ECONOMIC BULLETIN

Publication September 2011

DEVELOPMENTS IN THE WORLD ECONOMY

Global economic activity has lost momentum in recent months, as evidenced by the decline in sentiment indicators. Transitory factors such as the supply-chain disruptions following the Great East Japan Earthquake as well as high commodity prices appear to have contributed to the moderation in global activity. In addition, in many advanced economies medium-term growth continues to hold back compared with earlier post recession recoveries. This contrasts with continued robust growth in most emerging economies. Headline inflation in advanced economies has stabilised, while price pressures continue to be more pronounced in emerging economies.

Europe: At its meeting on 8 September 2011 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 1.50%, 2.25% and 0.75% respectively. Euro area real GDP growth decelerated to 0.20% quarter-on-quarter in the second quarter of 2011, after 0.80% in the first quarter. A number of developments seem to dampen the underlying momentum in the euro area, including a moderation in the pace of global growth, related declines in equity prices and in business confidence, and unfavourable effects resulting from ongoing tensions in a number of euro area sovereign debt markets. As a consequence, real GDP growth is expected to increase very moderately in the second half of this year. ECB macroeconomic projections foresee annual real GDP growth in a range between 1.40% and 1.80% in 2011 and between 0.40% and 2.20% in 2012. Downside risks mainly relate to the ongoing tensions in some segments of the financial markets in the euro area and at the global level, as well as to the potential for these pressures to spill over into the euro area real economy. With regard to price developments, annual HICP inflation was 2.50% in August 2011, unchanged from July, with high energy and other commodity prices as the main drivers. Looking ahead, inflation rates are likely to stay clearly above 2% over the coming months. Turning to fiscal policies, a number of governments have announced additional measures to ensure the achievement of their consolidation targets. To ensure credibility, it is now crucial that the announced measures be frontloaded and implemented in full. Fiscal consolidation and structural reforms must go hand in hand to strengthen confidence, growth prospects and job creation. This will help these countries to strengthen competitiveness, increase the flexibility of their economies and enhance their longer-term growth potential. In this respect, labour market reforms are key, with a focus on the removal of rigidities and the implementation of measures which enhance wage flexibility. These measures should be accompanied by structural reforms that increase competition in product markets, particularly in services and, where appropriate, the privatisation of services currently provided by the public sector, thereby facilitating productivity growth and supporting competitiveness.

Greece: On 21 July 2011 the Eurozone leaders agreed a new rescue package for Greece. The package included a new loan of €109 billion from the European Union and the IMF. Both the new loan and the previous loan of €110 billion will have a new maturity that could extend to 30 years and a new interest rate of 3.50% compared to the existing rate of 4.50%. It was also agreed that there will be a high involvement of the European Financial Stability Facility (EFSF) by being able to use part of its €440 billion funds to purchase bonds from the primary and secondary markets. A Private Investors' Participation plan was also decided, asking from financial institutions on a voluntary basis to swap their bonds with new ones of longer maturities up to 30 years. Investors will be affected by a 21% write-down in the value of their bonds, being a step towards the sustainability of Greece's huge debt of 150% to GDP.

United States: On 9 August 2011 the US Federal Open Market Committee (FOMC) decided to maintain its target range for the federal funds rate at 0.0% to 0.25%. The FOMC continues to anticipate that economic conditions are likely to warrant exceptionally low levels for the federal funds rate for an extended period. At the end of June the Federal Reserve System completed its purchases of USD 600 billion of longer-term Treasury securities as planned, while maintaining its existing policy of reinvesting principal payments from its securities holdings. The economy continued its recovery in the first half of 2011, albeit at a slower pace than 2010. US real GDP increased at an annual rate of 1.30% in the second quarter of 2011. This followed annualised growth of 0.40% in the first quarter of the year, from earlier estimates of 1.90%. Weak economic developments and higher energy prices in the second quarter resulted in a slowdown in personal consumption expenditure. Weak developments in housing and labour markets, lower confidence and growing uncertainty surrounding the US fiscal outlook might have a more lasting impact, extending the moderation in economic momentum to the second half of the year. As regards price developments, annual CPI inflation remained at 3.60% in July, the same rate as in June. The increase in headline inflation since the start of the year continues to reflect the marked annual rise in energy prices of 20.1%.

United Kingdom: On 8 September 2011 the Bank of England's Monetary Policy Committee voted to maintain the official Bank Rate paid on commercial bank reserves at 0.50%. The Committee also voted to maintain the stock of asset purchases financed by the issuance of central bank reserves at £200 billion. GDP growth declined to 0.20% in the second quarter, from 0.50% in the previous quarter, on a quarter-on-quarter basis. Looking ahead, growth is likely to remain subdued in the short term, even though monetary stimuli should support economic activity. In the longer term, growth in domestic demand is still expected to remain constrained by tight credit conditions, household balance sheet adjustment and substantial fiscal tightening. Annual CPI inflation increased to 4.40% in July 2011 from 4.20% in June. Further price increases are expected by the Bank of England, which sees inflation peaking later this year at 5 percent before falling back towards its 2 percent target within the next two years. The strength of inflation reflects the effects of past increases in both the rate of VAT to 20% and the prices of energy and other imported goods and services.

Japan: The Japanese economy continued to show signs of recovery, with an easing of the supply-side constraints triggered by the Great East Japan Earthquake. Industrial production increased by 3.90% month-on-month in June, following growth of 6.20% in the previous month, implying that, thus far, industrial production has recovered almost 66% of the losses arising from the earthquake. Real exports of goods rose by 8.60% in June, after increasing by 4.60% in the previous month. Annual core CPI inflation remained at 0.10%. At its meeting on 6 September 2011, the Bank of Japan decided to keep its target for the uncollateralised overnight call rate unchanged at 0.0% to 0.1%.

Energy News: Brent crude oil prices stood at USD 110.6 per barrel on 12 September, which is 16% higher than at the beginning of the year and 5% lower than at the beginning of August. Looking ahead, market participants expect lower oil prices in the medium term, with futures contracts for December 2012 trading at around USD 107 per barrel.

CYPRUS ECONOMY

On 11 July a catastrophic explosion which occurred at the Electricity Authority of Cyprus' largest plant, wiped out 53 percent of the island's energy production. Before the explosion, the GDP growth rate in real terms during the second quarter of 2011 was estimated at 1.40% over the corresponding quarter of 2010. However, after the explosion, Cyprus' growth outlook is estimated to be close to zero for 2011 and 1% for 2012, mainly due to reduced power production (since electricity output is one of the components of GDP), but also due to serious business disruptions in the first months after the incident. Higher electricity costs imposed to consumers in order to finance the restoration of the electricity plant will also contribute to lower disposable income and thus lower demand and growth. The secondary sector of the economy (Construction, Manufacturing) continues to present negative growth rates, while positive growth rates are recorded in the sectors of Trade, Tourism, Banking and Services. The rate of increase of the Consumer Price Index for August 2011 dropped to 2.90% compared to 3.70% in July 2011 and 3.20% in August 2010. For the period January-August 2011, the CPI recorded an increase of 3.30% compared to the corresponding period of 2010. The registered unemployed persons in August 2011 reached 26.657 persons. Based on the seasonally adjusted data, the number of registered unemployed for August 2011 increased to 28.328 persons in comparison to 27.804 in the previous month. In comparison with August 2010, an increase of 4.292 persons or 19.20% was recorded which was mainly observed in the sectors of trade (an increase of 1.191 unemployed persons), construction (781), public administration (425), manufacturing (393), transportation and storage (267), accommodation and food service activities (165), as well as to newcomers in the labour market where an increase of 851 unemployed persons was recorded.

Main Economic Indicators

Period: Second Quarter of 2011					
	Europe	*United States*	*United Kingdom*	*Japan*	*Cyprus*
Real GDP (year on year 2010-2009 %)	1.80	3.00	1.30	3.98	1.00
Real GDP (2nd quarter 2011 compared to 2nd quarter 2010)	1.60	1.30	0.70	-1.30	1.40
Unemployment (%)	9.97	9.10	7.77	4.60	7.50
CPI (year on year %)	2.73	3.60	4.40	-0.40	3.30

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