 2019 and 1.7% in 2020. HICP inflation excluding food and energy was 1.0% in February 2018, unchanged from January but up from 0.9% in December 2017. The moderation in late 2017 partly reflected the impact of large declines in inflation across a number of services items. It is projected to be at 1.1% in 2018, 1.5% in 2019 and 1.8% in 2020.

United States: At its meeting on March 21, 2018, the Federal Open Market Committee (FOMC) decided to raise the target range for the federal funds rate by 25 basis points, bringing it at 1.50% to 1.75%. This decision marks another step in the ongoing process of gradually scaling back monetary policy accommodation--a process that has been under way for several years now. The stance of monetary policy remains accommodative, thereby supporting strong labour market conditions and a sustained return to 2.0% inflation. Job gains averaged 240,000 per month over the past three months, well above the pace needed in the longer run to absorb new entrants into the labour force. The unemployment rate remained low in February at 4.1%, while the labour force participation rate moved higher. Although the growth rates of household spending and business investment appear to have moderated early this year, gains in the fourth quarter were strong and the fundamentals underpinning demand remain solid. The economic outlook has strengthened in recent months. Several factors are supporting the outlook: fiscal policy has become more simulative, ongoing job gains are boosting incomes and confidence, foreign growth is on a firm trajectory, and overall financial conditions remain accommodative. Against this backdrop, inflation remains below the 2.0% longer-run objective. Overall consumer prices, as measured by the price index for personal consumption expenditures, increased 1.7% in the 12 months ending in January. The core price index, which excludes the prices of energy and food and is typically a better indicator of future inflation, rose 1.5% over the same period. However, the shortfall of inflation from 2.0% reflects, at least partly, some unusual price declines that occurred nearly a year ago. In coming months, as those earlier declines drop out of the calculation, inflation should move up closer to 2.0% and stabilize around that level over the medium term. Various forces will continue to affect inflation; at times it may be above 2.0% just as at times it may be below. The median projection for the growth of inflation-adjusted GDP is 2.7% in 2018, 2.4% in 2019, and 2.0% in 2020, a bit above its estimated longer-run rate. The median projection for the unemployment rate stands at 3.8% in the fourth quarter of 2018 and runs at 3.6% over the next two years, almost a percentage point below the median estimate of its longer-run normal rate. Finally, the median inflation projection is 1.9% in 2018, 2.0% next year, and 2.1% in 2020. Real GDP growth is stronger, the unemployment rate is lower, and inflation is slightly higher. The median projection for the federal funds rate is 2.1% at the end of 2018, 2.9% at the end of 2019, and 3.4% at the end of 2020. By 2020, the median federal funds rate is modestly above its estimated longer-run level trend.

United Kingdom: At its meeting ending on March 21, 2018, the Monetary Policy Committee (MPC) voted unanimously to maintain the Bank Rate at 0.5%. 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 projections, set out in the February *Inflation Report*, GDP was expected to grow by around 1.75 % per year on average over the forecast period. While modest by historical standards, that growth rate was expected to exceed the diminished rate of supply growth of the economy, which was projected to be around 1.5% per year. As a result, a small margin of excess demand was projected to emerge by early 2020 and build thereafter. That pushed up on domestic costs, although CPI inflation fell back gradually as the effects of sterling's past depreciation faded. Inflation remained above the 2.0% target in the second and third years of the MPC's central projection. GDP growth in the fourth quarter was revised down slightly, to 0.4%, with the composition of demand implying less rotation towards net trade and business investment than anticipated at the time of the February *Report*. CPI inflation fell from 3.0% in January to 2.7% in February. Inflation is expected to ease further in the short term although to remain above the 2.0% target. Pay growth continued to pick up. The unemployment rate remained low in the three months to January. The firming of shorter-term measures of wage growth in recent quarters and a range of survey indicators suggest pay growth will rise further in response to the tightening labour market. This provides increasing confidence that growth in wages and unit labour costs will pick up to target-consistent rates. Developments regarding the United Kingdom's withdrawal from the European Union – and in particular the reaction of households, businesses and asset prices to them – remain the most significant influence on, and source of uncertainty about, the economic outlook. In such exceptional circumstances, the MPC's remit specifies that the Committee must balance any significant trade-off between the speed at which it intends to return inflation sustainably to the target and the support that monetary policy provides to jobs and activity. The steady absorption of slack has reduced the degree to which it is appropriate for the MPC to accommodate an extended period of inflation above the target.

Japan: The economic expansion is seen to gradually decelerate. Economic activity is projected to remain relatively solid over the short term, benefiting from the current positive momentum and accommodative monetary policy stance. Looking further ahead, however, growth is expected to gradually slow. Apart from diminishing support from fiscal policy and quickly contracting spare capacity, this deceleration also reflects a decline in the positive impact of infrastructure investment related to the 2020 Olympics.

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

Energy News: Oil prices increased from around USD 45 per barrel at end-June 2017 to about USD 69 per barrel at the end of March 2018. The main drivers of this increase were stronger than expected growth in global demand, the effectiveness of the strategy adopted by the Organization of the Petroleum Exporting Countries (OPEC) and some non-OPEC countries to curb their production of oil– partly offset by rising US production – and geopolitical events.

CYPRUS ECONOMY AND MAJOR DEVELOPMENTS

In the 4th quarter of 2017, Cyprus' Real GDP (seasonally adjusted) recorded a positive rate of growth of 3.9% compared to 4.1% in the 3rd quarter of 2017 on an annual basis. Growth is expected to reach the 3.60% in 2018 and 2.9% in 2019 (IMF's projections). Inflation (HICP) for January 2018 decreased by 1.5% when compared to January 2017, while compared to December of 2017 decreased by 1.9%. In February 2018, HICP decreased by 0.4% when compared to February 2017, while compared to January of 2018 increased by 1.2%. For the period January-February 2018 the HICP recorded a decrease of -0.9% compared to the corresponding period of the previous year. It is expected to be in the area of 0.70% in 2018 and 1.1% in 2019. In February 2018, deposits amounted €48.7 billion, compared to €48.6 billion in January 2018 and at €49.4 billion the end of 2017.

Main Economic Indicators

	Eurozone	*United States*	*United Kingdom*	*Japan*	*China*	*Cyprus*
Real GDP (year-on-year 2017-2016 %)	2.3	2.5	1.4	1.7	6.9	3.9
Forecasted Real GDP (year-on-year 2018-2017 %)	2.4	2.8	1.50	1.3	6.50	3.6
Forecasted Unemployment 2018 (%)	8.4	3.9	4.4	2.6	4.0	10.0
Forecasted Inflation 2018 (%)	1.5	2.4	2.5	1.0	1.6	0.7

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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