ECONOMIC BULLETIN

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DEVELOPMENTS IN THE WORLD ECONOMY

Despite a slight softening of momentum, the near-term global outlook remains essentially solid, supported by accommodative monetary policies in advanced economies and significant fiscal stimulus in the United States. Further ahead, global activity is expected to slow as output is close to potential in many advanced economies. Global trade growth is seen as remaining resilient in the near term. However, the implementation of higher trade tariffs and the possibility of wider protectionist measures represent a key risk to global growth momentum. Global inflationary pressures are expected to rise slowly as spare capacity diminishes.

Europe: At its monetary policy meeting on 14 June 2018, the Governing Council concluded that progress towards a sustained adjustment in inflation had been substantial so far. The Governing Council will continue to make net purchases under the asset purchase programme (APP) at the current monthly pace of €30.0 billion until the end of September 2018. The Governing Council anticipates that, after September 2018, subject to incoming data confirming its medium-term inflation outlook, it will reduce the monthly pace of the net asset purchases to €15.0 billion until the end of December 2018 and then end net purchases. The Governing Council intends to maintain its policy of reinvesting the principal payments from maturing securities purchased under the APP for an extended period of time after the end of its net asset purchases, and in any case for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation. The Governing Council decided to keep the key ECB interest rates unchanged and expects them to remain at their present levels at least through the summer of 2019 and in any case for as long as necessary to ensure the continued sustained convergence of inflation towards levels that are below, but close to 2.0% over the medium term. The euro area economic expansion remains solid and broad-based across countries and sectors, despite recent weaker than expected data and indicators. Quarterly real GDP growth moderated to 0.4% in the first quarter of 2018, following growth of 0.7% in the previous quarters. This moderation reflects a pull-back from the very high levels of growth in 2017, compounded by an increase in uncertainty and some temporary and supply-side factors at both the domestic and the global level, as well as weaker impetus from external trade. The latest economic indicators and survey results are weaker, but remain consistent with ongoing solid and broad-based economic growth. The euro area foresee annual real GDP increasing by 2.1% in 2018, 1.9% in 2019 and 1.7% in 2020. Euro area annual HICP inflation increased to 1.9% in May 2018, from 1.2% in April. This reflected higher contributions from energy, food and services price inflation. On the basis of current futures prices for oil, annual rates of headline inflation are likely to hover around the current level for the remainder of the year. While measures of underlying inflation remain generally muted, they have been increasing from earlier lows. Domestic cost pressures are strengthening amid high levels of capacity utilisation, tightening labour markets and rising wages. Uncertainty around the inflation outlook is receding. Looking ahead, underlying inflation is expected to pick up towards the end of the year and thereafter to increase 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. The euro area unemployment rate continued to decline and stood at 8.5% in April – the lowest level seen since December 2008. The decline was broad-based across age and gender groups and unemployment durations. Survey indicators have moderated somewhat from very high levels, but still point to continued employment growth in the second quarter of 2018. In that context, signs of labour shortages have increased in some countries and sectors. Annual HICP inflation is foreseen at 1.7% in 2018, 2019 and 2020. A gradual increase in HICP inflation excluding energy and food, which is expected to rise from 1.1% in 2018 to 1.6% in 2019 and 1.9% in 2020, and a declining contribution from energy inflation, given the technical assumption that oil prices will evolve in line with the oil futures curve. The expected rise in underlying price pressures reflects in particular increasing labour market tightness and concomitant wage pressures, especially in some countries.

United States: At its meeting on June 13, 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 1.75% to 2.0%. Economic growth appears to have picked up in the current quarter, largely reflecting a bounce back in household spending. Business investment continues to grow strongly, and the overall outlook for growth remains favourable. Several factors support this assessment: Fiscal policy is boosting the economy, ongoing job gains are raising incomes and confidence, foreign economies continue to expand, and overall financial conditions remain accommodative. The median projection for the growth of real GDP is 2.8% this year, 2.4% next year, and 2.0 % in 2020. Compared with the projections made in March, this median growth path is little changed. In the labour market, job gains averaged 180,000 per month over the past three months, well above the pace needed in the longer run to provide jobs for new entrants into the workforce. The unemployment rate declined over the past two months and stood at 3.8% in May, its lowest level in nearly two decades. Meanwhile, the labour force participation rate has been roughly unchanged since late 2013. That is a positive sign, given that the aging of the population is putting downward pressure on the participation rate. The job market is expected to remain strong. The median of Committee participants' projections for the unemployment rate stands at 3.6% in the fourth quarter of this year and runs at 3.5% over the next two years, a percentage point below the median estimate of its longer-run normal rate. This median path is just a bit lower than that from March. After many years of running below the 2.0% longer-run objective, inflation has recently moved close to that level. Overall consumer prices, as measured by the price index for personal consumption expenditures, increased 2.0% over the 12 months ending in April. The core price index, which excludes prices of energy and food and tends to be a better indicator of future inflation, rose 1.8% over the same period. As expected, inflation moved up as the unusually low readings from last March dropped out of the calculation. The recent inflation data have been encouraging, but after many years of inflation below the objective, the committee wants to ensure that inflation remains near the symmetric 2.0% longer-run goal on a sustained basis. The Committee would be concerned if inflation were running persistently above or below the 2.0% objective. Of course, many factors affect inflation—some temporary and others more lasting—and at any given time inflation may be above or below 2.0%. For example, the recent rise in oil prices will likely push inflation somewhat above 2.0% in coming months. But that transitory development should have little, if any, consequence for inflation over the next few years. The median of participants' projections for inflation runs at 2.1% through 2020. Relative to the March projections, the median inflation projection is a little higher this year and next. The median projection for the federal funds rate is 2.4% at the end of 2018, 3.1% 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. The Committee's gradual approach for increasing the federal funds rate will best promote a sustained expansion of economic activity, strong labour market conditions, and inflation near the symmetric 2.0% goal and is reflected in participants' projections for the appropriate path for the federal funds rate.

United Kingdom: At its meeting ending on 20 June 2018, the Monetary Policy Committee (MPC) voted by a majority of 6-3 to maintain Bank Rate at 0.5%. All members agree that any future increases in Bank Rate are likely to be at a gradual pace and to a limited extent. 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 May *Inflation Report*, GDP was expected to grow by around 1.75% per year on average over the forecast, conditioned on the gently rising path of Bank Rate implied by market yields at the time. In those projections, growth continued to rotate towards net trade and business investment and away from consumption. While modest by historical standards, the projected pace of GDP growth over the forecast was nevertheless slightly faster than the diminished rate of supply growth, which averaged around 1.5% per year. As a result, a small margin of excess demand was projected to emerge by early 2020, feeding through into higher rates of pay growth and domestic cost pressures. Nevertheless, CPI inflation continued to fall back gradually as the effects of sterling's past depreciation faded, reaching the 2.0% target in two years. CPI inflation was 2.4% in May, unchanged from April. Inflation is expected to pick up by slightly more than projected in May in the near term, reflecting higher dollar oil prices and a weaker sterling exchange rate. Most indicators of pay growth have picked up over the past year and the labour market remains tight, suggesting that domestic cost pressures will continue to firm gradually. At the same time, growth of unit wage costs appeared to have picked up. Headline annual wage growth in the three months to April had been 2.5% in the whole economy and 2.6% for the private sector while regular pay had risen by 2.8% and 2.9% respectively, broadly in line with expectations in the May Report.
The MPC sets monetary policy to meet the 2.0% inflation target, and in a way that helps to sustain growth and employment. In pursuing that objective, the main challenges for the Committee had continued to be to assess the economic implications of the United Kingdom withdrawing from the European Union and to identify the appropriate policy response to that changing outlook, including to the substantial depreciation of sterling that had been associated with the decision. During the negotiation period, those economic implications would be influenced significantly by the expectations of households, firms and financial markets about the United Kingdom's eventual economic relationships with the European Union and other countries, and the transition to them.

Japan: The economic expansion is projected to decelerate gradually. In the near term, activity is expected to rebound after the weak first-quarter outcome, supported by the accommodative monetary policy stance. Further ahead, growth is projected to decelerate as fiscal support wanes and spare capacity diminishes. Wages are rising moderately in the context of a tightening labour market, which is expected to support household spending and contribute towards a modest increase in inflation.

China: Activity is projected to decelerate moderately**.** Output has recently been supported by strong consumption, government support and solid export performance, which have offset the effects of a mild slowdown in housing market activity amid slowing credit growth and tightening financial conditions. Further ahead, the pace of expansion is foreseen to slow gradually, consistent with the emphasis of China's leadership on accepting slower expansion in order to reduce risks and address imbalances in the economy.

Energy News: Oil prices have risen sharply in the past two months, although they have seen a moderation more recently**.** Compared with the early part of this year, the increase has, in part, reflected resilient global demand. At the same time, oil supply has been largely unchanged, as output cuts stemming from the agreement between OPEC members and other oil-producing countries were offset by an increase in production in the United States. Pressure on the spot price rose further in mid-May, when the United States decided to withdraw from the Joint Comprehensive Plan of Action imposing sanctions on Iran. Subsequently, news that OPEC, Russia and their partners are discussing the possibility of ending the production cuts has driven the price down. Past experience suggests that oil price increases driven by shifts in supply or uncertainties about future supply have tended to be associated with weaker global activity, while demand-driven price increases have, in general, not fully offset the stronger global demand.1 With the recent oil price increase reflecting both resilient global demand and precautionary effects associated with uncertainty about future supply, the net impact of the higher oil price on the global economy is judged to be modest overall. Nonetheless, the change in oil prices is likely to have some distributional effects across countries, with the outlook for oil exporters strengthening in particular.

CYPRUS ECONOMY AND MAJOR DEVELOPMENTS

In the 1st quarter of 2018, Cyprus' Real GDP (seasonally adjusted) recorded a positive rate of growth of 4.0% compared to 3.9% in the 1st quarter of 2017 on an annual basis. Growth is expected to reach the 4.0% in 2018 and 4.2% in 2019 (IMF's projections). Inflation (HICP) for May 2018 increased by 1.0% when compared to May 2017, while compared to April of 2018 increased by 1,4%. For the period January-May 2018 the HICP recorded a decrease of 0.3 % compared to the corresponding period of the previous year. It is expected to be in the area of 0.2% in 2018 and 1.0% in 2019. In May 2018, deposits amounted to €50.9 billion, compared to €50.5 billion in April 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 %)	2.4	2.3	1.7	1.7	6.9	3.9
Forecasted Real GDP (year-on-year 2018-2017 %)	2.1	2.8	1.3	1.1	6.5	4.0
Forecasted Real GDP (year-on-year 2019-2018 %)	1.9	2.4	1.5	1.0	6.3	4.2
Forecasted Unemployment 2018 (%)	8.4	3.6	4.2	2.5	4.0	9.5
Forecasted Inflation 2018 (%)	1.7	2.1	2.5	1.0	2.1	0.2

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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