

MACROECONOMIC MONITOR OF CYPRUS

Updated on 16 May 2014

- In the 1st quarter of 2014, GDP (in seasonally adjusted terms) contracted by -4.1% compared with -5% in the 4th 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 -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 4.9 points in April 2014 compared to March 2014, although still remaining in the negative territory (see graph 1.3). The increase is due to ameliorating climate conditions in all sectors of the economy and among consumers, but with greater contribution of the services and retail trade sectors.
- Exports of goods increased by 2.8% in January-March 2014 compared to the corresponding period in 2013 mainly due to the exports of pharmaceutical products, cement and halloumi cheese.
- In January-April 2014 tourist arrivals increased by 1.4% compared to the corresponding period in 2013 (see graph 6.3). An increase of 1.2% was recorded in arrivals from the United Kingdom, a 3.2% decrease in arrivals from Greece and an 11.8% increase in arrivals from Russia. Revenues from tourism in January-February 2014 increased by 4.8% compared to the corresponding period in 2013.
- 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 5.4% in 2013 compared to 2012. 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 significantly from 14.8% in March 2013 to 17.4% in March 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 4th review.
- Compensation per employee in 2013 declined by 5.9% compared to 2012, contributing to a decline of nominal unit labour cost and improving cost

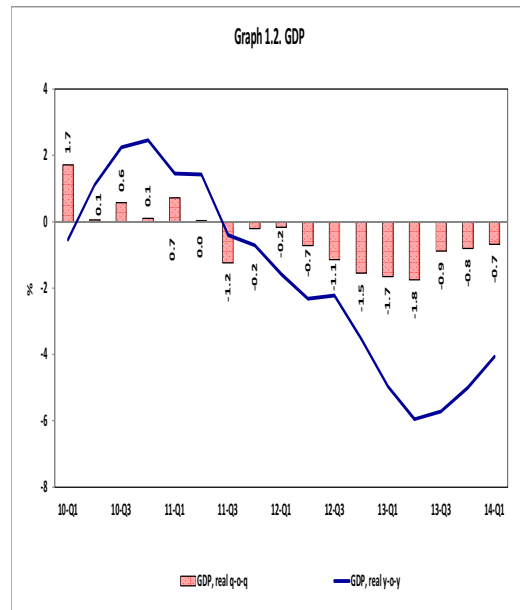
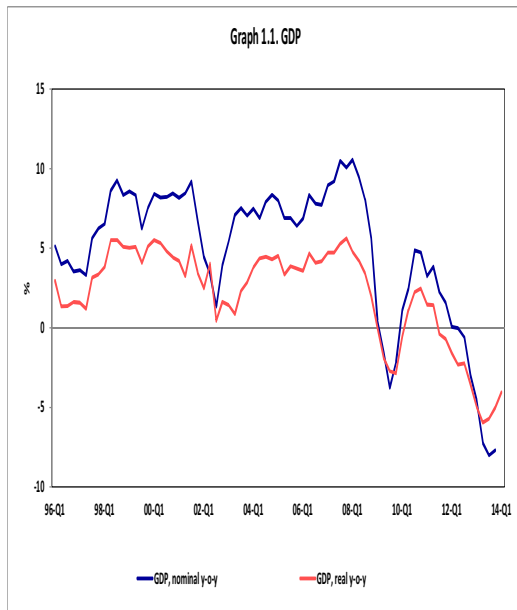
competitiveness (see graphs 5.3-5.5). The observed wage adjustment is expected to help containing the upward pressure on unemployment.

- Inflation as measured by the HICP, decreased at a rate of -0.4% in April 2014 compared to -0.9% in March 2014 and for 2014 so far it stands at -1% (see graph 5.1). Core HICP inflation decreased at a rate of -0.1% in January-April 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 mn (1.9 of GDP) compared with a deficit of €1.217 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 a small 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-April 2014, the budget balance (on a cash basis) recorded a surplus of €135,7 mn (0.9% of GDP) compared to a surplus of €18,2 mn (0.1% of GDP) in January-April 2013.
- Monetary Financial Institutions (MFI) loans to domestic residents (private sector), declined with an annual rate of 7.6% in March 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 substantial fall presenting an annual decline of 11.5% in March 2014, reflecting the negative climate of confidence (see graph 8.1). In March 2014, a deceleration in the fall was observed compared to February 2014.
- 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 bail-in of creditors. However, the decline in deposit rates is much bigger than the decline in lending rates (see graph 8.5). In March 2014, deposit interest rates for maturity up to 1 year exhibited an increase, whereas deposits up to 3 months exhibited a marginal decrease, compared with the previous month. The lending interest rates to households for house purchase exhibited a small decrease, whereas the rate for other loans up to €1 mn for businesses exhibited an increase. 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 4th quarter of 2013 on an annual basis. Cumulative from the 1st 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 3% lower and property transfers were 20.1% higher in January-April 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 5.3% in March 2014 (see graph 7.2).

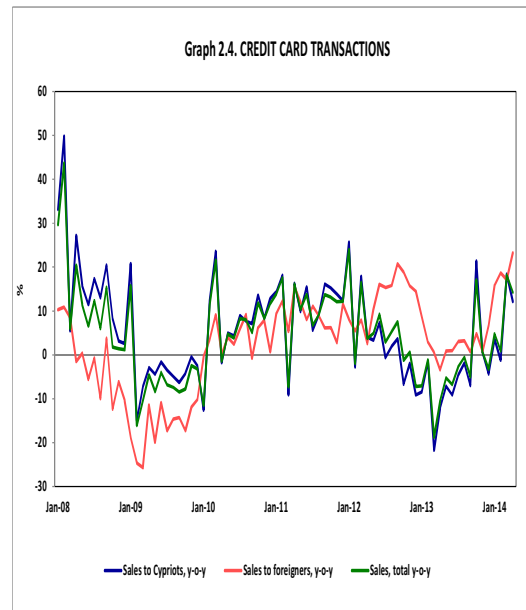
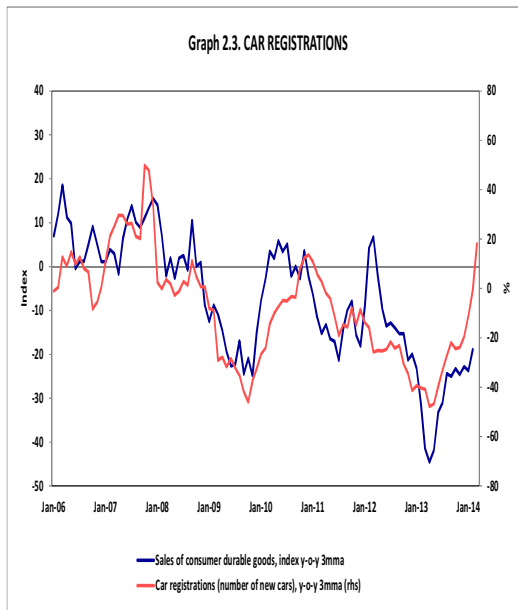
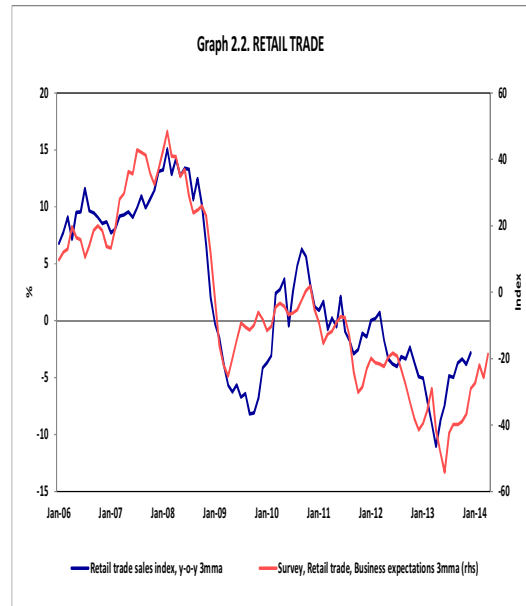
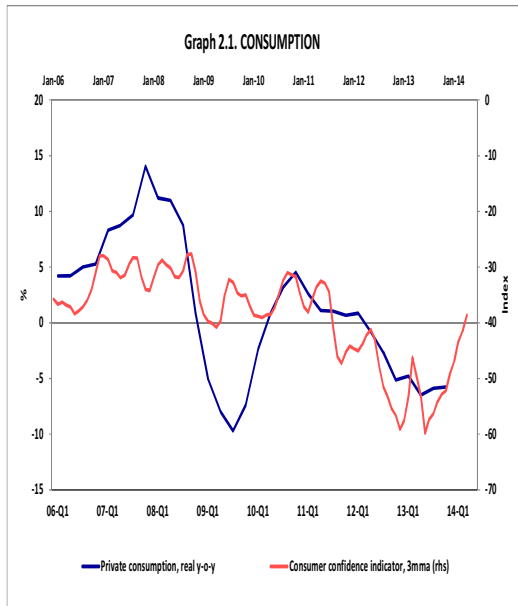
- The Cyprus Government bond spread compared to the German Government bond, increased slightly in mid May 2014 compared to mid April 2014 to around 380 basis points above the German bond on 16/05/2014 from around 360 basis points above on 16/04/2014 (see graph 8.6, yields refer to the bonds maturing in 2020).

1. OUTPUT



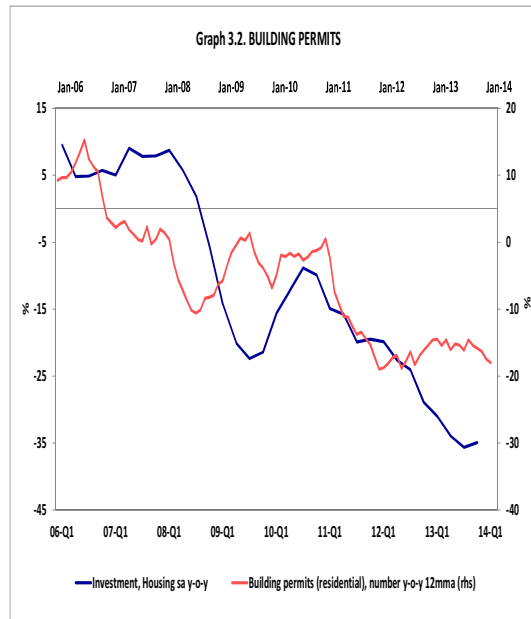
Sources: Eurostat, DG ECFIN, Cystat

2. CONSUMPTION



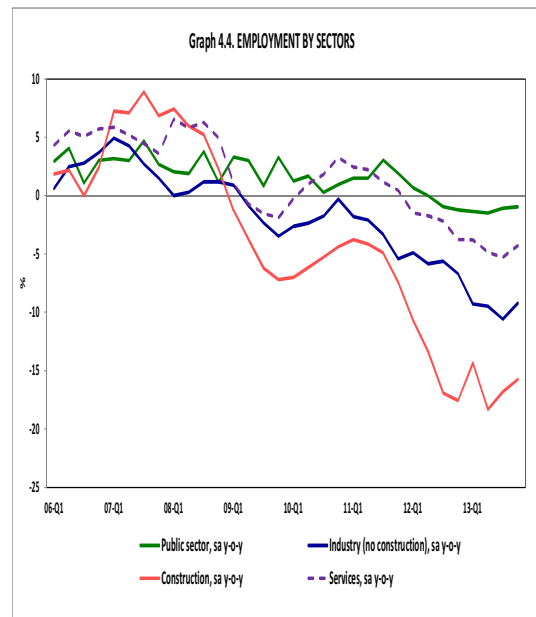
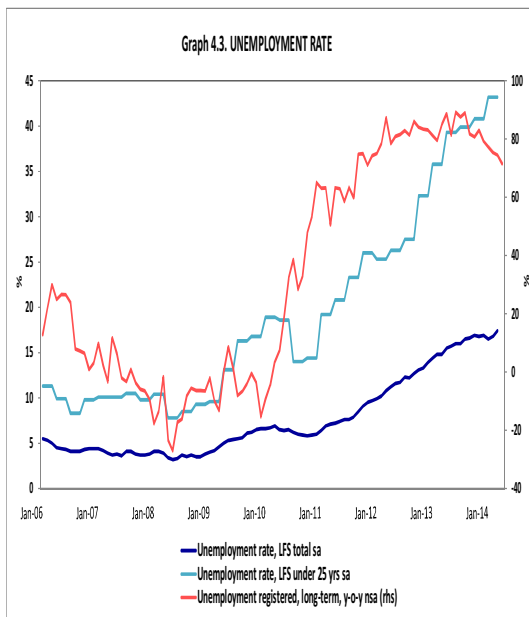
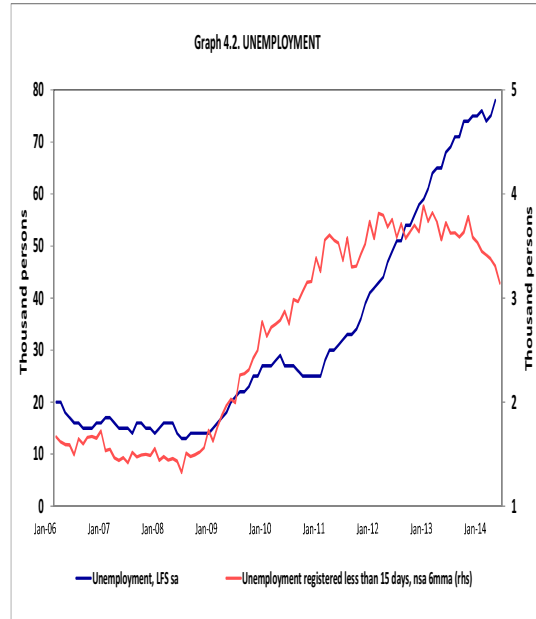
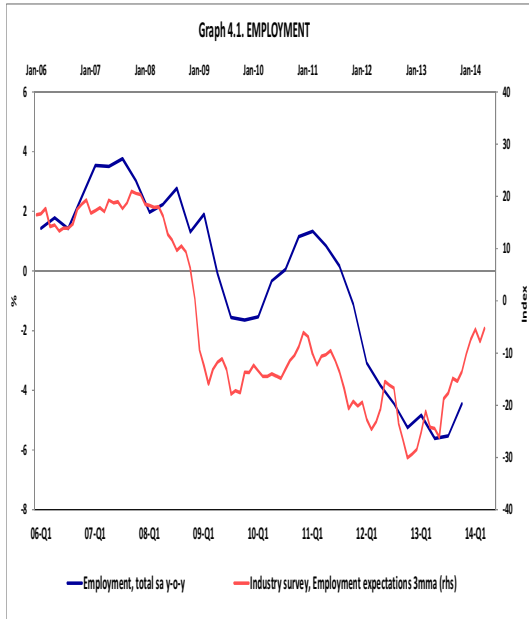
Sources: Eurostat, DG ECFIN, Cystat, JCC Payment Systems Ltd

3. INVESTMENT



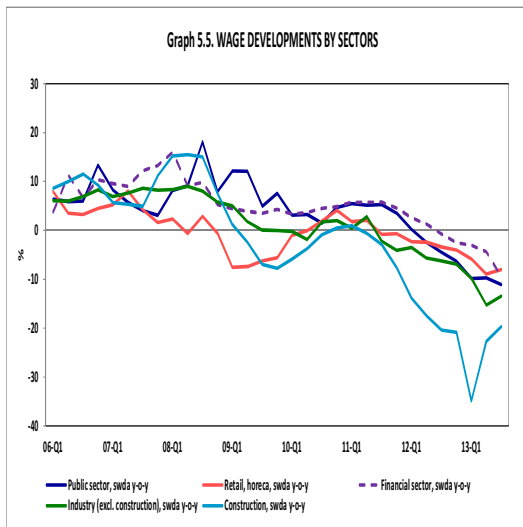
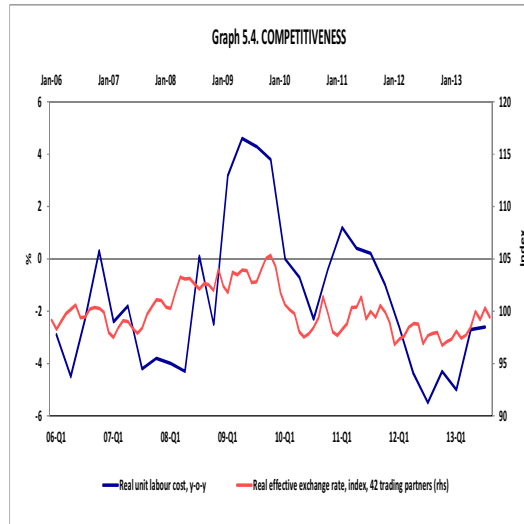
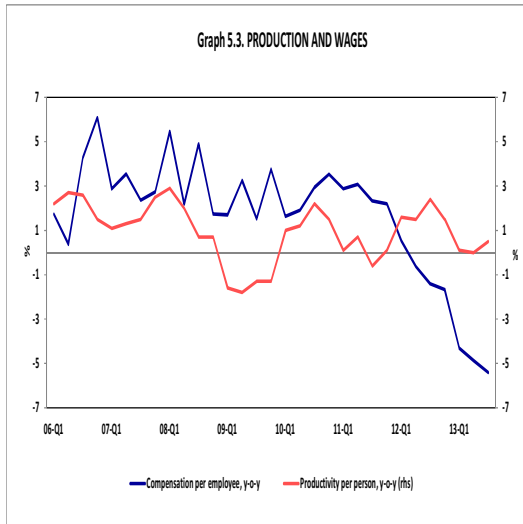
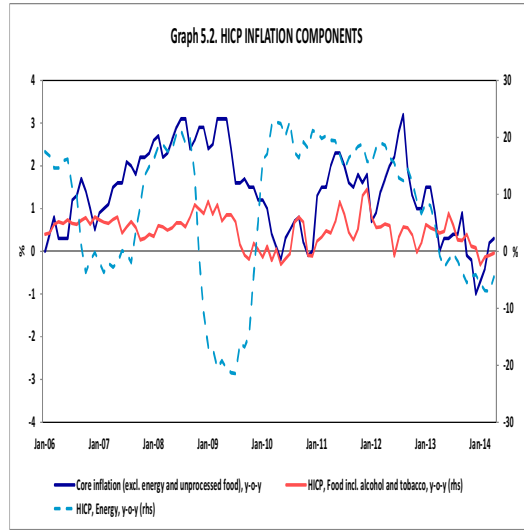
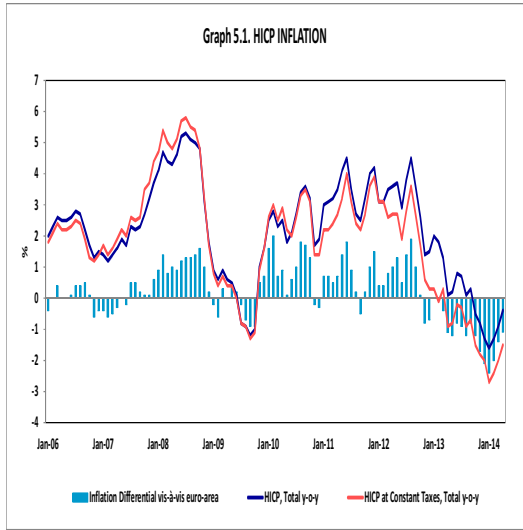
Sources: Eurostat, DG ECFIN, Cystat

4. LABOUR MARKET



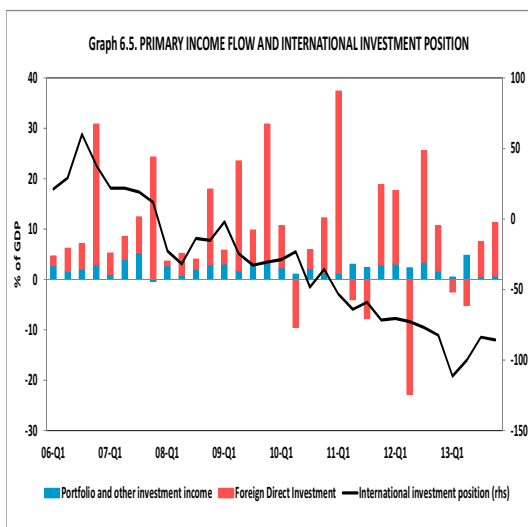
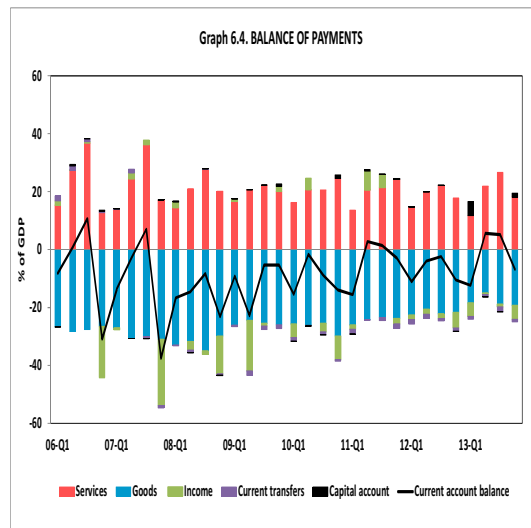
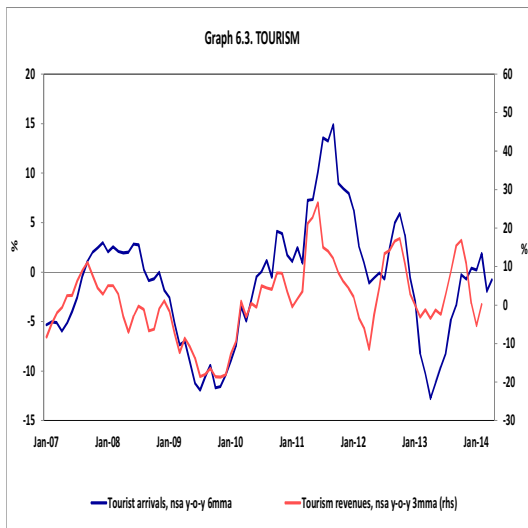
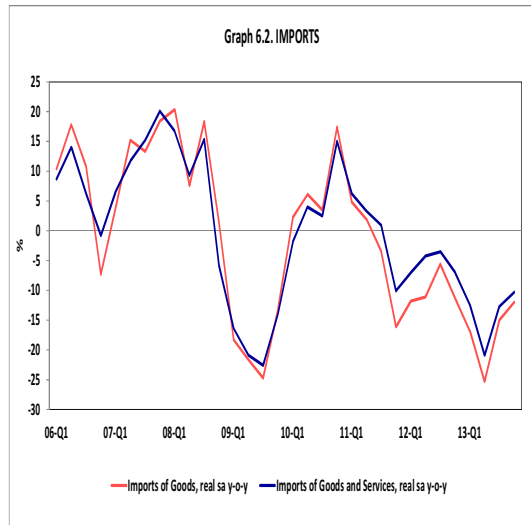
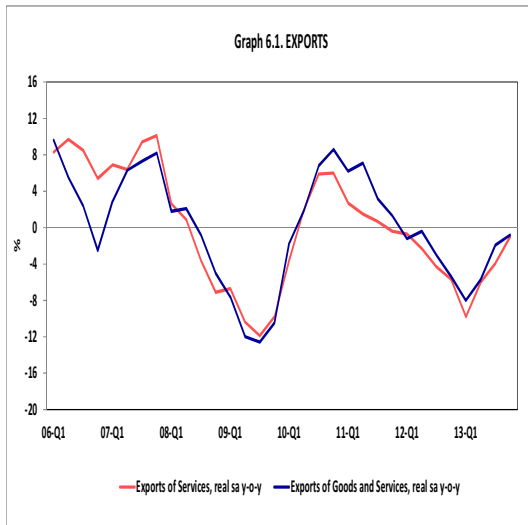
Sources: Eurostat, DG ECFIN, Cystat

5. INFLATION, WAGES



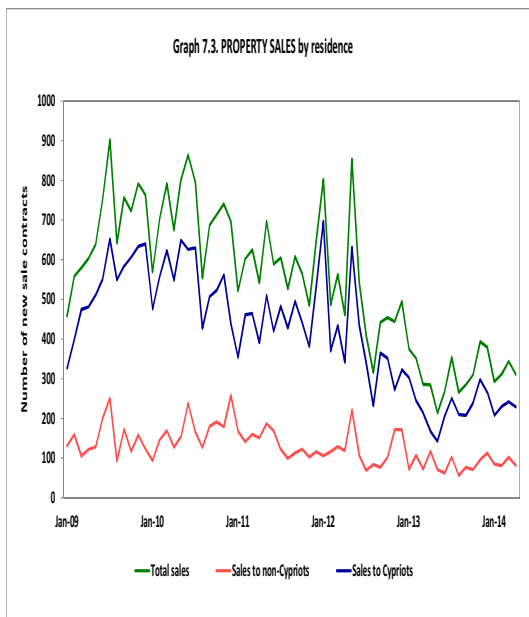
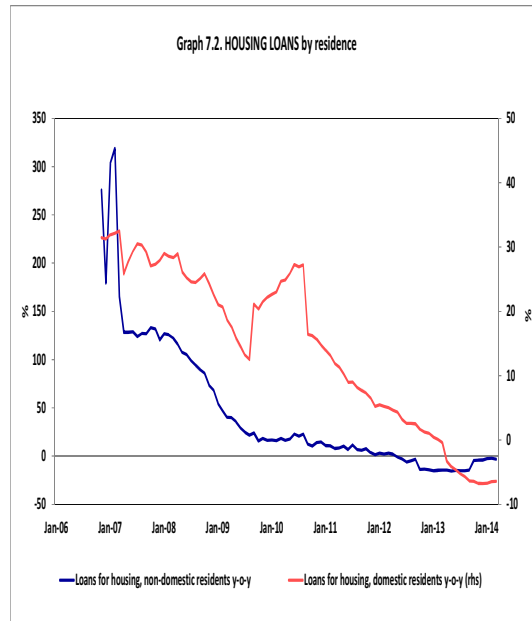
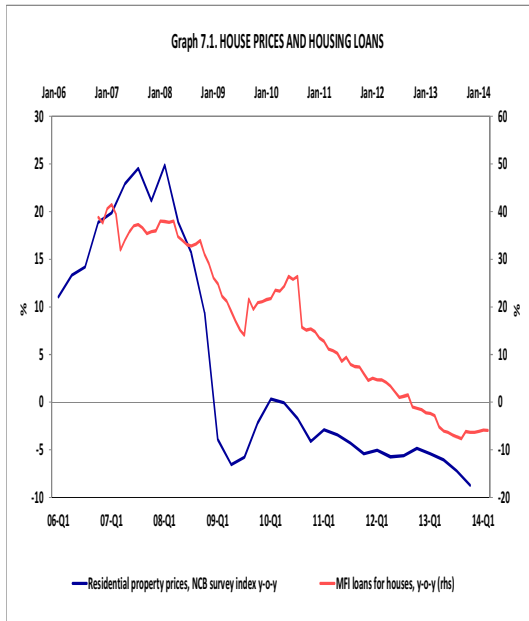
Source: Eurostat

6. EXTERNAL SECTOR



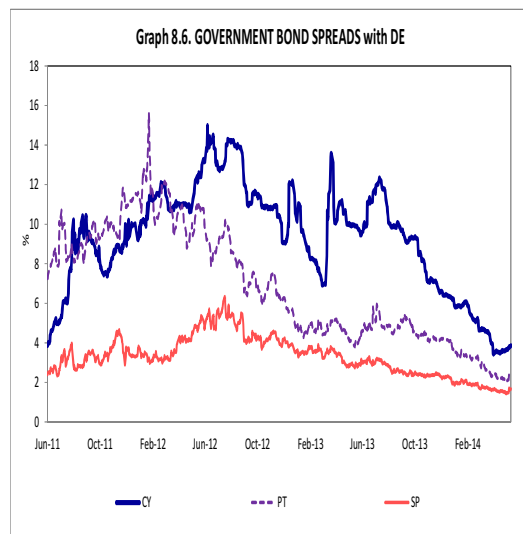
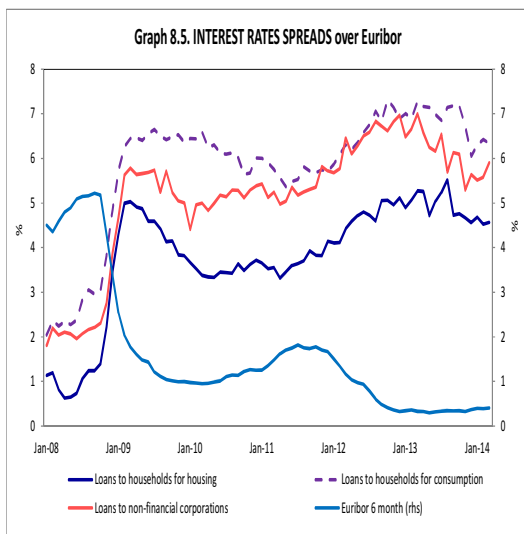
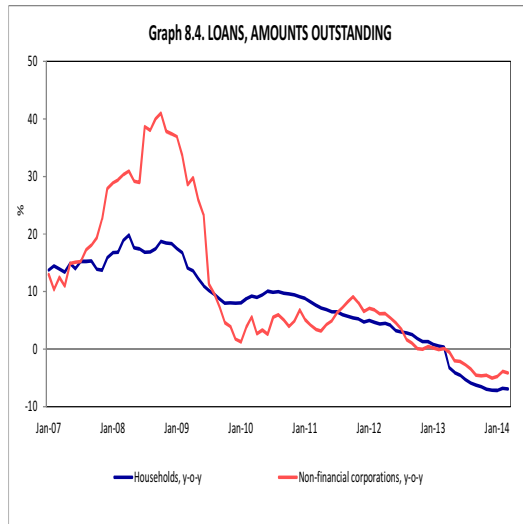
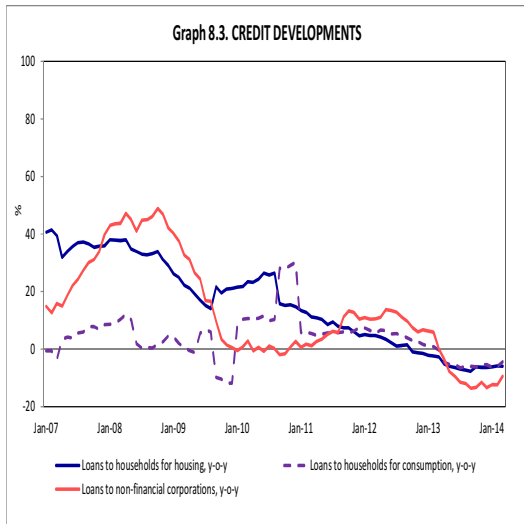
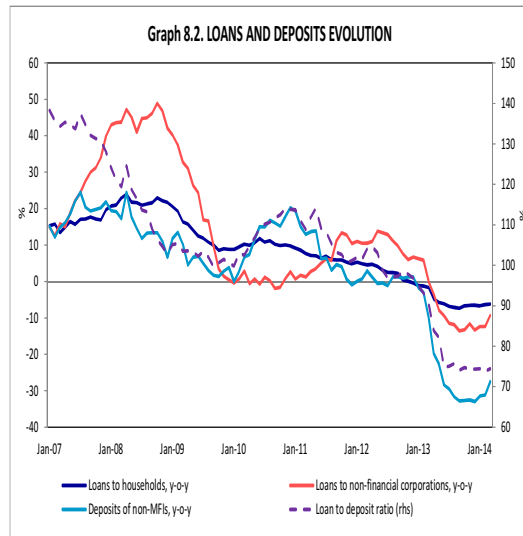
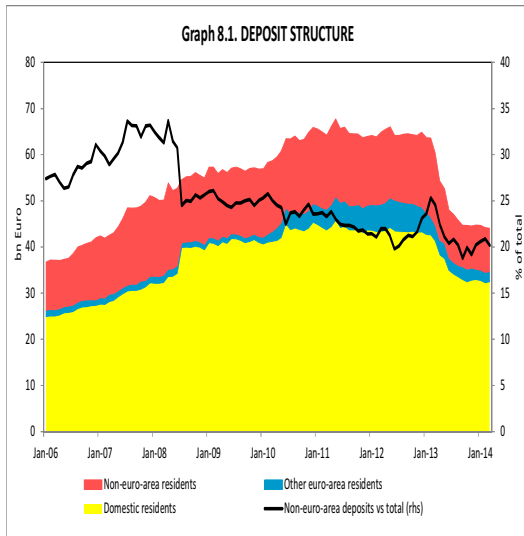
Sources: Eurostat, Cystat, ECB, CBC

7. HOUSING



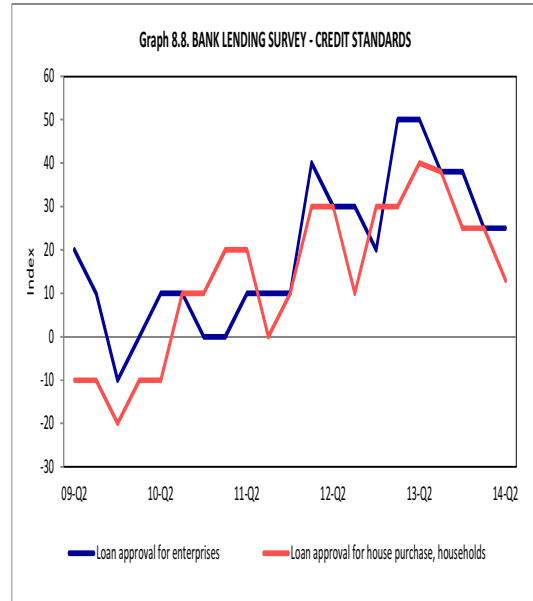
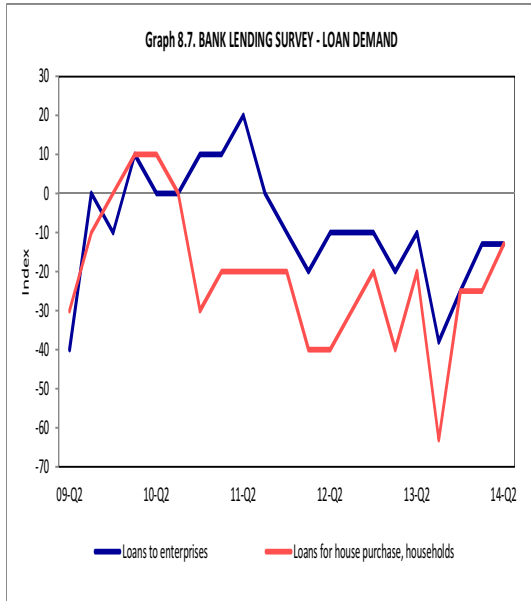
Sources: ECB, CBC, Dep. of Lands and Surveys

8. FINANCIAL SECTOR



Sources: ECB, CBC, Bloomberg

8. FINANCIAL SECTOR – cont.



Source: ECB