



MACROECONOMIC MONITOR OF CYPRUS

July 2018

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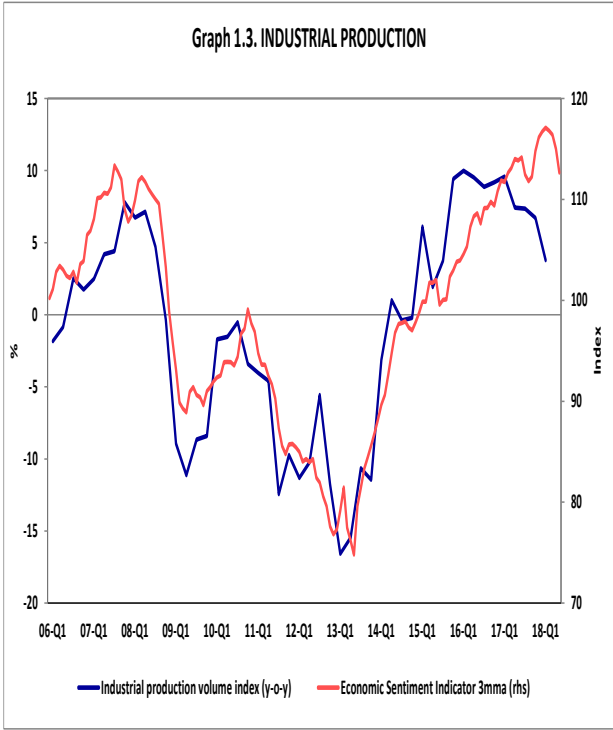
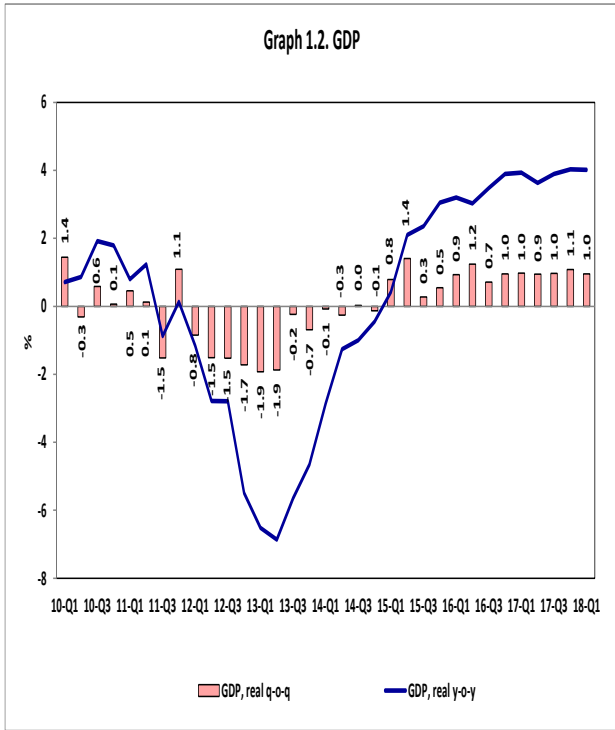
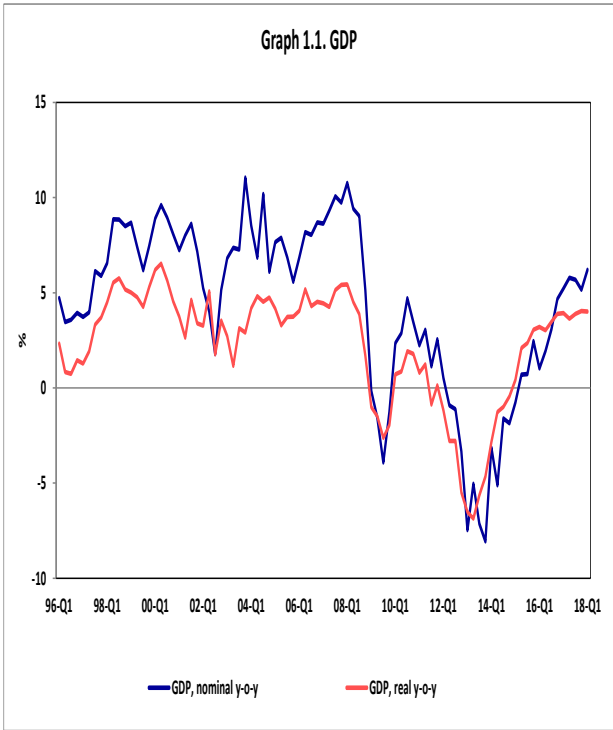
Updated on 18 July 2018

- **In the 1st quarter of 2018, GDP** (in seasonally adjusted terms) **recorded a positive rate of growth of 4.0%, same as in the 4th quarter of 2017** on an annual basis (see graphs 1.1-1.2). The increased activity was broad based and is mainly attributed to sectors: hotels and restaurants, retail and wholesale trade, construction, manufacturing, professional, scientific and technical activities and administrative and support service activities (see graphs 3.1-3.4 and 6.1-6.2).
- Developments are currently driven by increases in **private consumption and net exports** (see graphs 2.1-2.4).
- The economic sentiment indicator (ESI-CypERC) in June 2018, decreased by 7.0 points compared with May 2018 (see graph 1.3). The decline resulted from confidence losses in all sectors surveyed, and among consumers. Compared with June 2017, it has also decreased by 7.0 points.
- During the period January-June 2018 **tourist arrivals increased at a rate of 12.4%** compared to January-June 2017 (see graph 6.3). An increase of 15.6% was recorded in tourist arrivals from Greece, a 9.7% increase from the UK, a 9% increase from Germany, while a 4.7% decrease was recorded from Russia.
- **Employment** developments reflect conditions of strong economic activity (see graphs 4.1 and 4.4). Employment in persons **increased by 4.0%** in the 1st quarter of 2018 compared to the 1st quarter of 2017. Increases were mainly in the sectors of construction, accommodation and food service activities, wholesale and retail trade, manufacturing and professional, scientific and technical activities.
- **Labour Force Survey (LFS) unemployment**, in monthly seasonally adjusted terms, decreased to **8.4% in May 2018 compared to 11.4% in May 2017** (see graphs 4.2-4.3). The most affected segment of the population is youth unemployment, although it has been on a downward trend since the 3rd quarter of 2013 falling to 22.4% in 2018Q1 from the peak of 40.4% in the 3rd quarter of 2013. Particularly challenging is also the relatively high long-term unemployment.
- **Compensation per employee** increased by 1.0% in the 1st quarter of 2018 compared to the 1st quarter of 2017 (see graphs 5.3-5.5).
- **Inflation (HICP)** in June 2018 increased by 1.7% compared to an increase of 1.0% in May 2018 (see graph 5.1). For the period January-June 2018 the HICP remained stable compared to the corresponding period of the previous year. Core HICP inflation also remained stable in January-June 2018 (see graph 5.2). All subcategories of HICP presented a decrease except categories of housing, health, transport, education and restaurants and hotels.
- **Imports of goods increased by 16.7%** in January-May 2018 compared to January-May 2017. The increase in imports is affected by developments in imports of transport equipment (aircrafts and vessels). Imports of goods, excluding imports of aircrafts and vessels, exhibit an increase of 12.5%.
- **Exports of goods increased by 90.2%** in January-May 2018 compared to January-May 2017 due to exports of transport equipment (aircrafts and vessels) occurred in 2018. Exports of goods, excluding exports of aircrafts and vessels, exhibit an increase of 26.7%.
- The **current account (CA)** balance (see graph 6.4) improved in the 1st quarter of 2018, recording a deficit of €86.3 mn (-0.4% of GDP), compared with a deficit of €738.3 mn (-3.8% of GDP) in the 1st quarter of 2017. This improvement was mainly due to the trade balance of goods, with exports of goods, mostly ships, recording very large increases compared with 2017Q1. The current account balance was, to a much lesser extent, positively affected by the improvement in services while both, primary and secondary income, recorded deterioration. The CA balance for 2018Q1, adjusted to exclude imports/exports of Special Purpose Entities (SPEs) that primarily operate in the shipping industry (ship registration/deregistration) with a small footprint on the economy, records a deficit of 2.1% of GDP compared to a deficit of 2.4% of GDP the same quarter the year before.
- The **primary income** recorded a **deficit of €128.2 mn** in the 1st quarter of 2018 compared to a deficit of €60.6 mn in the 1st quarter of 2017 (see graph 6.4).

- The **secondary income** recorded a **deficit of €112.0 mn** in the 1st quarter of 2018 compared to a deficit of €90.1 mn in the 1st quarter of 2017 (see graph 6.4).
- The **international investment position (IIP)** (see graph 6.5) recorded a small improvement in the 1st quarter of 2018, showing a net liability position at €22,867.6 mn, compared with €23,139.4 mn the previous quarter. The decrease in Cyprus' net liabilities was mainly due to the improvement in direct investment and, to a lesser extent, portfolio investment and financial derivatives. Other investment, on the contrary, worsened.
- The **gross external debt** reached €105,756.2 mn in the 1st quarter of 2018, compared with €107,058.5 mn in 2017Q4. The improvement was mainly due to the decrease in the debt of monetary financial institutions (excluding the CBC) and, to a lesser extent, the decrease in the debt of the government and intercompany lending. The debt of other sectors, on the other hand, recorded an increase, which mitigated the above improvements.
- **General government budget balance (GGBB)** was in surplus in January-May 2018, of the order of €386.9 mn (1.9% of GDP) compared to a surplus of €115.9 mn (0.6% of GDP) during the corresponding period the year before (see graph 9.1).
- **General government primary balance (GGPB)** was in surplus in January-May 2018, of the order of €544.3 mn (2.6% of GDP) compared to a surplus of €288.7 mn (1.6% of GDP) during the corresponding period the year before (see graphs 9.1-9.2).
- **Total revenue** exhibited a positive rate of growth of about 11.9%, reaching €3,073.1 mn in January-May 2018, compared to €2,746.2 mn during the corresponding period the year before (see graph 9.3).
- **Total expenditure** exhibited a positive rate of growth of about 2.1%, reaching €2,686.2 mn in January-May 2018, compared to €2,630.3 mn during the corresponding period the year before (see graph 9.3).
- Monetary Financial Institutions (MFI) **loans to domestic residents** (private sector), **decreased** with an **annual rate of 0.9%** in May 2018, affecting both households and enterprises (see graphs 8.2-8.4). This is reflecting the tight lending conditions (see graphs 8.7-8.8).
- **Deposits of domestic** residents held with MFIs (private sector) exhibited an increase translating into an **annual rate of 2.9%** in May 2018, reflecting the improving performance of the economy (see graph 8.1).
- Overall **lending and deposit interest rates** in Cyprus continue to decline, creating an environment conducive to growth (see graph 8.5). In May 2018, **deposit interest rates** for maturity of up to 1 year decreased and of up to 3 months remained unchanged compared with the preceding month. The **lending interest rates** to households for primary residence and the rate for other loans up to €1 mn for businesses decreased. The interest rate for bank overdrafts to non-financial corporations also decreased. A significant deviation of the Cypriot interest rates, compared to the euro area average still prevails.
- Eurostat's **house price index** for Cyprus recorded an **increase of 3.7%** in the **1st quarter of 2018** compared to the 1st quarter of 2017.
- The CBC's **residential property price index** recorded an increase of **0.4%** in the **4th quarter of 2017** compared to the 3rd quarter of 2017 and an increase of 1.5% compared to the 4th quarter of 2016. Cumulative from the 1st quarter of 2008 it has declined by 28% (see graph 7.1), revealing an adjustment to the conditions of lower domestic and foreign demand.
- According to the Department of Lands and Surveys, new sale contracts were up by 23.8% while, transfers of property were up by 23.6% in January-June 2018 compared to January-June 2017 (see graph 7.3). MFI mortgage loans to domestic residents for housing declined with an annual rate of 0.5% in May 2018 (see graph 7.2).
- The Cyprus Government bond yield was below the respective German Government bond yield by 43 basis points on 18/07/2018 (see graph 8.6, yields refer to the bonds maturing in 2020).

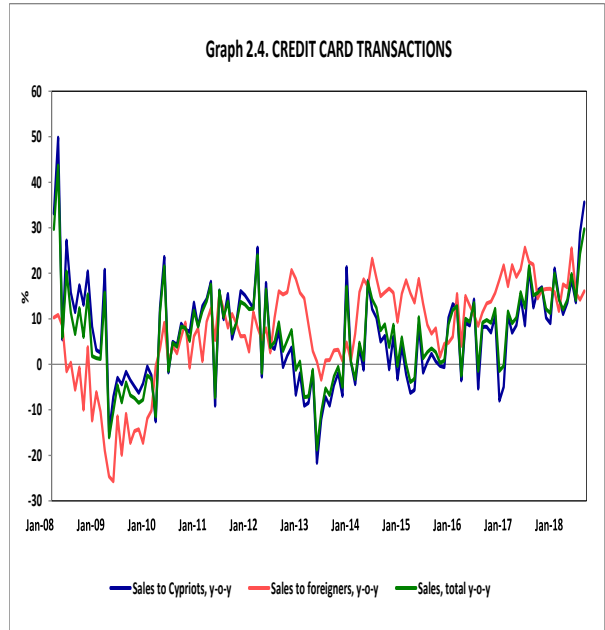
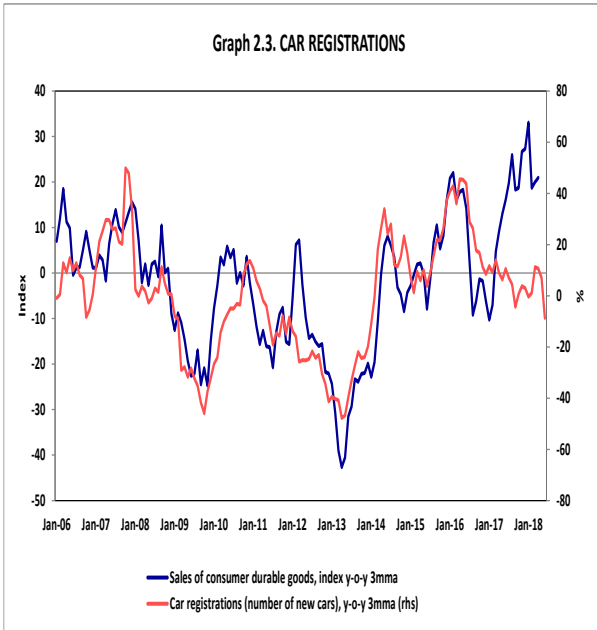
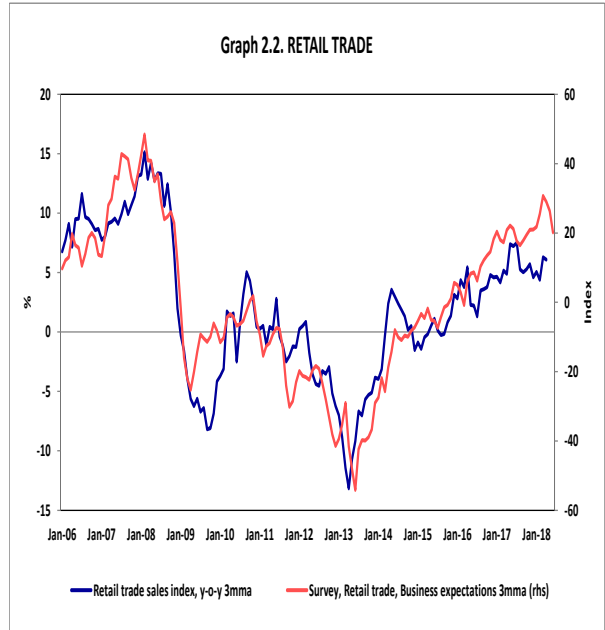
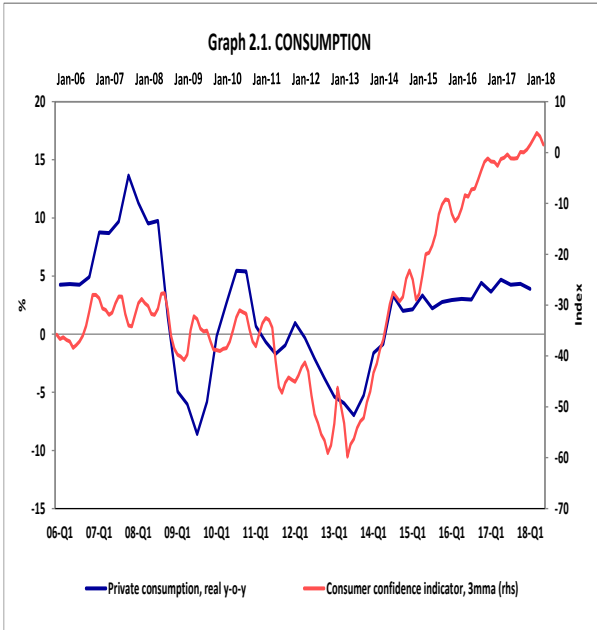
- NPEs represent the remaining legacy challenge currently faced by the Cyprus economy, amounting to approximately 41.7% of total lending in February 2018 compared to 42.5% in December 2017 and 46.4% at the end of 2016, whereas NPEs over 90 days past due amounted to approximately 32.1% of total lending in March 2018 compared to 32.6% in December 2017 and 34.0% at the end of 2016.
- There was a significant increase in January 2018, in figures for total loans, NPEs and impairment, mainly due to the introduction of IFRS 9 and a related methodology change in the accounting treatment as of January 1st, 2018 that requires additional impairment provisions to be recognised, imposing stricter criteria and requirements.
- NPEs in absolute terms are generally exhibiting a downward trend, reaching €20.3 bn in March 2018, down from €27.3 bn in 2015. NPEs are classified based on the harmonised definition of the European Banking Authority which includes loans that have been restructured and, even though meet the revised repayment program, retain the NPE status for at least 12 months after restructuring before being reclassified as performing. The downward trend in NPEs can be attributed to increased repayments, restructurings successfully completed and reclassified as performing facilities, write-offs and settlement of debt through swaps with immovable property.
- Accumulated provisions on lending represented 49.1% of NPEs in March 2018, a significant increase compared to 47.3% as at end 2017 and 42.4% as at the end of 2016, thus facilitating restructuring activity with a view to cure NPEs of viable customers.
- The Authorities aim to further facilitate the reduction of NPFs, namely by strengthening the effectiveness of the legal framework related to the management of non-performing exposures and strategic defaulters, addressing the most challenging portfolio of NPFs (mortgage loans or SME loans with primary residence of the borrower as collateral) through burden sharing between stakeholders and state support targeting vulnerable households (“ESTIA” scheme) and the sale of Cyprus Cooperative Bank (CCB) to strategic investor(s). The strengthening of the legal framework was completed with the enactment of a series of laws on July 8th. The enhanced framework facilitates the development of a functioning secondary market for NPEs in Cyprus, further strengthens the law on foreclosures, enhancing the sale of loans law and introducing a law on loan securitization.
- The “ESTIA” scheme has been developed in co-operation with specialized consultants and in constant consultation with the European Institutions, aiming at: a) the protection of the Primary Residency and b) the mitigation of the issue of non-performing loans in the Cypriot banking system. Its implementation is expected to have a positive impact on the resilience of Cypriot Banks.
- On 25/06/2018, the Government agreed with Hellenic Bank over the transfer of assets amounting to €10.3 bn and deposits of €9.7 bn of the Cyprus Cooperative Bank (CCB). The Government issued government bonds amounting to €3.19 bn to bolster the CCB’s assets. The terms of the acquisition also include an Asset Protection Scheme (APS) created by the CCB, and guaranteed by the Republic of Cyprus.
- Against the State’s deposit of €3.54 bn (€3.19 plus €351 mn) with CCB, CCB pledged assets in return. The pledge covers CCB’s NPEs as well as other non-core assets. The above pledge was based on a bilateral agreement signed between the two parties. The state deposit as well as the above assets will remain in the residual entity. The Residual Entity’s sole and single activity will be to manage the assets within in its perimeter, with the objective of divesting, liquidating or winding down the assets in an orderly manner but with a view to maximising the value to repay the State as much and as swiftly as possible.
- By retaining most of CCB’s non-performing exposures (NPEs) in the residual entity, the transaction will reduce banking sector NPEs by €5.7 bn and bring the NPE ratio to 35% from 42%.

1. OUTPUT



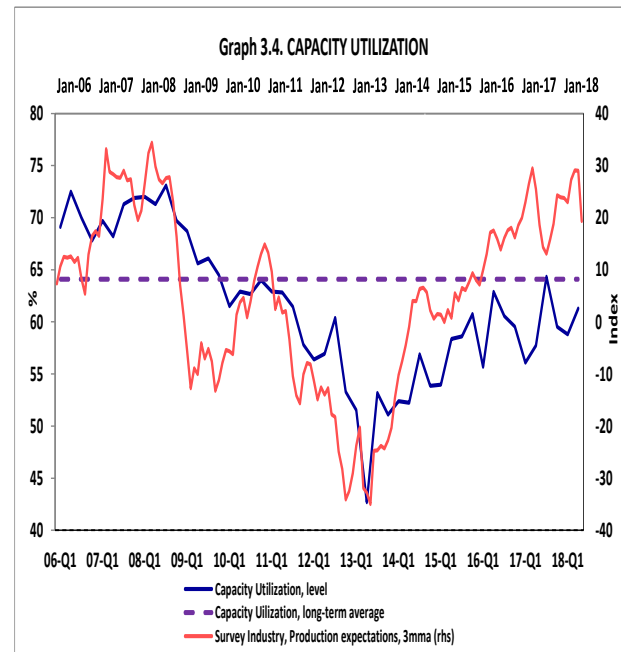
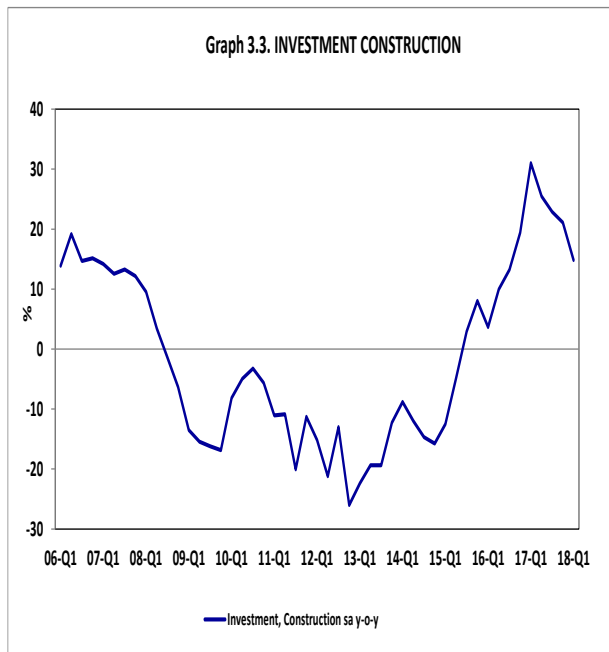
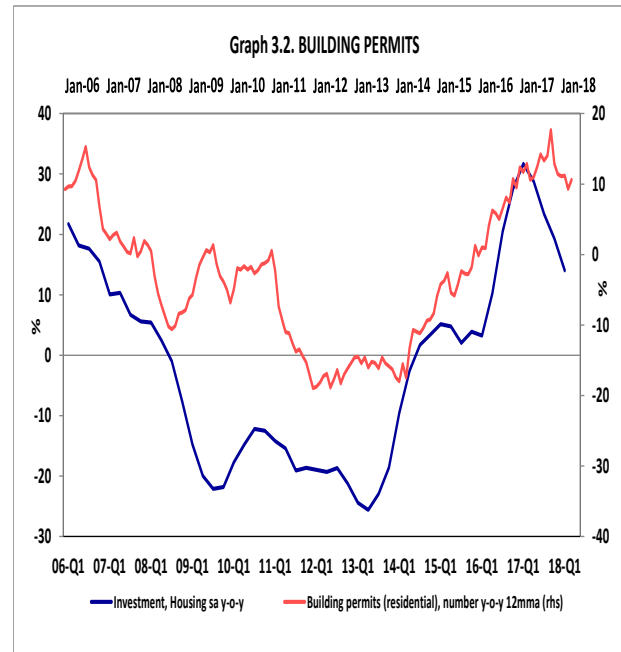
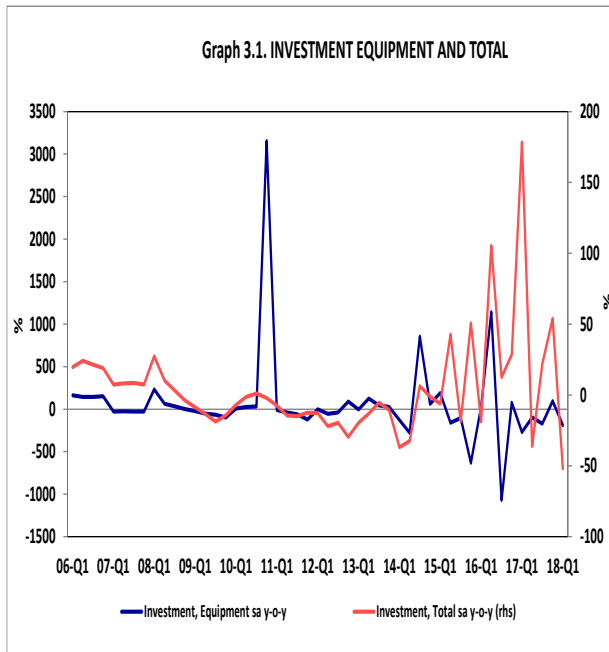
Sources: Eurostat, DG ECFIN, Cystat

2. CONSUMPTION



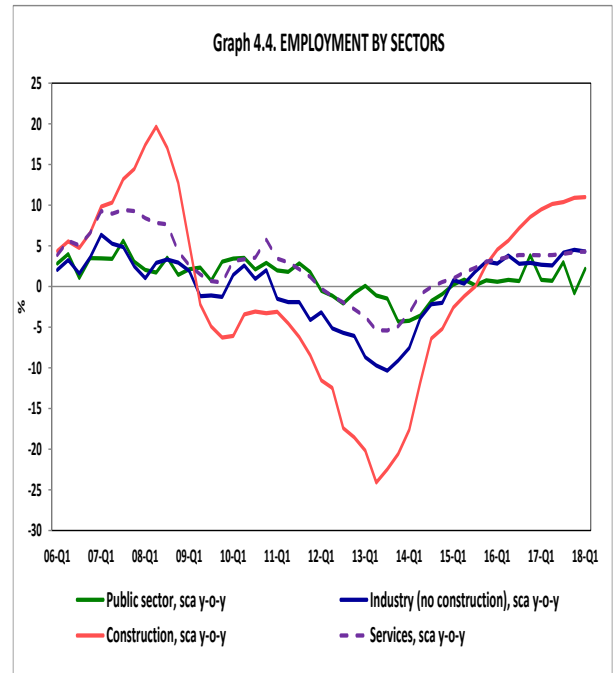
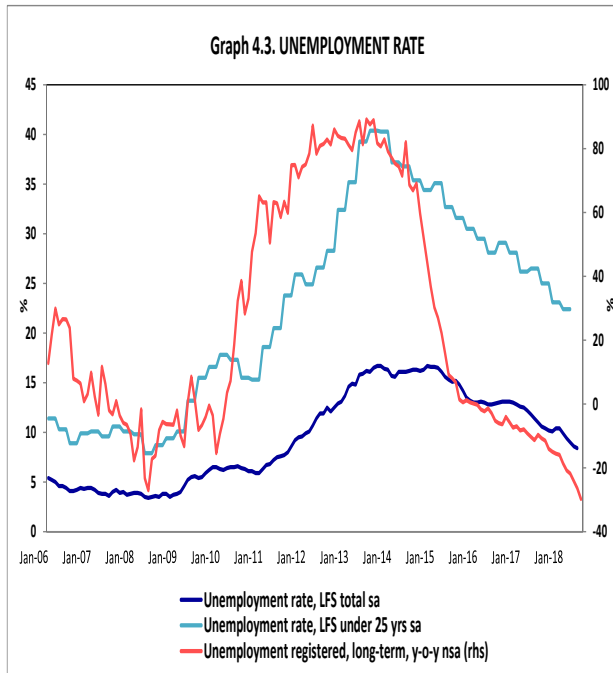
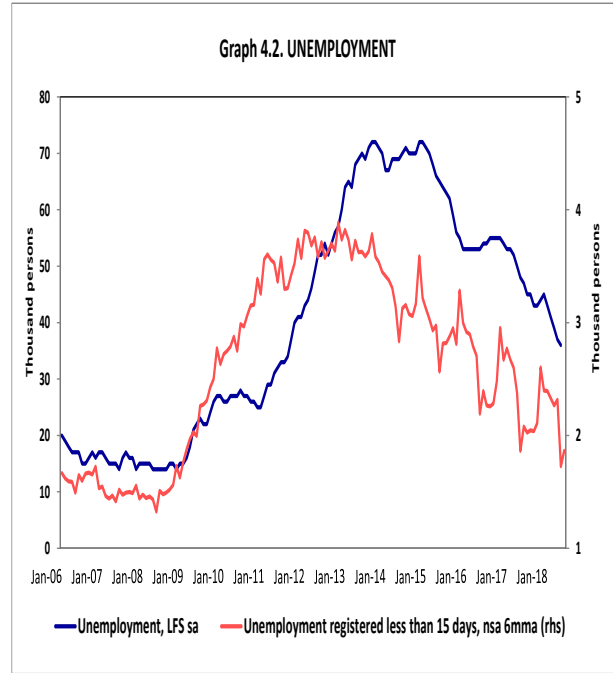
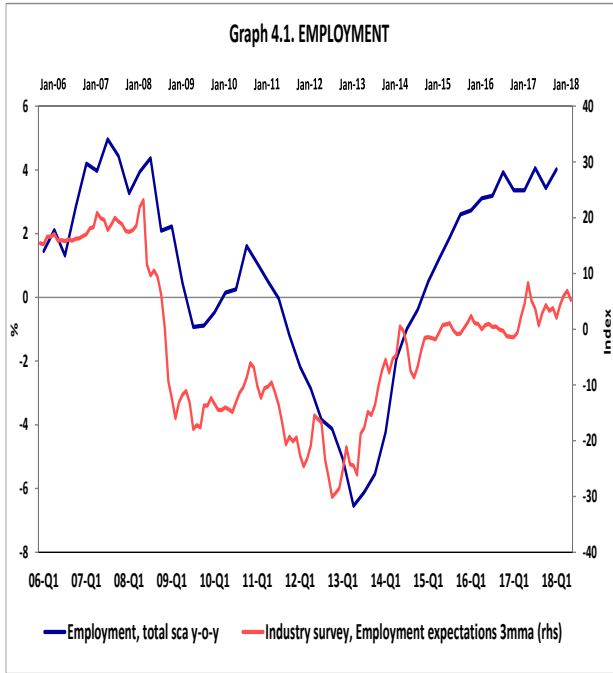
Sources: Eurostat, DG ECFIN, Cystat, JCC Payment Systems Ltd

3. INVESTMENT



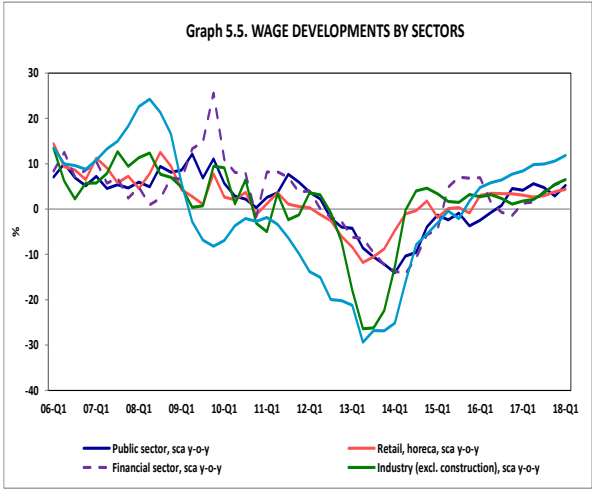
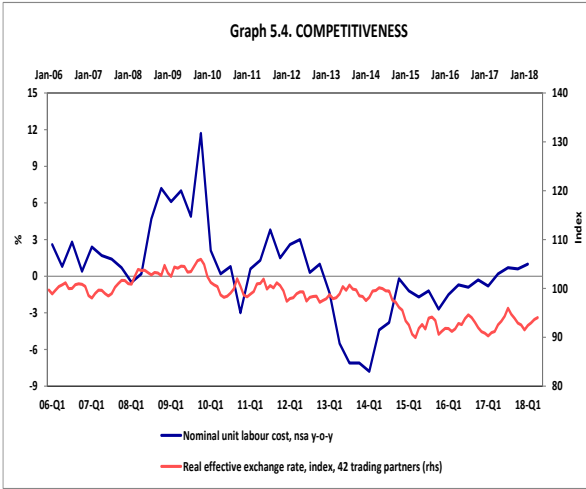
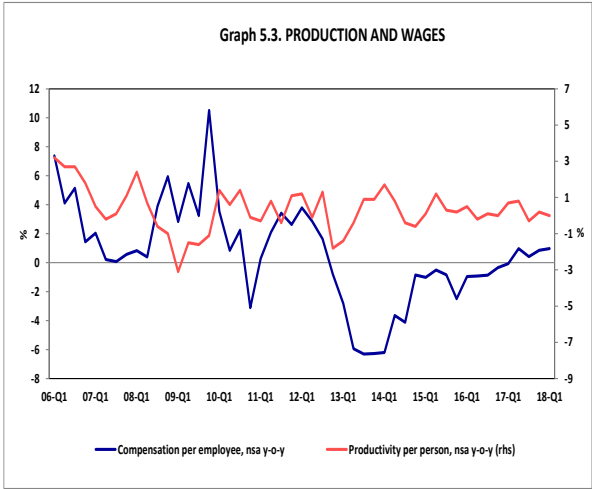
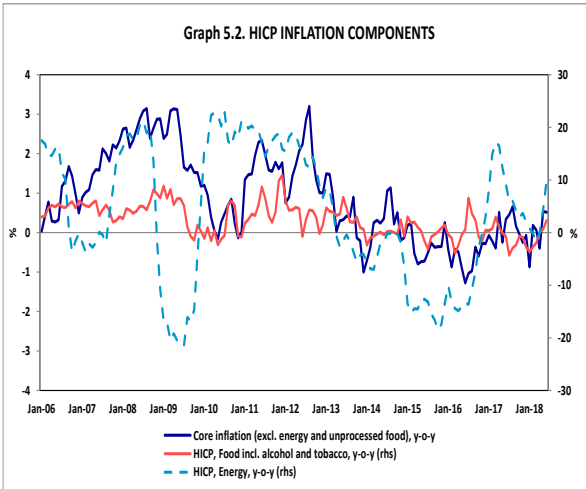
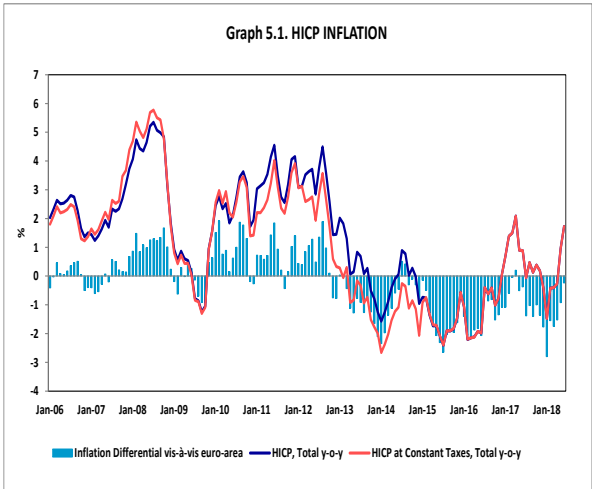
Sources: Eurostat, DG ECFIN, Cystat

4. LABOUR MARKET



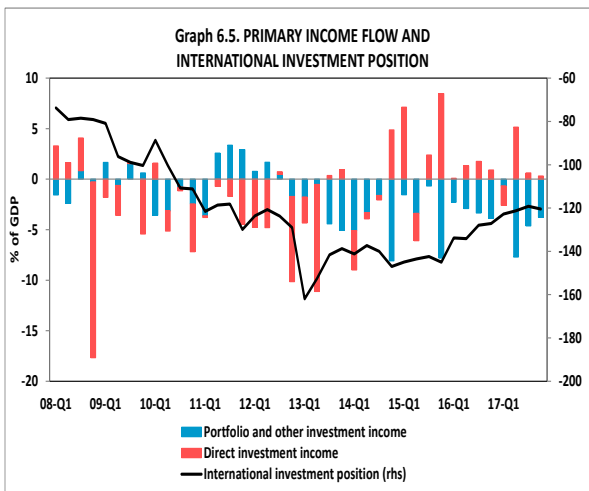
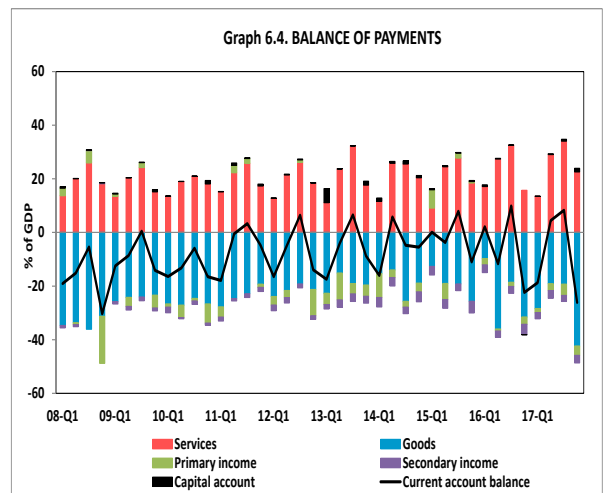
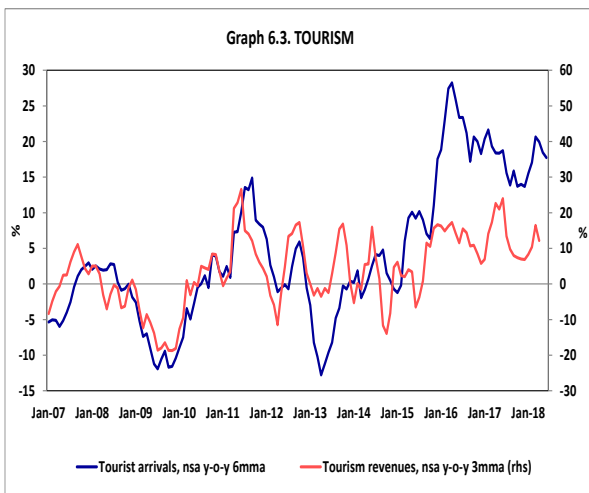
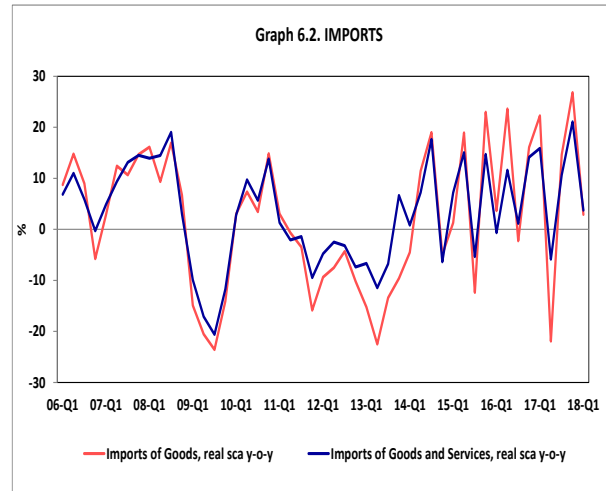
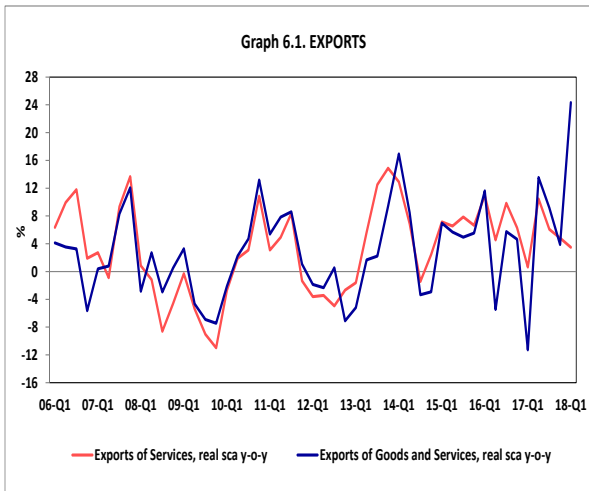
Sources: Eurostat, DG ECFIN, Cystat

5. INFLATION, WAGES



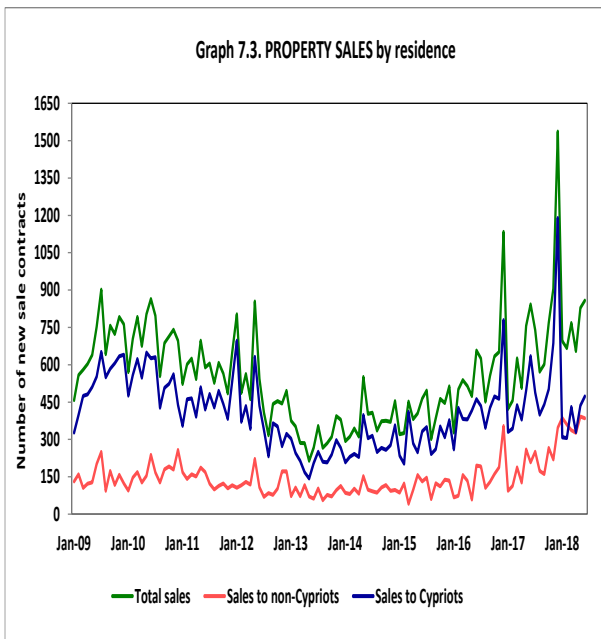
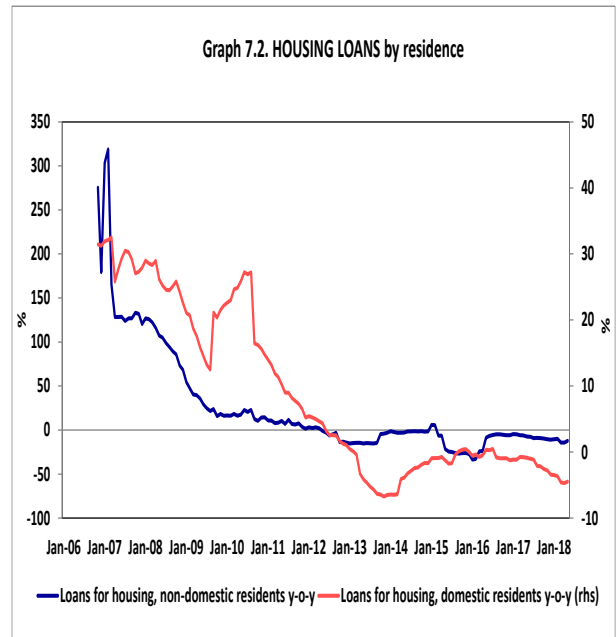
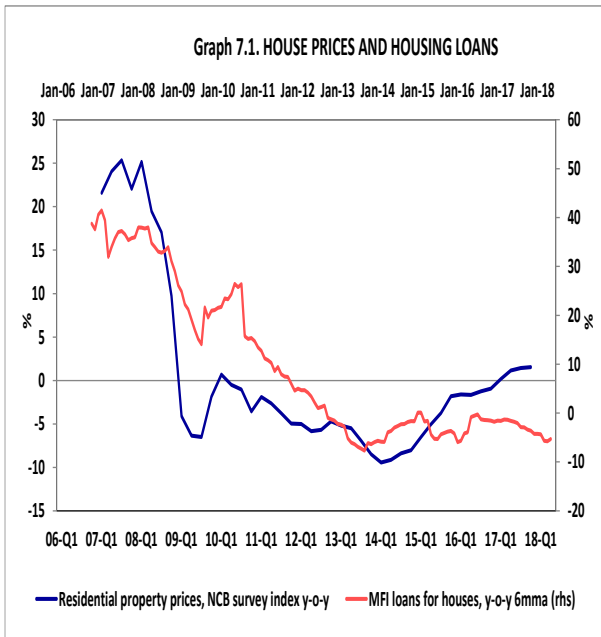
Source: Eurostat

6. EXTERNAL SECTOR



Sources: Eurostat, Cystat, ECB, CBC

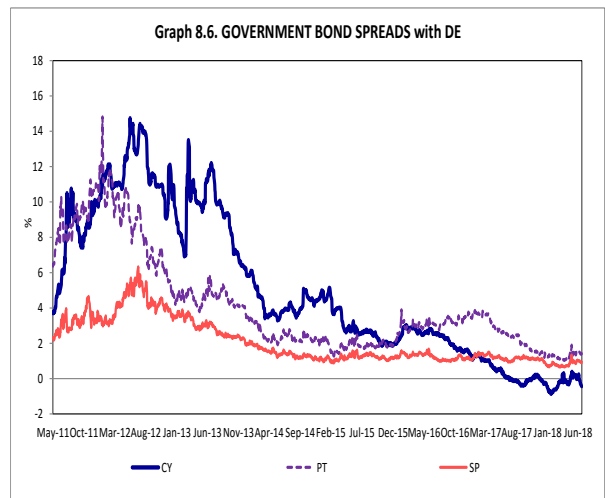
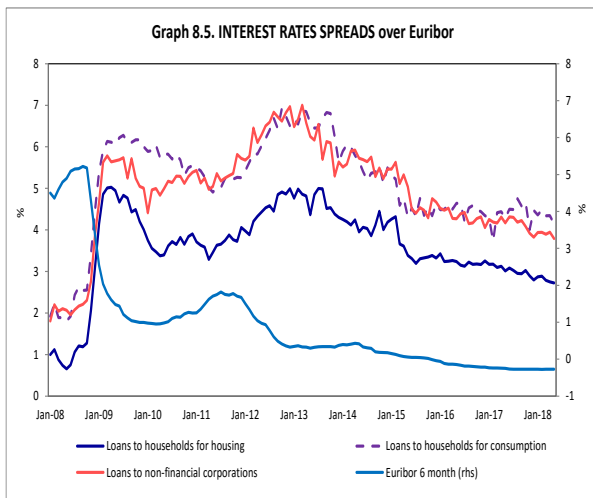
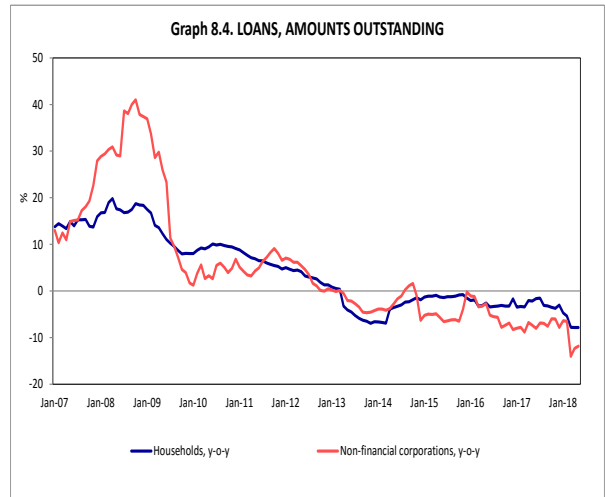
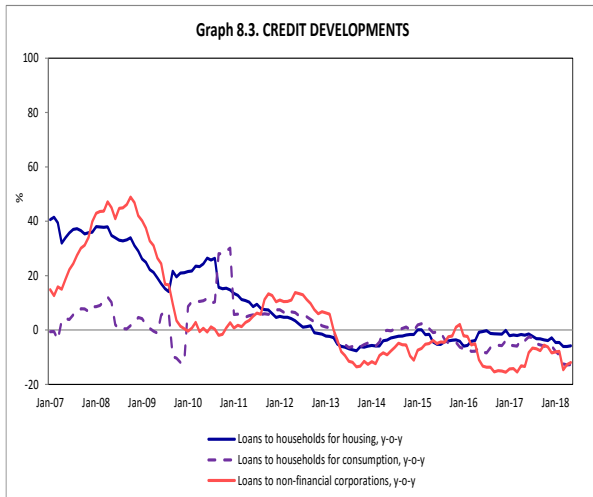
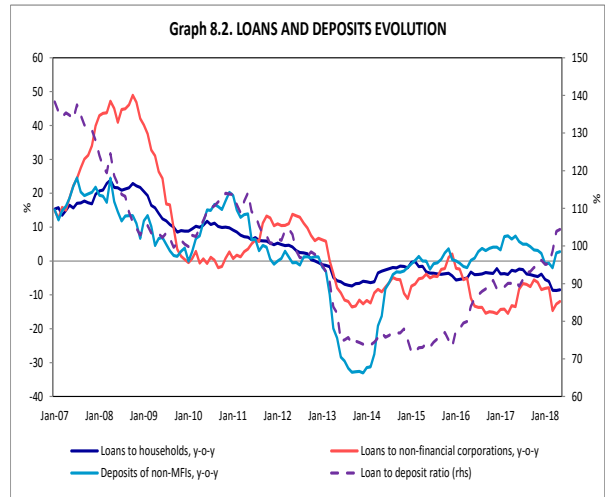
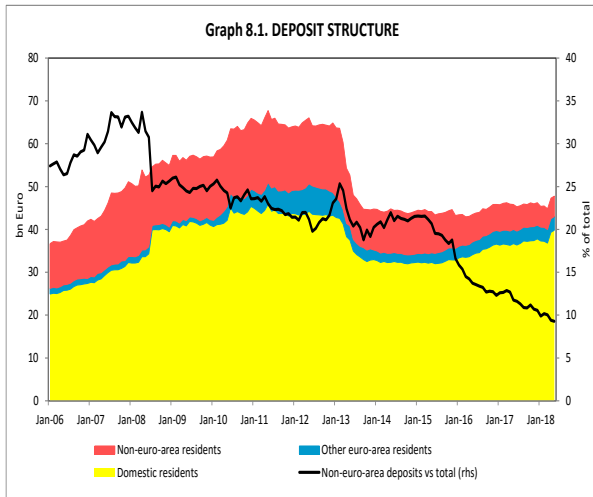
7. HOUSING



Note: According to the relevant modifications to the codification of the term "Alien" in the Land Information System, the way the statistics are presented has been modified. Therefore, the suggestion of the Department of Lands and Surveys is to avoid the comparison of the specific data from 2018 onwards, with the data of the previous years.

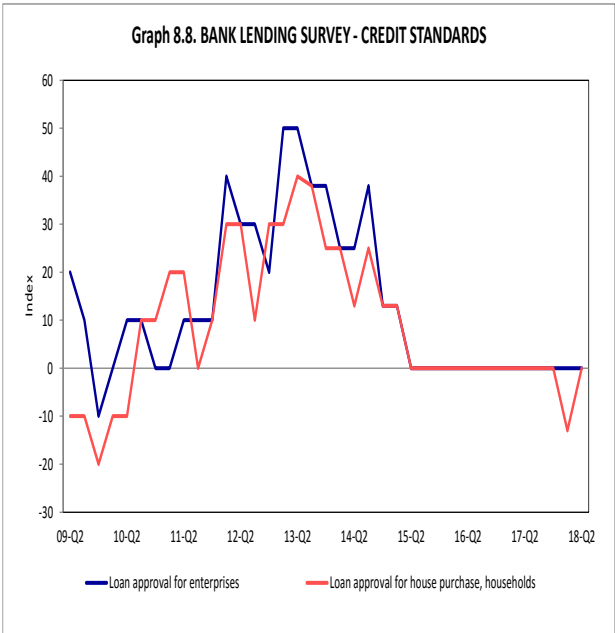
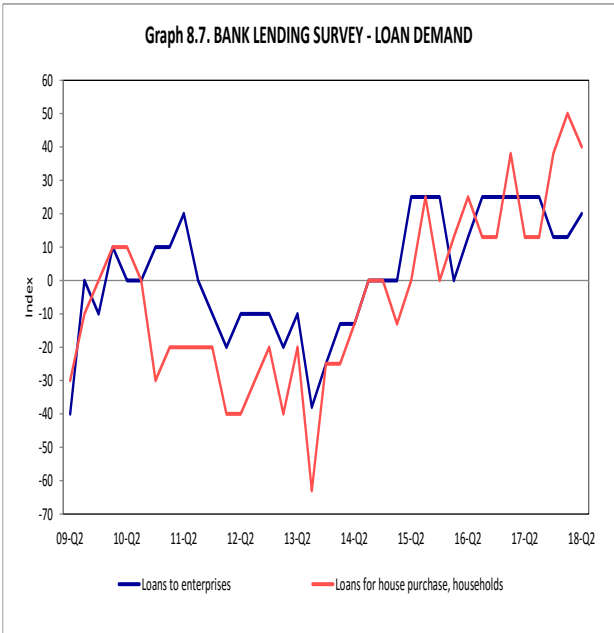
Sources: ECB, CBC, Dep. of Lands and Surveys

8. FINANCIAL SECTOR



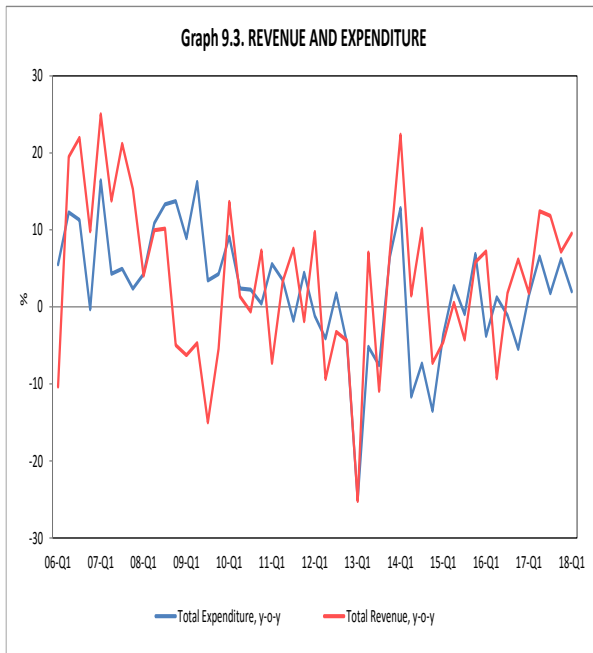
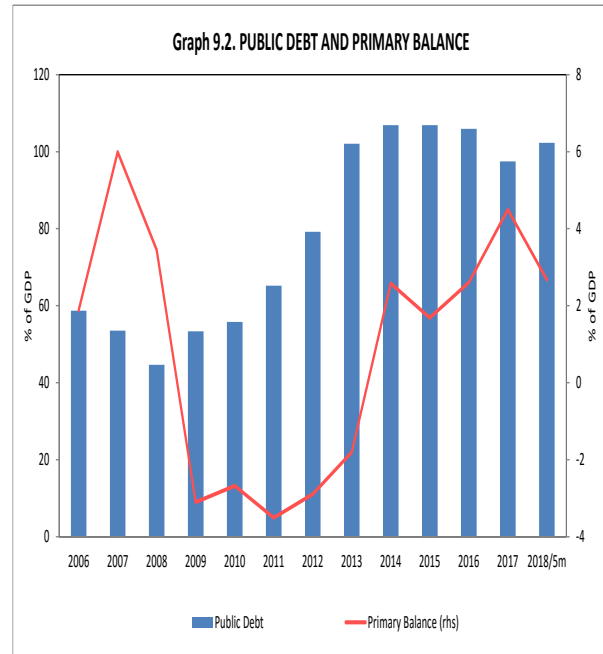
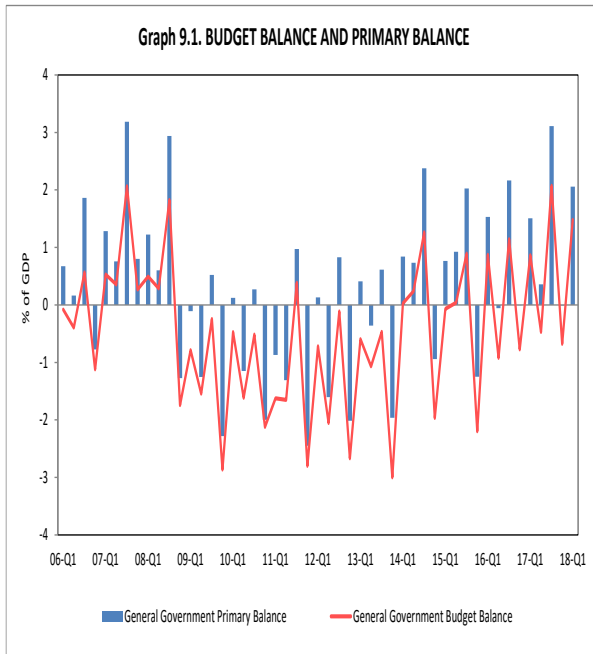
Sources: ECB, CBC, Bloomberg

8. FINANCIAL SECTOR – CONT.



Source: ECB

9. PUBLIC SECTOR



Sources: Ministry of Finance, Cystat