ECONOMIC BULLETIN

Publication December 2016

DEVELOPMENTS IN THE WORLD ECONOMY

Global activity has improved in the second half of this year and is expected to continue strengthening, although remaining below its pre-crisis pace. Data released in the past few months suggest relatively stable expansion in advanced economies and a slight improvement in emerging market economies. Global inflation is still dampened by the effects of past oil price declines and the abundant global spare capacity is expected to weigh on underlying inflation over the medium term. The global outlook continues to be overshadowed by several factors, including the adverse effect of low commodity prices on commodity-exporting countries, the gradual rebalancing of the Chinese economy, and growing policy uncertainty in the United States.

Europe: At its monetary policy meeting on 8 December 2016, based on the regular economic and monetary analyses, the Governing Council conducted a comprehensive assessment of the economic and inflation outlook and the monetary policy stance. The assessment confirmed the need to extend the asset purchase programme beyond March 2017 to preserve the very substantial amount of monetary support that is necessary to secure a sustained convergence of inflation rates towards levels below, but close to, 2% over the medium term. The Eurosystem will continue to make purchases under the asset purchase programme (APP) at the current monthly pace of €80 billion until the end of March 2017. From April 2017, net asset purchases are intended to continue at a monthly pace of €60 billion until the end of December 2017, or beyond, if necessary. The key ECB interest rates were kept unchanged and the Governing Council continues to expect them to remain at present or lower levels for an extended period of time, and well past the horizon of net asset purchases. The economic recovery in the euro area is continuing. Euro area real GDP increased by 0.30%, quarter-on-quarter in the third quarter of 2016, following similar growth in the second quarter. Incoming data point to a-continuation of the growth trend in the fourth quarter of 2016. Looking further ahead, the Governing Council expects the economic expansion to proceed at a moderate but firming pace. The pass-through of the ECB’s monetary policy measures to the real economy is supporting domestic demand and has facilitated deleveraging. Improvements in corporate profitability and very favourable financing conditions continue to promote a recovery in investment. The effects of the ECB’s monetary policy measures continue to support growth in money and credit. Banks have been passing on their favourable funding conditions, leading to lower lending rates and improved credit supply, thereby contributing to the gradual recovery in loan dynamics. Moreover, sustained employment gains, which are also benefiting from past structural reforms, provide support for households’ real disposable income and private consumption. At the same time, there are indications of a somewhat stronger global recovery. However, economic growth in the euro area is expected to be dampened by a sluggish pace of implementation of structural reforms and remaining balance sheet adjustments in a number of sectors. Regarding inflation, on the basis of current oil futures prices, headline inflation rates are likely to pick up significantly further at the turn of the year, to rates above 1%, mainly owing to base effects in the annual rate of change of energy prices. Supported by the ECB’s monetary policy measures aiding economic recovery, inflation rates should increase further in 2018 and 2019. The December 2016 Eurosystem staff macroeconomic projections for the euro area foresee annual Harmonised Index of Consumer Prices (HICP) inflation at 0.20% in 2016, 1.30% in 2017, 1.50% in 2018 and 1.70% in 2019.

United States: At its meeting on 14 December 2016 the Federal Open Market Committee decided to raise the target range for the federal funds rate by 25 bps, bringing it to 0.50% to 0.75%. In doing so, the Committee recognises the considerable progress the economy has made toward the dual objectives of maximum employment and price stability. The unemployment rate fell to 4.60 % in November, the lowest level since 2007, prior to the recession. The Committee’s projection for real GDP growth is 1.90% for 2016, 2.10% for 2017 and close to 2% for 2018 and 2019. Turning to inflation, the 12-month change in the price index for personal consumption expenditures was nearly 1.50% in October, still short of the 2% objective but up more than a percentage point from a year earlier. Core inflation - which excludes energy and food prices that tend to be more volatile than other prices - has risen to 1.75%. As the transitory influences of earlier declines in energy prices and prices of imports continue to fade and as the job market strengthens further, the Committee expects overall inflation to rise to 2% over the next couple of years. The committee’s median projection for the federal funds rate is 1.40% by the end of 2017, 2.10% by the end of 2018, and 2.90% by the end of 2019.

United Kingdom: At its meeting ending on 14 December 2016 the Bank of England's Monetary Policy Committee (MPC) voted unanimously to maintain Bank Rate at 0.25%. The Committee voted unanimously to continue with the programme of sterling non-financial investment-grade corporate bond purchases totalling up to £10 billion, financed by the issuance of central bank reserves. The Committee also voted unanimously to continue with the programme of £60 billion of UK government bond purchases to take the total stock of these purchases to £435 billion, financed by the issuance of central bank reserves. Output was expected to grow at a moderate pace in the near term, but slow from the beginning of next year. In part that reflected the likelihood that household real income growth would slow and hence weaken household spending. It also reflected uncertainty over future trading arrangements, and the risk that UK-based firms' access to EU markets could be materially reduced, which could restrain business activity and supply growth over a protracted period. The timing and extent of this slowing will depend crucially on the evolution of wages and how resilient household spending is to the pressure on real incomes from higher inflation. Twelve-month CPI inflation stood at 1.20% in November, up from 0.90% in October and 1.00% in September. Looking forward, the MPC expects inflation to rise to the 2% target within six months. The unemployment rate was projected to rise to around 5.50% by the middle of 2018 and to stay at around that level throughout 2019. The Committee noted that the path of monetary policy following the referendum on EU membership would depend on the evolution of the prospects for demand, supply, the exchange rate, and therefore inflation.

Japan: In Japan, although real GDP grew at a robust pace in the third quarter, underlying economic activity continues to advance modestly. Headwinds from soft foreign demand and weak private consumption prevail. Looking ahead, accommodative financial conditions and positive corporate profits should spur investment. Exports are expected to pick up gradually as foreign demand increases despite the past appreciation of the yen. By contrast, private consumption is expected to continue at a modest pace. Fiscal stimulus measures are expected to support domestic demand over the next few years.

China: China's growth stabilised in the third quarter of the year, supported by strong consumption and infrastructure spending. While the near-term outlook is dominated by the extent of the policy stimulus, economic growth is expected to remain on a gradual downward trend in the medium term. Investment growth will continue to moderate as overcapacity is gradually cut back. Consumption is foreseen to be the main driver of growth.

Energy News: On 30 November 2016, the Organization of the Petroleum Exporting Countries (OPEC) set the terms for reintroducing an oil production target of 32.5 million barrels per day. The agreement involves a cut in output of 1.2 million barrels per day, to be implemented through a uniform 4.50% reduction of each member's supply, from January to June 2017. The agreement to reduce the supply of oil may be extended to the end of 2017. The global supply will be curbed by 1.90%, which compares with its 2.60% growth over the period 2015-16. Following the agreement, the Brent oil price soared, rising from USD 46 on 29 November, to USD 56 on 27 December.

CYPRUS ECONOMY AND MAJOR DEVELOPMENTS

Cyprus' Real GDP growth rate is expected to grow by 2.80% in 2016 and by 2.20% in 2017 (IMF's October projections). The actual growth during Q1, Q2 and Q3 2016 was 2.60%, 2.80% and 2.90% respectively. Unemployment is at 12% in October 2016 (2016 IMF projection at 13.0%). Inflation (HICP) for November 2016 was -0.80% and -1.00% in October 2016 (2016 IMF projection at -1%). Deposits in the banking system are on an upward trend during the recent months. They recorded an increase of €0.6 billion in October 2016, reaching the amount of €48.3 billion.

Main Economic Indicators

Period: Third Quarter of 2016					
	Eurozone	***United States***	***United Kingdom***	***Japan***	***Cyprus***
Real GDP (year-on-year 2015-2014 %)	2.00	2.60	2.20	1.20	1.50
Forecasted Real GDP (year-on-year 2016-2015 %)	1.60	1.60	2.00	0.90	2.80
Forecasted Real GDP (year-on-year 2017-2016 %)	1.40	2.20	1.20	1.00	2.20
Real GDP (3rd quarter 2016 compared to 3rd quarter 2015 %)	1.70	1.70	2.20	1.10	2.90
Unemployment (%), October 2016	10.10	4.60	4.80	3.00	12.00 (*)
Inflation (3rd quarter 2016 compared to 3rd quarter 2015 %)	0.30	1.10	0.70	-0.50	-1.40

** Data for October 2016*

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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