ECONOMIC BULLETIN

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DEVELOPMENTS IN THE WORLD ECONOMY

While global economic activity has remained resilient, it has become more uneven and signs of moderating momentum are emerging. The maturing global economic cycle, waning policy support across advanced economies and the impact of tariffs between the United States and China are weighing on global activity. Global trade growth has decelerated somewhat, and uncertainties about future trade relations have risen. At the same time, financial conditions remain accommodative in advanced economies, whereas they have tightened for some emerging markets. Looking ahead, global economic activity is expected to decelerate in 2019 and remain steady thereafter. Global inflationary pressures are expected to rise slowly as spare capacity diminishes.

Europe: At its monetary policy meeting on 13 December, the Governing Council decided to end the net asset purchases in December 2018, while keeping the key ECB interest rates unchanged and enhancing the forward guidance on reinvestment. While incoming information has been weaker than expected, reflecting softer external demand but also some country and sector-specific factors, the underlying strength of domestic demand continues to underpin the euro area expansion and gradually rising inflation pressures. This supports the Governing Council's confidence that the sustained convergence of inflation to its aim will proceed and will be maintained even after the end of the net asset purchases. At the same time, uncertainties related to geopolitical factors, the threat of protectionism, vulnerabilities in emerging markets and financial market volatility remain prominent. Therefore, significant monetary policy stimulus is still needed to support the further build-up of domestic price pressures and headline inflation developments over the medium term. The Governing Council's forward guidance on the key ECB interest rates, reinforced by the reinvestments of the sizeable stock of acquired assets, continues to provide the necessary degree of monetary accommodation for the sustained convergence of inflation to its aim. In any event, the Governing Council stands ready to adjust all of its instruments, as appropriate, to ensure that inflation continues to move towards its inflation aim in a sustained manner. Real GDP growth increased by 0.2%, quarter on quarter, in the third quarter of 2018, following growth of 0.4% in the previous two quarters. The latest data and survey results have been weaker than expected, reflecting a diminishing contribution from external demand and some country and sector-specific factors. While some of these factors are likely to unwind, this may suggest some slower growth momentum ahead. At the same time, domestic demand, also backed by the Governing Council's accommodative monetary policy stance, continues to underpin the economic expansion in the euro area. The strength of the labour market, as reflected in ongoing employment gains and rising wages, still supports private consumption. Moreover, business investment is benefiting from domestic demand, favourable financing conditions and improving balance sheets. Residential investment remains robust. In addition, the expansion in global activity is still expected to continue, supporting euro area exports, although at a slower pace. The euro area foresees annual real GDP increasing by 1.9% in 2018, 1.7% in 2019, 1.7% in 2020 and 1.5% in 2021. Euro area flash estimate annual HICP inflation declined to 2.0% in November 2018, from 2.2% in October. On the basis of current futures prices for oil, headline inflation is likely to decrease over the coming months. Measures of underlying inflation remain generally muted, but domestic cost pressures are continuing to strengthen and broaden amid high levels of capacity utilisation and tightening labour markets, which is pushing up wage growth. Looking ahead, underlying inflation is expected to increase over the medium term, supported by the ECB's monetary policy measures, the ongoing economic expansion and rising wage growth. The euro area foresees annual HICP inflation at 1.8% in 2018, 1.6% in 2019, 1.7% in 2020 and 1.8% in 2021. HICP inflation excluding energy and food is is expected to rise from 1.0% in 2018 to 1.4% in 2019, 1.6% in 2020 and 1.8% in 2021. The euro area general government budget deficit is projected to have declined significantly in 2018 but to increase somewhat next year. The fall in 2018 was mainly the result of favourable cyclical conditions and declining interest payments. The aggregate fiscal stance for the euro area is expected to be broadly neutral in 2018, to loosen in 2019 and 2020, and to turn neutral again in 2021. The euro area unemployment rate stood at 8.1% in October, unchanged from the third quarter of 2018, and remains at the lowest level seen since November 2008. Survey indicators have moderated somewhat from very high levels, but still point to continued employment growth in the fourth quarter of 2018. While indicators of labour shortages have moderated slightly in some sectors and countries, they remain at historically very high levels. Private consumption rose by 0.1%, quarter on quarter, in the third quarter of 2018, following somewhat stronger growth in the second quarter. Retail trade displayed zero growth in the third quarter of 2018. Moreover, new passenger car registrations in October were more than 16.0% below the level recorded in the third quarter. However, these data are currently difficult to interpret owing to the temporary bottlenecks in car production and sales. While crude oil prices are still far below the peaks recorded in 2012, they have been volatile recently, giving rise to heightened uncertainty about households' purchasing power. From a longer-term perspective, increasing labour income continues to support the solid underlying momentum in consumer spending. In addition, the strengthening of households' balance sheets remains an important factor behind steady consumption growth, particularly as households' creditworthiness is a key determinant of their access to credit.

United States: At its meeting on 19 December 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 2.25% to 2.50%. The labor market has continued to strengthen and economic activity has been rising at a strong rate. Job gains have been strong, on average, in recent months, and the unemployment rate has remained low. Household spending has continued to grow strongly, while growth of business fixed investment has moderated from its rapid pace earlier in the year. On a 12-month basis, both overall inflation and inflation for items other than food and energy remain near 2.0%. Indicators of longer-term inflation expectations are little changed, on balance. The median of Committee participants' projections for the growth of real GDP is 3.0% in 2018 and 2.5% in 2019. With growth remaining next year above its longer-run normal value, the economy has been adding jobs at a pace that will continue bringing the unemployment rate down over time. Wages have moved up for workers across a wide range of occupations—a welcome development. The unemployment rate is projected to fall a bit further, to 3.5% by the end of 2019. Inflation in the median projection remains near 2.0%. Over the next year, if events play out broadly as expected, the federal funds rate will be in a range in which judgments of people both inside and outside the Fed will sometimes differ regarding whether the stance of policy is modestly accommodative, neutral, or modestly restrictive. When rates are in this range, the FOMC makes policy in light of the array of diverse views on the Committee. According to FOMC, actual policy will, as always, be adjusted as incoming data shed light on the state of the economy, the outlook, and the changing balance of risks. Neither the pace nor the ultimate destination of any further rate increases is predetermined. FOMC will adjust monetary policy as best they can to keep the expansion on track, the labor market strong, and inflation near 2.0%. The committee knows that its policy decisions affect all American families and businesses, and it'll continue to make its decisions objectively and based solely on the best information and analysis. So there's a fairly high degree of uncertainty about both the path and the ultimate destination of any further increases. The projections about the appropriate path of policy assume that the economy evolves broadly in line with the projections for growth, employment, unemployment, and inflation. If the economy were instead to falter, lower interest rates would be appropriate. Conversely, if inflationary pressures were to rise more than expected, higher interest rates would be appropriate. Right now the economic outlook appear roughly balanced.

United Kingdom: At its meeting ending on 19 December 2018, the Monetary Policy Committee (MPC) sets monetary policy to meet the 2.0% inflation target, and in a way that helps to sustain growth and employment. The MPC voted unanimously to maintain Bank Rate at 0.75%. 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. Since the MPC's previous meeting, the near-term outlook for global growth has softened and downside risks to growth have increased. Global financial conditions have tightened noticeably, particularly in corporate credit markets. Oil prices have fallen significantly, however, which should provide some support to demand in advanced economies. The decline in oil prices also means that UK CPI inflation is likely to fall below 2.0% in coming months. The Committee judges that the loosening of fiscal policy in *Budget 2018*, announced after the November *Inflation* Report projections were finalised, will boost UK GDP by the end of the MPC's forecast period by around 0.3%, all else equal. GDP growth in 2018 Q3 had been 0.6%, in line with expectations at the time of the November Inflation Report. GDP growth had slowed to 0.4% in the three months to October, with monthly growth of 0.1% following two months of flat output. The slowing in growth was apparent in services, particularly in the distribution sector, and in manufacturing output. Twelve-month CPI inflation had fallen to 2.3% in November, slightly lower than expected at the time of the November Inflation Report. Household consumption was estimated to have risen by 0.5% in 2018 Q3, slightly stronger than had been expected in the November Report. There were signs, however, that retail spending growth might fall in Q4. Retail sales volumes had grown by 1.2% in Q3 but fell by 0.5%, on the month, in October. Persistent job market tightness was likely to be a key driver of the recent strengthening in labour cost growth. Employment had increased by 79,000 in the three months to October. The unemployment rate had remained at 4.1% in the three months to October, in line with Bank staff expectations immediately prior to the release, but slightly higher than expected in the November Report. Since the Committee's previous meeting, Brexit uncertainties had intensified. Judging the appropriate stance of monetary policy required separating these shorter-term developments from the dynamics of the economy once more clarity emerged about EU withdrawal and from other more persistent factors affecting inflation. The Committee considered each in turn. The MPC had judged in November that, were the economy to develop broadly in line with its Inflation Report projections, an ongoing tightening of monetary policy over the forecast period, at a gradual pace and to a limited extent, would be appropriate to return inflation sustainably to the 2% target at a conventional horizon. The MPC judged at this month's meeting that the current stance of monetary policy was appropriate.

Japan: Activity is expected to rebound in the near term, but the pace of the economic expansion is projected to decelerate gradually thereafter. The adverse impact of a series of natural disasters weighed on activity in the third quarter of 2018, although growth is expected to recover in the fourth quarter. Looking ahead, activity will benefit from accommodative monetary policy, but increasingly binding capacity constraints are expected to weigh on growth. Wages are rising moderately, amid a tight labour market, which should support household spending.

China: Activity has remained strong, supported by solid consumption, government policy support and robust exports, possibly due in part to frontloading of orders in anticipation of higher tariffs. However, in the near term a slowing housing market and the lagged effects of earlier deleveraging efforts should weigh on growth. Also, new trade tariffs implemented by the US Administration are expected to adversely impact activity. Their overall effect in China is assumed to be relatively contained, though, owing to the recently enacted policy stimulus measures. Over the medium term, progress on the implementation of structural reforms is expected to result in an orderly slowdown and some rebalancing of the Chinese economy.

Energy News: Before the recent fall in oil prices, past increases put some upward pressure on global consumer price inflation. Annual consumer price index inflation in the countries of the Organisation for Economic Co-operation and Development (OECD) rose to 3.1% in October. Excluding food and energy, inflation was unchanged at 2.3%, pausing on a very moderate upward trend observed over the past year (Chart 3). At the same time, despite tightening labour markets across advanced economies, wage pressures remain relatively subdued.

CYPRUS ECONOMY AND MAJOR DEVELOPMENTS

- Real GDP growth rate (seasonally adjusted) is positive and is estimated at 3.7% in the third quarter of 2018. It recorded a positive rate of growth of 4.0% in the second quarter of 2018. Growth is expected to reach 4.2% in 2018 and 4.1% in 2019 (IMF's December projections). Unemployment decreased to 8.5% in October 2018 compared to 10.0% in October 2017. It is expected to average at around 8.5% in 2018 and 7.0% in 2019 (IMF's December projections). Inflation (HICP) increased by 1.6% in November 2018 compared to November 2017, while compared to October 2018 decreased by 1.5%. For the period January – November 2018, HICP recorded an increase of 0.8% compared to the correspondent period of the previous year. HICP is expected to be around 0.9% in 2018 and 1.8% in 2019 (IMF's December projections). In November 2018, deposits amounted to €47.5 billion, compared to €47.8 billion in October 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	1.8	1.9	6.9	3.9
Forecasted Real GDP (year-on-year 2018-2017 %)	1.9	2.9	1.3	0.8	6.6	4.2
Forecasted Real GDP (year-on-year 2019-2018 %)	1.6	2.5	1.5	0.9	6.2	4.1
Forecasted Unemployment 2018 (%)	8.2	3.9	4.1	2.4	4.0	8.5
Forecasted Inflation 2018 (%)	1.7	2.5	2.5	1.0	2.1	0.9

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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