

ECONOMIC BULLETIN

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DEVELOPMENTS IN THE WORLD ECONOMY

The world economy is continuing gradually along its path to recovery. Following rather subdued growth at the start of the year, momentum in some advanced economies has been firming up. The latest survey indicators point to some softening in growth momentum in the fourth quarter. Geopolitical risks in Ukraine/Russia and the Middle East remain elevated, although so far with limited repercussions on global activity and energy prices. Global trade remained weak in view of sluggish investment in many countries, but recovered in the third quarter. Global inflation has declined in recent months, largely on the back of sharply falling oil prices. Inflationary pressures are expected to remain low in an environment of overcapacity and declining commodity prices.

Europe: The Governing Council decided at its meeting on 4 December 2014 to keep the key ECB interest rates unchanged. As regards the non-standard monetary policy measures, the Eurosystem has started purchasing covered bonds and asset-backed securities. These purchase programmes will last for at least two years. Taken together, the measures will have a sizeable impact on the Eurosystem's balance sheet, which is intended to move towards the dimensions it had at the beginning of 2012. In this context, early next year the Governing Council will reassess the monetary stimulus achieved, the expansion of the balance sheet and the outlook for price developments. It will also evaluate the broader impact of recent oil price developments on medium-term inflation trends in the euro area. Should it become necessary to further address risks of too prolonged a period of low inflation, the Governing Council remains unanimous in its commitment to using additional unconventional instruments within its mandate. This would imply altering early next year the size, pace and composition of the measures. All of the monetary policy measures are geared towards keeping in line with the Governing Council's aim of achieving inflation rates below, but close to, 2%. Regarding the economic analysis, real GDP in the euro area rose by 0.20%, quarter-on-quarter, in the third quarter of this year. This was in line with earlier indications of a weakening in the euro area's growth momentum, leading to a downward revision of the outlook for euro area real GDP growth in the most recent forecasts. Macroeconomic projections for the euro area foresee annual real GDP increasing by 0.80% in 2014, 1.00% in 2015 and 1.50% in 2016. Compared with previous projections, these have been revised substantially downwards. Downward revisions were made to the projections for both domestic demand and net exports. The risks surrounding the economic outlook for the euro area are on the downside. In particular, the weak euro area growth momentum, alongside high geopolitical risks, has the potential to dampen confidence and especially private investment. In addition, insufficient progress in structural reforms in euro area countries constitutes a key downward risk to the economic outlook. Eurosystem staff macroeconomic projections for the euro area foresee annual Harmonised Index of Consumer Prices (HICP) inflation to reach 0.50% in 2014, 0.70% in 2015 and 1.30% in 2016, revised significantly downwards. These revisions reflect mainly lower oil prices and the impact of the downwardly revised outlook for growth, but they do not yet incorporate the recent sharp fall in oil prices. Over the coming months, annual HICP inflation rates could experience renewed downward movements, given the recent further decline in oil prices.

United States: The Federal Open Market Committee (FOMC) concluded its asset purchase programme at the end of October. At its meeting on December 17 the FOMC decided to keep its 0% to 0.25% target range and reaffirmed that, in determining how long to maintain this target range, it "will take into account a wide range of information, including measures of labour market conditions, indicators of inflation, and financial developments." Economic activity gained momentum, with real GDP increasing in the third quarter at an annualised rate of 3.90%, supported by both domestic and external demand. Net trade made a strong positive contribution to growth, amid a strong rise in exports and a decline in imports. Meanwhile, personal consumption expenditure and private fixed investment also contributed positively to growth, confirming the robust economic fundamentals. US economic recovery is expected to continue, supported by continued improvements in the labour and housing markets, accommodative financial conditions, and fading headwinds from household balance sheet repair and fiscal policy. Annual CPI inflation stood at 1.70% in October, reflecting mainly the sharp decline in energy costs.

United Kingdom: In the United Kingdom, the pace of economic activity remained robust, increasing at an annualized rate of 3.00% in the third quarter. Growth was driven by strong domestic demand, in particular private consumption and housing

investment, in turn supported by the decline in macroeconomic uncertainty and relatively loose credit conditions. The labour market continued to strengthen, and the unemployment rate declined to a five-year low of 6.00% in the three months to September, compared with more than 7.00% a year earlier. Inflation has remained below the Bank of England's target of 2.00% in the course of 2014, marginally increasing to 1.30% in October. At its meeting on 4 December 2014 the Bank of England's Monetary Policy Committee maintained the policy rate at 0.50% and the size of the Asset Purchase Programme at GBP 375 billion.

Japan: In Japan, economic activity was lower than expected in the third quarter, following a sharp contraction in the second quarter. Real GDP contracted unexpectedly by 0.40% in the third quarter, following a 1.90% decline in the second quarter. The Bank of Japan decided in November to keep its annual monetary easing unchanged, following its decision in October to expand it by 20-25% (i.e. to 80 billion Yen).

Energy News: Since July 2014 Brent crude oil prices have declined dramatically, with its price standing at USD 57 per barrel on 31 December, which is about 46% lower than the level one year ago. Looking ahead, the oil futures market expects slightly higher oil prices over the medium term, with June 2015 Brent futures contracts trading at USD 65 per barrel.

CYPRUS ECONOMY AND MAJOR DEVELOPMENTS

The GDP growth in real terms during the third quarter of 2014 is negative and estimated at -1.80% over the corresponding quarter of 2013 based on seasonally and working day adjusted data. Positive growth rates were recorded by the sectors of Trade, Hotels and Restaurants as well as the Legal and Accounting activities. Negative growth rates were recorded by the secondary sector of the economy (Manufacturing, Construction), as well as in the sectors of Banking, Transport and other Services. Inflation, as measured by the Harmonized Index stood at 0% in November 2014 while in October 2014 it increased at a rate of 0.30%. The corresponding rate for November 2013, was -0.80%. Unemployment, in monthly seasonally adjusted figures reached the level of 15.3% in October 2014 as compared to 15.9% at the end of 2013. The Troika (IMF, European Commission and ECB) are currently assessing their fifth review of the economic programme of Cyprus with the European Union having released their loan instalment of €350 million. However the IMF announced on 19 December that it will suspend their loan instalment of €86 million following Cyprus Parliament's decision to suspend its voting of the foreclosure legislation on 18 December.

Main Economic Indicators

Period: Third Quarter of 2014					
	Europe	United States	United Kingdom	Japan	Cyprus
Real GDP (year-on-year 2013-2012 %)	-0.40	1.90	1.70	1.53	-5.40
Forecasted Real GDP (year-on-year 2014-2013 %)	0.80	2.30	3.00	0.30	-3.20
Real GDP (3rd quarter 2014 compared to 3 rd quarter 2013 %)	0.80	3.90	3.00	-0.40	-1.80
Unemployment (%)	11.60	6.20	6.20	3.60	15.30 (*)
Inflation (3 rd quarter 2014 compared to 3 rd quarter 2013 %)	0.37	1.80	1.43	3.30	0.00

* Data for October 2014

Sources:

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

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