



# MACROECONOMIC MONITOR OF CYPRUS

March 2015

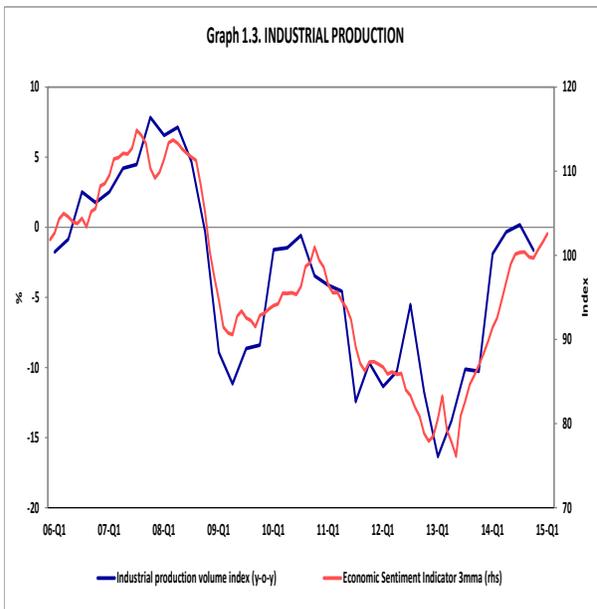
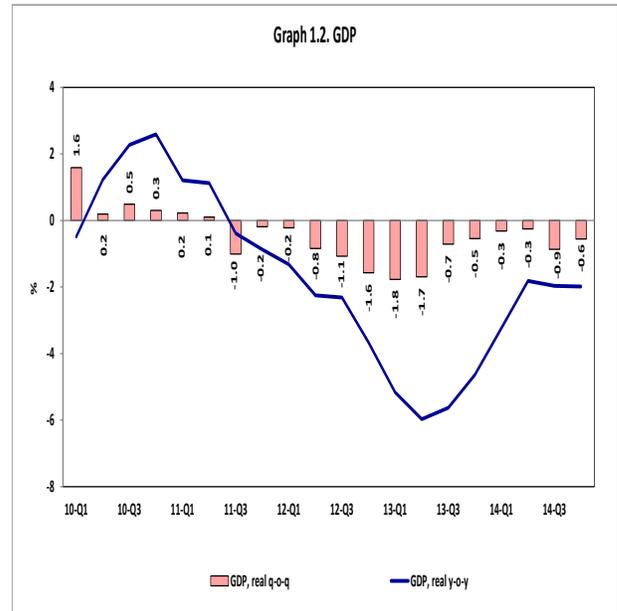
## MACROECONOMIC MONITOR OF CYPRUS

*Updated on 19 March 2015*

- **In the 4<sup>th</sup> quarter of 2014, GDP** (in seasonally adjusted terms) **contracted by -2% compared with -2% in the 3<sup>rd</sup> quarter of 2014** on an annual basis (see graphs 1.1-1.2) and for **2014 as a whole it has contracted by -2.3%**. The contraction was mainly due to the continued subdued performance of the secondary sector (manufacturing, construction), the financial sector and transport, while positive growth rates were recorded in the sectors of hotels and restaurants and also legal and accounting activities. From the expenditure side, government consumption and gross fixed capital investment contributed negatively while private consumption and net exports contributed positively (see graphs 3.1-3.4 and 6.1-6.2).
- The business operating environment remains constrained, given that lending to non-financial corporations is subdued and interest rates are still relative to economic conditions high and we assume the negative trends to dissipate significantly in 2015 with a gradual restoration of lending at more affordable rates.
- Developments are currently driven by lower, but improving, **domestic demand** (see graphs 2.1-2.4).
- The **economic sentiment indicator** by CypERC **increased by 0.9 points in February 2015** compared to January 2015, but still remaining in the negative territory (see graph 1.3). This increase is due to the improvement of the climate in services and manufacturing.
- **Exports of goods increased by 131.8%** in January 2015 compared to January 2014, mainly due to the transfer of economic ownership of mobile transport equipment with total value of €158.6 mn.
- In January-February 2015 **tourist arrivals increased by 7.7%** compared to January-February 2014 (see graph 6.3). An increase of 73.5% was recorded in tourist arrivals from Israel, a 30% increase from Germany, a 1.5% increase from the UK and a 7% increase from Greece. On the other hand a 5.2% decrease was recorded in arrivals from Russia.
- **Employment** is showing an adjustment to the conditions of lower economic growth (see graphs 4.1 and 4.4). Employment in persons **decreased by 1.9%** in 2014 compared to 2013. The decrease was more pronounced in the construction sector, the activities of households as employers and manufacturing.
- **Labour market** developments exhibit **considerable flexibility** adjusting to the new environment. This led to a decrease in the marginal costs of businesses and at the same time this allowed businesses to provide goods and services at reduced prices.
- **Labour Force Survey (LFS) unemployment**, in monthly seasonally adjusted terms, **increased from 15.7% in January 2014 to 16.1% in January 2015** (see graphs 4.2-4.3). The most affected segment of the population is youth, although it has been on a downward trend since January 2014. Particularly challenging is also the increase in long-term unemployed.
- **Compensation per employee in 2014 declined by around 4.7% compared to 2013**, contributing to a decline of nominal unit labour cost and improving cost competitiveness further (see graphs 5.3-5.5). The observed wage adjustment is expected to help containing the upward pressure on unemployment.
- **Inflation (HICP) for February 2015 was -0.8%** compared to -0.7% in January 2015 (see graph 5.1) and for 2015 so far it stands at -0.7%. Core HICP inflation increased by 0.2% in January-February 2015 (see graph 5.2). All subcategories of HICP presented a decrease except for food and non-alcoholic beverages, alcoholic beverages and tobacco, clothing and footwear, health, communication and restaurants and hotels which presented an increase.

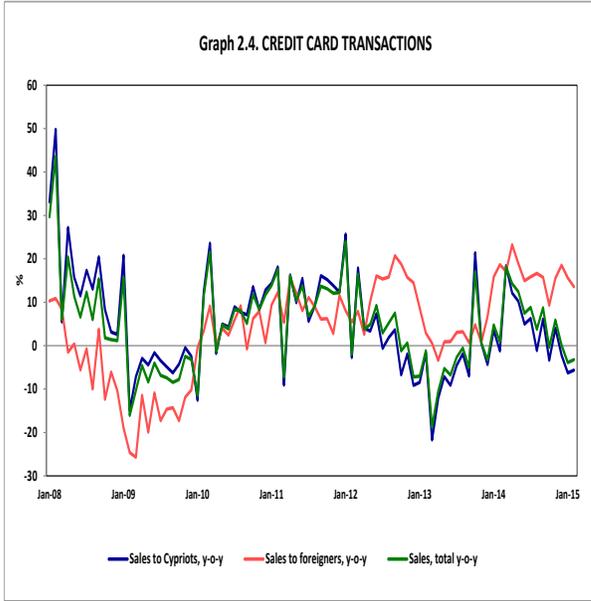
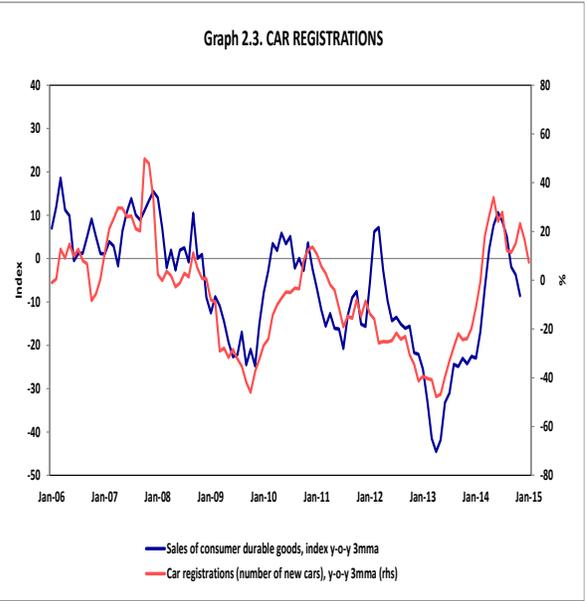
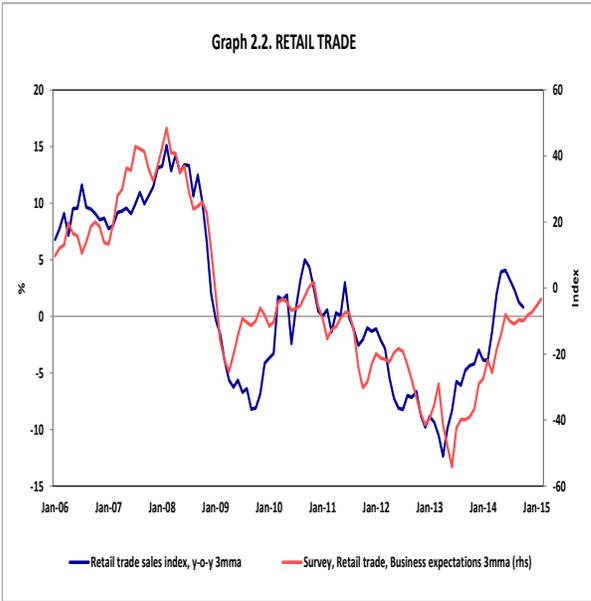
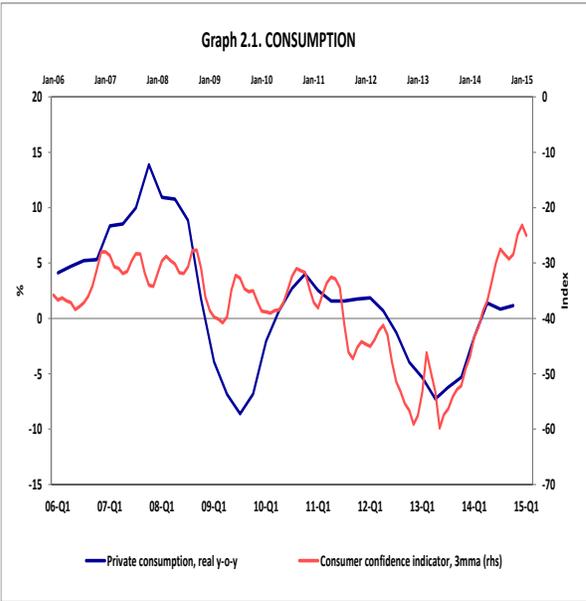
- The **current account balance** in the first nine months of 2014 recorded a **deficit of €1,158.4 mn (-6.6% of GDP)** compared with a deficit of €371.9 mn (-2.1% of GDP) in the first nine months of 2013 (see graph 6.4) mainly due to the deterioration of the goods and services balance.
- The **primary income** recorded a **deficit of €418.7 mn** in the first nine months of 2014 compared with a deficit of €268 mn in the first nine months of 2013 (see graph 6.4) mainly due to lower direct investment income.
- The international investment position of Cyprus (see graph 6.5) recorded deterioration in September 2014 reaching -€28,339.3 mn compared with -€27,172.8 mn in June 2014.
- Developments in **public finances** exceeded expectations. General government budget balance (GGBB) was in deficit in 2014, of the order of **€7.2 mn (0.0% of GDP)** compared to a deficit of €890.7 mn (-4.9% of GDP) the year before (see graph 9.1).
- Similarly, general government **primary balance** (GGPB) **was in surplus** in 2014, of the order of **€487.8 mn (2.8% of GDP)** compared to a deficit of €327.3 mn (-1.8% of GDP) the year before (see graphs 9.1-9.2).
- General government debt (see graph 9.2) in 2014 stood at €18,750.7 mn and as a percentage to GDP at 107.1%.
- **Total revenue** exhibited a **positive** rate of growth of about **6.1%**, reaching €7,014.0 mn in 2014, compared to €6,610.4 mn the year before (see graph 9.3).
- **Total expenditure** exhibited a **negative** rate of growth of about **6.4%**, reaching €7,021.2 mn in 2014, compared to €7,501.1 mn the year before (see graph 9.3).
- Monetary Financial Institutions (MFI) **loans to domestic residents** (private sector), marginally **increased** with an annual **rate of 0.5%** in January 2015, affecting both households and enterprises (see graphs 8.2-8.4). This is reflecting low demand and tight lending conditions (see graphs 8.7-8.8).
- **Deposits of domestic** residents held with MFIs (private sector) exhibited a contraction presenting an **annual decline of 2.6%** in January 2015, reflecting the negative climate in confidence (see graph 8.1).
- Overall lending and deposit interest rates in Cyprus have declined, however, the decline in deposit rates is much bigger than the decline in lending rates (see graph 8.5). In January 2015, deposit interest rates for maturity up to 1 year increased and for maturity up to 3 months decreased compared with the previous month. The lending interest rates to households for primary residence acquisition and the rate for other loans up to €1 mn for businesses increased. The rate for bank overdrafts to non-financial corporations decreased. A significant deviation of the Cypriot interest rates, compared to the euro area average is still observed.
- The CBC's residential property price index declined by 8.2% in the 4<sup>th</sup> quarter of 2014 compared to the 4<sup>th</sup> quarter of 2013. Cumulative from the 1<sup>st</sup> quarter of 2008 it has declined by 28.4% (see graph 7.1), revealing a modest adjustment to the conditions of lower domestic and foreign demand.
- According to the Department of Lands and Surveys, new sale contracts were up by 7% while, transfers of property were down by 0.7% in January-February 2015 compared to January-February 2014 (see graph 7.3). MFI loans to domestic residents for housing declined with an annual rate of 2.4% in January 2015 (see graph 7.2).
- The Cyprus Government bond spread compared to the German Government bond, decreased in mid-March 2015 compared to February 2015 to around 375 basis points above the German bond on 18/03/2015 from around 468 basis points above on 27/02/2015 (see graph 8.6, yields refer to the bonds maturing in 2020).

1. OUTPUT



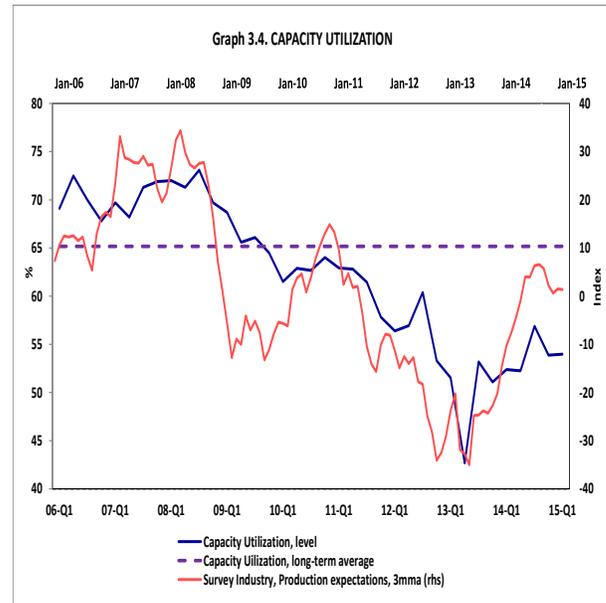
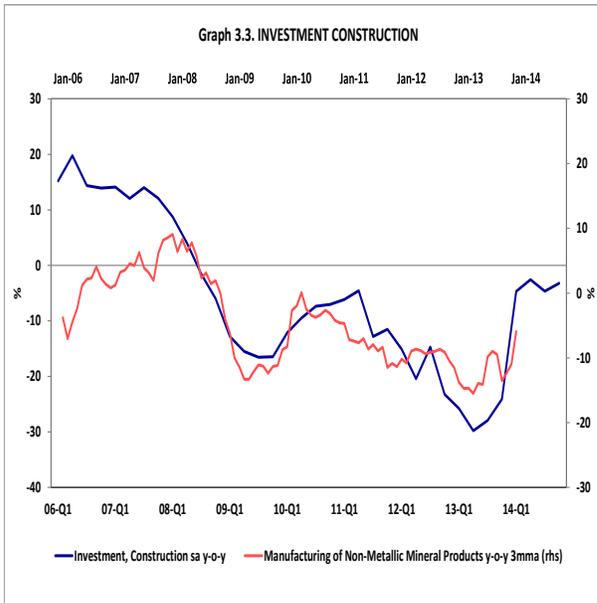
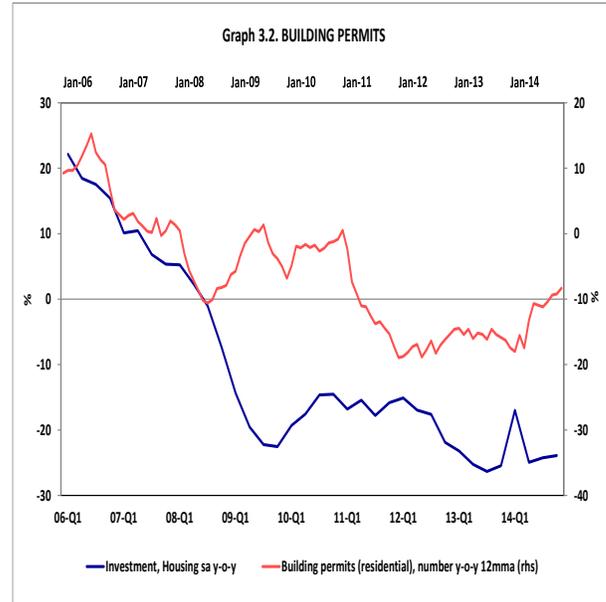
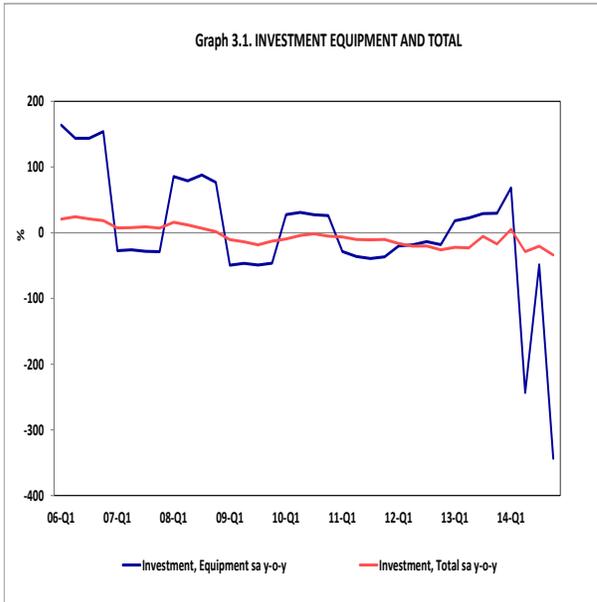
Sources: Eurostat, DG ECFIN, Cystat

2. CONSUMPTION



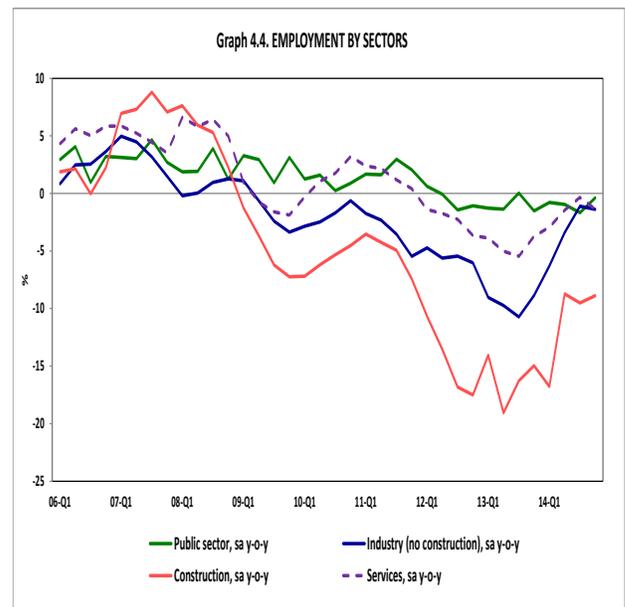
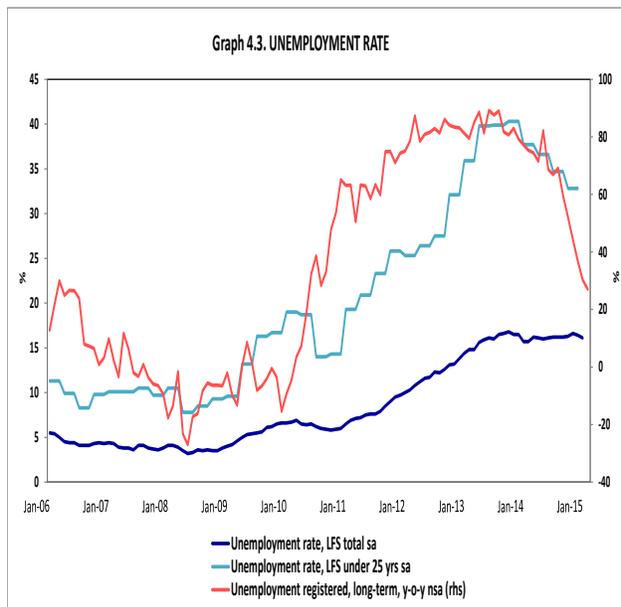
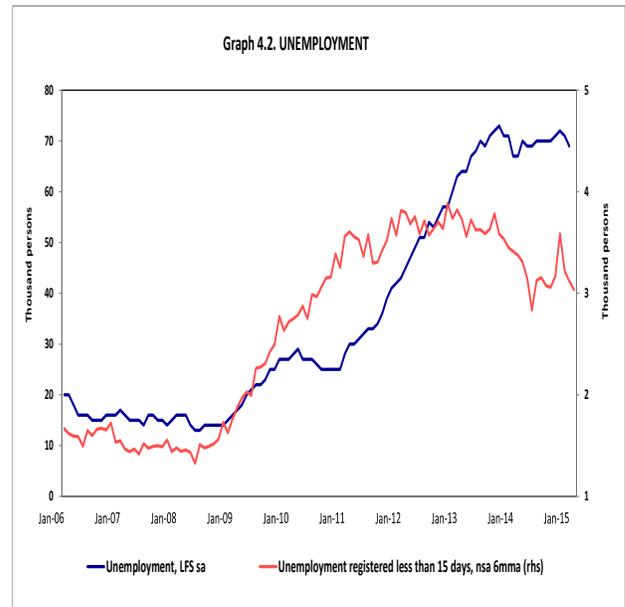
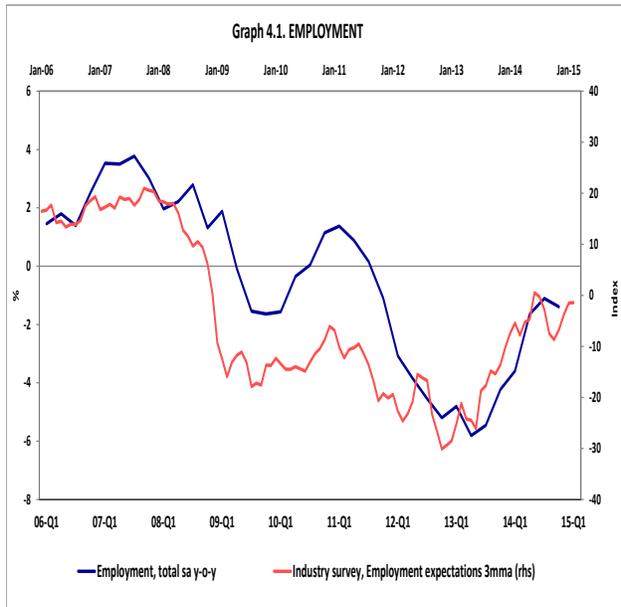
Sources: Eurostat, DG ECFIN, Cystat, JCC Payment Systems Ltd

3. INVESTMENT



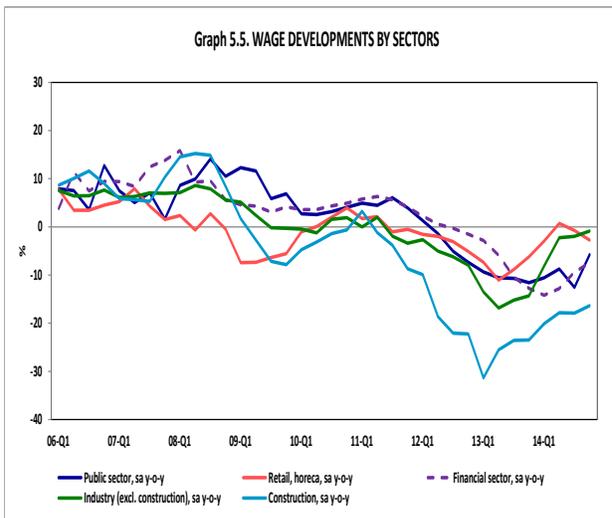
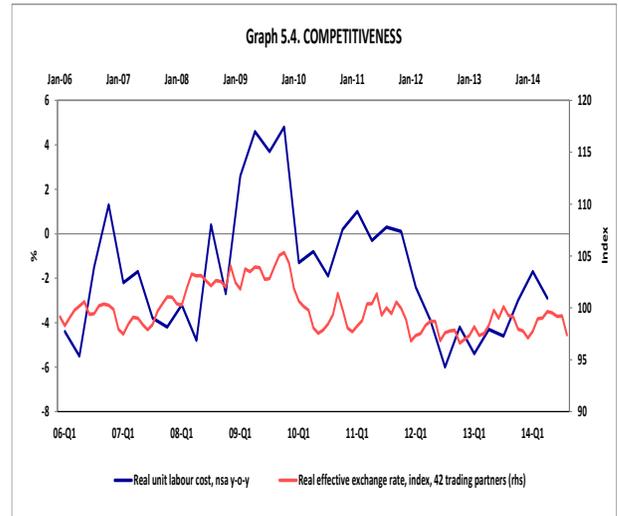
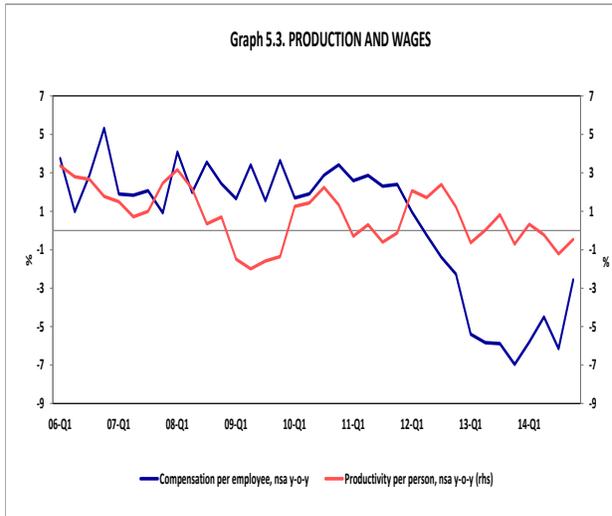
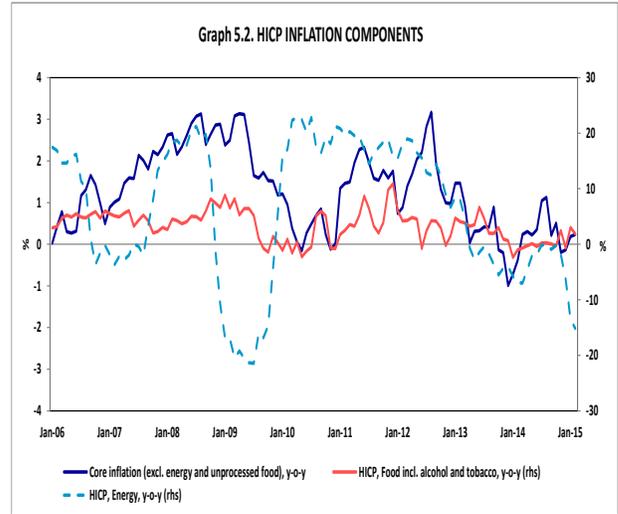
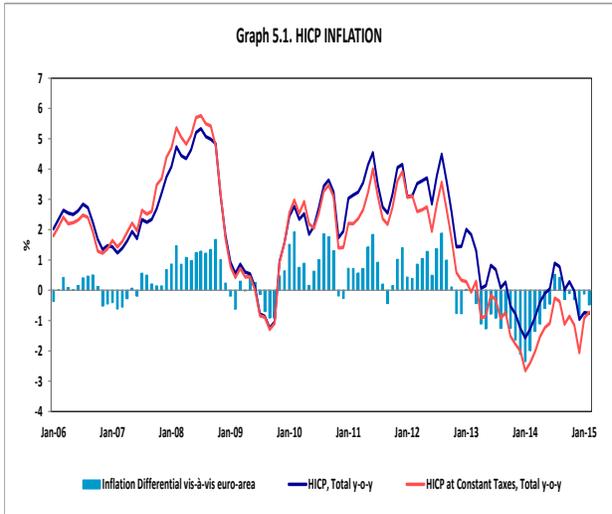
Sources: Eurostat, DG ECFIN, Cystat

4. LABOUR MARKET



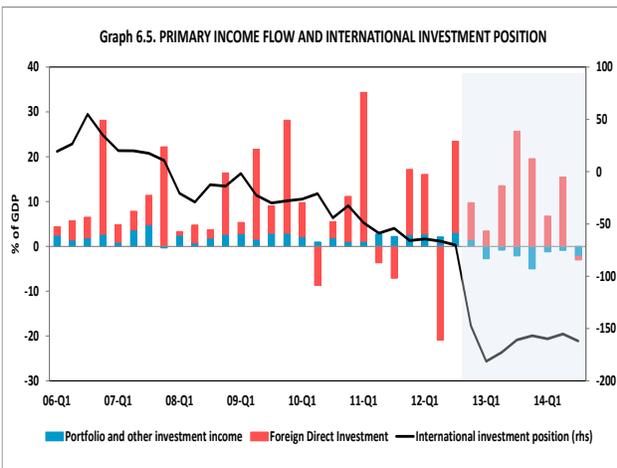
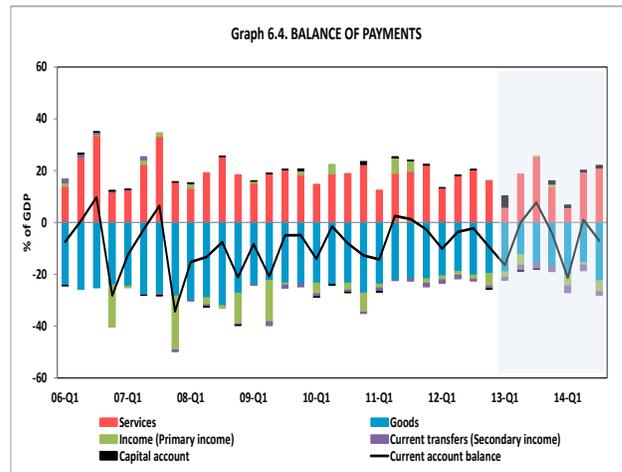
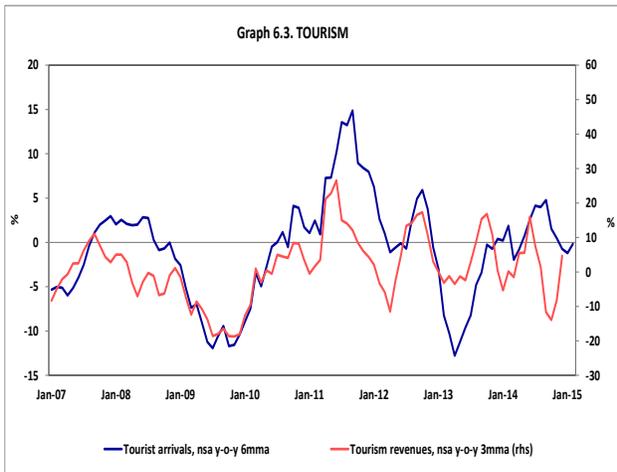
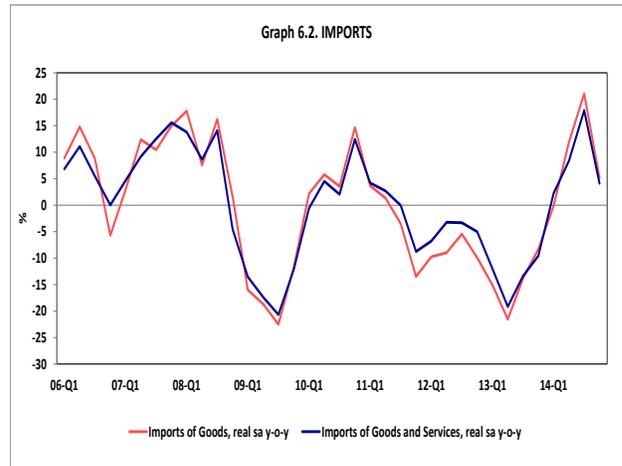
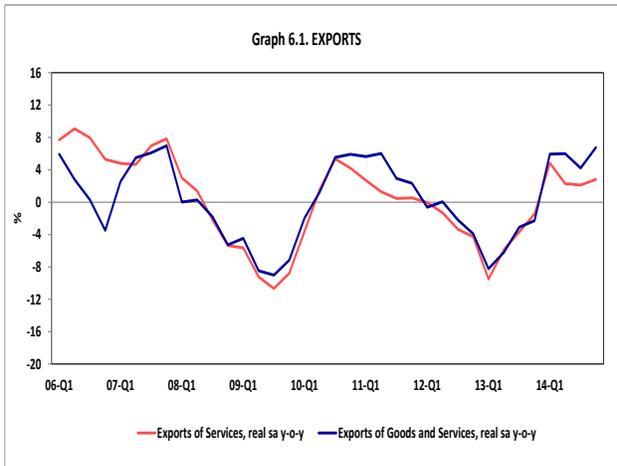
Sources: Eurostat, DG ECFIN, Cystat

5. INFLATION, WAGES



Source: Eurostat

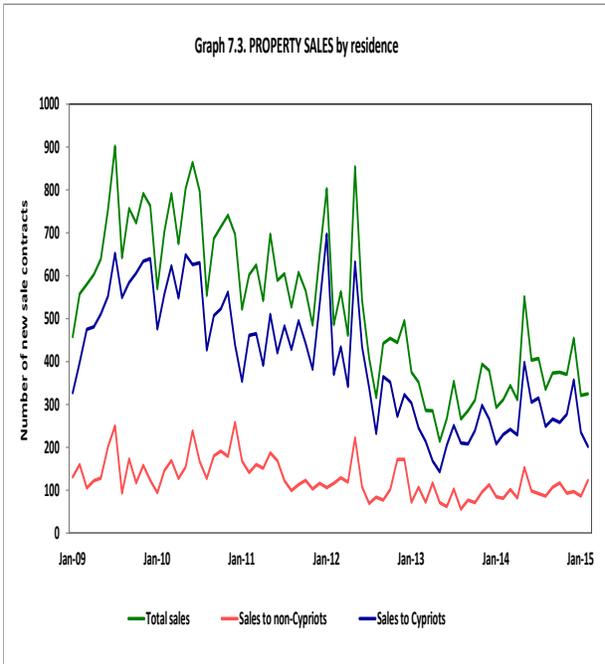
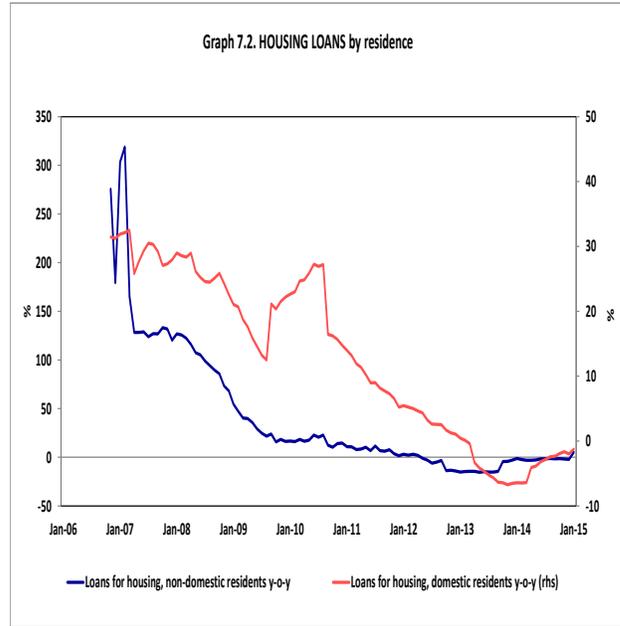
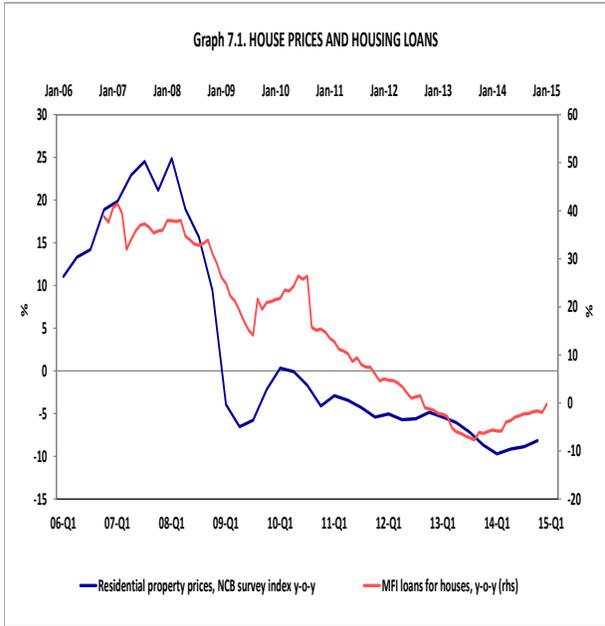
6. EXTERNAL SECTOR



Sources: Eurostat, Cystat, ECB, CBC

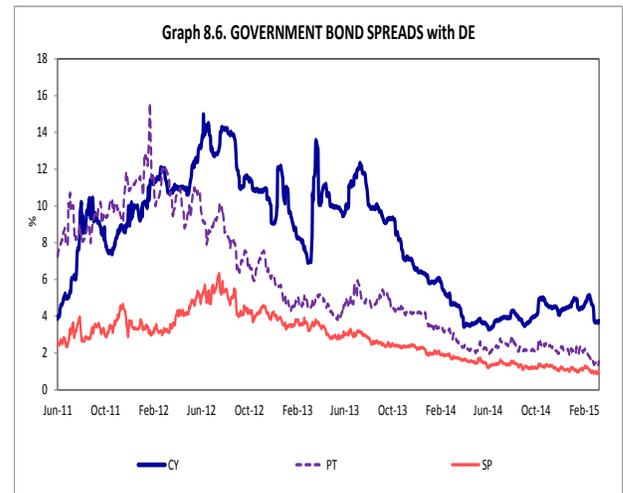
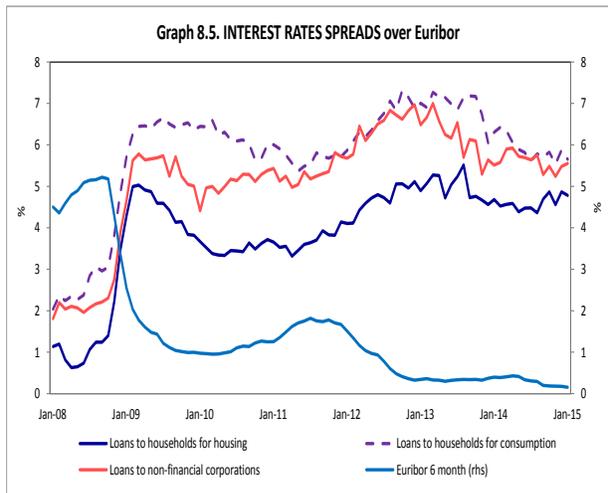
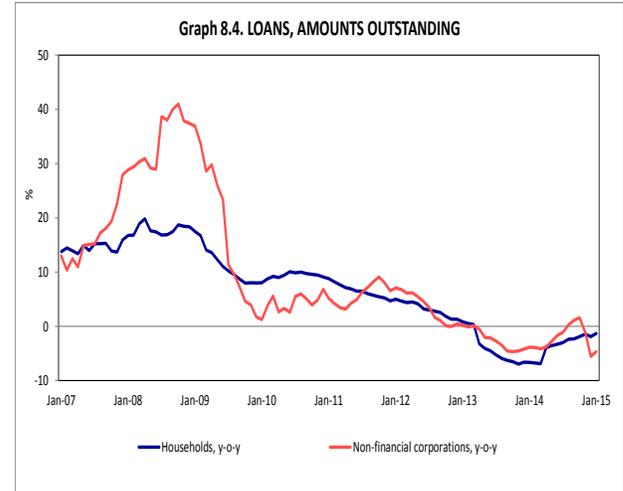
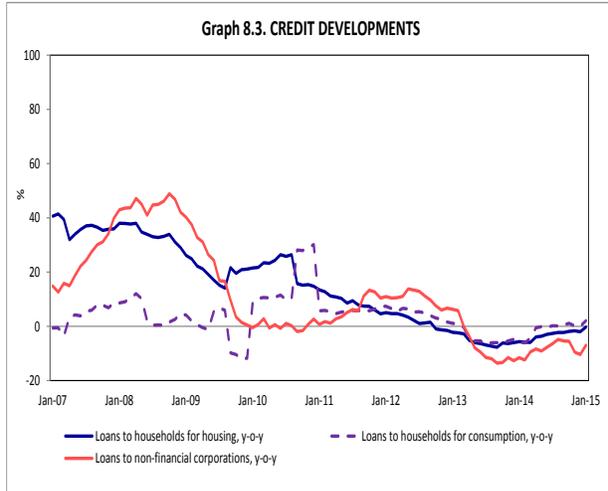
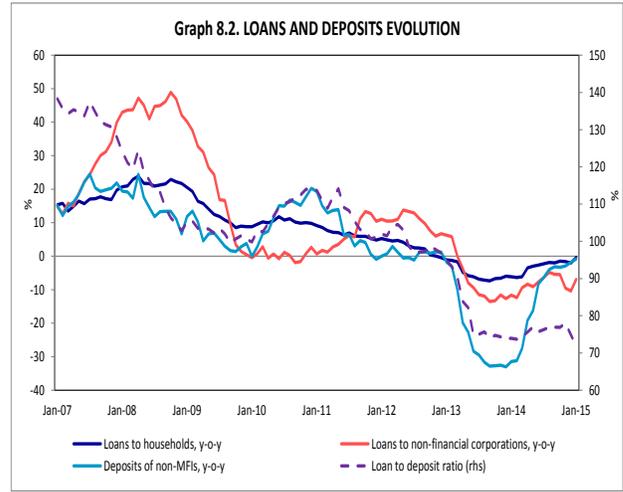
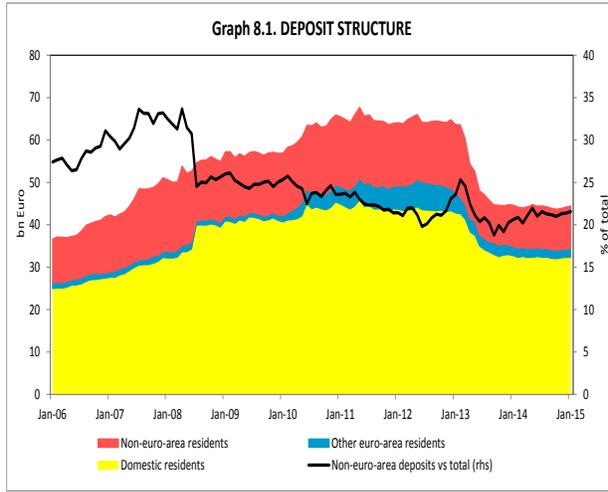
Note: Regarding graphs 6.4 and 6.5, BoP data from 2013 onwards and IIP data from 2012Q4 onwards are compiled in accordance with the new international methodological standards (BPM6) and are not comparable to data prior to this.

7. HOUSING



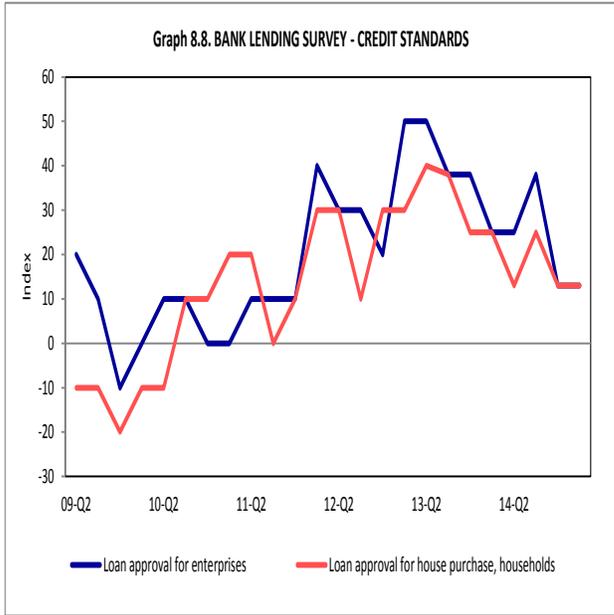
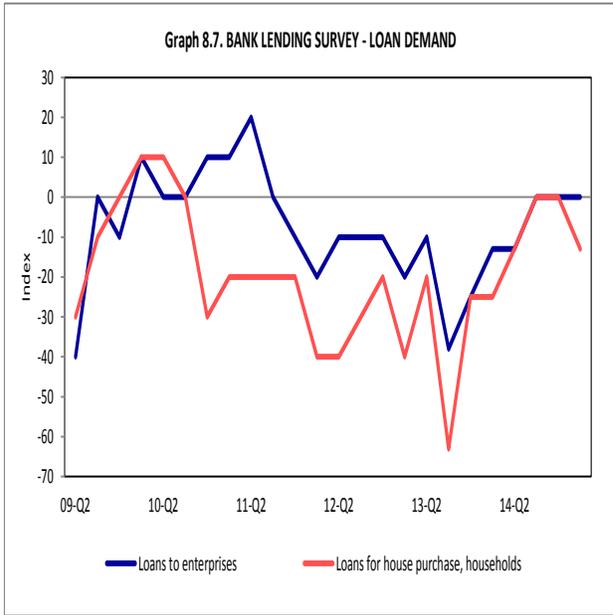
Sources: ECB, CBC, Dep. of Lands and Surveys

8. FINANCIAL SECTOR



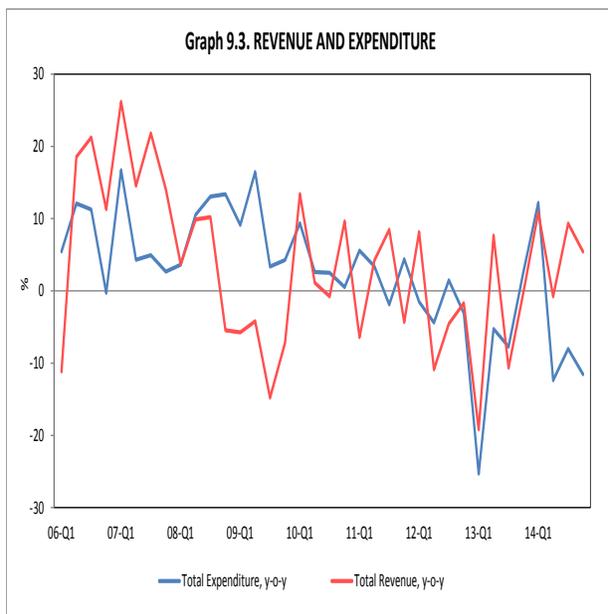
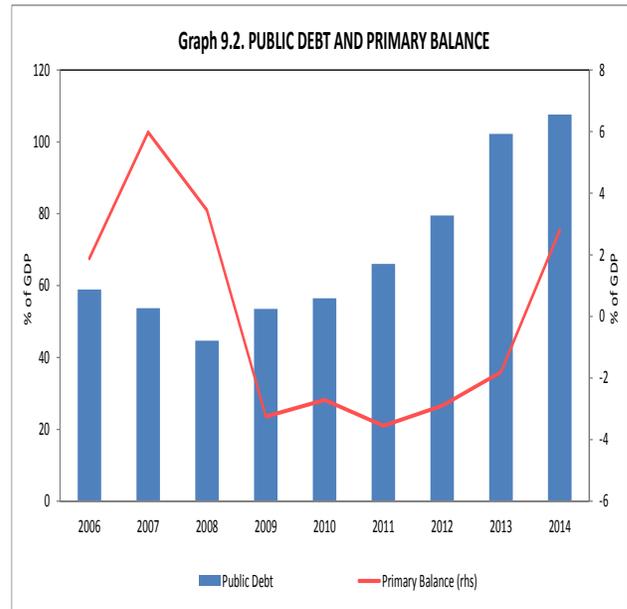
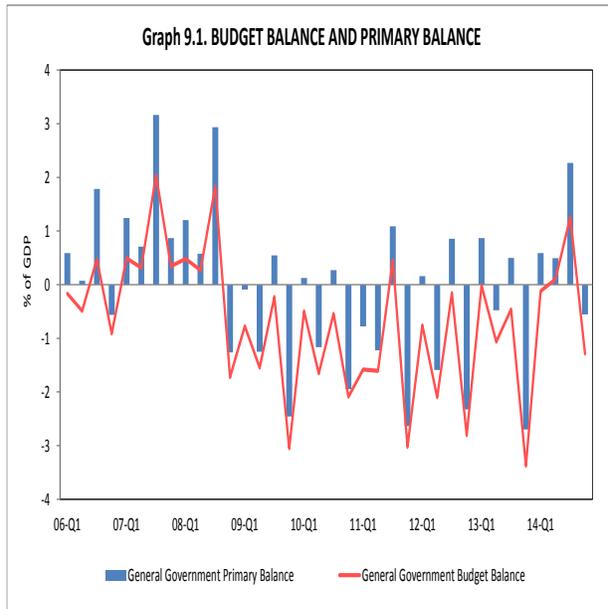
Sources: ECB, CBC, Bloomberg

8. FINANCIAL SECTOR – CONT.



Source: ECB

9. PUBLIC SECTOR



Sources: Ministry of Finance, Cystat