

ECONOMIC BULLETIN

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DEVELOPMENTS IN THE WORLD ECONOMY

The world economy continues to grow at a slow pace. The global recovery lost momentum over the course of 2012 as confidence deteriorated. World trade weakened further as the slowdown in advanced economies spilled over into emerging markets. Subdued global growth dynamics are set to continue, as sentiment has shown signs of stabilization at low levels in the fourth quarter. Thereafter, global economic activity is expected to strengthen only gradually, with growth in the emerging economies expected to be more solid than in the advanced economies. Headline global inflation has been increasing in recent months, after having declined earlier in 2012, largely driven by energy prices.

Europe: Based on its regular economic and monetary analyses, the Governing Council decided at its meeting on 6 December to keep the key ECB interest rates unchanged. Owing to high energy prices and increases in indirect taxes in some euro area countries, inflation rates have been elevated for some time. As regards the economic analysis, following a contraction of 0.20%, quarter on quarter in the second quarter of 2012, euro area real GDP declined by 0.10% in the third quarter. Available statistics signal further weakness in activity in the last quarter of the year. Macroeconomic projections for the euro area foresee annual real GDP growth in a range between -0.60% and -0.40% for 2012, between -0.90% and 0.30% for 2013 and between 0.20% and 2.20% for 2014. Compared with the September 2012 the ranges for 2012 and 2013 have been revised downwards. The Governing Council continues to see downside risks to the economic outlook for the euro area. These are mainly related to uncertainties about the resolution of sovereign debt and governance issues in the euro area, geopolitical issues and fiscal policy decisions in the United States possibly dampening sentiment and delaying further the recovery of private investment, employment and consumption. Euro area annual Harmonised Index of Consumer Prices (HICP inflation) fell to 2.20% in November 2012, down from 2.50% in October. On the basis of current futures prices for oil, inflation rates are expected to decline further to below 2% next year. In an environment of weak economic activity in the euro area, underlying price pressures should remain moderate. This assessment is also reflected in the December 2012 macroeconomic projections for the euro area, which foresee annual HICP inflation of 2.50% for 2012, between 1.10% and 2.10% for 2013 and between 0.60% and 2.20% for 2014. In order to ensure an adequate transmission of monetary policy to the financing conditions in euro area countries, it is essential to continue strengthening the resilience of banks where needed. The soundness of banks' balance sheets will be a key factor in facilitating both an appropriate provision of credit to the economy and the normalisation of all funding channels. Decisive steps for establishing an integrated financial framework will help to accomplish this objective. A Single Supervisory Mechanism (SSM) is one of the main building blocks. It is a crucial move towards re-integrating the banking system.

United States: In the United States, real GDP growth accelerated in the third quarter of 2012. Real GDP increased at an annualised rate of 2.70% in the third quarter of 2012, up from 1.30% in the second quarter. Compared with the second quarter, the increase in growth was mainly led by positive contributions from personal consumption expenditure and by an upturn in government spending and inventory investment. Economic activity in the third quarter also benefited from the acceleration in residential private investment and a small positive contribution of net exports. On the other hand, non-residential private investment subtracted 0.20% from real GDP growth, more than previously estimated. Real disposable personal income growth was modest, leading to a drop in the personal saving rate. Excluding food and energy, annual CPI inflation was stable at 2%. Looking ahead, annual inflation is expected to remain above 2% in the near term, as a result of higher energy prices. On the other hand, considerable slack in product and labour markets is expected to continue to limit upward price pressures. At its meeting on 12 December the Federal Open Market Committee (FOMC) stated that economic activity had continued to expand at a moderate pace, while employment growth had been slow and the unemployment rate had remained elevated. The FOMC decided to continue purchasing additional agency mortgage-backed securities at a pace of USD 40 billion per month, as announced in September. It also announced that it would continue with its programme to extend the average maturity of its holdings of securities until the end of the year initially at a pace of \$45 billion per month, as well as with its existing policy of reinvesting principal payments from its holding of agency debt and agency mortgage backed securities. The FOMC also decided to keep the target range for the federal funds rate at 0% to 0.25% and anticipated that exceptionally low levels for the federal funds rate were likely to be warranted until at least mid-2015.

United Kingdom: At its meeting on 6 December, the Bank of England's Monetary Policy Committee maintained the policy rate at 0.50% and the size of its asset purchase programme at GBP 375 billion. In the third quarter of 2012 real GDP growth increased by 1%, quarter on quarter driven mainly by gains in private consumption and exports. Annual CPI inflation increased to 2.70% in October, from 2.20% in September. The unemployment rate dropped by 0.10 percentage

point to 7.80% in the three months to September 2012. Looking ahead, the economic recovery is likely to gather pace only very gradually, as domestic demand is expected to be constrained by tight credit conditions, ongoing household balance sheet adjustment, substantial fiscal tightening, and subdued foreign demand.

Japan: In Japan, real GDP contracted by 0.90%, quarter on quarter, in the third quarter of 2012, having increased by 0.30% in the previous quarter. Major drags on the economy originated from a sharp drop in exports, as well as a decline in private business investment and private consumption. The weakness of exports, together with an increase in imports, was also reflected in the current account, which turned to a deficit in September for the first time since the beginning of the series in 1985. At its latest monetary policy meeting on 19 December, the Bank of Japan decided to maintain its target for the uncollateralised overnight call rate at around 0% to 0.10%.

Energy News: Oil prices have been trading in a range of USD 106-116 per barrel since early October, after recovering during the third quarter of 2012 from lows reached in June 2012. Brent crude oil prices stood at USD 111.11 per barrel on 31 December, which is 4% higher than at the beginning of 2012, but 7% below this year's peak of USD 120.11 reached in March. Looking ahead, market participants expect somewhat lower oil prices over the medium term, with futures contracts for December 2013 trading at USD 104 per barrel.

CYPRUS ECONOMY

The GDP growth rate in real terms during the third quarter of 2012 is negative and estimated at -2% over the corresponding quarter of 2011. Based on seasonally and working day adjusted data, GDP growth rate in real terms is estimated at -2.10%. Negative growth rates were recorded by the secondary sector of the economy (Construction, Manufacturing), as well as in the sectors of Trade, Transport and Services (Public Administration, Recreational and Cultural Activities). Positive growth rates were presented by the sectors of Tourism and Legal & Accounting Activities. The rate of increase of the Consumer Price Index (CPI), and therefore the rate of inflation for November 2012 dropped to 1.20% compared to 1.70% in October 2012 and 3.80% in November 2011. Decreases have been recorded in the prices of petroleum products. For the period January-November 2012, the CPI recorded an increase of 2.50% compared to the corresponding period of 2011. Based on the seasonally adjusted data that shows the trend of unemployment, the number of registered unemployed for November 2012 decreased to 39,105 persons compared to 39,241 in the previous month. In comparison with November 2011, an increase of 7,696 persons or 24.2% was recorded which was mainly observed in the sectors of trade (an increase of 1,625 unemployed persons), construction (an increase of 1,343), accommodation and food service activities (an increase of 1,148), manufacturing (an increase of 792), public administration (an increase of 626), as well as to newcomers in the labour market where an increase of 512 unemployed persons was recorded. The Cyprus Government is currently under negotiations with the Troika (the European Union, the International Monetary Fund and the European Central Bank) to sign a Memorandum of Understanding for recapitalizing the Cypriot Banks and refinancing the Public Debt. The Memorandum includes proposals that aim at correcting long-term structural problems of the Cypriot economy but also austerity measures that aim to reduce the public deficit and debt.

Main Economic Indicators

Period: Third Quarter of 2012					
	<i>Europe</i>	<i>United States</i>	<i>United Kingdom</i>	<i>Japan</i>	<i>Cyprus</i>
<i>Real GDP (year-on-year 2011-2010 %)</i>	1.50	1.70	0.68	-0.78	0.50
<i>Estimated Real GDP (year-on-year 2012-2011 %)</i>	-0.40	2.20	-0.10	1.70	-2.10
<i>Real GDP (3rd quarter 2012 compared to 3rd quarter 2011 %)</i>	-0.60	3.10	0.00	-3.50	-2.00
<i>Unemployment (%)</i>	11.53	8.07	7.93	4.23	12.20
<i>CPI (year-on-year %)</i>	2.53	1.70	2.43	-0.37	2.50

Sources:

- 1) *European Central Bank*
- 2) *Statistical Service of Cyprus (CYSTAT)*
- 3) *Bloomberg Statistics*

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