

# MACROECONOMIC MONITOR OF CYPRUS

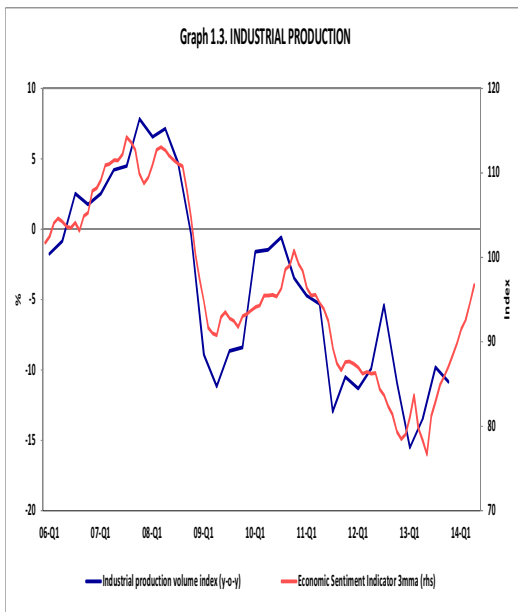
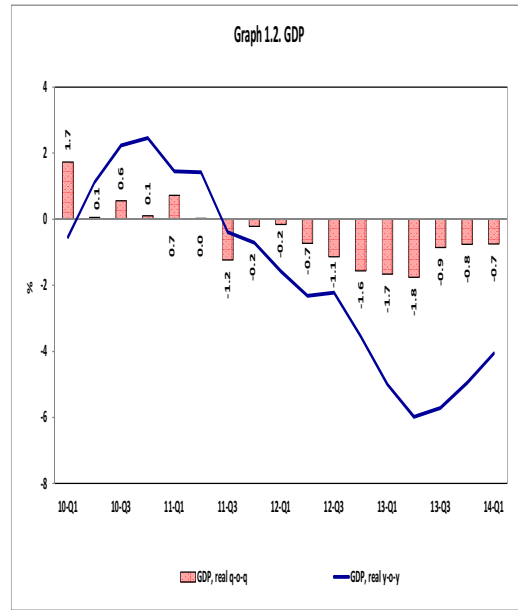
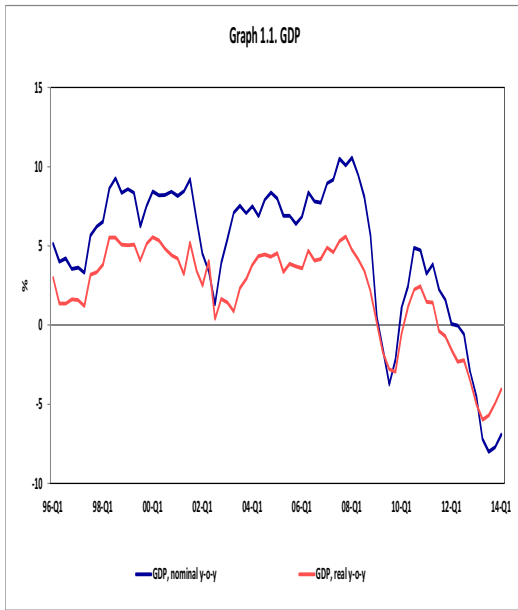
*Updated on 16 June 2014*

- In the 1<sup>st</sup> quarter of 2014, GDP (in seasonally adjusted terms) contracted by -4.1% compared with -4.9% in the 4<sup>th</sup> quarter of 2013 on an annual basis (see graphs 1.1-1.2). The contraction was mainly due to the subdued performance of the secondary sector (construction, manufacturing) and the financial sector. 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).
- 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 3½-4%, 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) that compares favourably to the anticipated lower levels expected originally.
- The economic sentiment indicator by CypERC presents a less negative picture, as it increased by 2.3 points in May 2014 compared to April 2014, although still remaining in the negative territory (see graph 1.3). This increase is mainly due to the improvement in the economic climate in services and consumers, as well as marginal improvement in manufacturing.
- Exports of goods decreased by 10.1% in January-April 2014 compared to the corresponding period in 2013.
- In January-May 2014 tourist arrivals increased by 3.5% compared to the corresponding period in 2013 (see graph 6.3). An increase of 1.7% was recorded in arrivals from the United Kingdom, a 3% decrease in arrivals from Greece and a 14% increase 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 decreased by 4.6% in the 1<sup>st</sup> quarter of 2014 compared to the 1<sup>st</sup> quarter of 2013. The decrease was more pronounced in the construction, trade and manufacturing sectors.
- Labour market developments exhibited flexibility and are adjusting accordingly to the new environment. This led to an increase in profitability of business and at the same time this allowed business to offer goods and services at reduced prices.
- Labour Force Survey (LFS) unemployment, in monthly seasonally adjusted figures, increased from 15.6% in April 2013 to 16.4% in April 2014, reflecting the effect of a protracted slowdown in economic activity (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 rise to about 18.2% in 2014 compared to a forecast of 18.6% of the 4<sup>th</sup> review.
- Compensation per employee in the 1<sup>st</sup> quarter of 2014 declined by around 4.5% compared to the 1<sup>st</sup> quarter of 2013, contributing to a decline of nominal unit labour costs 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 as measured by the HICP, decreased at a rate of -0.1% in May 2014 compared to -0.4% in April 2014 and for 2014 so far it stands at -0.8% (see graph 5.1). Core HICP inflation decreased at a rate of -0.1% in January-May 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 2013 recorded a deficit of €310.1 mn (1.9 of GDP) compared with a deficit of €1,217.1 mn (6.9% of GDP) in 2012 (see graph 6.4). This development was mainly due to the improvement in the goods account.
- The income account recorded a deficit of €451.9 mn in 2013 compared with a deficit of €456 mn in 2012 (see graph 6.4).
- The international investment position of Cyprus (see graph 6.5) recorded an improvement in 2013, reaching €14,138.3 mn compared with €14,594.1 mn in 2012, thus remaining in a net liability position (Cyprus' liabilities exceed the respective assets).
- In January-May 2014, the budget balance recorded a surplus of €56.2 mn (0.4% of GDP) compared to a deficit of €88.5 mn (0.5% of GDP) in the corresponding period of 2013.
- Monetary Financial Institutions (MFI) loans to domestic residents (private sector), declined with an annual rate of 7.7% in April 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 8.7% in April 2014 vis-à-vis April 2013, reflecting the negative climate of confidence (see graph 8.1). In March and April 2014, a deceleration in the contraction of deposits was observed.
- 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 of creditors. However, the decline in deposit rates is much bigger than the decline in lending rates (see graph 8.5). In April 2014, deposit interest rates for maturity up to 1 year exhibited an increase, whereas deposits up to 3 months remained effectively the same, compared with the previous month. The lending interest rates to households for house purchase exhibited an increase, whereas the rate for other loans up to €1 mn for businesses exhibited a small decrease. The rate for bank overdrafts to non-financial corporations remained effectively the same. 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 8.7% in the 4<sup>th</sup> quarter of 2013 compared to the 4<sup>th</sup> quarter of 2012. Cumulative from the 1<sup>st</sup> quarter of 2008 it has declined by around 22% (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 19.7% while transfers of property were up by 27.6% in January-May 2014 compared to the corresponding period in 2013 (see graph 7.3). MFI loans to domestic residents for housing declined with an annual rate of 4.9% in April 2014 (see graph 7.2).

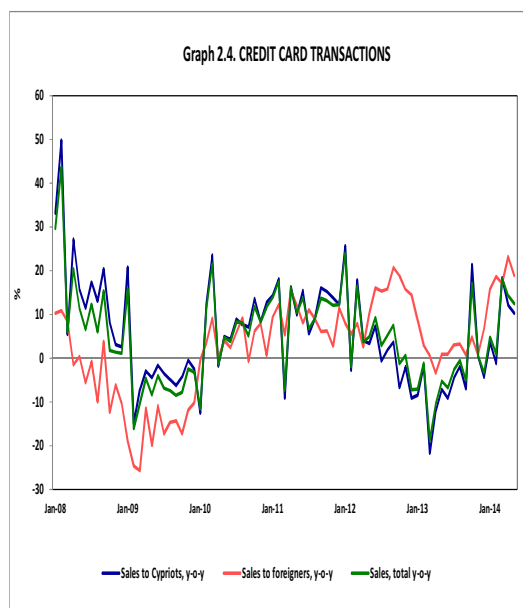
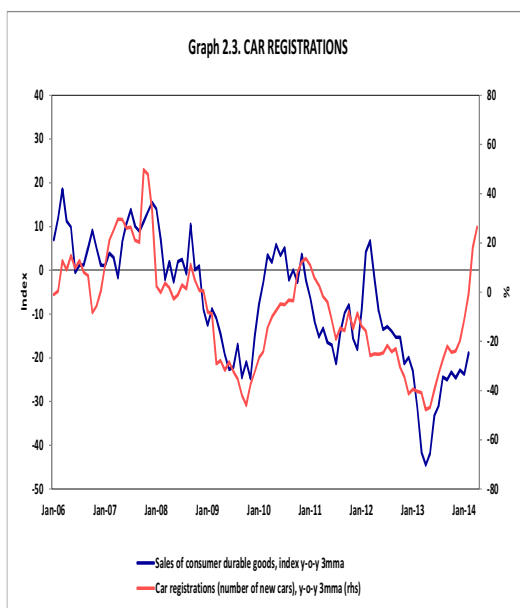
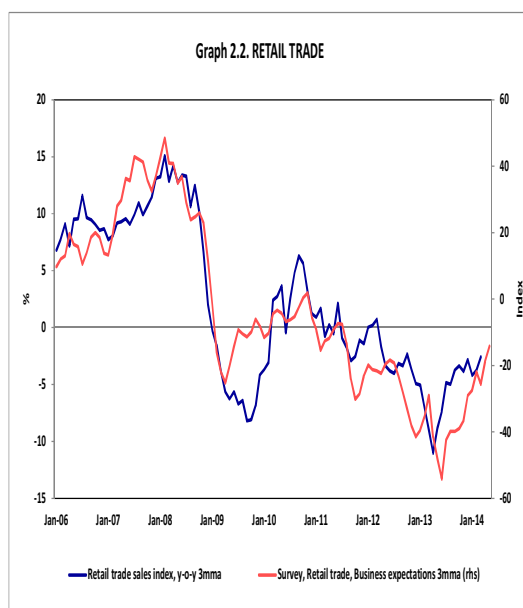
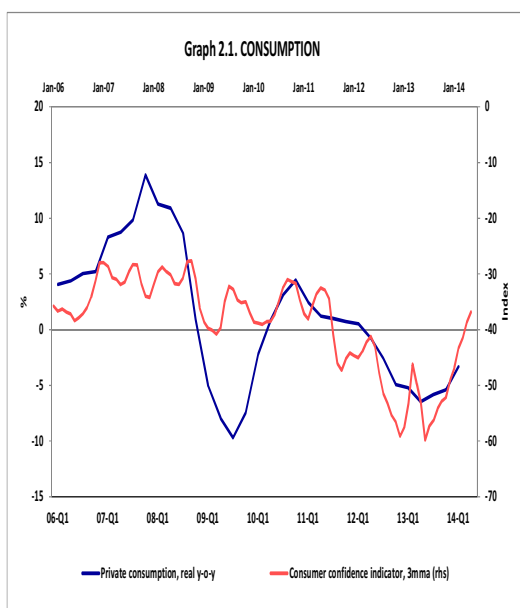
- The Cyprus Government bond spread compared to the German Government bond, declined in mid June 2014 compared to mid May 2014 to around 334 basis points above the German bond on 16/06/2014 from around 380 basis points above on 16/05/2014 (see graph 8.6, yields refer to the bonds maturing in 2020).
- The Republic of Cyprus issued a new 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



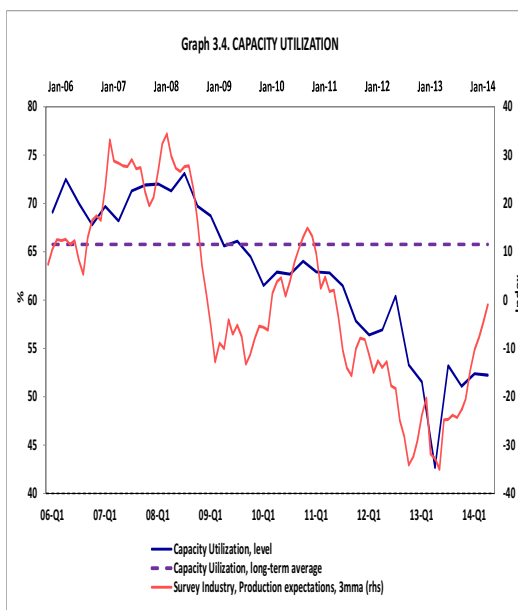
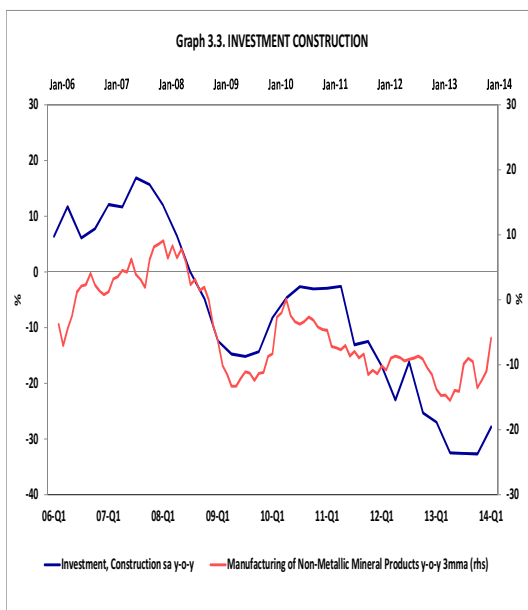
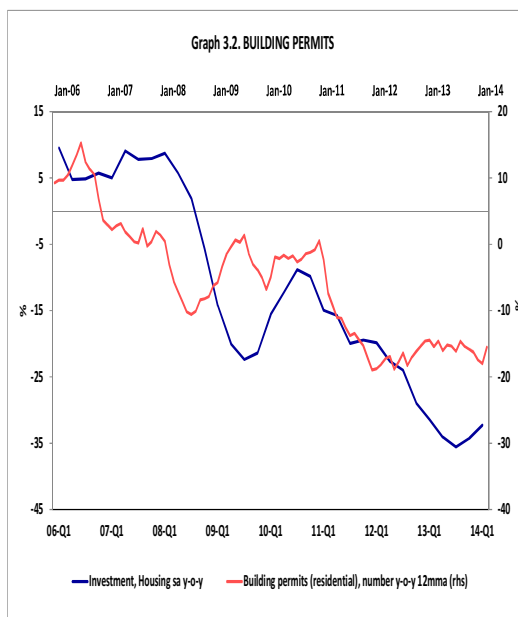
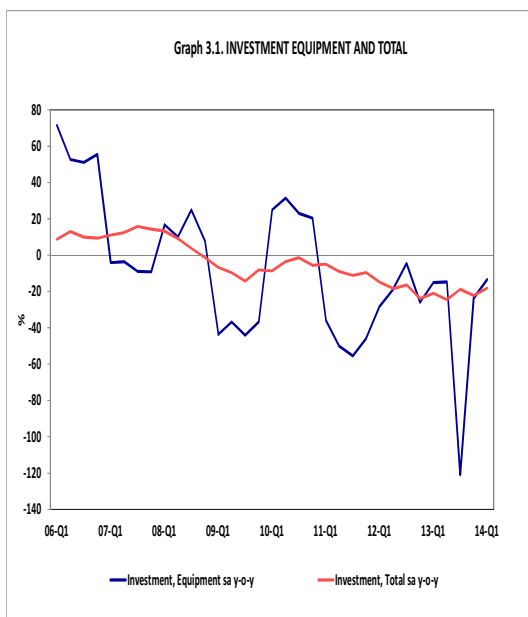
Sources: Eurostat, DG ECFIN, Cystat

## 2. CONSUMPTION



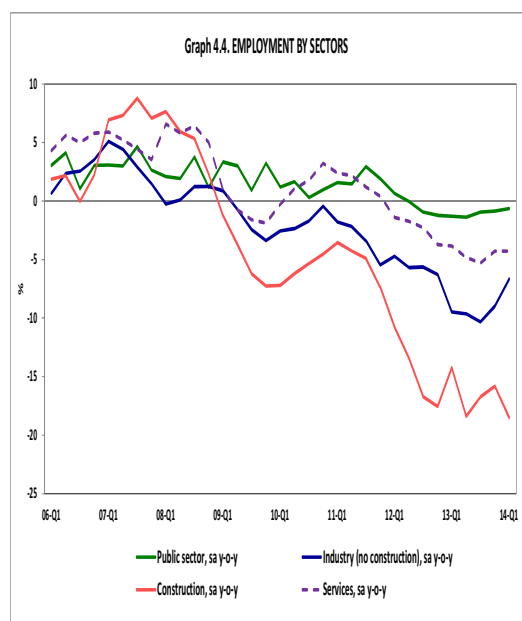
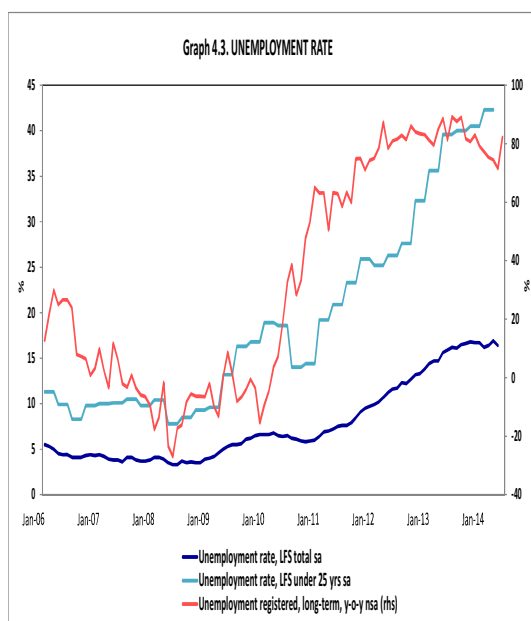
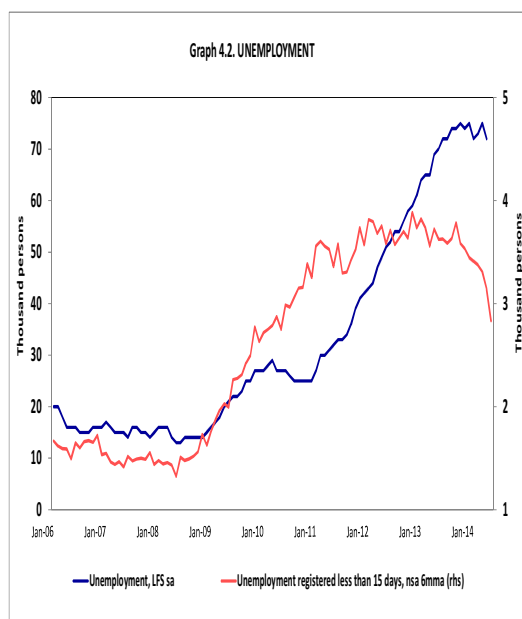
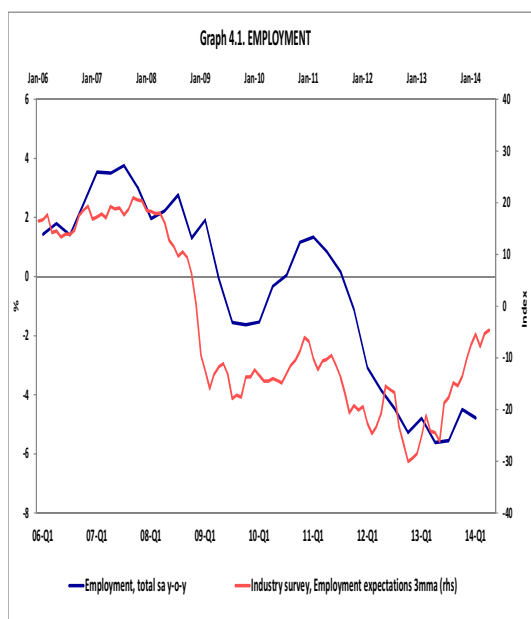
Sources: Eurostat, DG ECFIN, Cystat, JCC Payment Systems Ltd

### 3. INVESTMENT



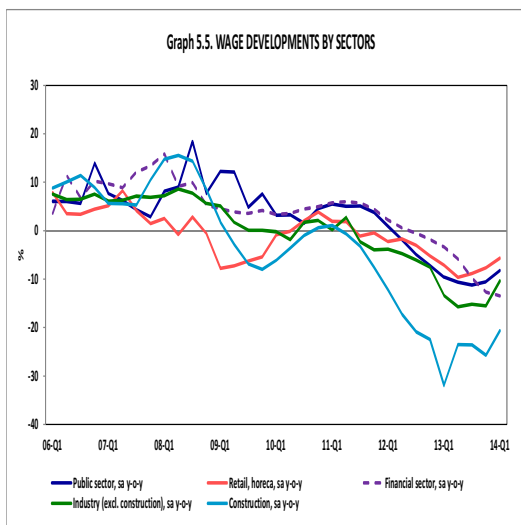
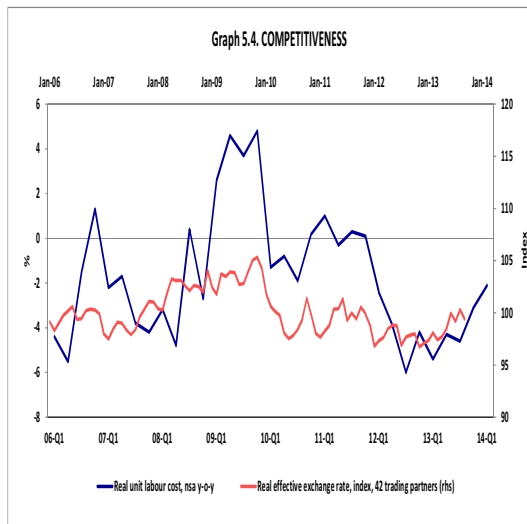
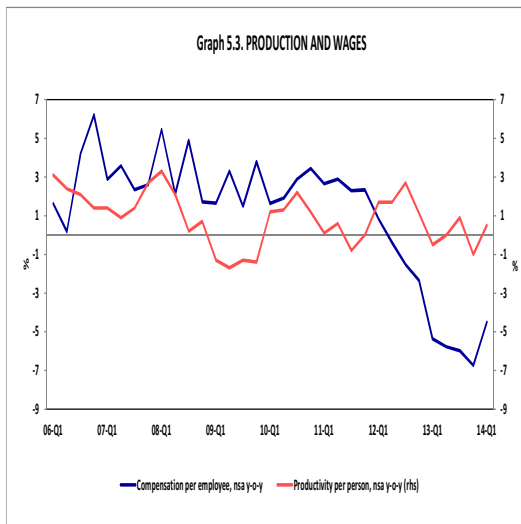
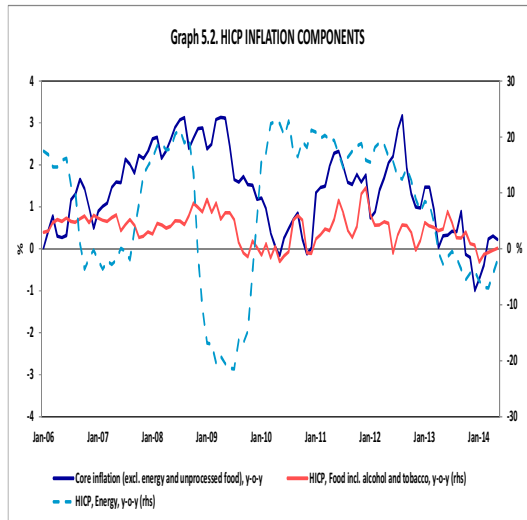
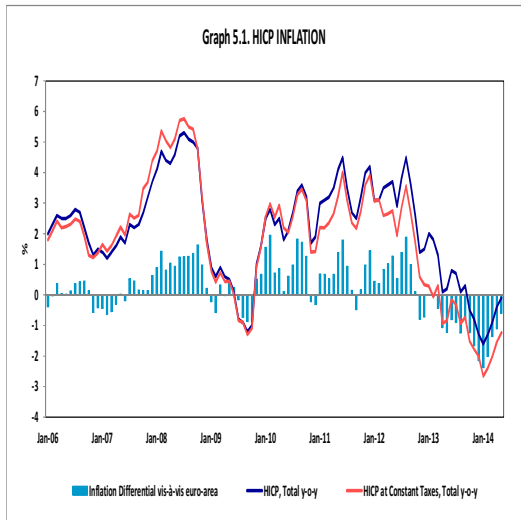
Sources: Eurostat, DG ECFIN, Cystat

## 4. LABOUR MARKET



Sources: Eurostat, DG ECFIN, Cystat

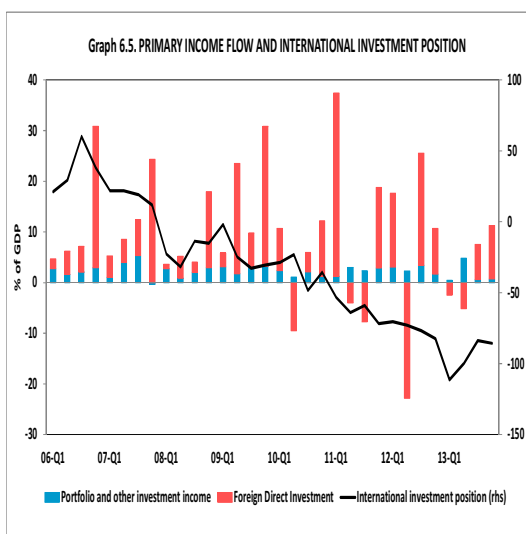
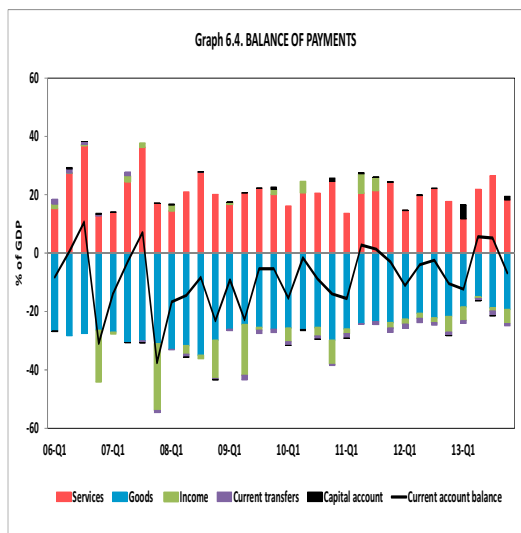
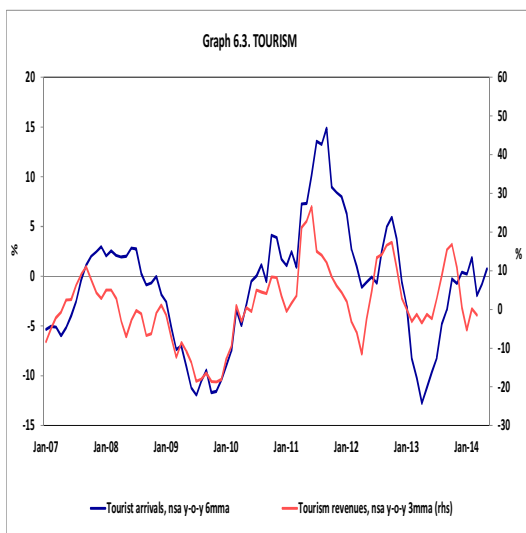
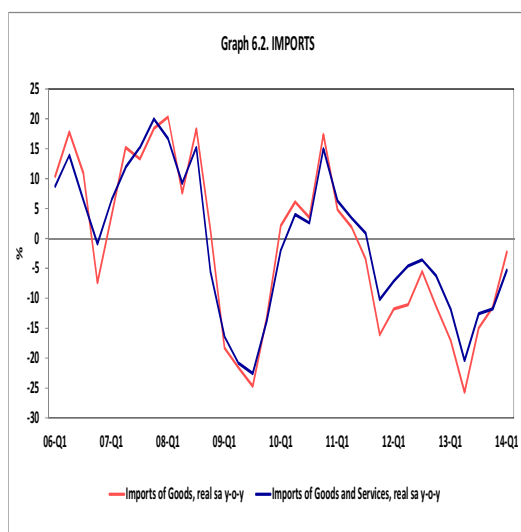
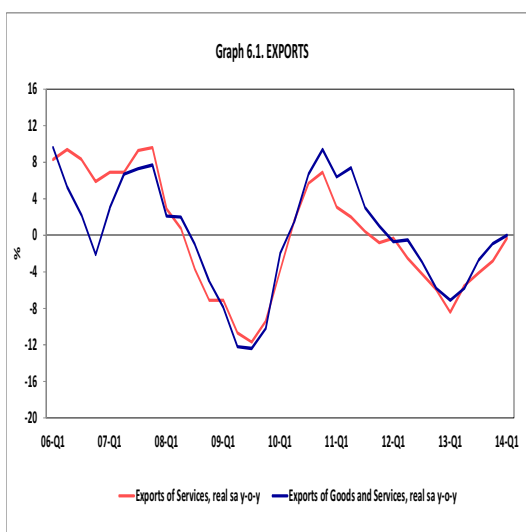
## 5. INFLATION, WAGES



Source: Eurostat

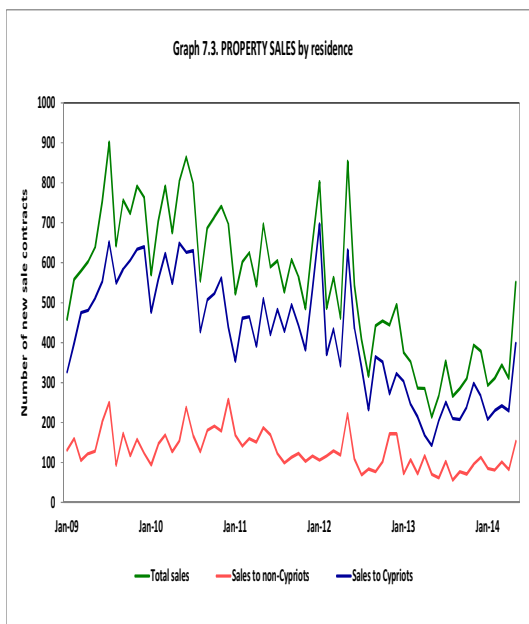
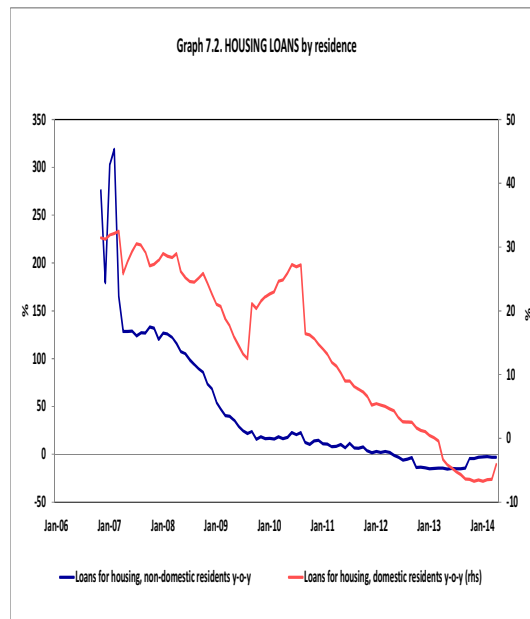
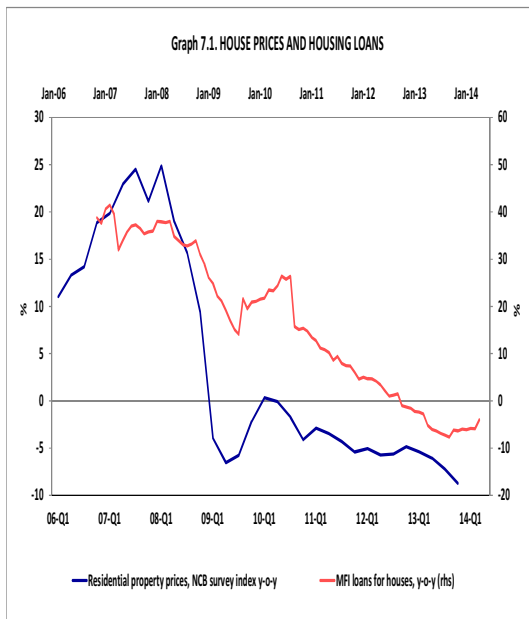


## 6. EXTERNAL SECTOR



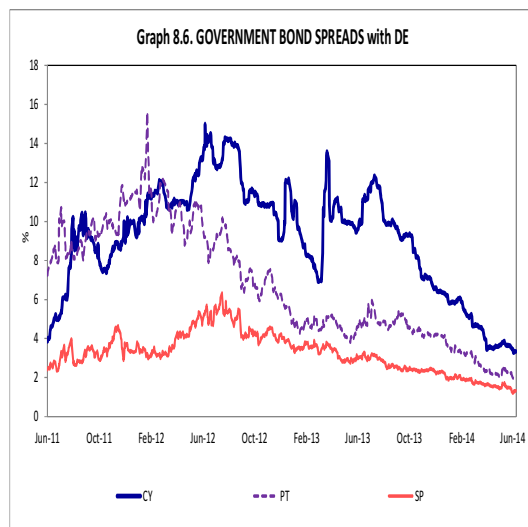
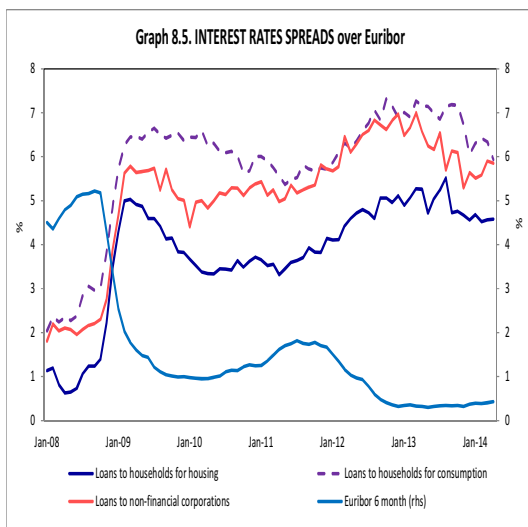
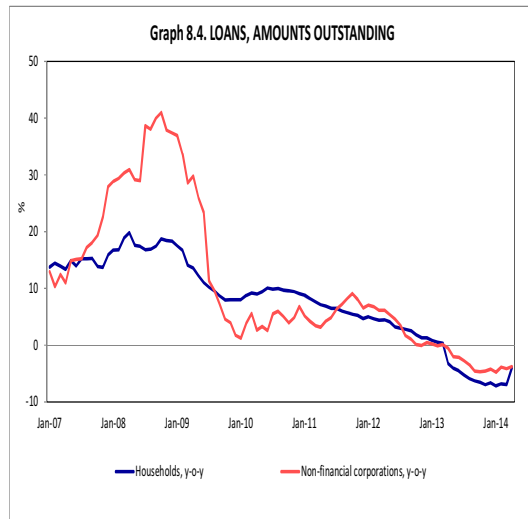
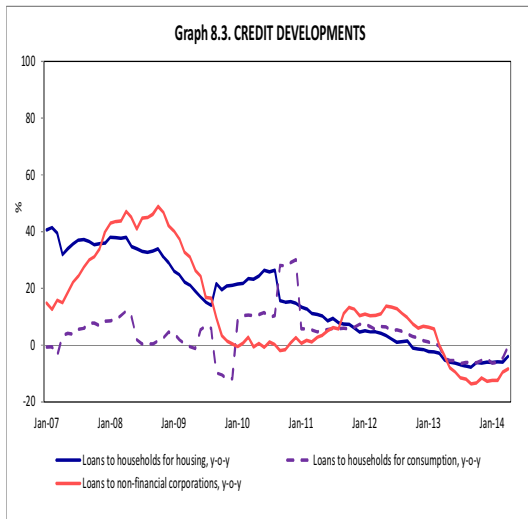
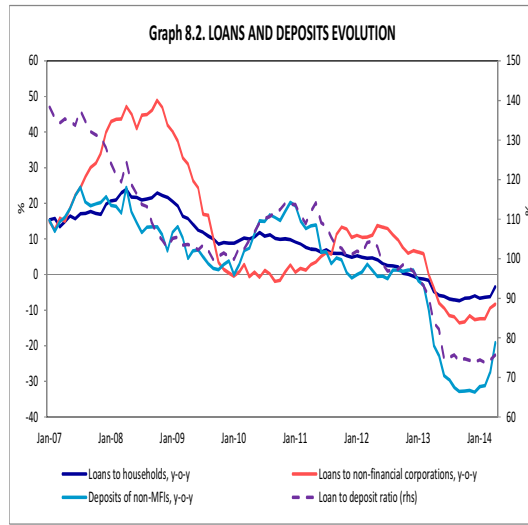
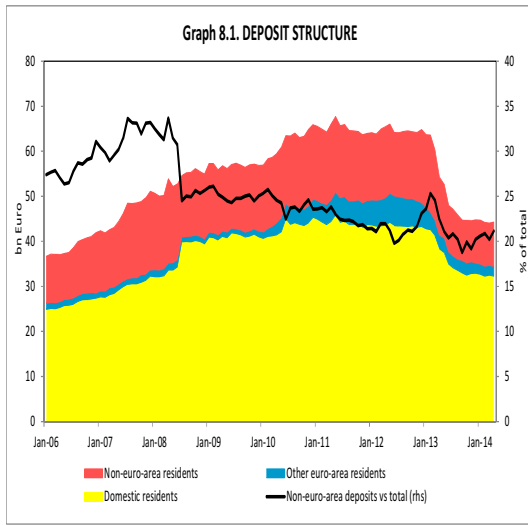
Sources: Eurostat, Cystat, ECB, CBC

## 7. HOUSING



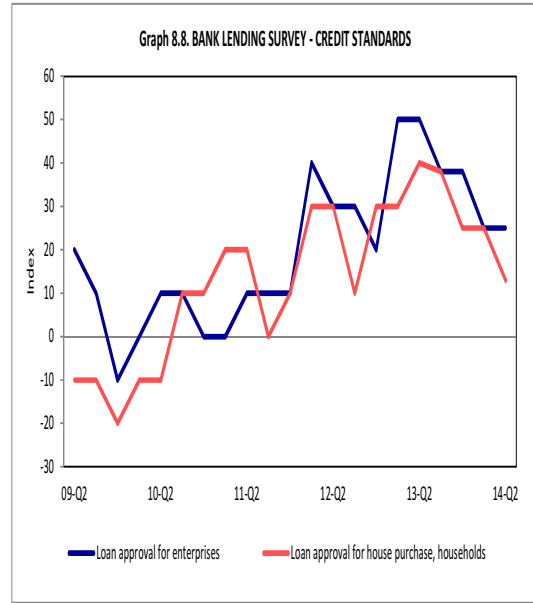
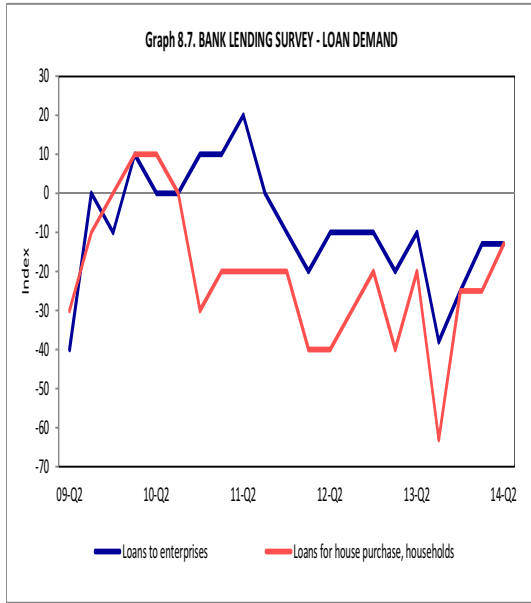
Sources: ECB, CBC, Dep. of Lands and Surveys

## 8. FINANCIAL SECTOR



Sources: ECB, CBC, Bloomberg

## 8. FINANCIAL SECTOR – cont.



Source: ECB