

MACROECONOMIC MONITOR OF CYPRUS

Updated on 24 November 2014

- In the 3rd quarter of 2014, GDP (in seasonally adjusted terms) contracted by -2% compared with -2.2% in the 2nd quarter of 2014 on an annual basis (see graphs 1.1-1.2). The contraction was mainly due to the continued subdued performance of the secondary sector (construction, manufacturing) and the financial sector, while positive growth rates were recorded in the sectors of tourism, trade and legal and accounting activities. On the expenditure side, the contraction was more pronounced in investments of construction (see graphs 3.1-3.4 and 6.1-6.2).
- The business operating environment remains constraint, given that lending to non-financial corporations is subdued and interest rates are still relative to economic conditions high. We maintain our view that growth in 2014 will remain negative, of about -2½% compared to a forecast of 2.8% contraction of the Autumn 2014 forecast of the European Commission, and we assume a rebound in 2015 with a gradual restoration of lending at affordable rates.
- Developments are currently driven by lower domestic demand (see graphs 2.1-2.4) that compares favourably to the anticipated lower levels expected originally.
- The economic sentiment indicator by CypERC decreased by 0.5 points in October 2014 compared to September 2014, still remaining in the negative territory (see graph 1.3). This decrease is due to the deterioration of the climate in all business sectors covered in the survey.
- Exports of goods decreased by 8.3% in January-September 2014 compared to the corresponding period in 2013.
- In January-October 2014 tourist arrivals increased by 1.5% compared to the corresponding period in 2013 (see graph 6.3). A decrease of 2.3% was recorded in arrivals from the United Kingdom, a 4.3% decrease in arrivals from Greece and a 5.4% increase 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 2.4% in the 1st half of 2014 compared to the 1st half of 2013. The decrease was more pronounced in the construction sector, activities of households as employers, financial and insurance activities, as well as public administration and defence.
- Labour market developments exhibit considerable flexibility adjusting to the new environment. This led to an increase in profitability 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 figures, decreased from 16.8% in September 2013 to 15.1% in September 2014 (see graphs 4.2-4.3). The most affected segment of the population is youth. Particularly worrying is also the rapid increase in long-term unemployed. The level of unemployment is expected to be about 15¼% in 2014 compared to a forecast of 16.2% of the Autumn 2014 forecast of the European Commission.
- Compensation per employee in the 1st half of 2014 declined by about 5.1% compared to the 1st half of 2013, contributing to a decline of nominal unit labour cost and improving cost competitiveness further (see graphs 5.3-5.5). The observed

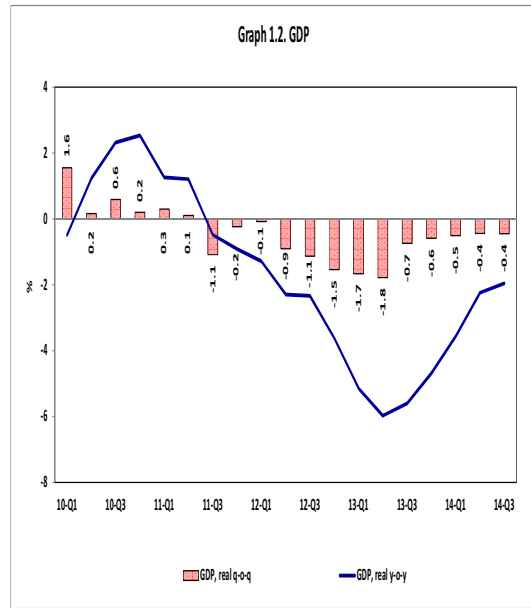
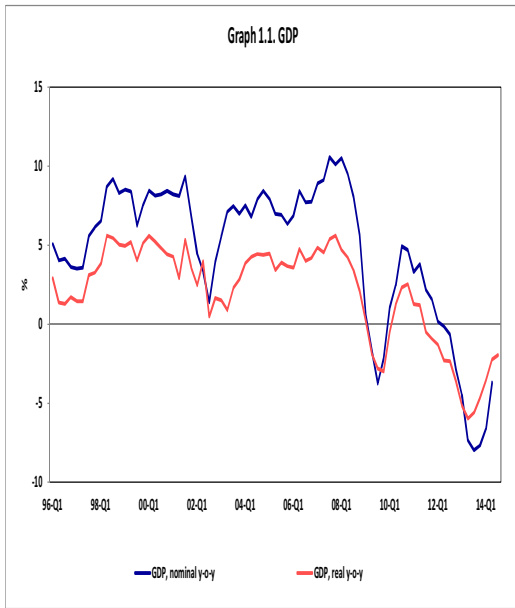
wage adjustment is expected to help containing the upward pressure on unemployment.

- Inflation (HICP) increased by 0.3% in October 2014 compared to 0% in September 2014 and for 2014 so far it stands at -0.2% (see graph 5.1). Core HICP inflation stands at 0.3% in January-October 2014 (see graph 5.2). All subcategories of HICP presented a decrease except for alcoholic beverages and tobacco, clothing and footwear, transport, communication and restaurants and hotels which presented an increase.
- The current account balance in the 1st half of 2014 recorded a deficit of €840.2 mn (4.8% of GDP) compared with a deficit of €728.3 mn (4% of GDP) in the 1st half of 2013 (see graph 6.4).
- The primary income recorded a deficit of €230.4 mn in the 1st half of 2014 compared with a deficit of €282.5 mn in the 1st half of 2013 (see graph 6.4).
- The international investment position of Cyprus (see graph 6.5) recorded a small improvement in June 2014 reaching -€27,172.8 mn compared with -€27,964.7 mn in March 2014.
- Developments in public finances continue to exceed expectations. General government budget balance (GGBB) was in surplus during the first nine months of 2014, of the order of €199.6 mn (1.2% of GDP) compared to a deficit of €278.3 mn (1.5% of GDP) during the corresponding period of the year before (see graph 9.1).
- General government primary balance (GGPB) was in surplus during the first nine months of 2014, of the order of €569.0 mn (3.3% of GDP) compared to a surplus of €161.3 mn (0.9% of GDP) during the corresponding period of the year before (see graphs 9.1-9.2).
- General government debt (see graph 9.2) during the first nine months of 2014 is at €18,393.0 mn (105.5% of GDP).
- Total revenue exhibited a positive rate of growth of about 6.6%, reaching €5,050.9 mn during the first nine months of 2014, compared to €4,736.8 mn during the corresponding period of the year before (see graph 9.3).
- Total expenditure exhibited a negative rate of growth of about 3.3%, reaching €4,851.3 mn during the first nine months of 2014, compared to €5,015.1 mn during the corresponding period of the year before (see graph 9.3).
- In accordance with the Autumn 2014 forecast of the European Commission, the budget balance is estimated to exhibit an improvement with the deficit falling to 3.0% of GDP in 2014 compared to a deficit of 4.9% the year before. We anticipate that the budget balance will not exceed -2% of GDP in 2014.
- Monetary Financial Institutions (MFI) loans to domestic residents (private sector), declined with an annual rate of 1.5% in September 2014, 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 3.2% in September 2014 vis-à-vis September 2013, reflecting the negative climate in confidence (see graph 8.1).
- Overall lending and deposit interest rates in Cyprus have declined compared to last year levels and the levels prevailing during the period prior to the bail-in. However, the decline in deposit rates is much bigger than the decline in lending rates (see

graph 8.5). In September 2014, deposit interest rates for maturity up to 1 year and up to 3 months have marginally decreased compared with the previous month. The lending interest rates to households for house purchase increased while the rate for other loans up to €1 mn for businesses decreased. 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 9.1% in the 2nd quarter of 2014 compared to the 2nd quarter of 2013. Cumulative from the 1st quarter of 2008 it has declined by 25.6% (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 23.7% while, transfers of property were up by 14.9% in January-October 2014 compared to the corresponding period of 2013 (see graph 7.3). MFI loans to domestic residents for housing declined with an annual rate of 3.2% in September 2014 (see graph 7.2).
- The Cyprus Government bond spread compared to the German Government bond, decreased in November 2014 compared to October 2014 to around 526 basis points above the German bond on 24/11/2014 from around 575 basis points above on 31/10/2014 (see graph 8.6, yields refer to the bonds maturing in 2020).
- The Republic of Cyprus issued a EUR 750 million benchmark bond due 25 June 2019. The transaction pays an annual coupon of 4.750% and was priced at a yield of 4.850% implying a spread of 414.1bps over the mid-swap reference. Joint bookrunners were Deutsche Bank, Goldman Sachs International, HSBC, UBS and VTB Capital.
- By geography, the Republic of Cyprus has achieved a broad distribution dominated by international investors, across Europe, the UK, and other international investors. By investor type, the quality of the orderbook was very high with very strong granularity. Real-money demand dominated the orderbook, at around two thirds, with Fund Managers the largest investor class at 51%, and well supported by Hedge Funds and Bank interest.

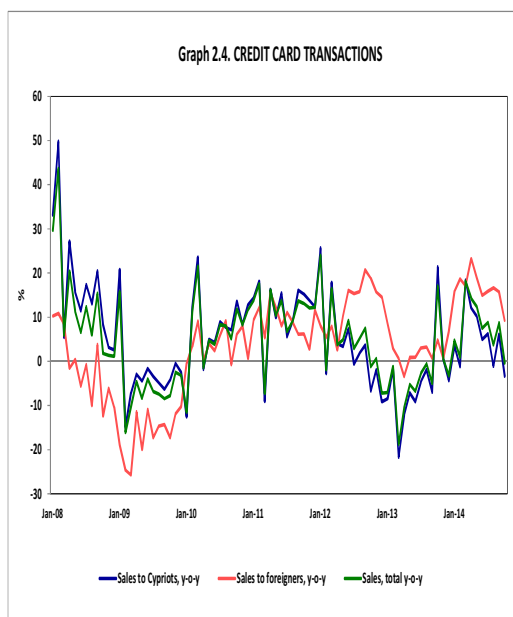
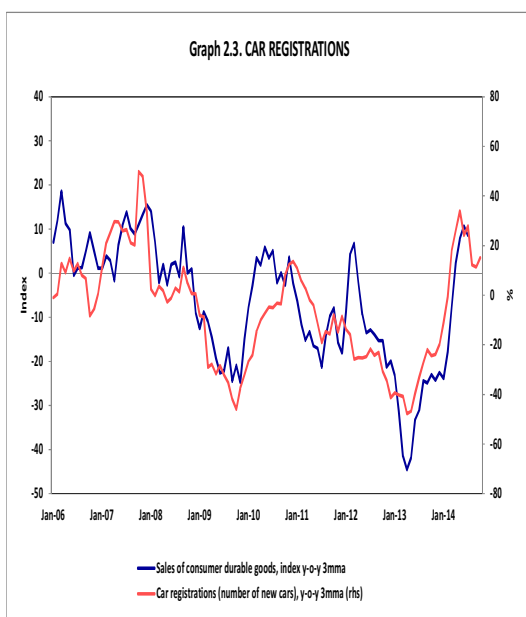
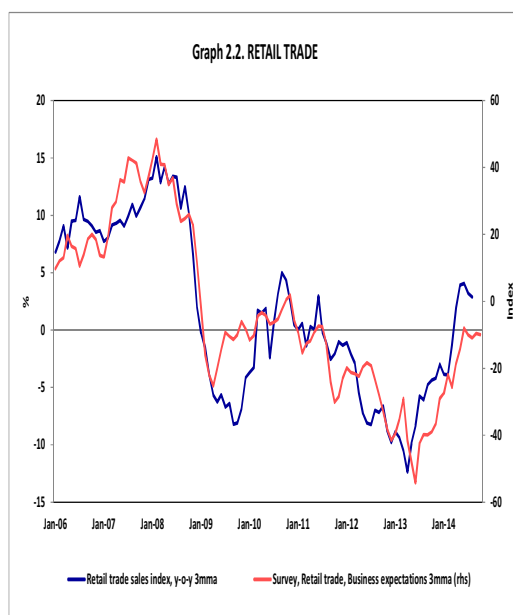
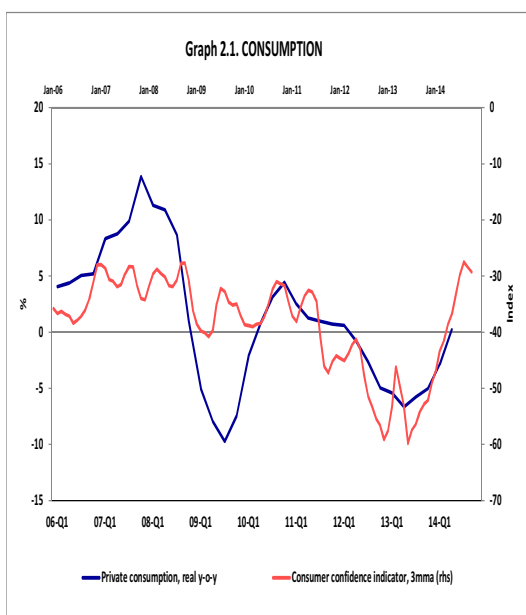
1. OUTPUT



Sources: Eurostat, DG ECFIN, Cystat

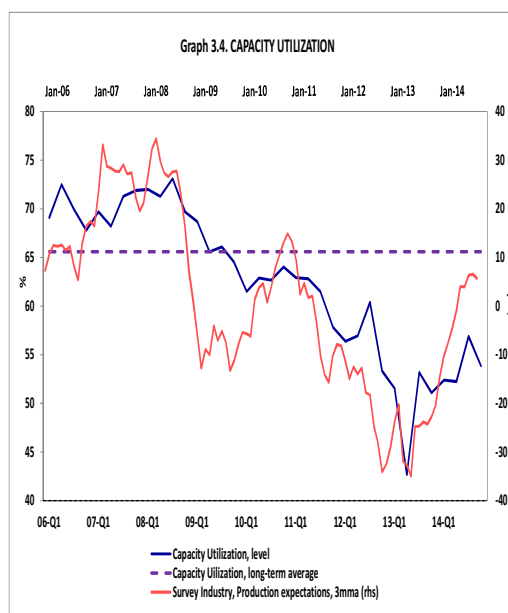
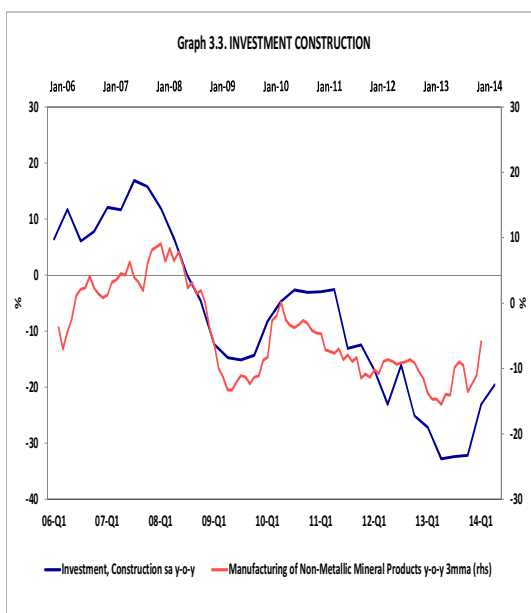
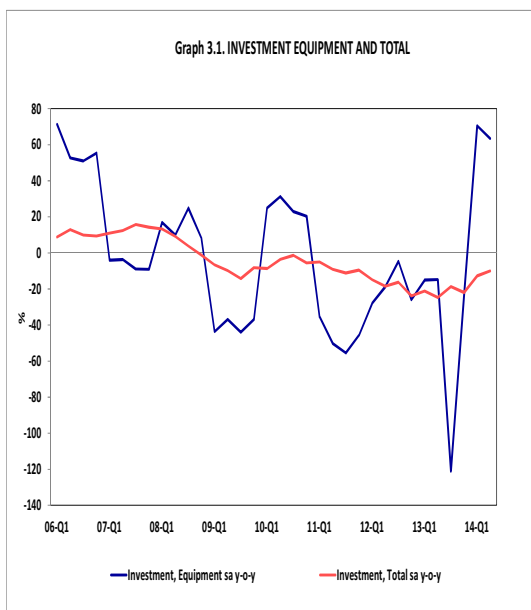
Note: Regarding graphs 1.1 and 1.2, real GDP data from 2010 onwards are compiled according to the European System of Accounts (ESA) 2010.

2. CONSUMPTION



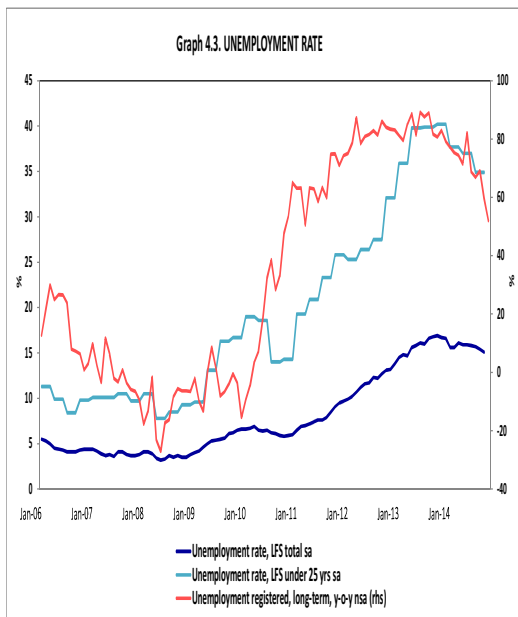
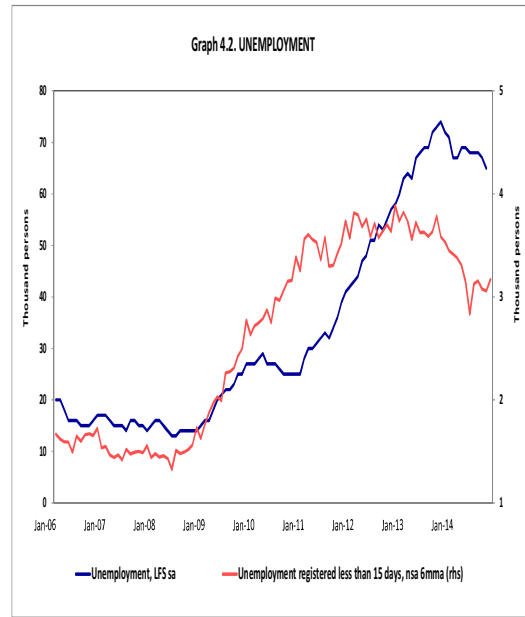
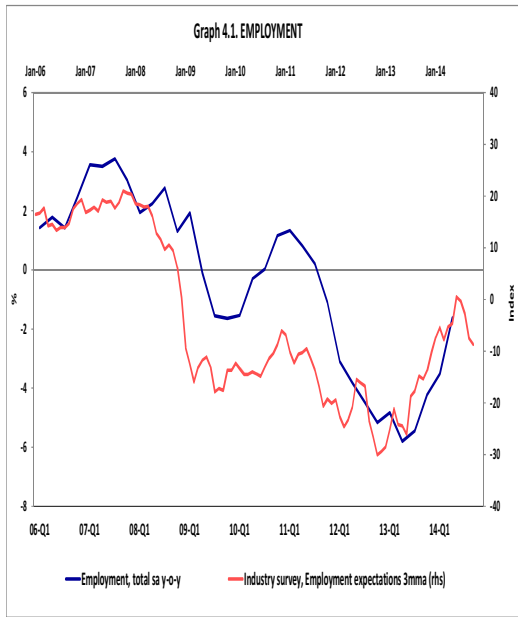
Sources: Eurostat, DG ECFIN, Cystat, JCC Payment Systems Ltd

3. INVESTMENT



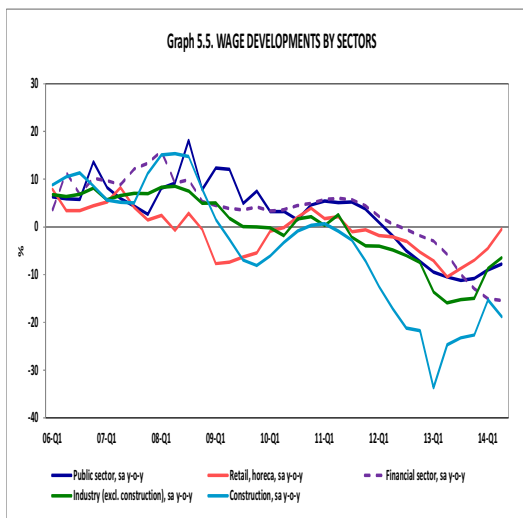
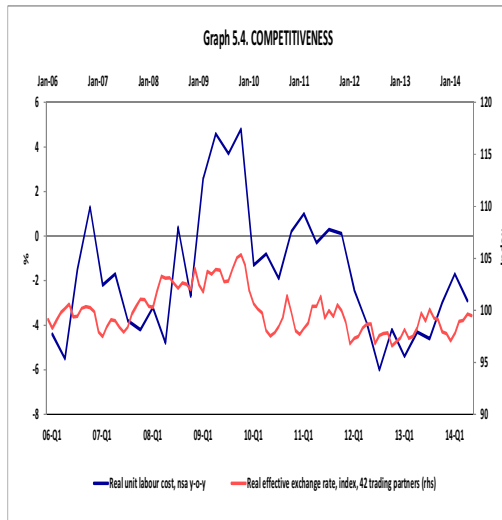
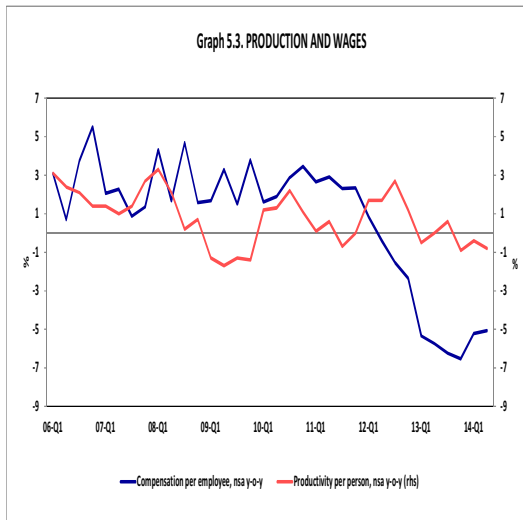
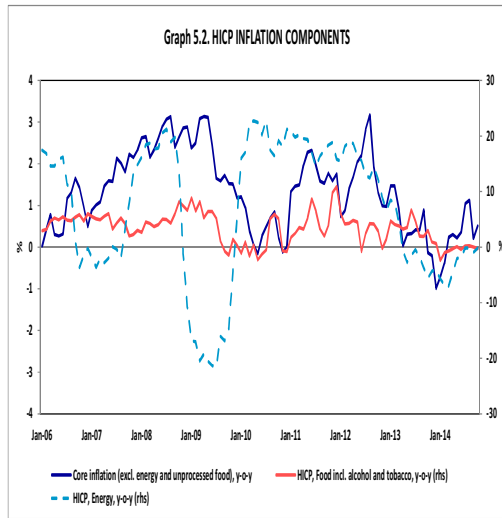
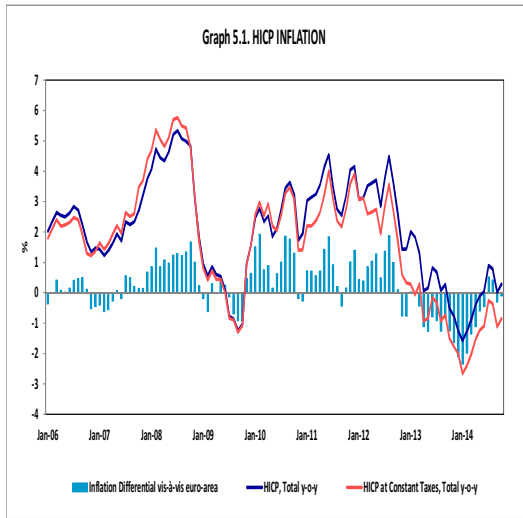
Sources: Eurostat, DG ECFIN, Cystat

4. LABOUR MARKET



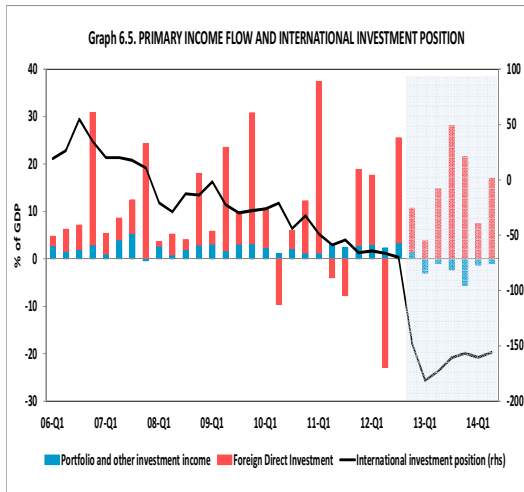
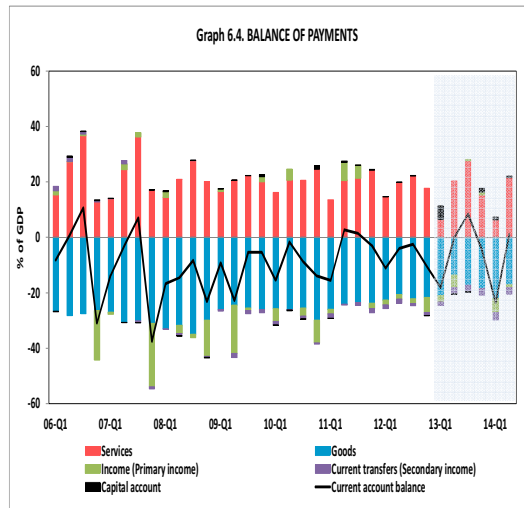
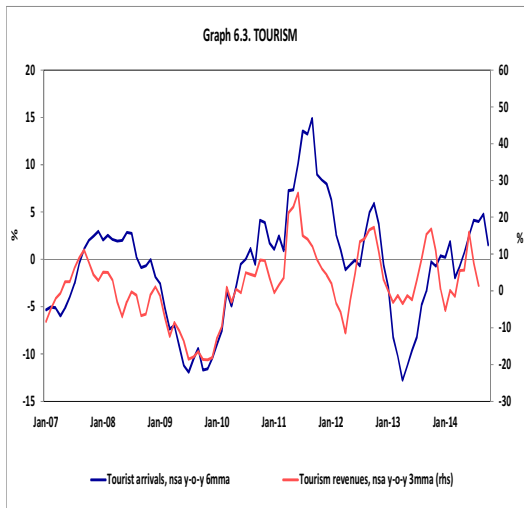
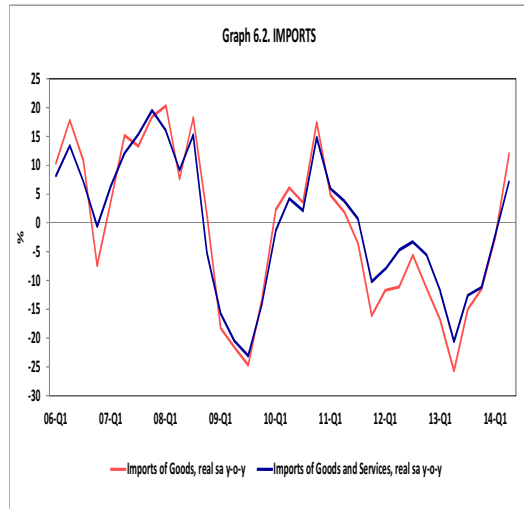
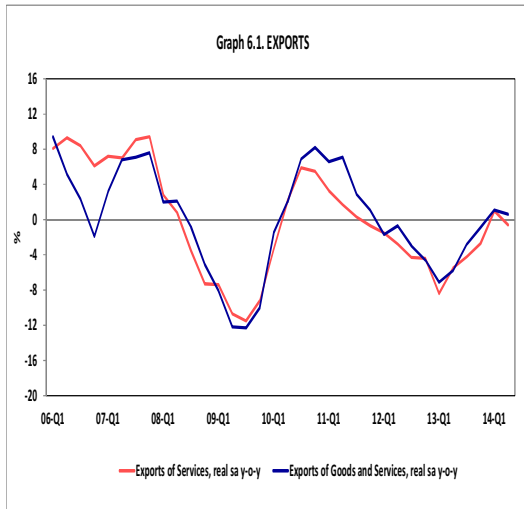
Sources: Eurostat, DG ECFIN, Cystat

5. INFLATION, WAGES



Source: Eurostat

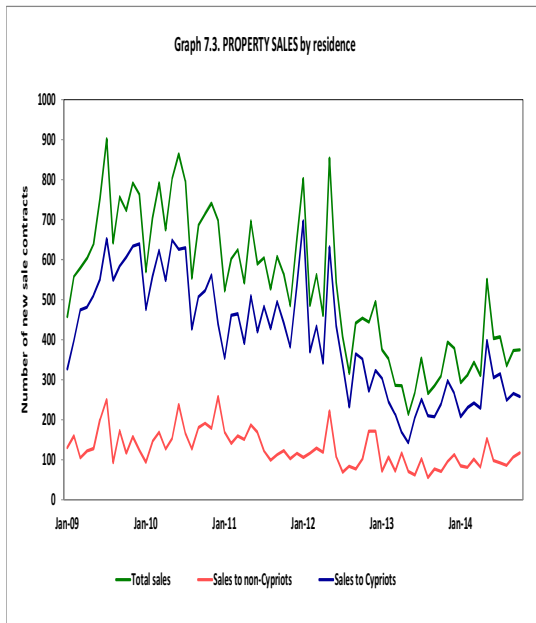
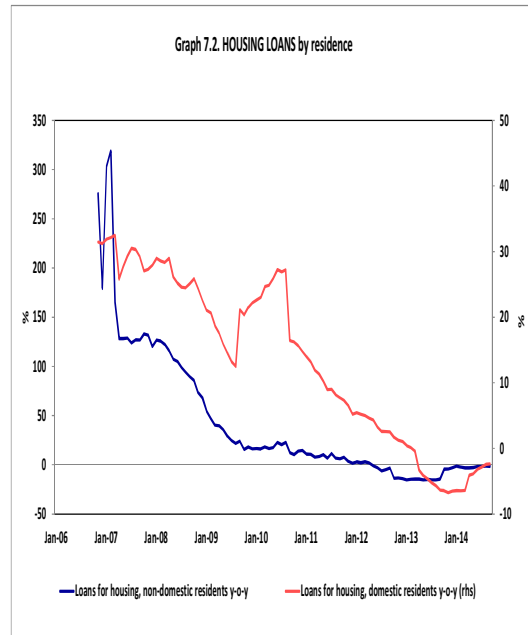
6. EXTERNAL SECTOR



Sources: Eurostat, Cystat, ECB, CBC

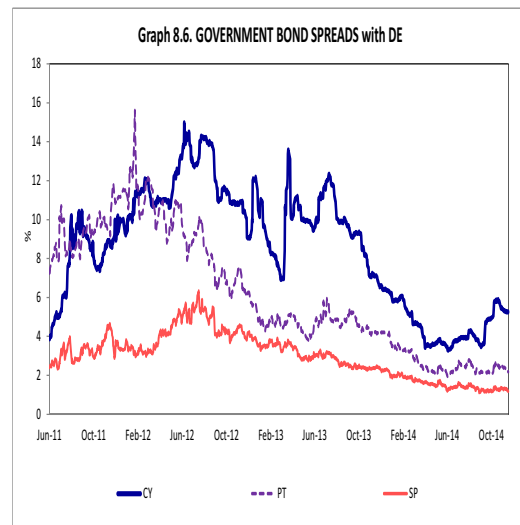
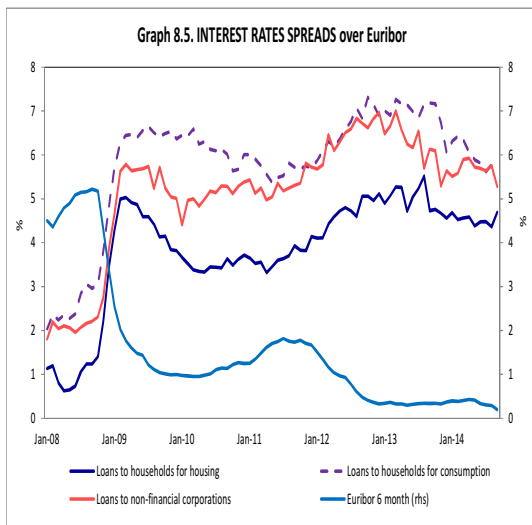
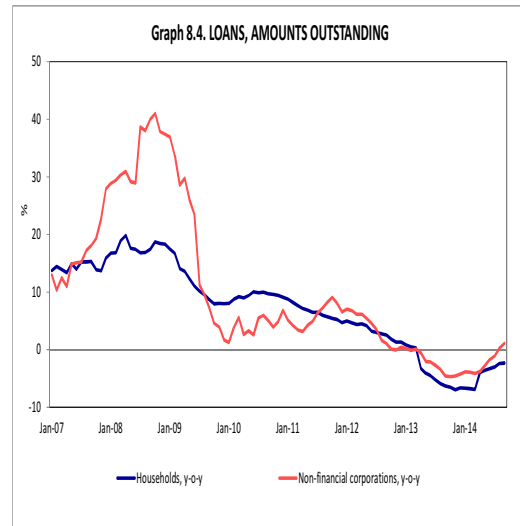
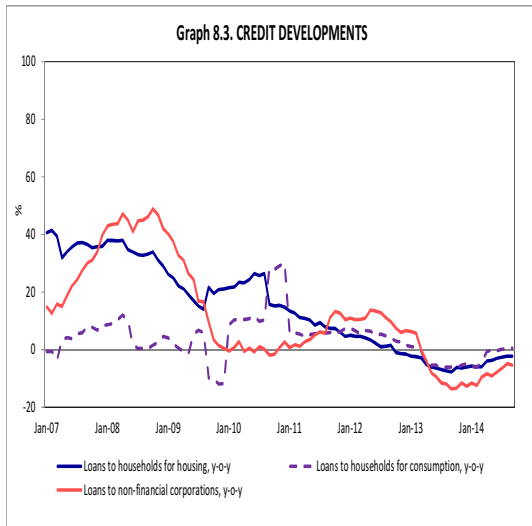
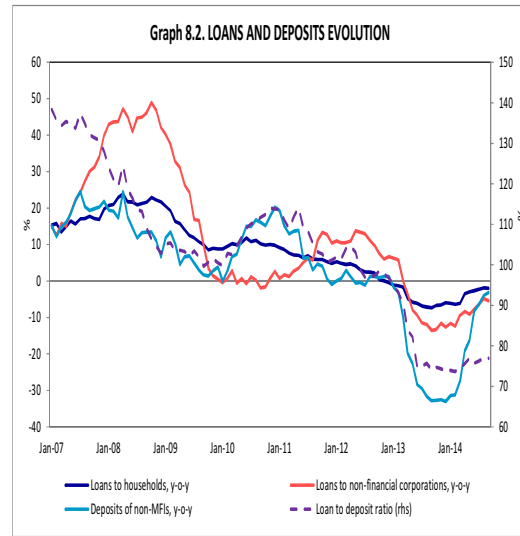
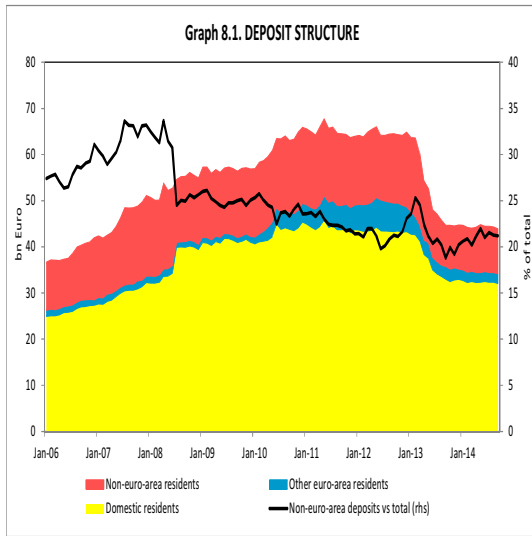
Note: Regarding graphs 6.4 and 6.5, BoP data from 2013 onwards and IIP data from 2012Q4 onwards are compiled in accordance with the new international methodological standards (BPM6) and are not comparable to data prior to this.

7. HOUSING



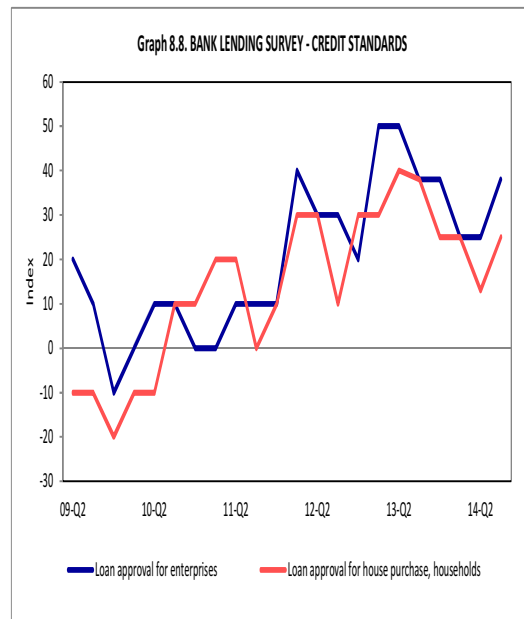
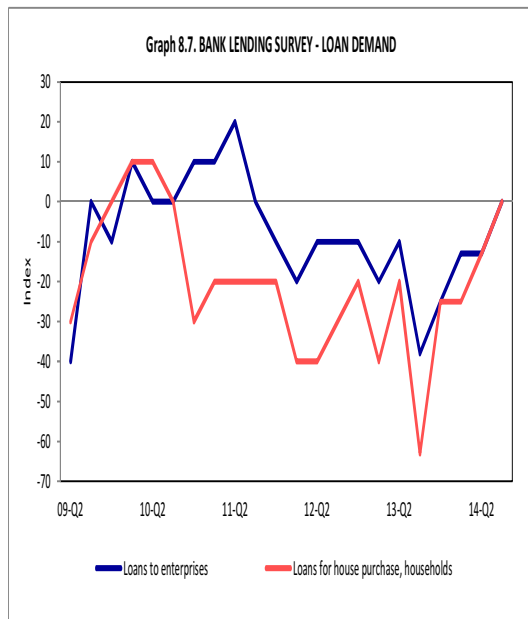
Sources: ECB, CBC, Dep. of Lands and Surveys

8. FINANCIAL SECTOR



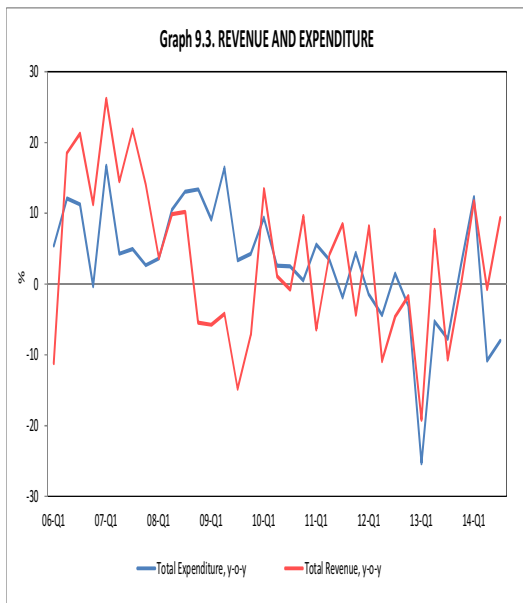
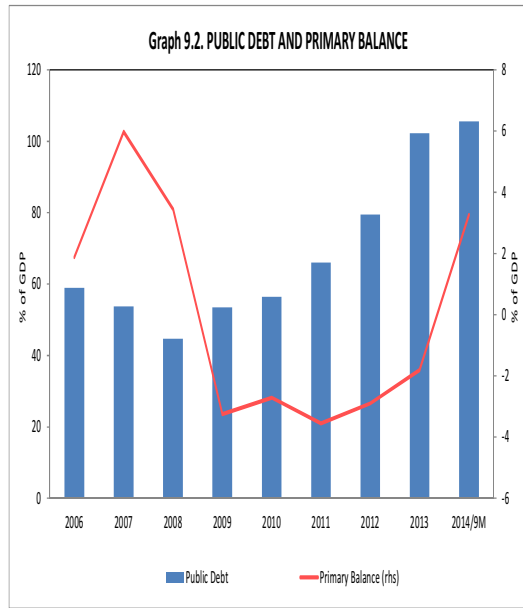
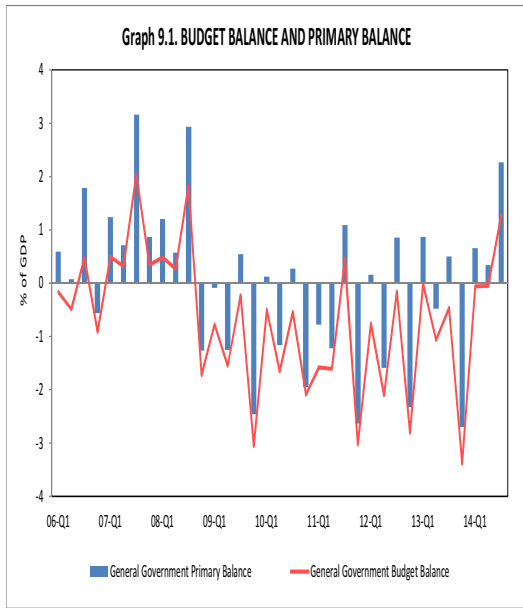
Sources: ECB, CBC, Bloomberg

8. FINANCIAL SECTOR – cont.



Source: ECB

9. PUBLIC SECTOR



Sources: Ministry of Finance, Cystat