



# MACROECONOMIC MONITOR OF CYPRUS

August 2018

## MACROECONOMIC MONITOR OF CYPRUS

*Updated on 28 August 2018*

### Macro economy

- **In the 2<sup>nd</sup> quarter of 2018, GDP** (in seasonally adjusted terms) **recorded a positive rate of growth of 3.9%, compared to 4.0% in the 1<sup>st</sup> quarter of 2018** on an annual basis (see graphs 1.1-1.2). The increased activity is mainly attributed to the sectors: hotels and restaurants, retail and wholesale trade, construction, manufacturing, professional, scientific and technical activities and administrative and support service activities while negative growth rate was recorded by the sector financial and insurance 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 July 2018, increased by 2.0 points compared with June 2018 (see graph 1.3). The increase was driven by improved business confidence in services, construction and industry. Compared with July 2017, the indicator was lower by 4.7 points.
- During the period January-July 2018 **tourist arrivals increased at a rate of 9.6%** compared to January-July 2017 (see graph 6.3). An increase of 11% was recorded in tourist arrivals from Greece, a 6.9% increase from the UK, a 4.3% increase from Germany, while a 5% 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 1<sup>st</sup> quarter of 2018 compared to the 1<sup>st</sup> 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 8.2% in June 2018 compared to 11.0% in June 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 3<sup>rd</sup> quarter of 2013 falling to 22.3% in 2018Q1 from the peak of 40.4% in the 3<sup>rd</sup> quarter of 2013. Particularly challenging is also the relatively high long-term unemployment.
- **Compensation per employee** increased by 1.0% in the 1<sup>st</sup> quarter of 2018 compared to the 1<sup>st</sup> quarter of 2017 (see graphs 5.3-5.5).
- **Inflation (HICP)** in July 2018 increased by 1.4% compared to an increase of 1.7% in June 2018 (see graph 5.1). For the period January-July 2018 the HICP increased by 0.2% compared to the corresponding period of the previous year. Core HICP inflation remained stable in January-July 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 15.8%** in January-June 2018 compared to January-June 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 12.8%.
- **Exports of goods increased by 62.4%** in January-June 2018 compared to January-June 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 30.4%.

### External Sector

- The **current account (CA)** balance (see graph 6.4) improved in the 1<sup>st</sup> 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 1<sup>st</sup> 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 a 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 **trade balance** improved in the 1<sup>st</sup> quarter of 2018, recording a surplus of €153.9 mn (0.8% of GDP), compared with a deficit of €587.6 mn (-3.1% of GDP) in the 1<sup>st</sup> quarter of 2017.
- The **primary income** recorded a **deficit of €128.2 mn** in the 1<sup>st</sup> quarter of 2018 compared to a deficit of €60.6 mn in the 1<sup>st</sup> quarter of 2017 (see graph 6.4).
- The **secondary income** recorded a **deficit of €112.0 mn** in the 1<sup>st</sup> quarter of 2018 compared to a deficit of €90.1 mn in the 1<sup>st</sup> quarter of 2017 (see graph 6.4).
- The **international investment position** (IIP) (see graph 6.5) recorded a small improvement in the 1<sup>st</sup> 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 1<sup>st</sup> 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.

### Public Finances

- **General government budget balance (GGBB)** was in surplus in January-June 2018, of the order of €326.9 mn (1.7% of GDP) compared to a surplus of €64.5 mn (0.3% of GDP) during the corresponding period the year before (see graph 9.1).
- **General government primary balance (GGPB)** was in surplus in January-June 2018, of the order of €528.5 mn (2.6% of GDP) compared to a surplus of €287.5 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 9.4%, reaching €3,662.7 mn in January-June 2018, compared to €3,349.1 mn during the corresponding period the year before (see graph 9.3).
- **Total expenditure** exhibited a positive rate of growth of about 1.6%, reaching €3,335.8 mn in January-June 2018, compared to €3,284.6 mn during the corresponding period the year before (see graph 9.3).
- The Cyprus Government bond yield was below the respective German Government bond yield by 37 basis points on 28/08/2018 (see graph 8.6, yields refer to the bonds maturing in 2020).

### Property Market

- Eurostat's **house price index** for Cyprus recorded an **increase of 3.7%** in the **1<sup>st</sup> quarter of 2018** compared to the 1<sup>st</sup> quarter of 2017.
- The CBC's **residential property price index** recorded an **increase of 0.6%** in the **1<sup>st</sup> quarter of 2018** compared to the 4<sup>th</sup> quarter of 2017 and an **increase of 1.8%** compared to the 1<sup>st</sup> quarter of 2017. Cumulative from the 1<sup>st</sup> quarter of 2008 it has declined by 27.5% (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 23.4% while, transfers of property were up by 26.1% in January-July 2018 compared to January-July 2017 (see graph 7.3). MFI mortgage loans to domestic residents for housing declined with an annual rate of 0.4% in June 2018 (see graph 7.2).

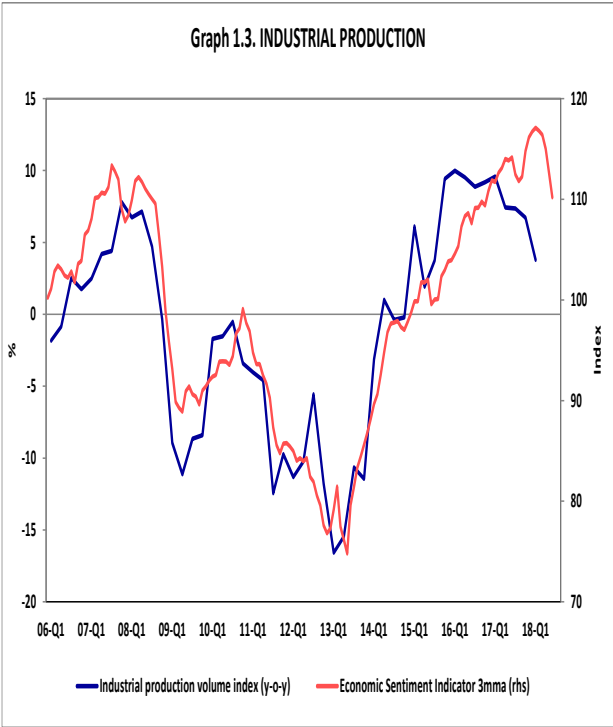
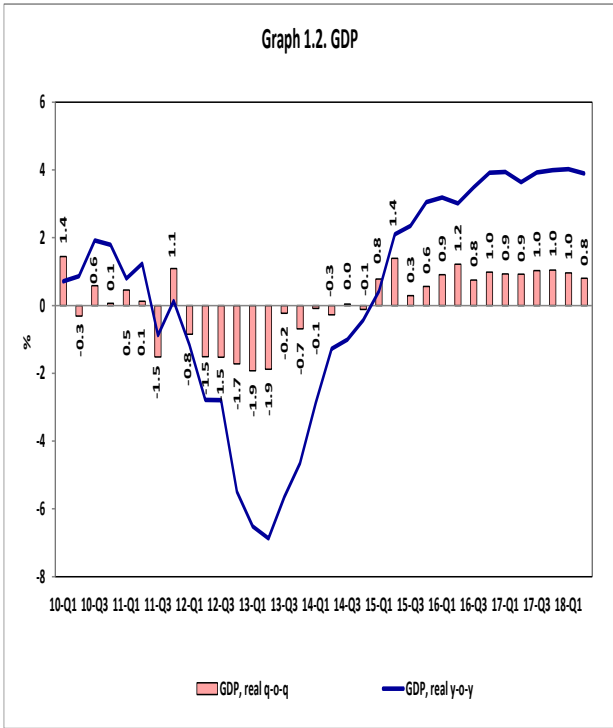
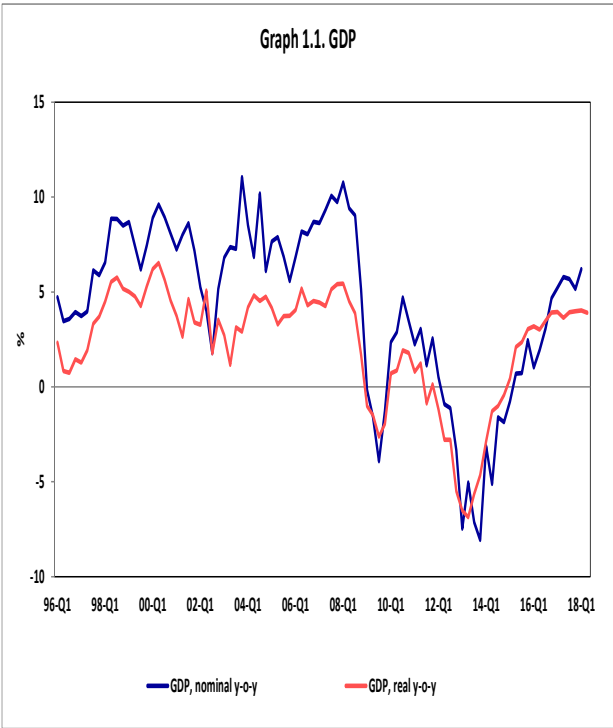
### Banking Sector Developments

- Monetary Financial Institutions (MFI) **loans to domestic residents** (private sector), **remained unchanged** in June 2018, (see graphs 8.2-8.4). This reflects 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 2.1%** in June 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 June 2018, **deposit interest rates** for maturity of up to 1 year and of up to 3 months decreased compared with the preceding month. The **lending interest rates** to households for primary residence decreased and the rate for other loans up to €1 mn for businesses increased. The interest

rate for bank overdrafts to non-financial corporations decreased. A significant deviation of the Cypriot interest rates, compared to the euro area average still prevails.

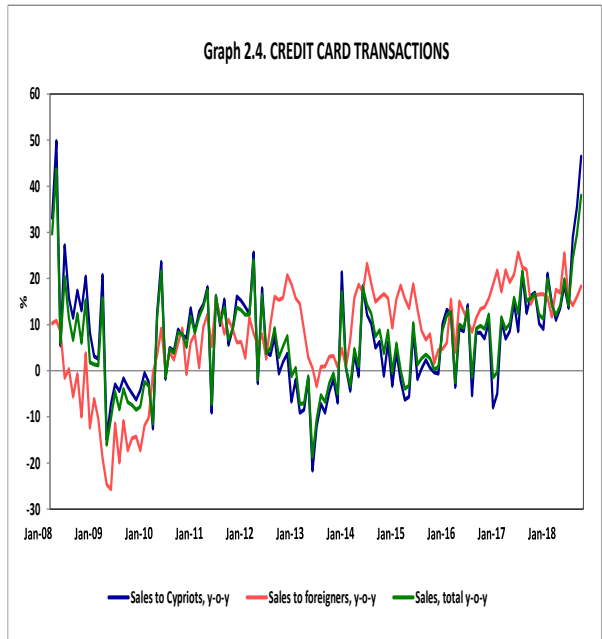
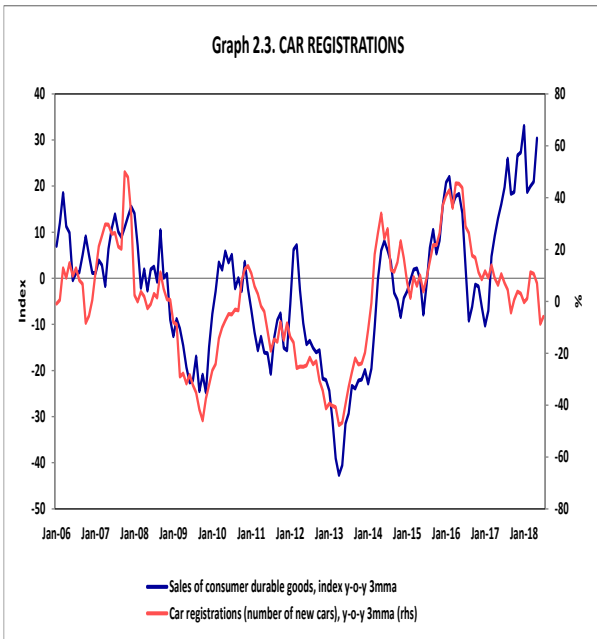
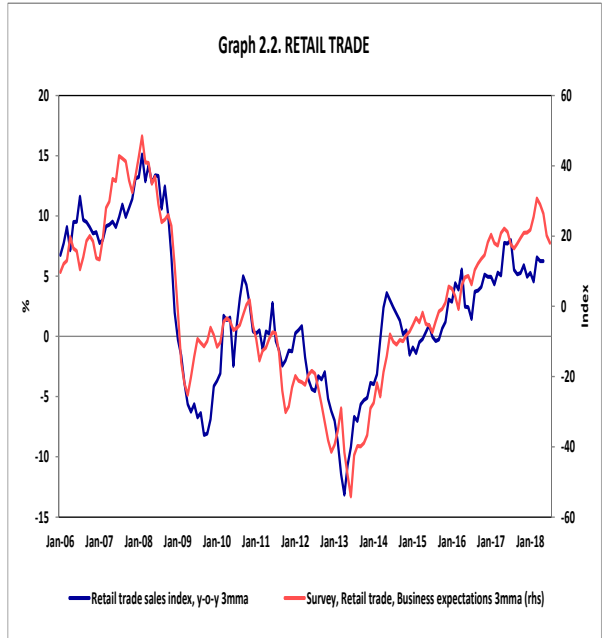
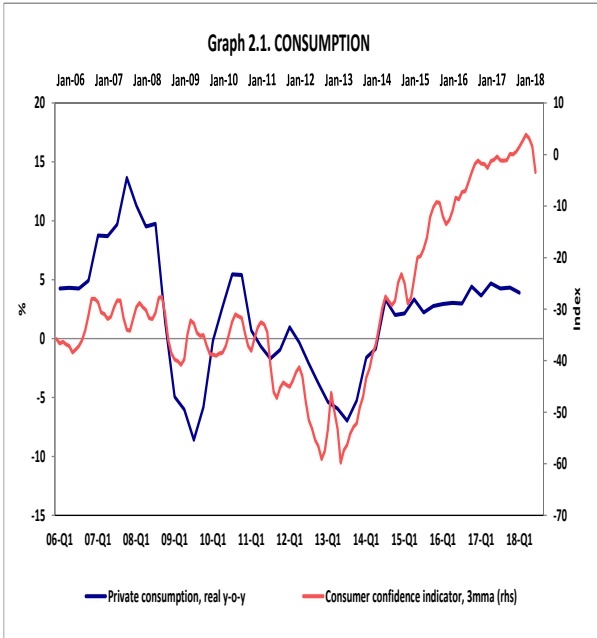
- NPEs represent the remaining legacy challenge currently faced by the Cyprus economy, amounting to approximately 41.6% of total lending in April 2018 compared to 42.5% in December 2017 and 46.4% at the end of 2016, whereas NPEs over 90 days past due amounted to approximately 32.6% of total lending in April 2018 compared to 32.6% in December 2017 and 34.0% at the end of 2016.
- NPEs in absolute terms are generally exhibiting a downward trend, reaching €20.2 billion in April 2018, down from €27.3 billion 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 49.0% of NPEs in April 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 Hellenic Bank. The strengthening of the legal framework was completed with the enactment of a series of laws on July 8<sup>th</sup>. The enhanced framework facilitates the development of a functioning secondary market for NPFs in Cyprus, further strengthens the law on foreclosures, enhancing the sale of loans law and introducing a law on loan securitization with a view to tackle the problem of strategic defaulters.
- 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. The scheme has been submitted to the Directorate General for Competition for its approval.
- 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 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%.
- Bank of Cyprus announced on 28<sup>th</sup> August 2018 the sale of a portfolio of loans of gross book value of €2.8 bn (of which €2.7 bn relate to nonperforming loans) to Apollo Global Management LLC. The transaction will reduce BOC’s stock of NPLs to €5.2 billion from €7.9 bn in the end of June 2018, resulting in a non-performing exposure (“NPE”) ratio improvement of around 10 percentage points. The Portfolio has a contractual balance of €5.7 bn. The net book value of the assets being sold as at 30 June 2018 amounted to €1.5 bn before the impact of the Transaction on the 2Q 2018 income statement. At completion, the Bank will receive gross cash consideration of around €1.4 bn. The above transaction in conjunction with the sale of a perimeter of assets and liabilities of CCB to Hellenic Bank will result in the overall reduction of NPLs to total loans by about 15 percentage points.

1. OUTPUT



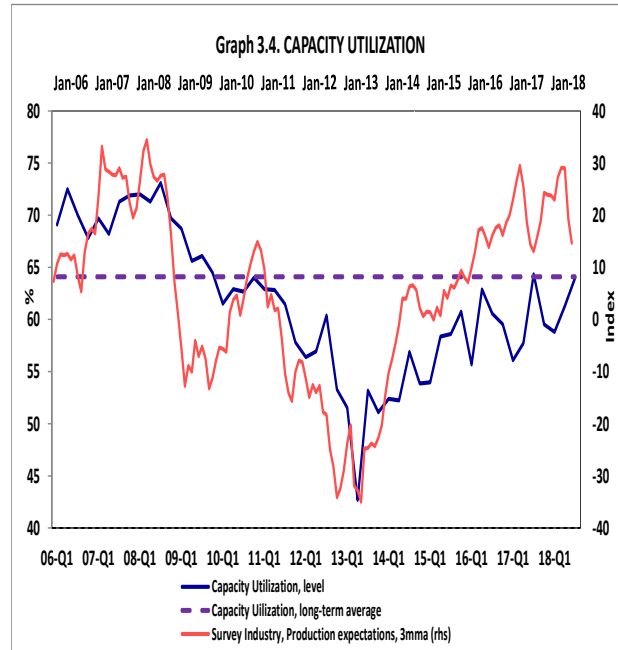
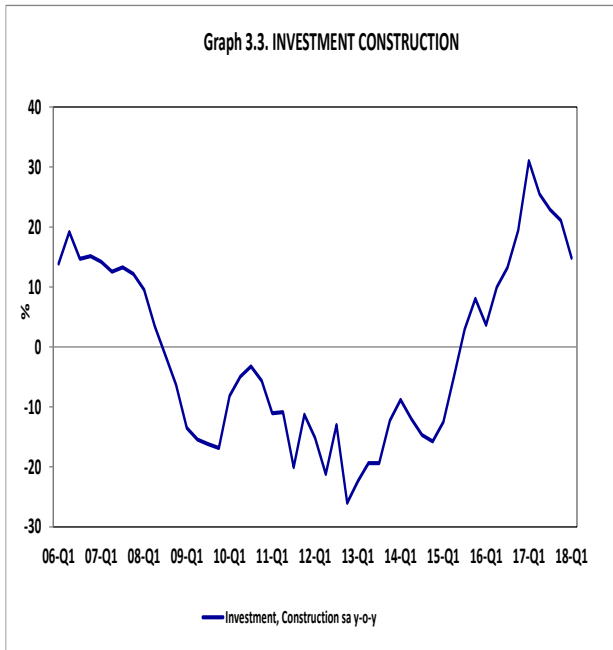
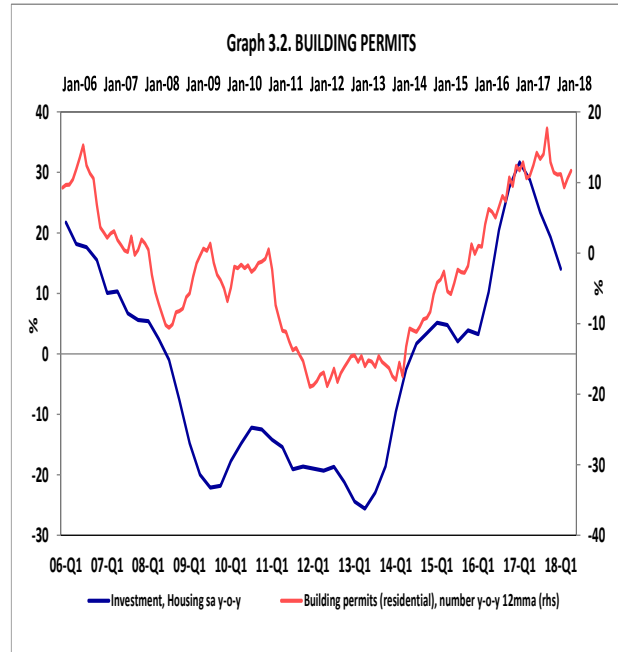
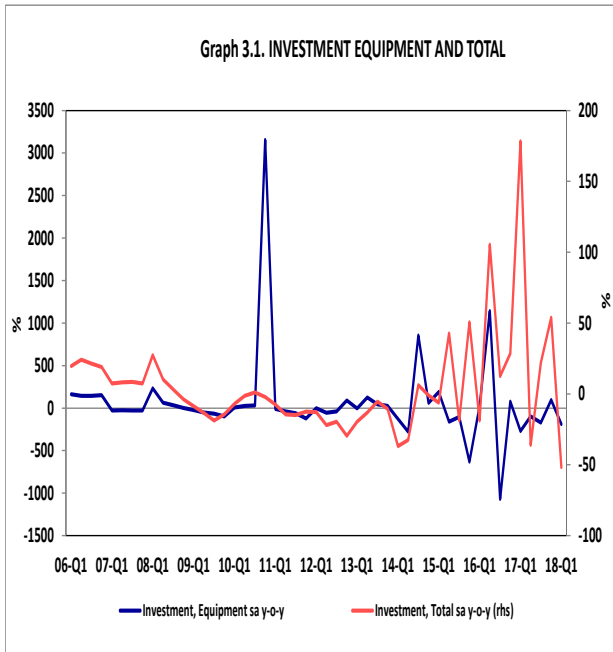
Sources: Eurostat, DG ECFIN, Cystat

**2. CONSUMPTION**



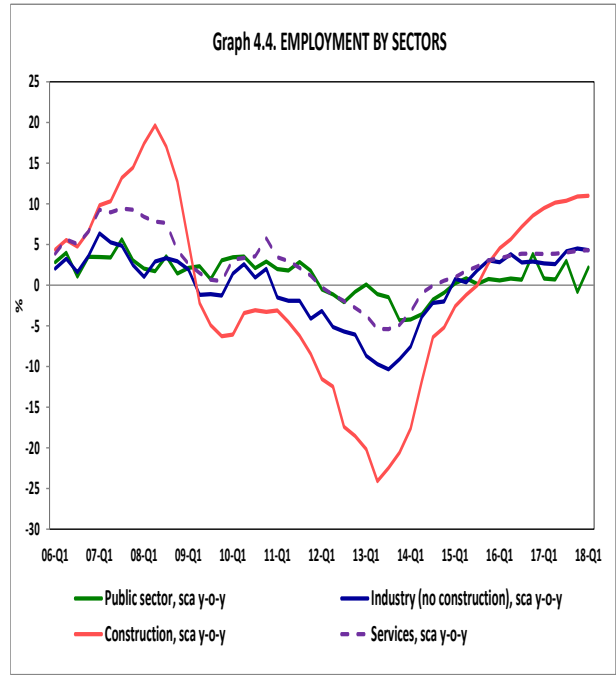
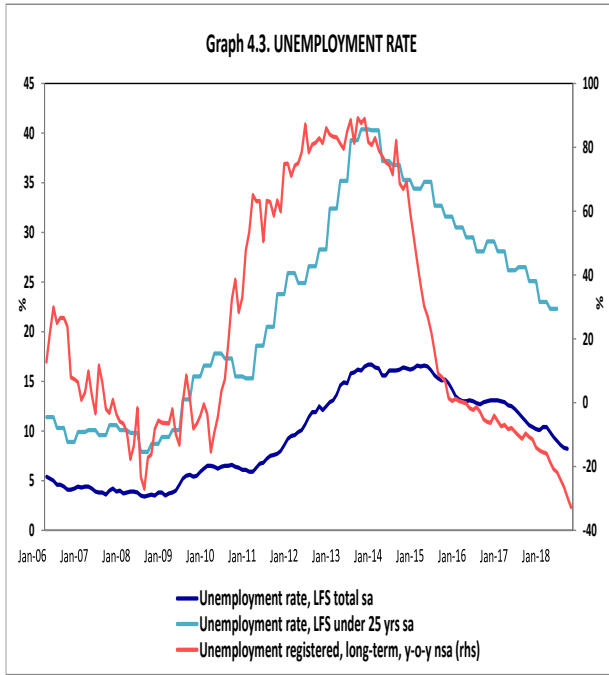
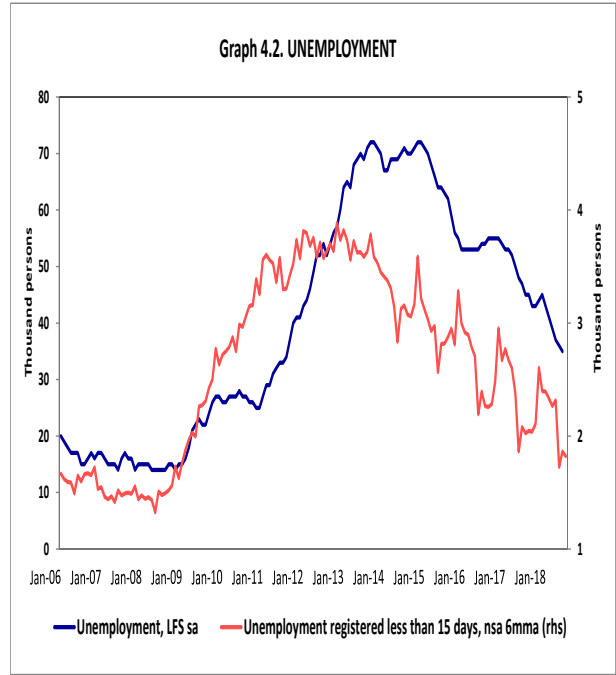
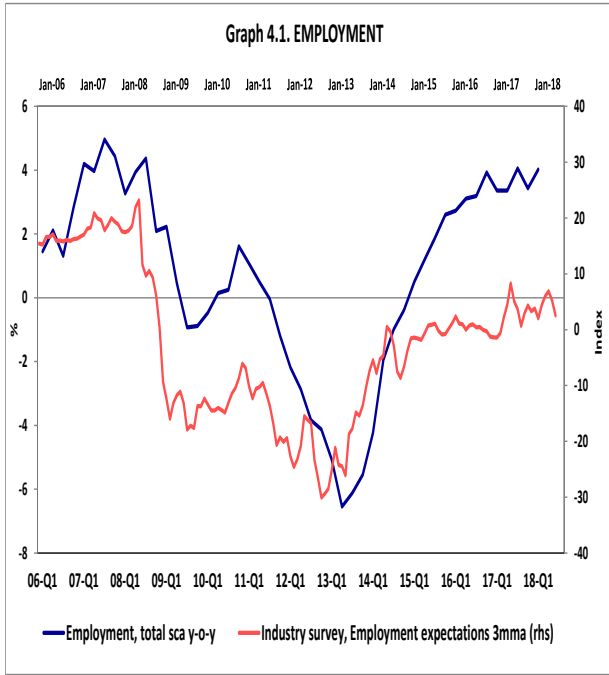
Sources: Eurostat, DG ECFIN, Cystat, JCC Payment Systems Ltd

3. INVESTMENT



Sources: Eurostat, DG ECFIN, Cystat

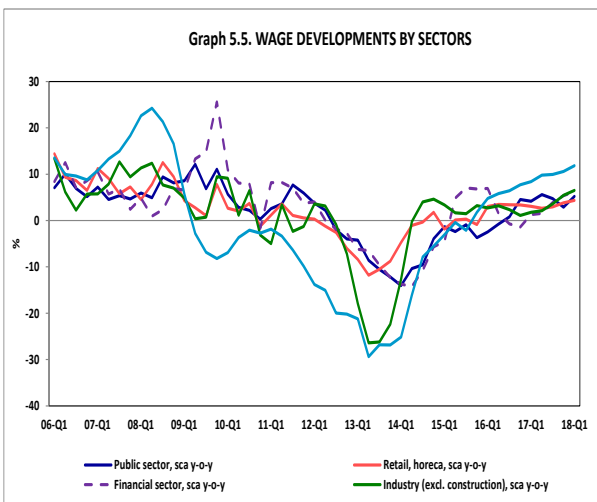
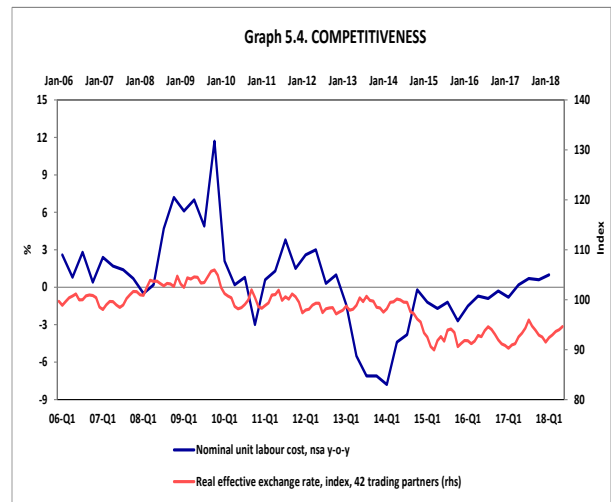
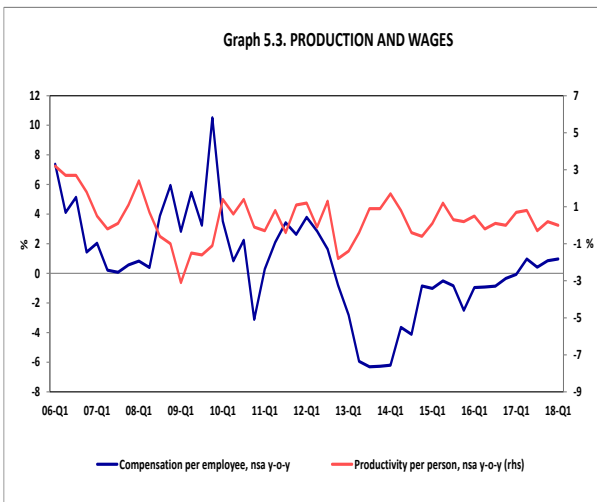
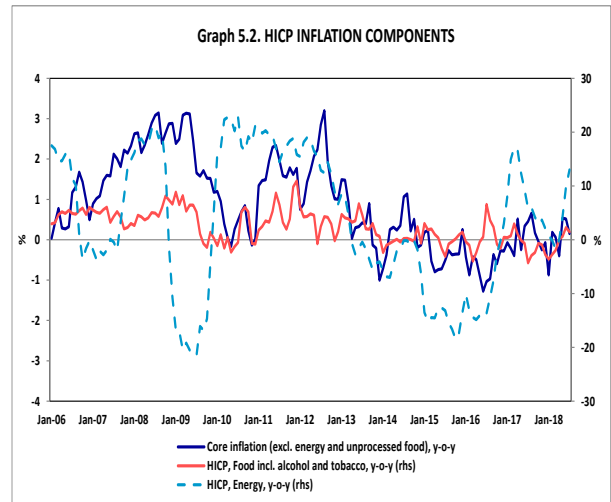
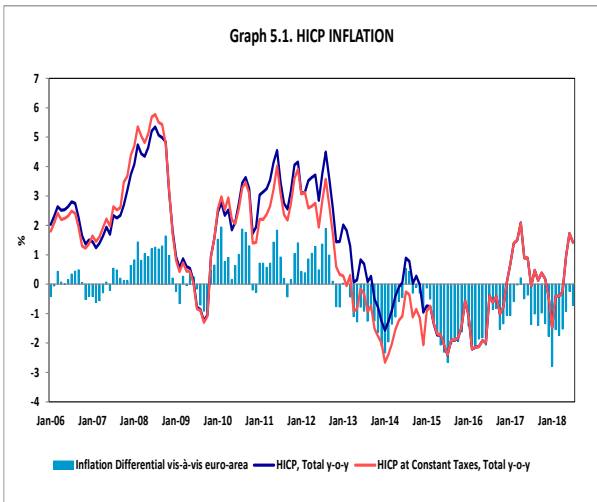
4. LABOUR MARKET



Sources: Eurostat, DG ECFIN, Cystat

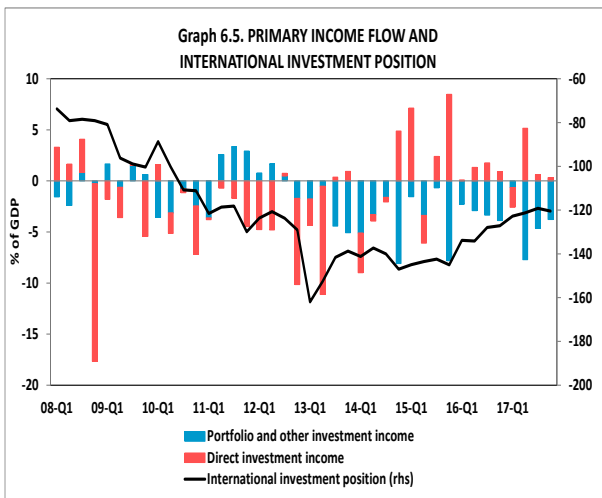
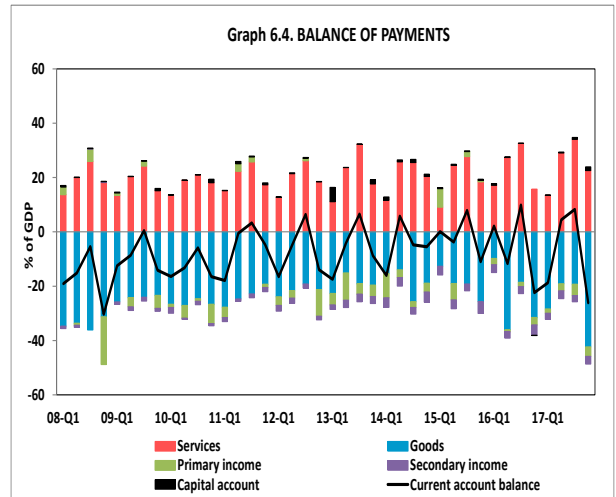
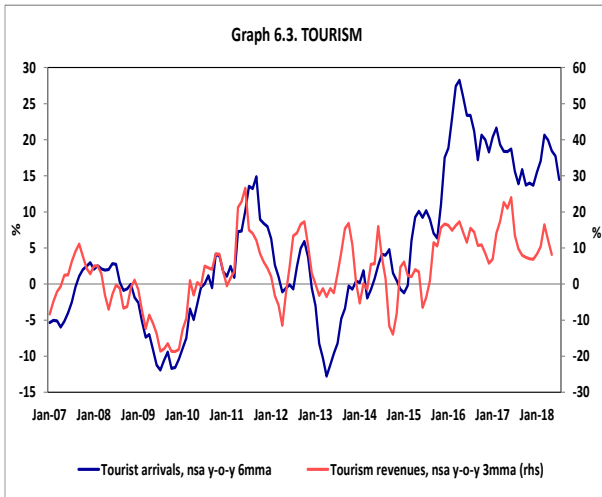
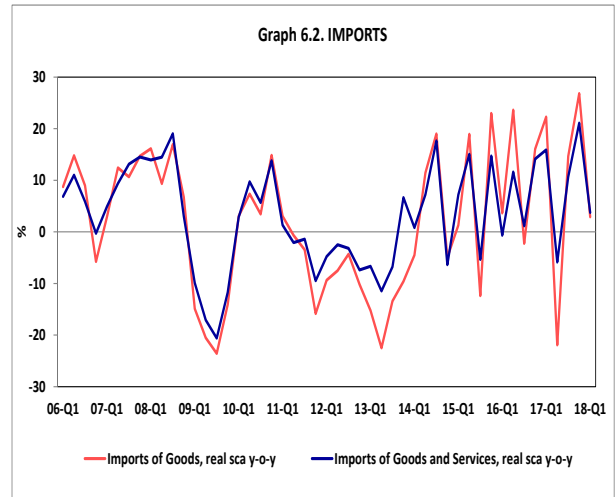
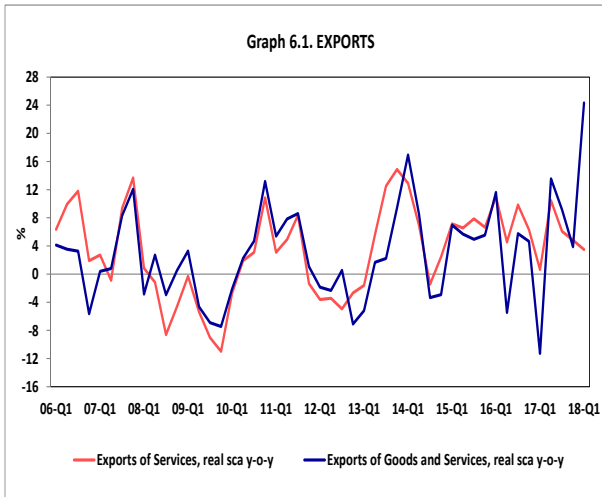


5. INFLATION, WAGES



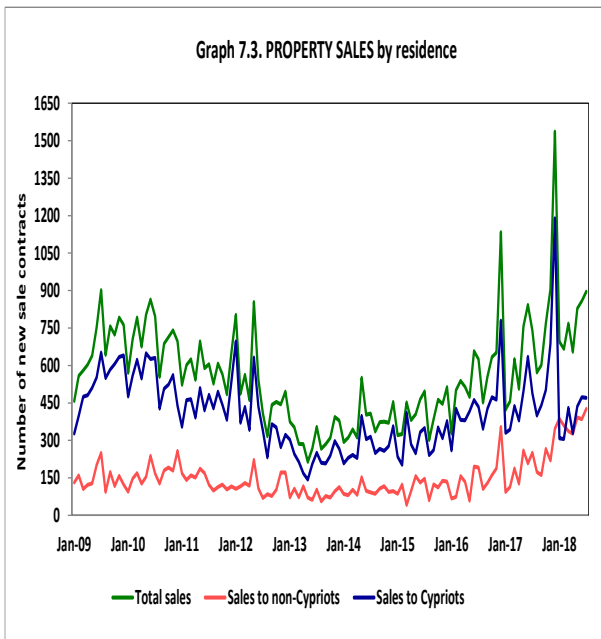
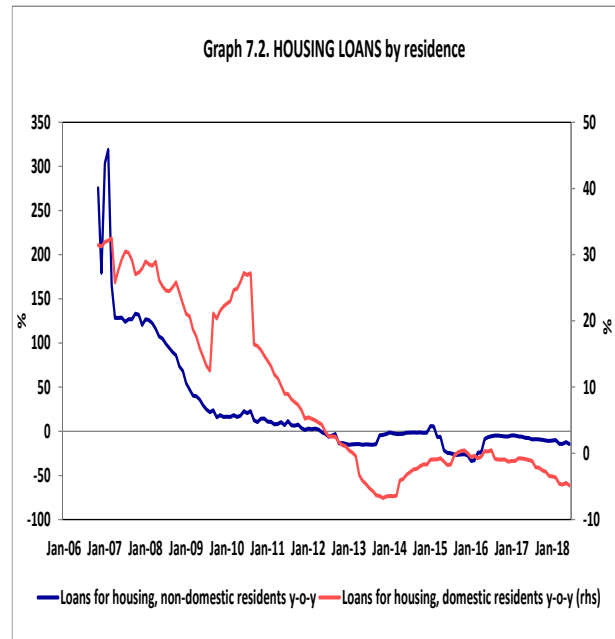
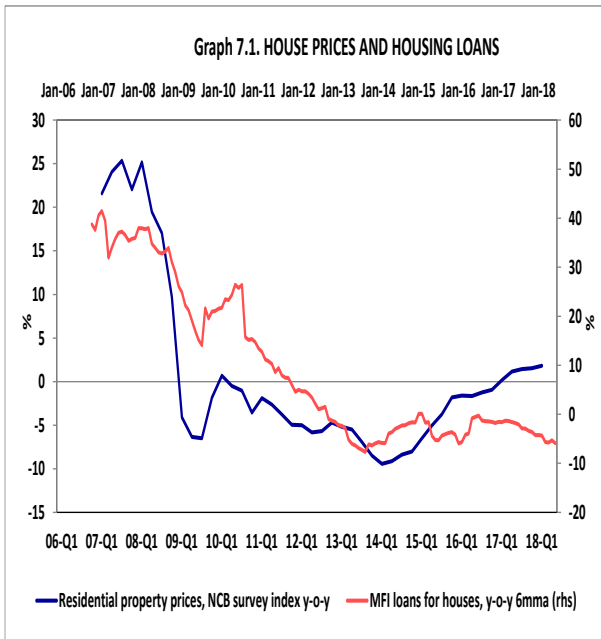
Source: Eurostat

6. EXTERNAL SECTOR



Sources: Eurostat, Cystat, ECB, CBC

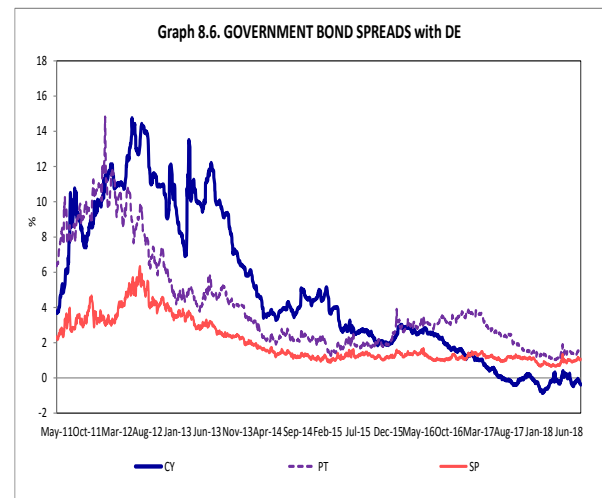
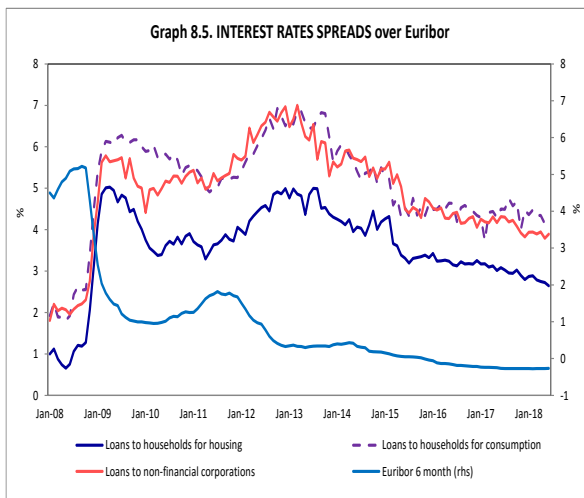
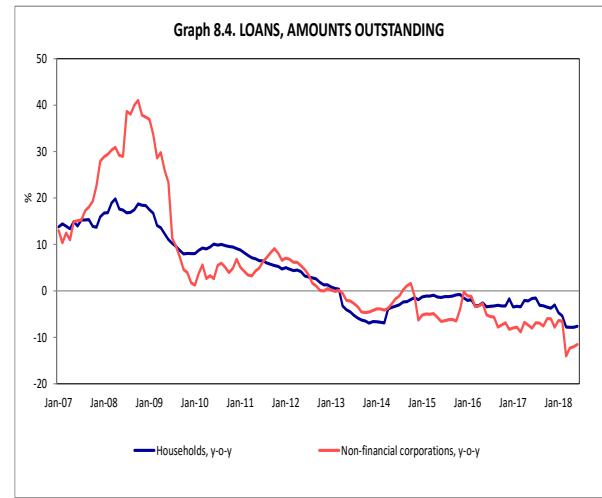
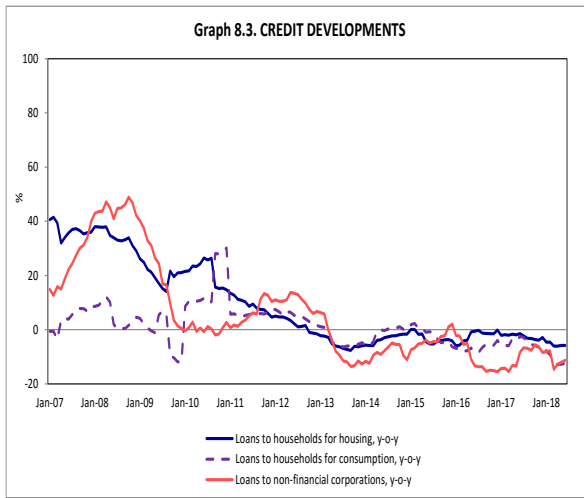
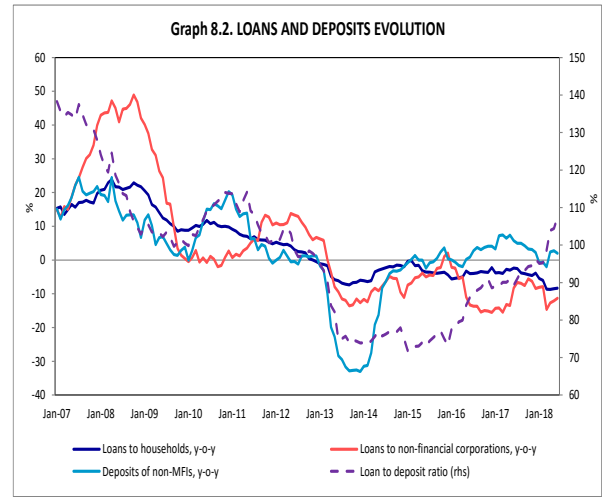
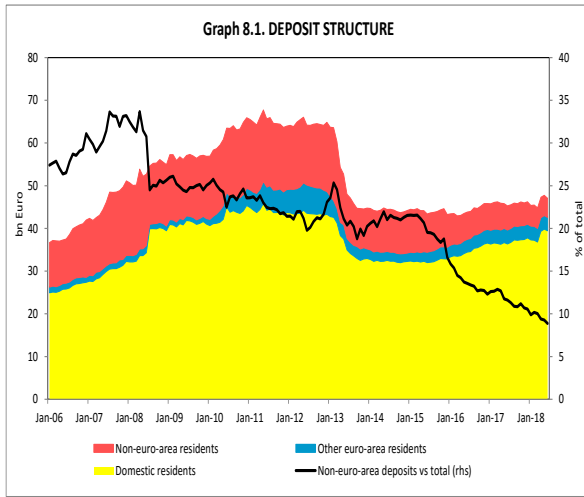
7. HOUSING



*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.*

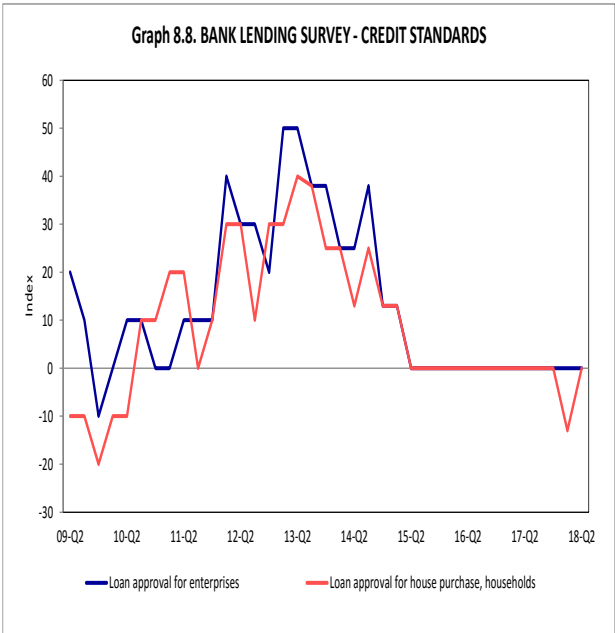
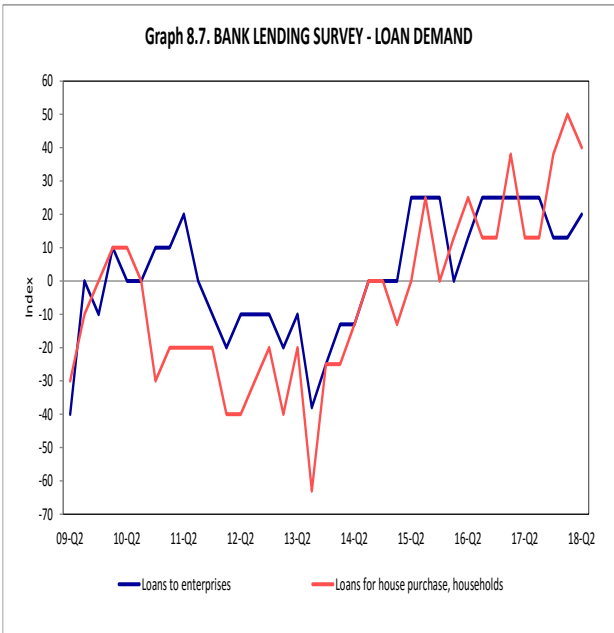
Sources: ECB, CBC, Dep. of Lands and Surveys

8. FINANCIAL SECTOR



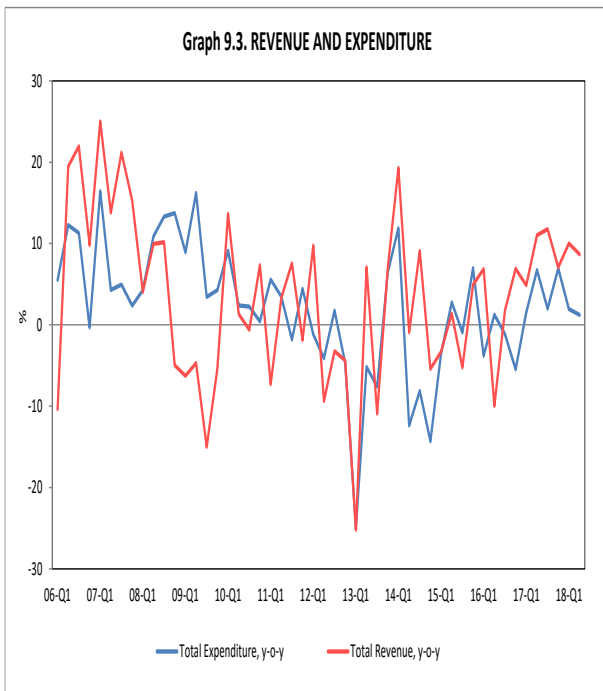
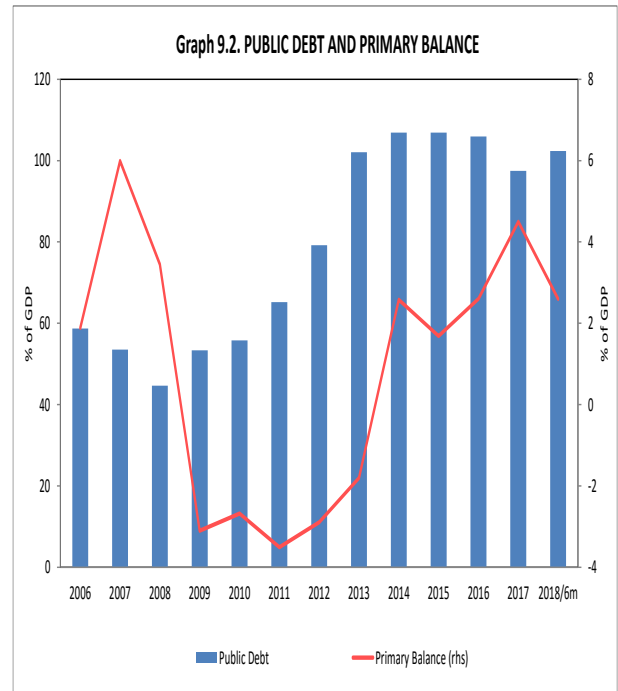
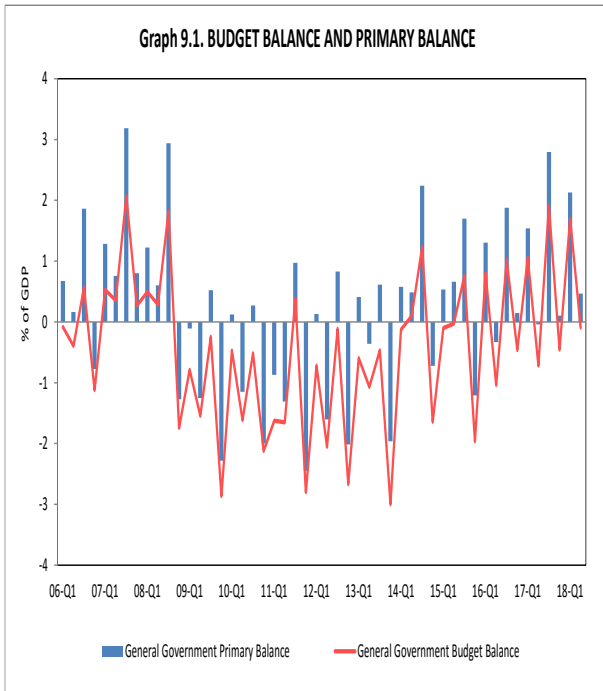
Sources: ECB, CBC, Bloomberg

8. FINANCIAL SECTOR – CONT.



Source: ECB

9. PUBLIC SECTOR



Sources: Ministry of Finance, Cystat