ECONOMIC BULLETIN

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DEVELOPMENTS IN THE WORLD ECONOMY

The subdued global growth recorded towards the end of last year persisted into the first quarter of 2016. Looking ahead, global activity is expected to continue to expand at a moderate pace. Low interest rates, improving labour market conditions and growing confidence support the outlook for advanced economies. By contrast, the geopolitical risks from the UK's referendum decision to exit the EU create considerable uncertainty on the impact that will have on global economic growth.

Europe: At its monetary policy meeting on 2 June 2016, the Governing Council decided to keep the key ECB interest rates unchanged and continued to expect these rates to remain at present or lower levels for an extended period of time, and well past the horizon of the Eurosystem's net asset purchases in order to secure a return of inflation rates to levels below, but close to 2%. Regarding nonstandard monetary policy measures, the Governing Council confirmed that the monthly asset purchases of €80 billion are intended to run until the end of March 2017, or beyond, if necessary. The ECB's measures continue to ease the cost of credit and contribute to a strengthening in credit creation. The economic recovery in the euro area is proceeding gradually. Additional monetary stimulus is expected from the monetary policy measures which are still to be implemented, namely the corporate sector purchase programme and the new series of targeted longer-term refinancing operations. Euro area real GDP increased significantly in the first quarter of 2016. Growth continues to be supported by domestic demand, while being dampened by weak exports. The latest data point to ongoing growth in the second quarter, though possibly at a lower rate than in the first quarter. Domestic demand remains supported by the pass-through of the monetary policy measures to the real economy. Favourable financing conditions and improvements in corporate profitability continue to promote investment. Moreover, sustained employment gains, which are also benefiting from past structural reforms, and still relatively low oil prices provide additional support for households' real disposable income and private consumption. However, the economic recovery in the euro area continues to be dampened by subdued growth prospects in emerging markets, the necessary balance sheet adjustments in a number of sectors and a sluggish pace of implementation of structural reforms. The June 2016 Eurosystem staff macroeconomic projections for the euro area foresee annual real GDP to increase by 1.60% in 2016 and 1.70% in 2017 and 2018. Regarding inflation, euro area annual Harmonised Index of Consumer Prices (HICP) in May 2016 was -0.10%. This low level of inflation reflects past falls in energy prices. Looking ahead, inflation rates are likely to remain very low or negative in the next few months before picking up in the second half of 2016, in large part owing to energy prices. The June 2016 macroeconomic projections foresee annual HICP inflation at 0.20% in 2016, 1.30% in 2017 and 1.60% in 2018. The UK's referendum result on 23 June of exiting the EU creates substantial uncertainty regarding the economic consequences both for the UK but also for the EU and more specifically on the impact that will have on economic growth.

United States: At its meeting on 16 June 2016, the Federal Open Market Committee (FOMC) decided to leave the target range for the federal funds rate to 0.25% - 0.50%. The Committee currently expects that economic activity will expand at a moderate pace and labour market indicators will strengthen. Inflation is expected to remain low in the near term, in part because of earlier declines in energy prices, but to rise to 2% over the medium term as the transitory effects of past declines in energy and import prices dissipate and the labour market strengthens further. Labour market conditions clearly continued to strengthen during the early months of this year. Payrolls expanded at a solid pace of almost 200,000 per month in the first quarter, and while the unemployment rate flattened out at close to 5%, the labour force participation rate moved up strongly. The unemployment rate dropped in May to 4.70%, its lowest level since late 2007, however the pace of improvement has slowed. Whether those signs of slowing will be confirmed by subsequent data, and how persistent any such slowing will be, remains to be seen. The projection for real GDP growth is 2% in 2015 and in 2016. Inflation is projected at 1.70% in 2016, rising to 1.90% in 2017 and reaching 2.00% in 2018.

United Kingdom: On 23 June 2016 the UK electorate voted in favour of exiting the EU by a margin of 51.9% to 48.1%. Prime Minister David Cameron announced that he will step down by October. Attention now is placed on the government succession because it will determine how the negotiations with the EU will be handled and the implementation of the exit process. The Bank of England announced that it will continue to provide liquidity to the market, promising to inject up to £250bn in order to stabilize the negative effects on the economy. The EU treaty provides for a maximum period of two years for a country to complete the exit negotiation process during which the existing EU regulations will continue to apply. The exact effects of the UK referendum decision on the UK economy (both short-term and long-term) remain to be seen.

At its meeting ending on 15 June 2016 the Monetary Policy Committee (MPC) voted unanimously to maintain Bank Rate at 0.50%. The Committee also voted unanimously to maintain the stock of purchased assets financed by the issuance of central bank reserves at £375 billion. Twelve-month CPI inflation was 0.30% in May and remains well below the 2% inflation target. This shortfall is due predominantly to unusually large drags from energy and food prices, which are expected to reduce over the next year. Activity growth slowed in Q1 and a further deceleration is expected in Q2. There are increasing signs that uncertainty associated with the EU referendum has begun to weigh on activity. In the Committee's latest projections, activity growth recovers later in the year. However, the May projection was conditioned on the continued UK membership to the European Union.

Japan: Following the decline in activity in the final quarter of 2015, GDP rebounded in the first quarter of this year. Looking ahead, activity should benefit from accommodative monetary policy and the boost to incomes from lower oil prices. A gradual rise in real wages, reflecting the tightening labour market, should also support household spending. Exports are expected to benefit from gradually improving foreign demand, but this will be tempered by the recent rebound of the yen. Moreover, fiscal consolidation will weigh on demand.

China: The Chinese economy is expected to slow in the medium term. Activity continues to be supported by low oil prices, robust consumption and a marked improvement in the housing market. Greater stability in financial markets and the renminbi exchange rate have helped to alleviate some of the uncertainty, which was particularly high at the start of the year. In the near term, monetary accommodation and fiscal stimulus is expected to provide some support for the economy. In the medium term, however, increasing emphasis on reducing overcapacity in some heavy industries and dealing with the related non-performing loans are expected to slow the pace of expansion.

Energy News: Oil prices have fallen sharply since mid-2014 and reached a ten-year low in early 2016. From their peak in June 2014 to the trough in January 2016, Brent crude oil prices dropped by USD 82 per barrel (70%). Since then, they have recovered modestly by around USD 17 per barrel and, based on oil futures contracts, are expected to rise only gradually in the medium term. The drivers of the recent oil price decline have changed over time. While most of the oil price decline in 2014 could be explained by the significant increase in the supply of oil, more recently the lower price has reflected weaker global demand. However, a more demand-driven oil price fall since the second half of 2015 suggests a less positive impact on the global economy. Although the low oil price may still support domestic demand through rising real incomes in net oil-importing countries, it would not necessarily offset the broader effects of weaker global demand. Brent crude oil spot prices on 28 June stood at $48/barrel, while the one-year futures contract price for June 2017 at around $51/barrel.

CYPRUS ECONOMY AND MAJOR DEVELOPMENTS

Troika's economic adjustment programme for Cyprus ended on 31 March 2016. The GDP growth rate in real terms during the first quarter of 2016 was 2.60% over the corresponding quarter of 2015. The increase of the GDP growth rate is mainly attributed to the sectors of tourism and professional services. Inflation for May 2016 was -1.90% and -2.10% in April 2016. The rate of unemployment stood at 11.60% in April 2016. Cyprus's major challenges include: the public administration wage bill legislation (a legislation that is pending for approval by Parliament) and the privatization of the Cyprus Telecommunications Authority (CYTA) which will have a positive impact on the country's high public debt. In addition, major challenges are the reduction of the banks' high Non-Performing Loans and the effective management of the potential economic impacts of the UK's decision to leave the EU.

Main Economic Indicators

Period: First Quarter of 2016					
	Eurozone	***United States***	***United Kingdom***	***Japan***	***Cyprus***
Real GDP (year-on-year 2015-2014 %)	1.70	2.40	2.30	0.60	1.60
Forecasted Real GDP (year-on-year 2016-2015 %)	1.60	1.90	1.80	0.60	1.50
Forecasted Real GDP (year-on-year 2017-2016 %)	1.60	2.30	2.10	0.80	2.00
Real GDP (1st quarter 2016 compared to 1st quarter 2015 %)	1.70	2.00	2.10	1.90	2.60
Unemployment (%), March 2016	10.20	4.70	5.10	3.20	11.60 (*)
Inflation (1st quarter 2016 compared to 1st quarter 2015 %)	0.00	1.10	0.40	0.10	-2.00

** Data for April 2016*

Sources:

1) *European Central Bank 2) Bank of England 3) Federal Reserve 4) Statistical Service of Cyprus (CYSTAT) 5) Bloomberg Statistics, 6) IMF*

USB BANK PLC

Treasury & Correspondent Banking   P.O. Box 28510, 2080 Nicosia, Cyprus   Telephone 22883344