

Cyprus: Macroeconomic Outlook in brief

January 2014

Main Messages

- April 2013, agreement of the Eurogroup on the MoU for Cyprus, supported by IMF
- ... provided financing of the order of 10 bln Euros for liquidity support and restructuring of the economy
- First and second Troika review missions positive: growth and fiscal targets achieved, all policies implemented as planned
- however still challenges looking forward, in particular due to weak growth outlook
- ... commitment of the Government to implement fiscal, structural and banking sector reforms, included in the MoU
- ... restoration of confidence to the banking sector key for gradual recovery over the medium-term horizon
- structural reforms, as provided in the MoU, in conjunction with promising prospects in tourism as well as in the energy sector are expected to contribute to gradual rebound of growth over the medium-term

The Cyprus economy in 2003-2008

	2003	2004	2005	2006	2007	2008
Real GDP (%)	1.9	4.2	3.9	4.1	5.1	3.6
HICP inflation (%)	4.0	1.9	2.0	2.2	2.2	4.4
Unemployment Rate (%)	4.1	4.7	5.3	4.5	3.9	3.7
Fiscal Deficit(-)/Surplus(+) (% of GDP)	-6.6	-4.1	-2.4	-1.2	3.5	0.9
Public Debt (% of GDP)	69.7	70.9	69.4	64.7	58.8	48.9

- Cyprus economic record over the last decades is sound (satisfactory growth, low unemployment, low inflation, manageable fiscal deficits, public debt)
- Satisfactory performance during 2003-2008
 - ✓ real GDP grew on average by around 4%, driven by export of services (tourism, business services, real estate)
 - ✓ the unemployment rate was at around 4½% on average
 - ✓ inflation was at low levels
 - ✓ the fiscal balance presented relatively small deficits in 2004-2006 and then turned into surplus in 2007-2008
 - ✓ the debt-to-GDP ratio was below 50% in 2008

The crisis after 2008

- The crisis has exposed problems that existed in the banking sector (excessive lending, excessive borrowing by corporations)
- Fiscal surpluses were depending on unstable sources
- Competitiveness problems (wages above productivity)

	2008	2009	2010	2011	2012	2013 ^f
Real GDP (%)	3.6	-1.9	1.3	0.4	-2.4	-5.5
HICP inflation (%)	4.4	0.2	2.6	3.5	3.1	0.4
Unemployment Rate (%)	3.7	5.4	6.3	7.9	11.8	16.0
Fiscal Deficit(-)/Surplus(+) (% of GDP)	0.9	-6.1	-5.3	-6.3	-6.4	-5.5
Public Debt (% of GDP)	48.9	58.5	61.3	71.5	86.6	113.5

Economic adjustment programme

Given the challenges, an ambitious economic programme was necessary to recapitalize banks and provide financing for the Government operations.

The programme will address short- and medium-term financial, fiscal and structural challenges facing Cyprus.

The measures are under three main pillars:

- Banking sector (improve supervision, strengthen liquidity, recapitalize banks, rebuild depositors' and market confidence)
- Public finances (fiscal consolidation in order to correct the excessive general government deficit by 2016 and achieve surpluses thereafter)
- Structural measures (to support competitiveness and sustainable and balanced growth)
 - Enhancement of Budgetary Framework, to safeguard fiscal discipline
 - Labour market reform, to contain wage costs
 - Pension reforms, to ensure long-term sustainability
 - Health care sector reform
 - Reform of the public sector, to improve service delivery to businesses and citizens

Economic adjustment programme

- Continuing monitoring of performance, through the EU and IMF
- Two positive review missions
- Cyprus economic adjustment programme on track
- The programme projects a recession in 2013-2014 and a gradual recovery in 2015-2016 and thereafter

Current situation

- GDP is expected to contract by around -5.5%, compared with -8.7% included in the economic adjustment programme
- Private consumption decline less pronounced than originally thought, tourism revenues in a positive territory – activities of international companies stable
- Unemployment increasing trend – however stabilization after 2014
- Substantial wage declines, enhancing competitiveness
- The fiscal deficit is much lower than expected – positive effects on public debt
- Banks have been recapitalized – they are now in a position to withstand shocks
- Foreign investors interest in Hellenic Bank
- Deposit outflows are slowing down
- Restructuring plan for problematic loans
- MoU provides for sizeable financial buffers. Cyprus in a position to withstand shocks, if they emerge

Foreign Investments

Top reasons to invest in Cyprus

- Strategic location between Europe, Asia and Africa
- Highly developed infrastructure
- Highly qualified and multilingual workforce
- Business friendly tax and legal system
- Sophisticated, high quality professional services and support
- Untapped potential for investments
- High quality of life

Conclusions

- Cyprus in a position to address challenges supported by strong commitment to implement MoU, growth package to stimulate investment and employment
- Low growth environment – however investment in infrastructure (related to natural gas), lower energy prices, improvement in exports expected to dampen downward impact on growth
- Unemployment to remain elevated – however stabilization is expected after 2014
- Wage moderation – positive effects on competitiveness
- Core inflation declining trend
- Fiscal challenges – buffers to address challenges
- Return to sovereign debt markets appears feasible over the medium-term