

ECONOMIC BULLETIN

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DEVELOPMENTS IN THE WORLD ECONOMY

The global recovery remains modest, diverse across regions and fragile while the world economy is likely to recover slowly. In most major non-euro area advanced economies, the moderate recovery is proceeding, but a number of factors will continue to restrain the medium-term growth outlook. In emerging market economies, growth decelerated slightly at the beginning of the year, but is expected to regain momentum over the course of 2013. Accordingly, these economies are expected to provide a significant contribution to global growth going forward. Meanwhile, world trade has remained subdued, although survey indicators continue to point towards a gradual recovery. With regard to consumer prices, inflation has resumed its downward trend in advanced economies, while developments have been more mixed in emerging markets.

Europe: Based on its regular economic and monetary analyses, the Governing Council decided at its meeting on 6 June to keep the ECB main refinancing operations rate unchanged at 0.50% following the cut in interest rates in May. The underlying price pressure in the euro area is expected to remain subdued over the medium term. Medium-term inflation expectations for the euro area continue to be firmly anchored in line with the Governing Council's aim of maintaining inflation rates below, but close to, 2%. Regarding the economic analysis, real GDP contracted by 0.20% in the first quarter of 2013, following a decline of 0.60% in the fourth quarter of 2012. Output has thus declined for six consecutive quarters, with labour market conditions remaining weak. Recent developments in economic sentiment survey data have shown some improvement from low levels. Eurosystem staff macroeconomic projections for the euro area foresee annual real GDP declining by 0.60% in 2013 and increasing by 1.10% in 2014. According to Eurostat's flash estimate, euro area annual Harmonized Index of Consumer Prices (HICP) inflation was 1.40% in May 2013, up from 1.20% in April. Annual inflation rates are expected to be subject to some volatility throughout the year. The underlying price pressure over the medium term is expected to remain subdued, reflecting low capacity utilisation and a modest pace of economic recovery. Over the medium term, inflation expectations remain firmly anchored in line with price stability.

United States: On 19 June 2013 the Federal Open Market Committee (FOMC) 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 will be appropriate at least as long as the unemployment rate remains above 6.50%. Inflation between one and two years ahead is not projected to be above 2.50%. The FOMC decided to continue purchasing additional agency mortgage-backed securities at a pace of USD 40 billion per month and longer-term Treasury securities at a pace of USD 45 billion per month. Real GDP growth accelerated in the first quarter of 2013 at an annualised quarter-on-quarter rate of 2.40% in the first quarter of 2013, up from 0.40% in the previous three months driven by strong personal consumption expenditure, which grew by an annualised 3.40%, the fastest growth rate in two years, and by a pick-up in inventories. Private fixed investment also contributed positively to real GDP growth, although growth slowed down sharply in the non-residential segment. On the other hand, government spending contracted further. Employment data for April was encouraging and there were upward revisions for the previous months, while the unemployment rate declined to 7.50%, reaching its lowest post-crisis level. Looking forward, the economic recovery is projected to continue its moderate course helped by a gradual upturn in domestic demand, which is supported by favourable monetary and financial conditions, a gradual improvement in housing and labour markets and a slow easing-up of the drag resulting from balance sheet repair. In April 2013 annual CPI declined to 1.10% from 1.50% in March and constitutes the lowest inflation rate since November 2010. This slowdown in annual inflation was led primarily by the sharp drop in energy prices, while food price growth remained stable.

United Kingdom: In the United Kingdom, real GDP increased by 0.30% quarter-on-quarter in the first quarter of 2013, driven mainly by domestic demand. The economic recovery is expected to gradually gather pace, but domestic demand continues to be constrained by tight credit conditions, ongoing private and public sector balance sheet adjustment, as well as weak household real income dynamics. The unemployment rate stood at just below 8%, although employment growth has slowed down markedly in recent months. Annual CPI inflation eased off by 0.40 percentage point to 2.40% in April 2013. The lower inflation figures were mainly due to energy and transport price dynamics. At its meeting on 6 June 2013, the Bank of England's Monetary Policy Committee maintained the policy rate at 0.50% and the total size of its asset purchase programme at GBP 375 billion.

Japan: In Japan, real GDP increased by 0.90% quarter-on-quarter in the first quarter of 2013 following a revised 0.30% expansion in the final quarter of 2012. The pick-up in growth was supported to a large extent by solid growth in private consumption and a positive contribution from net exports (the first in four quarters). Looking further ahead, the recovery is expected to gradually take hold in the course of 2013, driven mainly by higher fiscal and monetary stimulus and a rebound in exports on account of a weaker yen, as well as a recovery in global demand.

Energy News: Brent crude oil traded at USD 106 per barrel on 17 June. After a surge in prices in the first two months of this year, Brent prices declined to around USD 100 per barrel in March and April. In May oil prices traded in the range of USD 100-105 per barrel. Brent prices are about 5% higher compared with a year ago. Looking ahead, market participants expect lower oil prices over the medium term, with December 2014 futures prices trading at 97 USD per barrel.

CYPRUS ECONOMY AND MAJOR DEVELOPMENTS

Cyprus has secured an EU/IMF loan agreement/programme securing EUR 10 billion over the next three years, 2013 to 2016. An amount of EUR 13 billion is to be contributed by Cyprus through the restructuring of the banking sector (Laiki Bank and Bank of Cyprus), additional taxes, rolling over of domestic debt held by residents, privatizations, rescheduling the terms of the Russian Government Loan and allocation of CBC's profits. To this end, a bank resolution law was passed in mid-March 2013, under whose auspices three key steps were taken: (i) the Greek branches of Cypriot banks were sold to a Greek bank, (ii) Laiki Bank was intervened and its insured deposits, ELA, and enough assets to meet regulatory limits were transferred to Bank of Cyprus, while uninsured deposits and other assets were left in a run-off unit and (iii) Bank of Cyprus was intervened and recapitalized with participation of bank creditors, including uninsured depositors. All insured deposits were protected. As a result of these actions, the banking system shrunk by about 200% of GDP. In order to protect the liquidity of the banking sector, restrictions were imposed on both domestic as well as cross-border transactions.

The GDP growth rate in real terms during the first quarter of 2013 is negative and estimated at -4.40% over the corresponding quarter of 2012. According to the IMF's forecasts real GDP is expected to contract by 9% and 5% for 2013 and 2014 respectively. The rate of inflation for May 2013 continued in negative ground and dropped further to -0.70% compared to -0.30% in April 2013 and 2.90% in May 2012. For the period January-May 2013, the Consumer Price Index (CPI) recorded an increase of 0.70% compared to the corresponding period of 2012. Unemployment reached the level of 15.6% in April 2013.

Main Economic Indicators

Period: First Quarter of 2013					
	Europe	United States	United Kingdom	Japan	Cyprus
Real GDP (year-on-year 2012-2011 %)	-0.60	2.20	0.30	1.98	-2.40
Estimated Real GDP (year-on-year 2013-2012 %)	-0.60	1.90	0.90	1.70	-8.80
Real GDP (1 st quarter 2013 compared to 1 st quarter 2012 %)	-1.10	2.40	0.60	4.10	-4.40
Unemployment (%)	12.07	7.50	7.83	4.20	15.60 *
CPI (1 st quarter 2013 compared to 1 st quarter 2012 %)	1.83	1.10	2.40	-0.63	0.70

*Data for April 2013

Sources:

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

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