ECONOMIC BULLETIN

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DEVELOPMENTS IN THE WORLD ECONOMY

Global activity growth remained sustained in the first months of the year. Momentum in global trade improved markedly, driven mostly by increased trade from emerging market economies. Global headline inflation has stabilised in recent months, as the effect of past commodity price increases has diminished. However, oil prices have declined in recent weeks, which should dampen global inflation rates in the short term.

Europe: At its monetary policy meeting on 8 June 2017, the Governing Council of the ECB decided that the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged at 0.00%, 0.25% and -0.40% respectively. The Governing Council expects the key ECB interest rates to remain at their present levels for an extended period of time, and well past the horizon of the net asset purchases. Regarding non-standard monetary policy measures, the Governing Council confirms that the net asset purchases, at the current monthly pace of €60 billion, are intended to run until the end of December 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 inflation aim. The net purchases will be made alongside reinvestments of the principal payments from maturing securities purchased under the asset purchase programme. If the outlook becomes less favourable, or if financial conditions become inconsistent with further progress towards a sustained adjustment in the path of inflation, the Governing Council stands ready to increase the programme in terms of size and/or duration. The euro area economic expansion has gained momentum and is primarily supported by domestic demand. Real GDP increased by 0.60%, quarter on quarter, in the first quarter of 2017, following growth of 0.50% in the previous quarter. Domestic demand remained the engine behind growth in the first quarter of 2017 and changes in inventories contributed positively, whereas net trade provided a neutral contribution. Growth in euro area employment continued in the fourth quarter of 2016 and, as a result, employment stood 1.20% above the level recorded one year earlier. Euro area unemployment stood at 9.30%, in April 2017, the lowest reading since March 2009. Business investment is continuing its gradual recovery and it is expected to continue, supported by several factors, including still very favourable financing conditions, the ECB's very accommodative monetary policy, a need to modernise the capital stock after several years of subdued investment, above-average capacity utilisation rates, and high profit mark-ups in the non-financial sector. However, economic growth in the euro area is expected to be dampened by the sluggish pace of implementation of structural reforms and outstanding balance sheet adjustments in a number of sectors, notwithstanding ongoing improvements. The euro area annual real GDP is forecasted to increase by 1.90% in 2017, 1.80% in 2018 and 1.70% in 2019. The Euro area annual Harmonised Index of Consumer Prices (HICP) inflation in May 2017 was 1.40%, down from 1.90% in April. The increase in HICP inflation in the euro area is expected to be somewhat lower than previously expected. It is projected to increase from 0.20% in 2016 to 1.50% in 2017, 1.30% in 2018 and 1.60% in 2019, mainly from a strong positive contribution of HICP energy inflation in 2017, which decreases substantially in 2018. HICP inflation excluding energy and food is expected to rise only gradually over the medium term, from 0.90% in 2016 to 1.10% in 2017 and to 1.40% and 1.70% in 2018 and 2019, mainly due to the low wage growth rate.

United States: At its meeting on 14 June 2017, the Federal Open Market Committee (FOMC) decided to raise the target range for the federal funds rate by 25 basis points, bringing it to 1.00% to 1.25%. The decision reflects the progress the economy has made, and is expected to make, toward maximum employment and price stability objectives. Household spending, which was particularly soft earlier this year, has been supported by solid fundamentals, including ongoing improvement in the job market and relatively high levels of consumer sentiment and wealth. Business investment, which was weak for much of last year, has continued to expand. Exports have shown greater strength this year, in part reflecting a pickup in global growth. Overall, the economy will expand at a moderate pace over the next few years. In the labour market, job gains have averaged about 160,000 per month since the start of the year-a solid rate of growth that, although a little slower than last year, remains well above estimates of the pace necessary to absorb new entrants to the labour force. The unemployment rate has fallen about 0.50% point since the beginning of the year and was 4.30% in May, a low level by historical standards and modestly below the median of FOMC participants' estimates of its longer-run normal level. Turning to inflation, the 12-month change in the price index for personal consumption expenditures was 1.70% in April, which is lower than the average of the previous months. Core inflation-which excludes the volatile food and energy categories and tends to be a better indicator of future inflation-has also edged lower. The projection of GDP is 2.20 % this year, 2.10% in 2018, and edges down to 1.90% by 2019. The unemployment rate stands at 4.30 % in the fourth quarter of this year and ticks down to 4.20% in 2018 and 2019. The inflation projection is 1.60% this year and rises to 2.00 % in 2018 and 2019. The core inflation projection is 1.70% in 2017, and 2.00% in 2018 and 2019. The median projection for the federal funds rate is 1.40% at the end of this year, 2.10% at the end of next year, and 2.90% at the end of 2019.

United Kingdom: At its meeting ending on 14 June 2017, the Monetary Policy Committee (MPC) voted by a majority of 5-3 to maintain Bank Rate at 0.25%. 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. GDP growth declined markedly in the first quarter at 0.20%, in part reflecting weaker household spending. As for 2017 Q2, GDP is expected at 0.40%. Twelve-month CPI inflation had increased to 2.90% in May, higher than had been expected in the Committee's May Inflation Report projections. The twelve-month change in CPI excluding food, alcohol, tobacco and energy had risen to 2.60%, also higher than expected in May. Twelve-month CPI inflation could rise above 3.00% by the autumn, and it is expected to remain above the 2.00% target for an extended period as the depreciation of sterling continued to feed through into the prices of consumer goods and services. By contrast, pay growth had remained subdued. Annual economy-wide regular pay growth had been 1.70% in the three months to April, weaker than the assumption in the May Report. In the private sector, annual regular pay growth had been 2.00%, in line with the Committee's expectation.

Japan: Accommodative policies are expected to continue to support expansion. Accommodative monetary policy looser financial conditions and the fiscal stimulus programme should support domestic demand, while exports are expected to gradually recover as external demand improves. However, despite robust job creation, wage increases have remained modest, dampening private consumption.

China: Activity is expected to continue expanding at a robust pace, supported by resilient consumption and the buoyant housing market. However, an increased focus on containing financial stability risks has led to tighter financial conditions since late 2016. In the medium term, growth is anticipated to remain on a gradual downward trend, consistent with the authorities' desire to rebalance the economy.

Energy News: Brent crude oil prices have fluctuated in the range of USD 45 to USD 56 per barrel since early March. The price fluctuations reflect shifting concerns among market participants about the likely success of the OPEC strategy to curtail production, amid still high oil inventories and rising US shale production. The prolongation of the output cut for nine months, which was agreed by OPEC and 11 non-OPEC countries on 25 May 2017, was widely anticipated by markets and priced in before the meeting. Hopes raised by some participating countries that there might be agreement on an even deeper or longer cut did not materialise, which led to a renewed price drop in the aftermath of the meeting of about 6.00% in US dollar terms.

CYPRUS ECONOMY AND MAJOR DEVELOPMENTS

Cyprus' Real GDP recorded a positive rate of growth of 3.30% in the 1st quarter of 2017, and 2.90% in the 4th quarter of 2016 compared to the corresponding quarter of previous year. Growth is expected to reach 2.70% in 2017 and 2.50% in 2018. Inflation (HICP) averaged at 0.90% in May 2017. HICP is expected to be in the area of 1.50% in 2017 and 1.40% in 2018. Deposits in the banking system are on an upward trend during the recent months. However they recorded a slight decrease in April 2017, reaching the amount of €49.2 billion, compared to €49.6 billion in March 2017 and €49.0 billion as at the end of 2016.

Main Economic Indicators

	Eurozone	*United States*	*United Kingdom*	*Japan*	*China*	*Cyprus*
Real GDP (year-on-year 2016-2015 %)	1.70	1.60	1.80	1.00	6.70	2.80
Forecasted Real GDP (year-on-year 2017-2016 %)	1.90	2.20	1.60	1.30	6.60	2.70
Forecasted Real GDP (year-on-year 2018-2017 %)	1.80	2.10	1.30	1.00	6.30	2.50
Real GDP (1st quarter 2017 compared to 1st quarter 2016 %)	1.90	2.00	0.20	1.30	6.90	2.80
Unemployment (%), 2016	9.30 (*)	4.80	4.90	3.10	4.00	11.60 (*)
Inflation (1st quarter 2017 compared to 1st quarter 2016 %)	1.80	2.50	2.10	0.30	1.40	1.20

** Data for April 2017*

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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