

MACROECONOMIC MONITOR OF CYPRUS

Updated on 24 February 2014

- In the 4th quarter of 2013, GDP contracted by -5.3% on an annual basis and -1% on a quarterly basis (see graphs 1.1-1.2). The contraction was mainly due to the subdued performance of the secondary sector (construction, manufacturing). From the expenditure side, the contraction was more pronounced in investments of construction, while net exports made a positive contribution (see graphs 3.1-3.4 and 6.1-6.2).
- For 2013 as a whole, GDP contracted by -5.4% which compares favourably with initial market expectations following the deposit haircut in March 2013. However, the business operating environment remains constraint, given that lending to non-financial corporations is subdued and interest rates are still relatively high. We maintain our view that growth in 2014 will remain negative, around -4.5%, and we assume rebound in 2015 with a gradual restoration of lending at affordable rates.
- Developments are currently driven, mainly by lower domestic demand (see graphs 2.1-2.4).
- The economic sentiment indicator by CypERC presents a less negative picture, as it increased by 2.4 points in January 2014 compared to December 2013, although still remaining at negative levels (see graph 1.3). Expectations in some sectors showed an improvement albeit from low levels.
- Exports of goods increased substantially by 10% in 2013 compared to 2012, mainly due to the increase in the exports of pharmaceutical products, cement, potatoes and halloumi cheese. The largest increase was recorded in the exports of goods to the EU, particularly to the United Kingdom, and certain other non-EU countries.
- In 2013 per capita spending showed a noticeable improvement while revenues from tourism also showed a significant increase. In January 2014 tourist arrivals declined by 3.8% compared to January 2013 (see graph 6.3). A decrease of 14.6% was recorded in arrivals from the United Kingdom and 20% decrease in arrivals from Greece, while an increase of 23.1% was recorded in arrivals from Russia.
- Employment is also affected by the slowdown, showing an expected adjustment to the conditions of lower economic growth (see graphs 4.1 and 4.4). Employment in persons (FTE) decreased by 5.8% in the first nine months of 2013 compared to the first nine months of 2012. The decrease was more pronounced in construction, trade and manufacturing.
- Labour Force Survey (LFS) unemployment, in monthly seasonally adjusted figures, increased steeply from 13.9% in December 2012 to 17.5% in December 2013, reflecting the effect of a protracted slowdown in economic activity (see graphs 4.2-4.3). For 2013 as a whole, it averaged at around 16%. The category mostly affected is youth. Particularly worrying is also the rapid increase in long-term unemployment.
- Compensation per employee in the first nine months of 2013 declined by 4.9% compared to the first nine months of 2012, contributing to a decline of nominal unit labour cost by 5.1% and improving cost competitiveness (see graphs 5.3-5.5). The

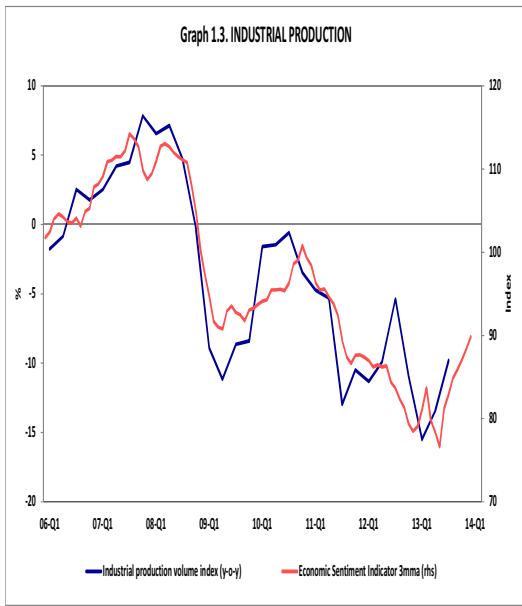
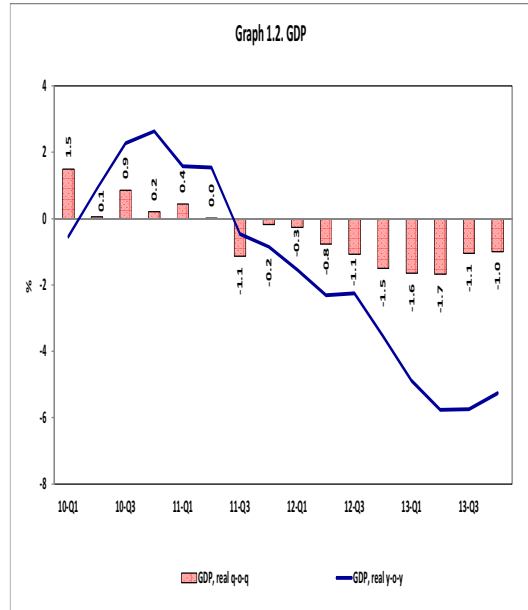
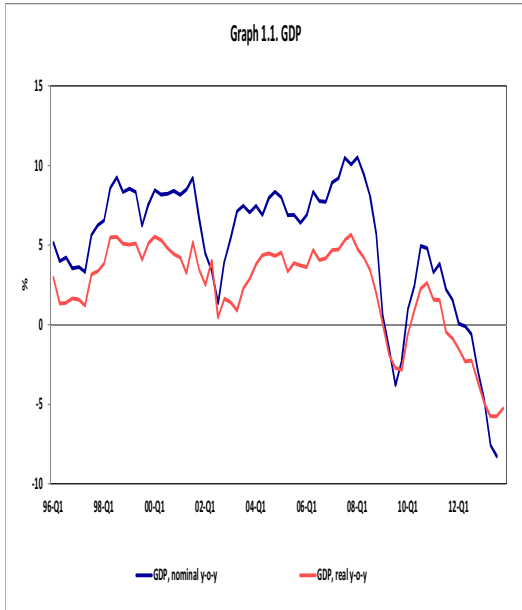
observed wage adjustment is expected to help containing the upward pressure on unemployment.

- Inflation as measured by the HICP, decreased at a rate of -1.6% in January 2014 compared to -1.3% in December 2013 (see graph 5.1). Core inflation decreased at a rate of -0.7% in January 2014 (see graph 5.2). All subcategories of HICP presented a decrease except for restaurants and hotels, communication, transport and alcoholic beverages and tobacco which presented an increase and clothing and footwear which remained unchanged.
- The current account balance in the first nine months of 2013 was in surplus of €34,2 mn compared with a deficit of €765 mn in the first nine months of 2012 (see graph 6.4). This development was mainly due to the improvement of the goods account.
- The income account recorded a deficit of €162,9 mn in the first nine months of 2013 compared with a higher deficit of €223,7 mn in the first nine months of 2012 due to the reduction in expenditure which exceeded the reduction in revenues for this category (see graph 6.4).
- The international investment position of Cyprus (see graph 6.5) recorded an improvement in September 2013, reaching €15.753 mn compared with €17.126 mn in June 2013, thus remaining in a net liability position (Cyprus' liabilities exceed the respective assets). This development was due to the improvement recorded in direct investment and to a lesser extent, in portfolio investment, in spite of the deterioration recorded in other investments.
- In 2013, the budget balance recorded a deficit of 5.1% of GDP as compared to a deficit of 6.4% of GDP in 2012. The relatively good performance in public finances is associated with formidable expenditure constraint in the context of the implementation of the MoU, as well as, to additional discretionary spending cuts, beyond those foreseen in the MoU. Nevertheless, public debt increased substantially to 112% of GDP, reflecting the steep decline of GDP, as well as, the recapitalization of the banking sector.
- Monetary Financial Institutions (MFI) loans to domestic residents (private sector), declined with an annual rate of 6.8% in December 2013, affecting both households and enterprises (see graphs 8.2-8.4). This is reflecting low demand and very tight lending conditions (see graphs 8.7-8.8).
- Deposits of domestic residents held with MFIs (private sector) exhibited a substantial fall presenting an annual decline of 14.9% in December 2013, reflecting the negative climate of confidence (see graph 8.1). During the last two months of 2013 though there is a deceleration in the fall.
- Overall the lending and deposit interest rates in Cyprus have declined compared to last year levels and the levels prevailing during the period prior to the levy on deposits. However, the decline in deposit rates is much bigger than the decline in lending rates (see graph 8.5). In December 2013, deposit interest rates for maturity up to 1 year exhibited a marginal increase, whereas the rate for deposits up to 3 months remained the same. The lending interest rates to households for house purchase and the rate for bank overdrafts to non-financial corporations exhibited a marginal decrease. The rate for other loans up to €1 mn for businesses exhibited an

increase. A significant deviation of the Cypriot interest rates, compared to the euro area average is still observed.

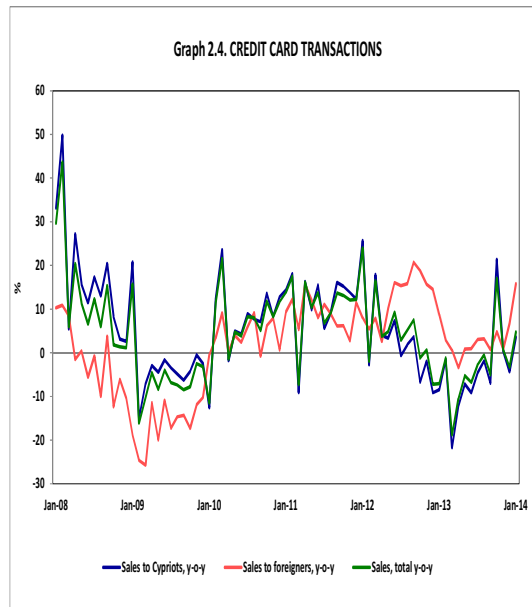
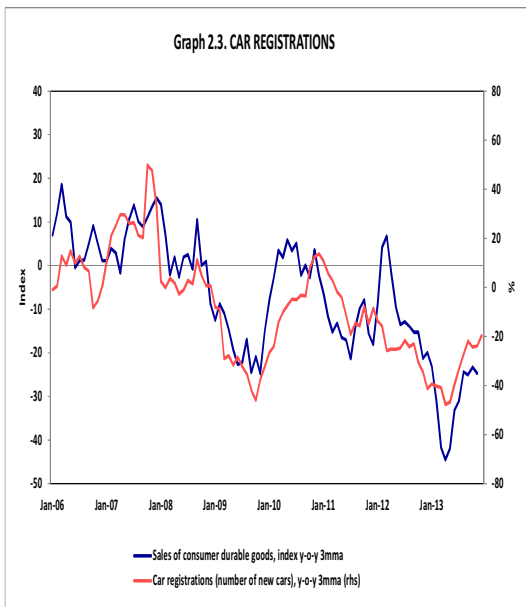
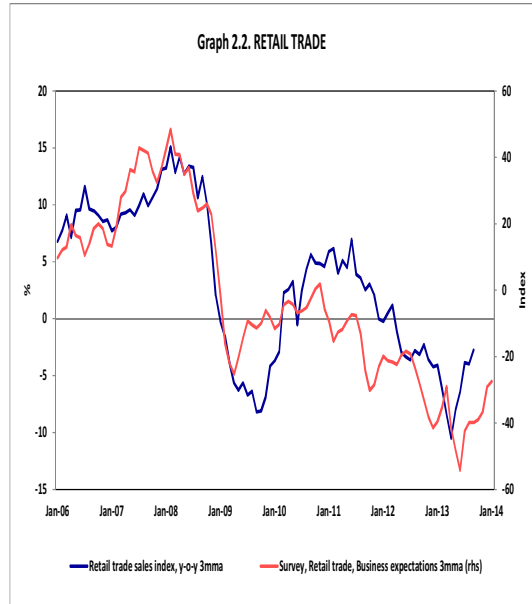
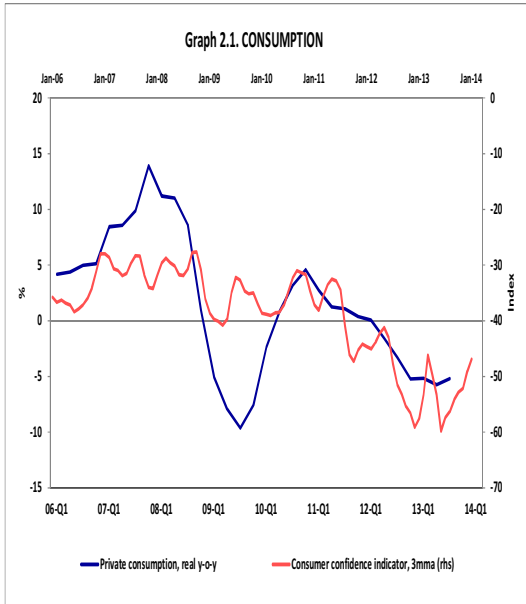
- The CBC's residential property price index declined by 7.2% in the 3rd quarter of 2013 on an annual basis. Cumulative from the 1st quarter of 2008 it has declined by around 20% (see graph 7.1), revealing a modest adjustment to the conditions of lower domestic and foreign demand.
- According to the Department of Lands and Surveys, new sale contracts were 21.9% lower and property transfers were 9% lower in January 2014 compared to January 2013 (see graph 7.3). MFI loans to domestic residents for housing declined with an annual rate of 5.3% in December 2013 (see graph 7.2).
- The Cyprus Government bond spread compared to the German Government bond, decreased further in February 2014 compared to January 2014 (see graph 8.6, yields refer to the bonds maturing in 2020).

1. OUTPUT



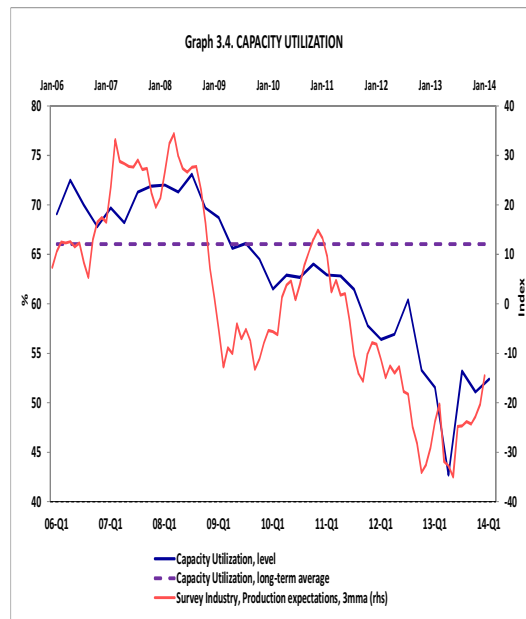
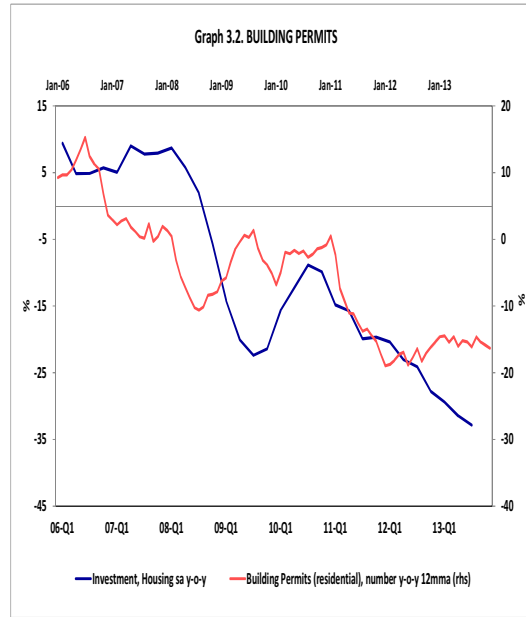
Sources: Eurostat, DG ECFIN, Cystat

2. CONSUMPTION



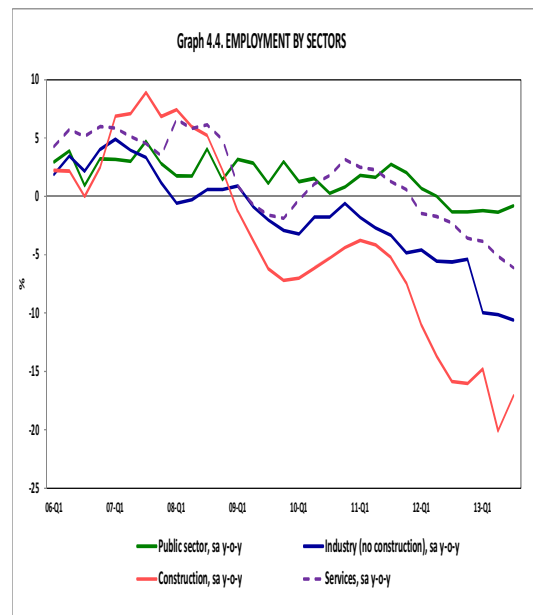
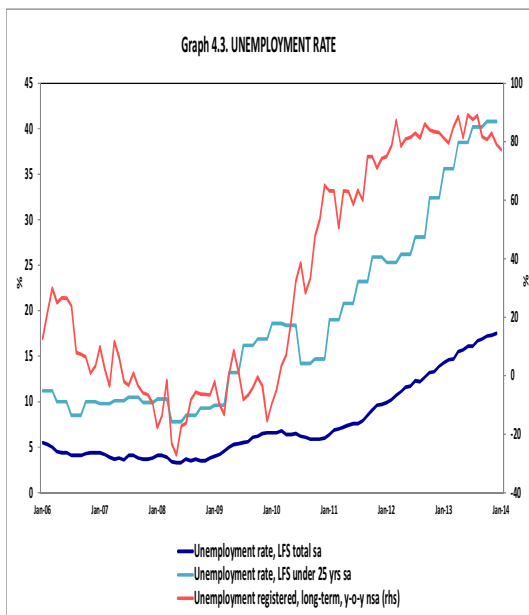
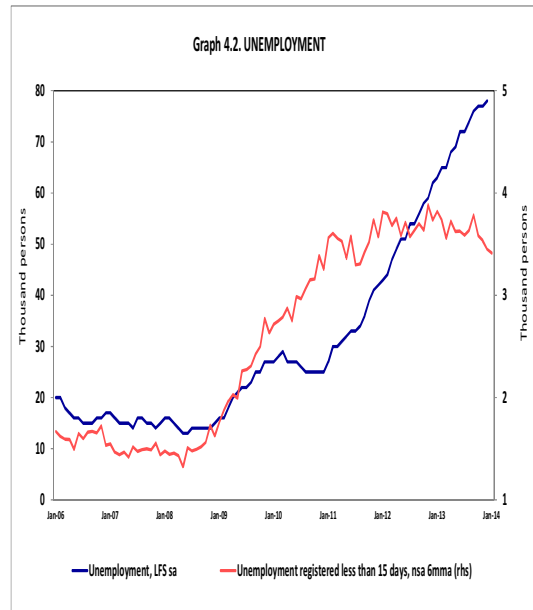
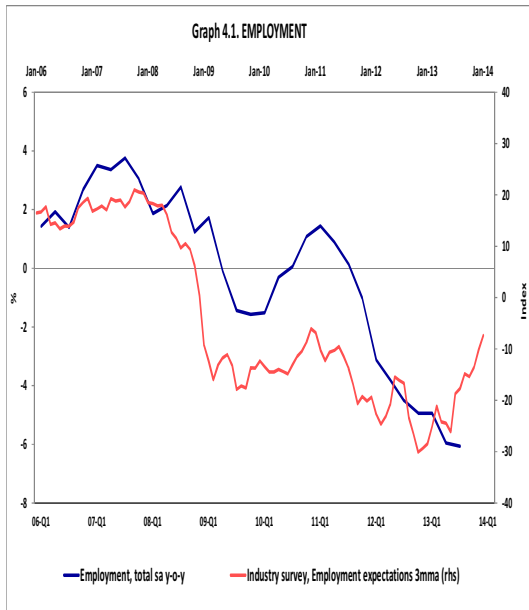
Sources: Eurostat, DG ECFIN, Cystat, JCC Payment Systems Ltd

3. INVESTMENT



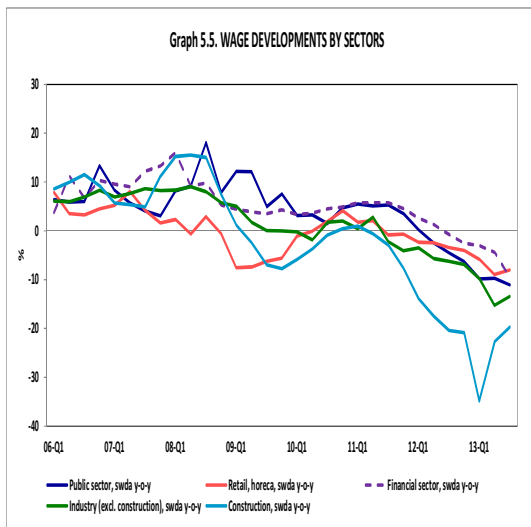
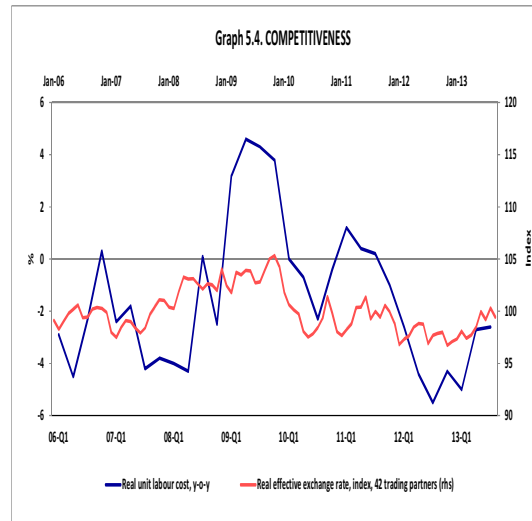
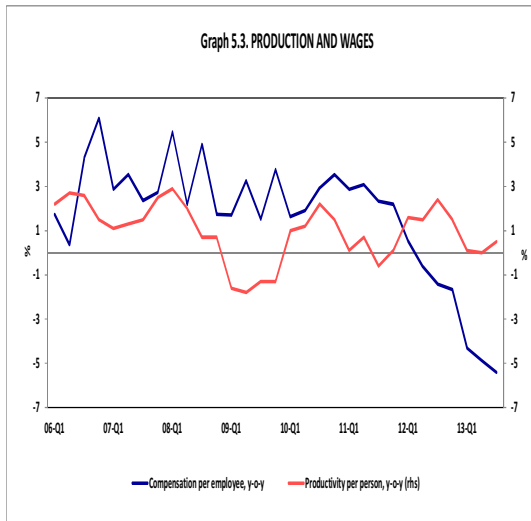
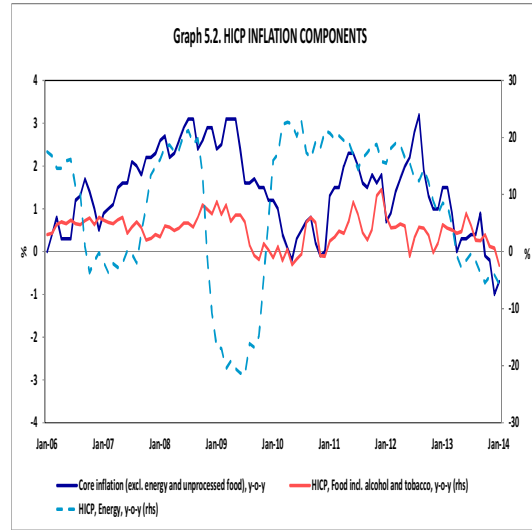
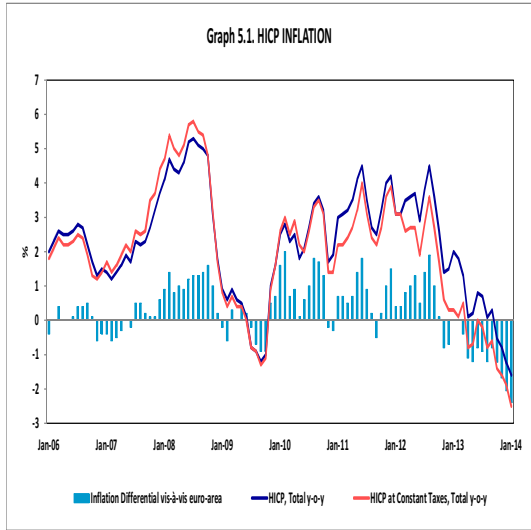
Sources: Eurostat, DG ECFIN, Cystat

4. LABOUR MARKET



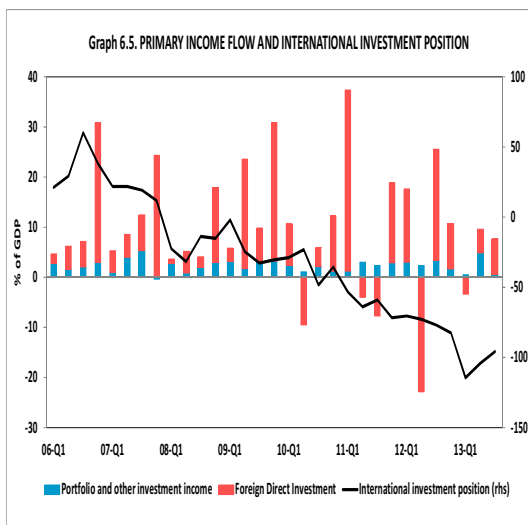
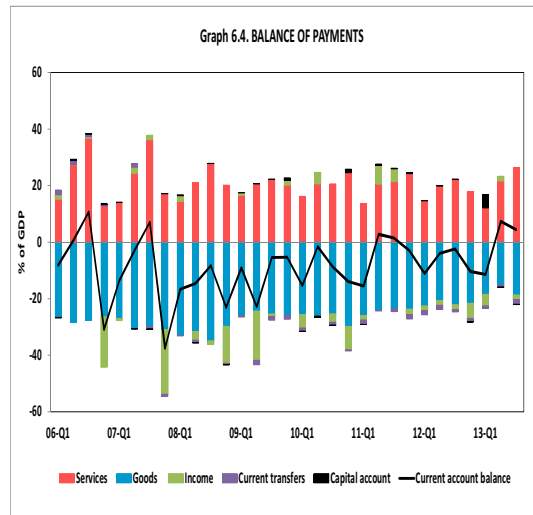
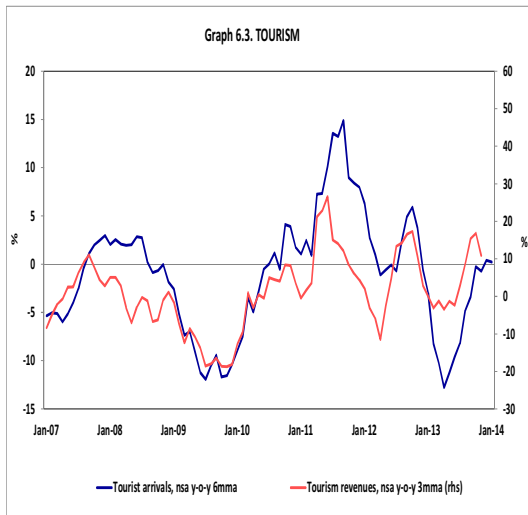
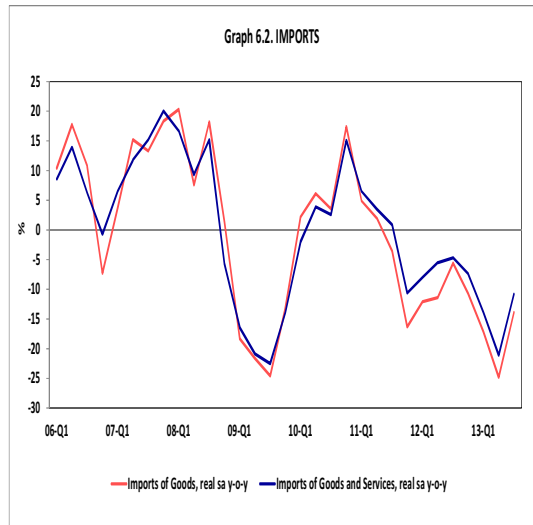
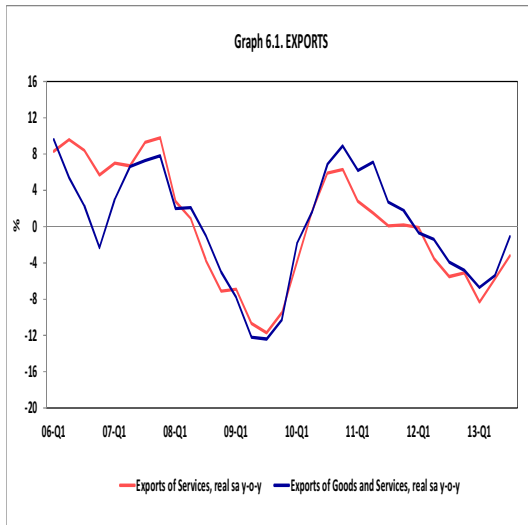
Sources: Eurostat, DG ECFIN, Cystat

5. INFLATION, WAGES



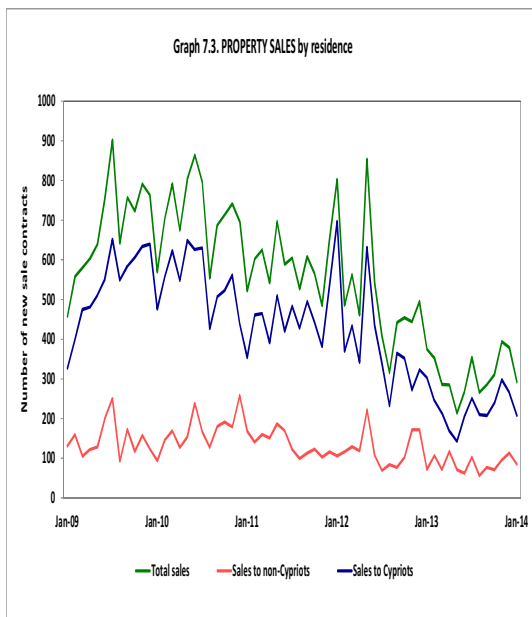
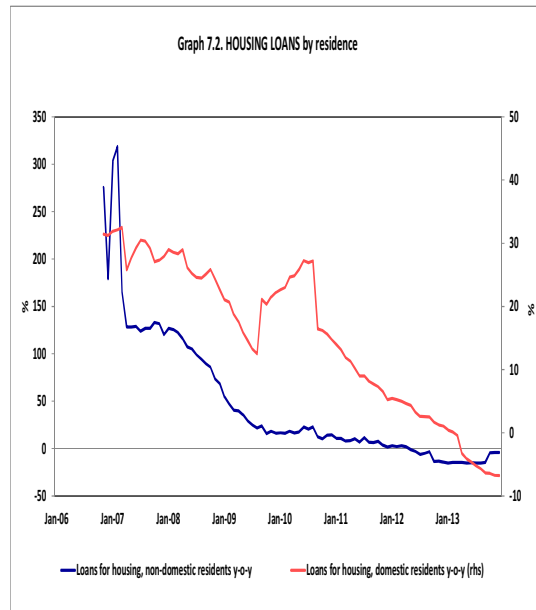
Source: Eurostat

6. EXTERNAL SECTOR



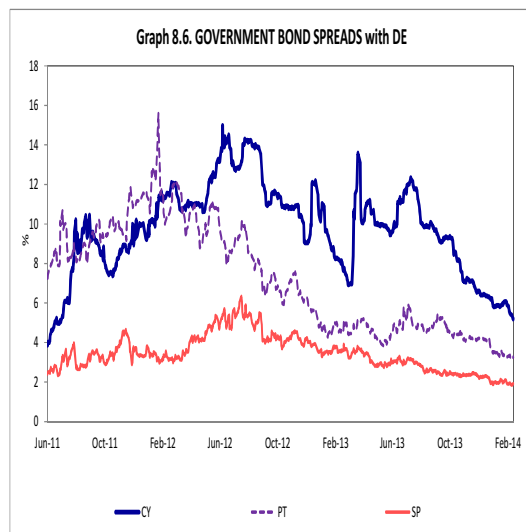
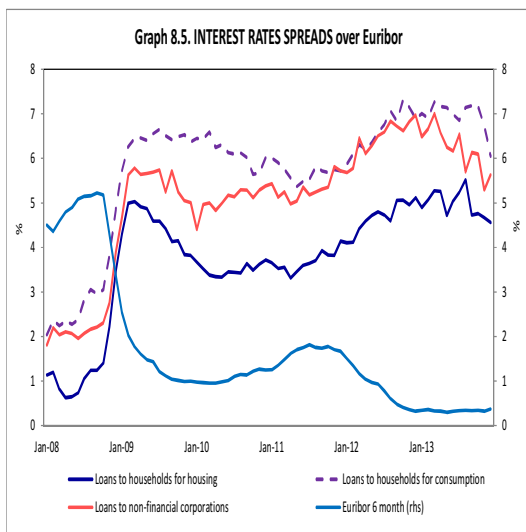
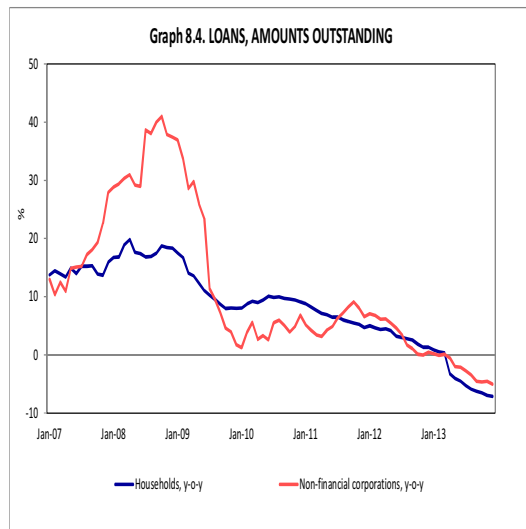
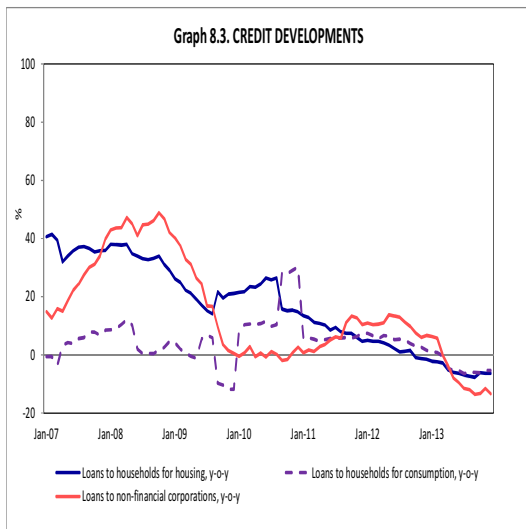
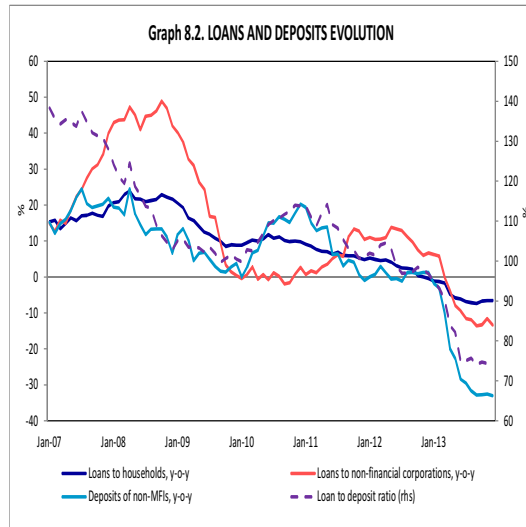
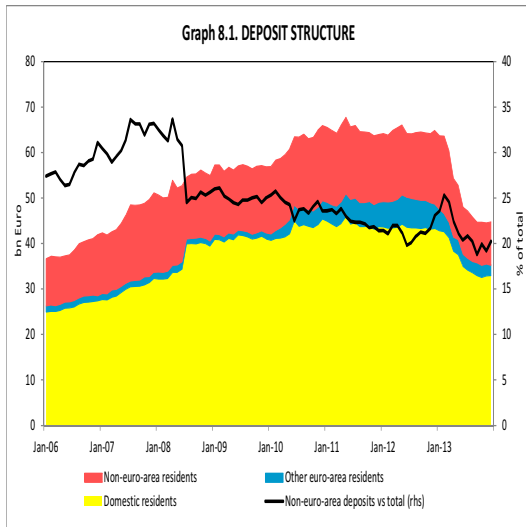
Sources: Eurostat, Cystat, ECB, CBC

7. HOUSING



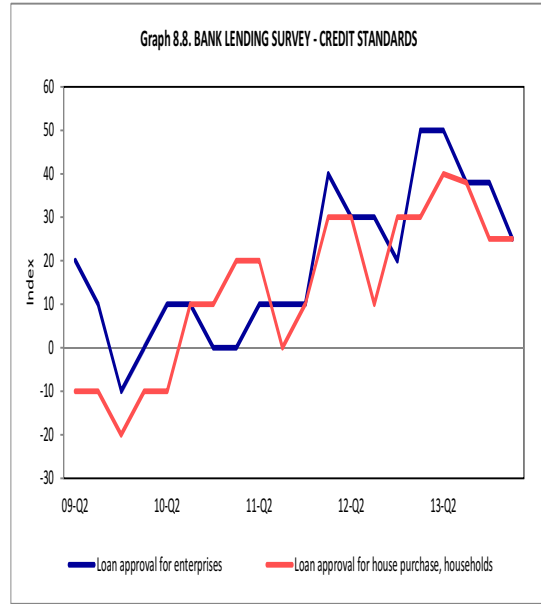
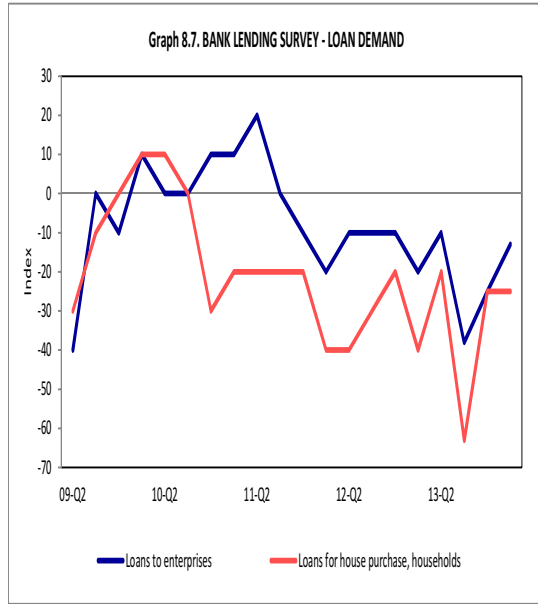
Sources: ECB, CBC, Dep. of Lands and Surveys

8. FINANCIAL SECTOR



Sources: ECB, CBC, Bloomberg

8. FINANCIAL SECTOR – cont.



Source: ECB