CENTRAL BANK OF CYPRUS
EUROSYSTEM

Annual Review of External Statistics

2012

INTRODUCTION

External Statistics – specifically balance of payments (BOP), and international investment position (IIP) statistics– measure all economic transactions and all financial positions between residents and non-residents, respectively. In addition, they constitute part of the external statistics of the European Union and the euro area. The purpose of this report is to provide a comprehensive account of the main developments in the external statistics of Cyprus, with an emphasis on developments in selected economic sectors.

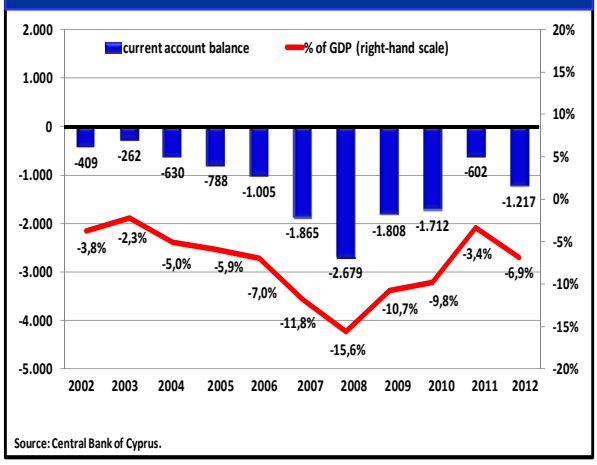
1. CURRENT ACCOUNT

Cyprus's current account deficit increased to €1.217 million in 2012, despite successive reductions in previous years. The current account deficit-to-GDP ratio was 6,9% , as against 3,4% in 2011. The balance for the trade in services continued to be positive (€3.310 million), whereas the goods and income components recorded deficits equal to €3.856 million and €456.0 million, respectively.

Cyprus's current account deficit increased to €1.217 million in 2012 from €601,8 million in 2011 (**Chart 1**). Expressed as a percentage of GDP, the current account deficit increased to 6,9% in 2012, which is significantly higher than the 3,4% recorded in 2011.

The main drivers of the increase in the current account deficit were the lower surplus in services and the significant deterioration of the income account (from a surplus to a deficit).

CHART 1 Current account balance 2002 -2012
(€ million)



Source: Central Bank of Cyprus.

More specifically, during the year under review there was:

(i) an increase in payments to non-residents in the income account
(ii) a reduction in receipts from the income account
(iii) a reduction in exports of services and
(iv) an increase in imports of services.

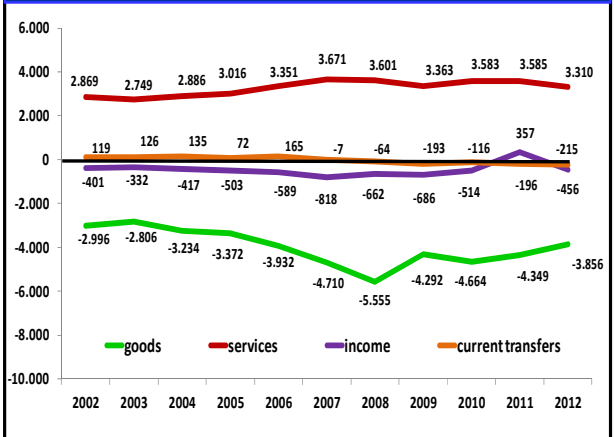
In contrast, the trade balance in goods improved significantly due to lower imports. In 2012 the trade deficit decreased to €3.856 million (**Chart 2**), down from €4.349 million in 2011. This improvement was due to significant reductions in all import categories except fuels and lubricants. In addition, exports of goods recorded a small increase during 2012.

The services surplus recorded a reduction of €275 million during the year under review. In particular, it fell from €3.585 million in 2011 to €3.310 million in 2012. This adverse development was driven by:

(i) reductions in the exports of "financial", "transport" and "other business" services,

(ii) increases in imports of travel, communication and other business services.

CHART 2 Current account main components - net balances 2002-2012 (€ million)

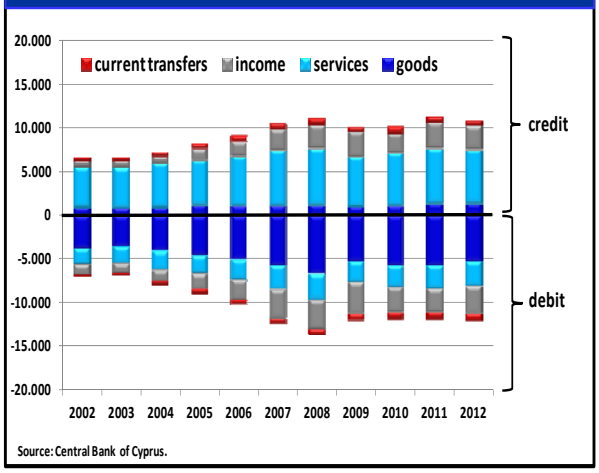


Source: Central Bank of Cyprus.

The income account recorded a deficit of €456 million in 2012, compared with a surplus of €357,3 million observed in 2011. Income payments to non-residents increased from €2.643 million in 2011 to €3.124 million in 2012. At the same time income receipts from non-residents decreased from €3.001 million in 2011 to €2.668 million in 2012.

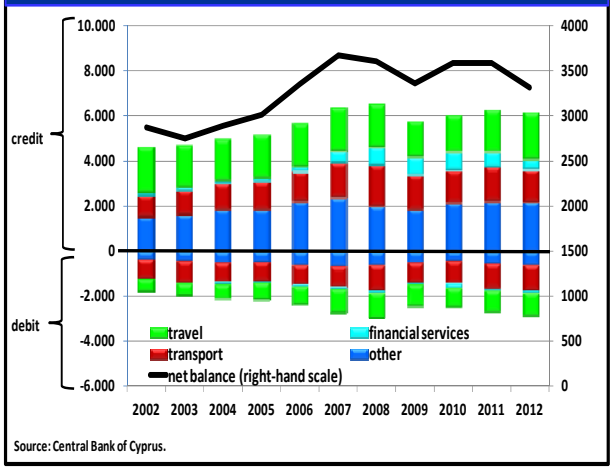
Chart 3 illustrates the year–on–year movement of current account debits (outward flows) and credits (inward flows). There was a fall in total credits and an increase in total debits, resulting mainly from corresponding movements in income. Opposite movements were recorded for credits and debits in 2011, showing increases in credits and decreases in debits. "Goods" and "services" are the two components of the current account with the highest cumulative share in both debits and credits.

CHART 3 Distribution of credit and debit in the current account 2002-2012 (€ million)



Source: Central Bank of Cyprus.

CHART 4 Current account - exports and imports of services 2002-2012 (€ million)



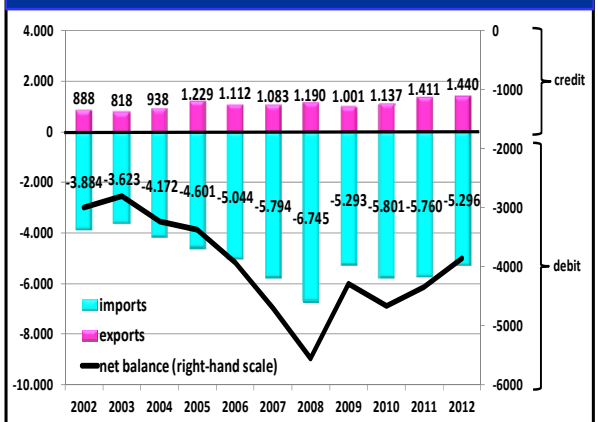
Source: Central Bank of Cyprus.

The most significant components of the services balance are examined in **Chart 4**. Receipts from services (credits) totalled €6.168 million in 2012,

down 2% from € 6.262 million in 2011. Services related payments (debits) reached €2.857 million, up 6% from €2.676 million in 2011.

Exports of services consisted mainly of "travel" and "other services" components. In 2012 "travel" services benefited from increases in both tourist arrivals and per head expenditure. In the case of import of services (debits), "travel" and "transport" were the two components with the highest contributions. Exports of services remained consistently higher than imports of services throughout the period 2002-2012. However, in 2012 there was a reduction in the services surplus by €300 million, from €3.600 million in 2011 to €3.300 million. The services balance breakdown by different components showed surpluses under "transport" (€319,4 million), "financial services" (€376,9 million), "travel" (€1.019 million) and "other services" (€1.595 million).

CHART 5 Current account - exports and imports of goods 2002-2012
(€ million)

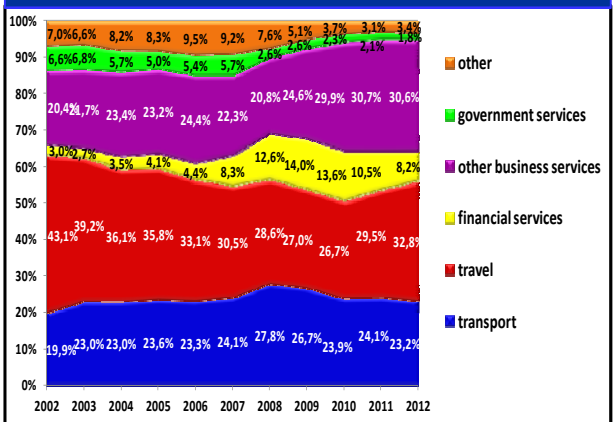


Source: Central Bank of Cyprus.

The year-on-year comparison of the trade deficit is demonstrated in **Chart 5**. Imports are consistently higher than exports. A significant increase in the trade deficit was recorded during the period 2002-2008 (reaching €5.555 million in 2008). Ever since, and with the exception of 2010, whereby a small increase was recorded, the deficit has been on a downward trend, closing at €3.856 million in 2012.

Further decomposition of exports of services by component is illustrated in **Chart 6**. This information enables the identification of the growing service sectors of the economy, where Cyprus poses a competitive advantage.

CHART 6 Services exports 2002-2012
(% shares)



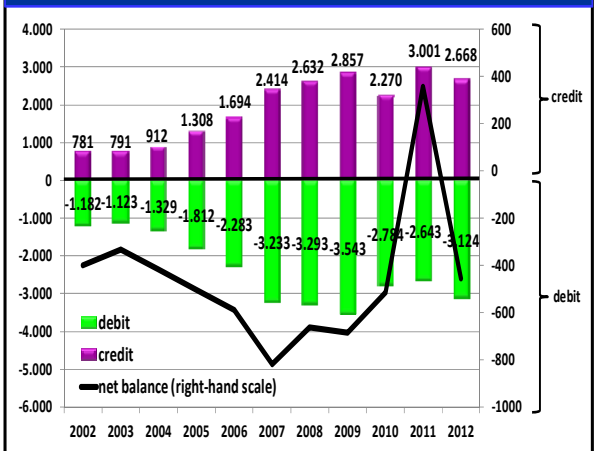
Source: Central Bank of Cyprus.

"Transport" and "travel" services, when taken together, contributed 56% of the total amount of services exported in 2012. The contribution of "other business" services (e.g. legal, accounting, management and triangular trade) remained stable at 31%, while "financial services" declined from 11% in 2011 to 8% in 2012.

Information on income account payments (debits) and receipts (credits) is presented in **Chart 7** (p.4). Income receipts decreased from €3.001 million in 2011 to €2.668 million in 2012, primarily due to a large reduction in foreign direct investment income which exceeded the increase in other investment income. Most of the reduction in foreign direct investment income is explained by the worsening performance of the banking sector abroad compared with 2011. On the other hand, income

payments increased by €481 million to €3.124 million in 2012. This development was mainly due to the increase recorded in income payments for other investments. Both credit and debit developments contributed to the switching of the income account balance from a surplus in 2011 (€357,3 million) to a deficit in 2012 (-€456,0 million).

CHART 7 Income account 2002-2012
(€ million)



Source: Central Bank of Cyprus.

2. CAPITAL ACCOUNT, FINANCIAL ACCOUNT AND INVESTMENT POSITIONS

2.1 Capital account

The capital account recorded relatively small amounts in 2012. Credits reached €38,7 million and debits €15,3 million (thus providing a net contribution of €23,4 million to the current account financing).

2.2. Financial account

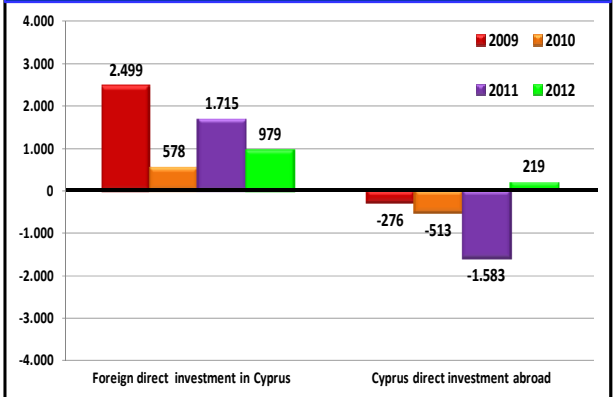
Based on the principle of double-entry accounting, the balance of the financial account is, by definition, equal to the balance of the current and capital accounts. In practice, however, this correlation is weak since, firstly, transactions cannot always be correctly attributed to the respective periods and, secondly, there are gaps in the statistical coverage of almost all sub-accounts. All these discrepancies are reflected in the "net errors and omissions" account.

For the sake of a more comprehensive analysis, the remainder of **Section 2** presents the flows in the financial account together with the stock positions of each investment category. Stock positions are recorded in the IIP and are further analysed in **Section 3** (p. 10).

2.2.1. Foreign direct investment

Total foreign direct investment flows in Cyprus increased by €978,6 million in 2012, due to increases in equities and re-invested earnings (€691,4 million) and "other" flows (€287,2 million). In contrast, foreign direct investment flows abroad decreased by €218,9 million. Furthermore, the total stock of direct investment abroad decreased by 42,5%. To a large extent, this decrease was due to the PSI (private sector involvement) effect and the provisions for bad debts reported by the branches and/or subsidiaries of Cypriot banks in Greece.

CHART 8 Flows of direct investment 2009-2012
(€ million)



Source: Central Bank of Cyprus.

Foreign direct investments constitute a long-term strategic objective of the Cyprus business model. Foreign direct investment flows in Cyprus (liabilities), increased by €979 million in 2012 (**Chart 8,** p.4), mainly due to re-invested earnings. Increases

in foreign direct investment flows in Cyprus were also recorded during the previous three years. In contrast, foreign direct investment flows abroad (assets) decreased by €219 million in 2012. This denotes withdrawals of investment funds placed by Cypriot investors in foreign countries in the form of "other" flows (e.g. inter-company loans). In 2011, investments placed by residents abroad increased by €1.583 million.

CHART 9 Direct investment equity flows including re-invested earnings 2009-2012 (€ million)

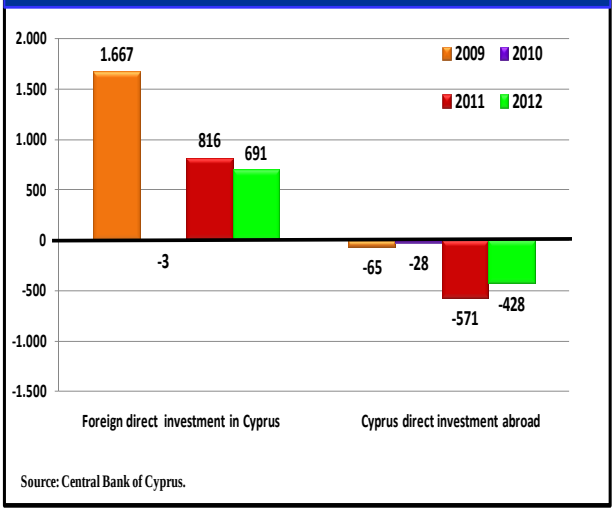


Chart 9 provides information on the equity flows component (including re-invested earnings) of foreign direct investment. Equity and re-invested earnings flows in Cyprus increased by €691,4 million in 2012, following a higher increase in 2011. This was also the case for foreign direct investment flows abroad, which increased by € 428 million in 2012 following a €571,1 million increase in 2011

"Other" flows refer mainly to intercompany lending, trade credits and other receivables. The flows associated with the last four years are presented in **Chart 10**. "Other" flows abroad decreased by €647 million in 2012, reversing the trend observed since 2009. On the other hand, "other" flows in Cyprus increased by €287,2 million, which is the lowest increase recorded since 2009.

CHART 10 Direct investment "other" flows 2009-2012 (€ million)

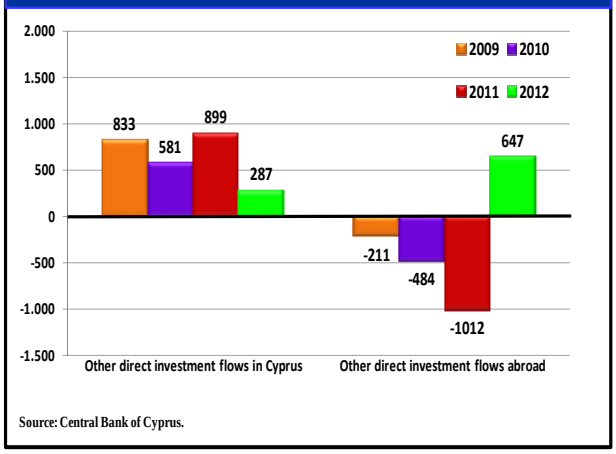


CHART 11 Foreign direct investment stocks 2002 - 2012 (€ million)

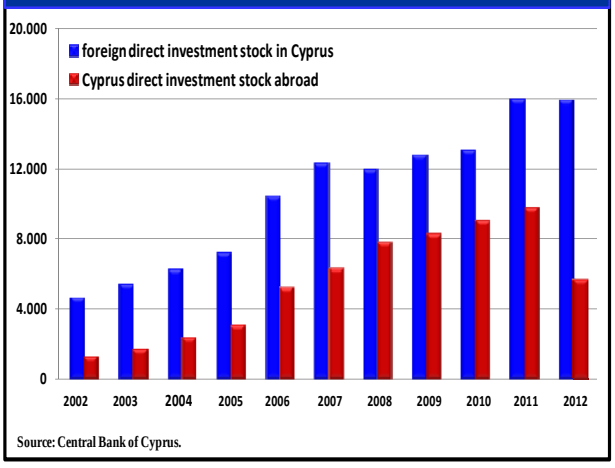
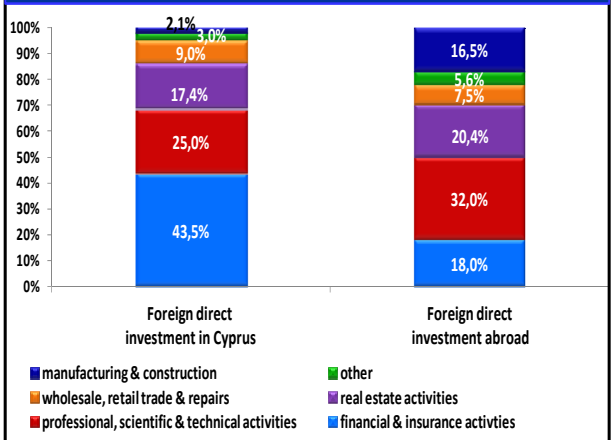


Chart 11 presents the annual amounts of foreign direct investment stocks recorded in Cyprus since 2002. By the end of 2012, the total stock of foreign direct investment accumulated in Cyprus was €15.952 million. The total stock of foreign direct investment placed by residents abroad dropped from €9.711 million in 2011 to €5.582 million in 2012 (a 42,3% reduction). In contrast, foreign direct investment in Cyprus remained stable. As a result,

the spread between investment stocks in Cyprus and abroad increased to €10.370 million in 2012.

CHART 12 Direct investment stocks by economic activity 2012
(% of stocks)

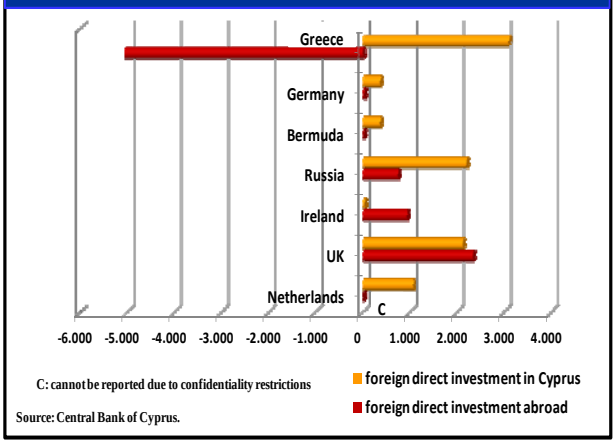


Source: Central Bank of Cyprus.

An important aspect of foreign direct investment is its allocation by economic activity (based on the economic sector into which the direct investment takes place). The main sectors for 2012 are presented in **Chart 12**. Most of the inward and outward direct investments for 2012 were directed to the financial, insurance, professional, scientific and technical activities sectors. With regards to foreign direct investment abroad, there was also a noticeable contribution by the manufacturing and construction sector.

Foreign direct investment is furter decomposed by country in **Chart 13**. It presents the main countries whose residents are investing in Cyprus, as well as the main target countries for Cypriot investors abroad. Only the top six countries are presented from each category. What can be observed from this list is that most direct investors in Cyprus come from Greece, the UK, Russia and the Netherlands. For Cypriot entities, the main direct investment destinations are the UK, Ireland and the Netherlands.

CHART 13 Direct investment stocks by country 2012
(€ million)



Source: Central Bank of Cyprus.

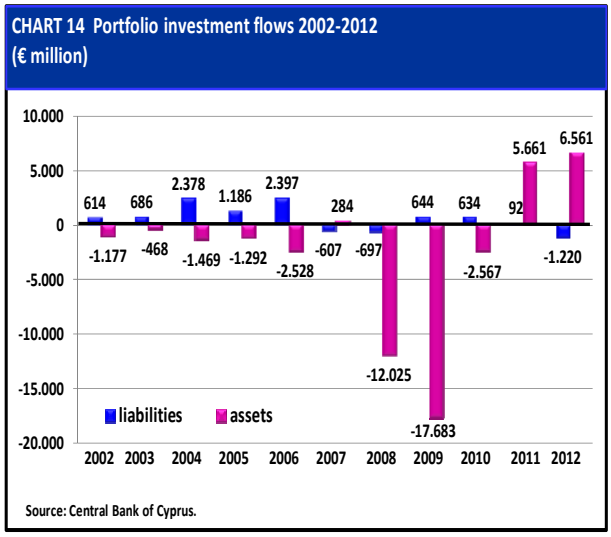
Stock reductions in foreign direct reflect the large negative stock value associated with Greece in **Chart 13** (€5.055 million). This amount represents mainly the PSI (private sector involvement) effect and other volume changes such as provisions for bad debts, reported by the branches and/or subsidiaries of Cypriot banks in Greece. It also explains the large reduction in the stock of direct investment placed by residents abroad.

2.2.2 Portfolio investment

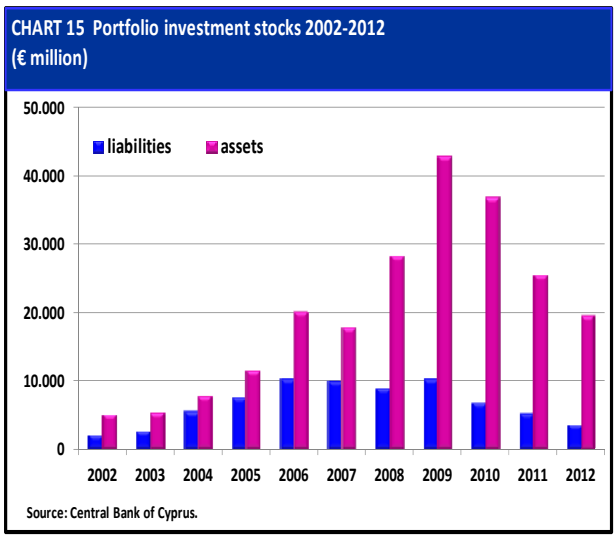
The total amount of foreign securities held by residents decreased by €6.561 million in 2012. Likewise, there was a €1.220 million reduction in the amount of securities issued by residents and held by foreign investors. Accordingly, portfolio investment stocks declined in both assets and liabilities. These investment positions comprised primarily of bonds and notes. The most important category of investors in bonds and notes issued by non-residents were the "other monetary financial institutions". On the liabilities side, bonds and notes were predominantly issued by the general government.

Portfolio investment flows are presented in **Chart 14** (p.7). Assets experienced considerable net inflows of the order of €6.561 million in 2012, representing net

sales of foreign securities held by residents. Net sales were also recorded in 2011 (€5.661 million).

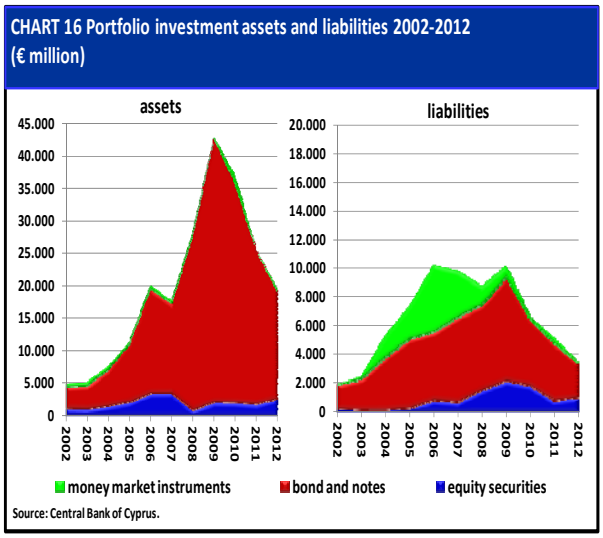


Portfolio investment liability flows in 2011 were €92 million, representing a net inflow of funds from securities issued by residents and held by non-residents. This was reversed in 2012 when foreign investors reduced their holding of securities issued by residents by €1.220 million.



Portfolio investment stocks declined for both assets and liabilities in 2012 (**Chart 15**). Assets dropped from €25.521 million in 2011 to €19.447 million in 2012 (a 23,8% reduction). Higher reductions were recorded in 2011. The stock of liabilities is significantly smaller and dropped further from €5.143 million in 2011 to €3.472 million in 2012 (a 32,5% reduction). Unlike liabilities, the average level of assets has increased considerably since 2008, when Cyprus joined the euro area.

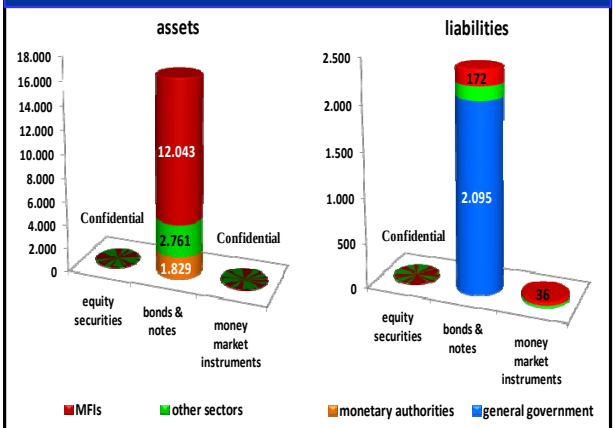
Chart 16 investigates the instrument composition of portfolio investment asset and liability stocks. Bonds and notes constitute the main component for both assets and liabilities, amounting to €16.632 and €2.412 million, respectively, as at end 2012. Equity investments represented only a small fraction of both assets and liabilities – on average, for the period covered by the analysis, these corresponded to 13% of total assets and 13,5% of total liabilities. Money market instruments provided a significant contribution only in liabilities (securities issues by residents) and only for the period 2005-2008.



Portfolio investments are most commonly analysed by sector and financial instrument (**Chart 17**, p.8). Due to confidentiality restrictions it is not possible to provide any information on equity securities and money market instruments in assets and equity securities in liabilities. For this reason, the emphasis

will be on bonds and notes, which, nevertheless, constitute the main instrument category in both assets and liabilities.

CHART 17 Portfolio investment by sector 2012
(€ million)

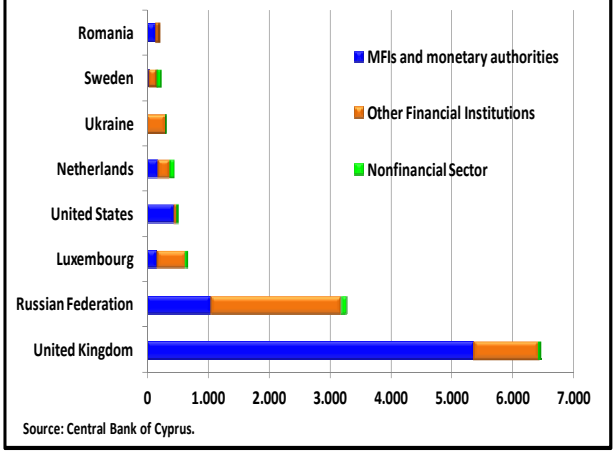


Source: Central Bank of Cyprus.

The most important investors in bonds and notes abroad (assets) were the monetary financial institutions (MFIs), other than the monetary authorities, with a cumulative investment of €12.043 million. To a smaller extent there were also investments by the monetary authorities and "other" sectors (with €1.829 and €2.761 million respectively). In liabilities, bonds and notes held by non-residents were mainly issued by the general government (€2.095 million).

In **Chart 18,** securities held by residents in 2012 are distinguished by country and economic sector. Most of the investment positions undertaken by residents abroad were placed in the UK (€6.440 million) and Russia (€3.270 million). MFIs and monetary authorities were the primary investors in the UK with €5.354 million. An additional €1.059 million is attributed to "other" financial institutions. With regards to portfolio investment in Russia, €2.133 million were invested by "other" financial institutions and €1.046 million by MFIs and the monetary authorities.

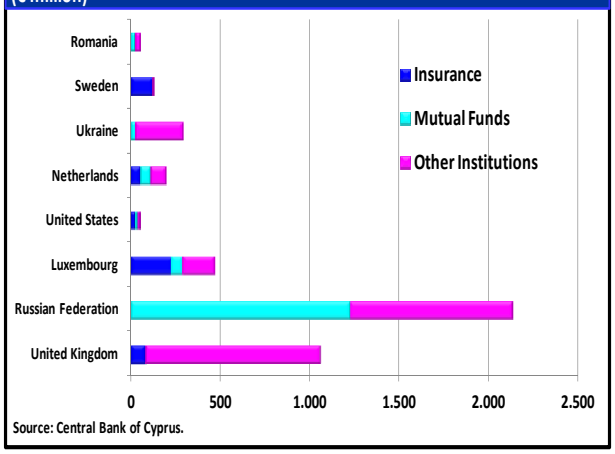
CHART 18 Portfolio investment assets held by residents 2012
(€ million)



Source: Central Bank of Cyprus.

The amounts on "other" financial institutions are further decomposed into the following segments: insurance companies, mutual funds and "other" institutions. These are shown in **Chart 19**. Insurance companies invested €78 million in the UK, €224 million in Luxembourg and €122 million in Sweden. Mutual funds invested €1.222 million in Russia and only small amounts in other countries.

CHART 19 Portfolio investment assets held by other resident financial institutions and excluding banks and monetary authorities 2012
(€ million)



Source: Central Bank of Cyprus.

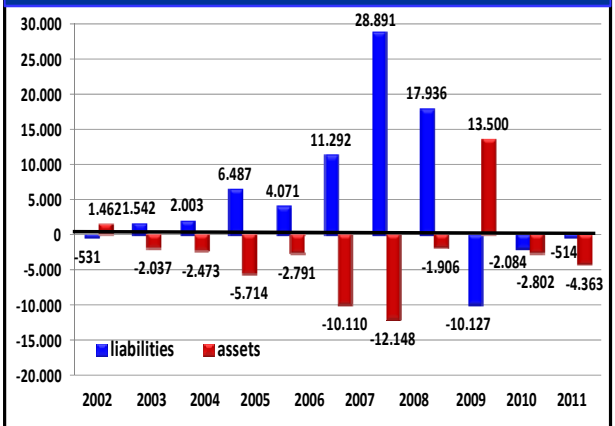
2.2.3 Other investment

Positions in other investment assets increased to €53.482 million in 2012. In contrast, positions in

liabilities dropped for the fourth consecutive year to €74.653 million. The great majority of other investment concerned loans/currency and deposits and were primarily associated with MFIs.

Other investment liability flows for 2012 decreased by €514 million. A €2.084 million decrease was also recorded in 2011. Both other investment asset and liability flows are illustrated in **Chart 20**. Reductions in liabilities represent withdrawals of investments placed by foreign investors in Cyprus. This is the third consecutive year where a reduction is observed. In contrast, other investment asset flows increased by €4.363 million in 2012, following a €2.802 million increase in 2011. This increase in assets represents mainly additional deposits placed by residents abroad.

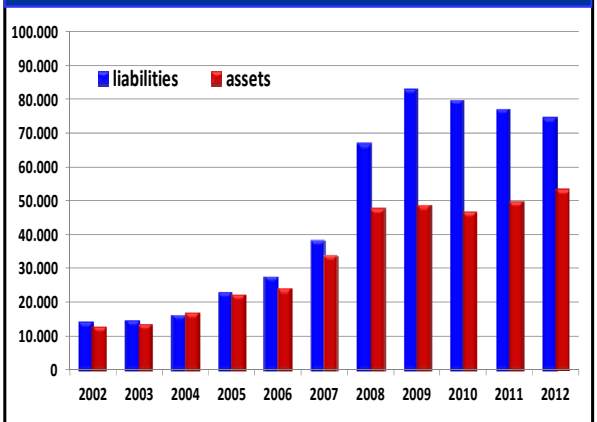
CHART 20 Other investment flows 2002-2012
(€ million)



Source: Central Bank of Cyprus.

Chart 21 provides information on other investment asset and liability stocks. There is a negative trend in liabilities since 2010. In 2012, total liabilities dropped to €74.653 million. Virtually without exception, liabilities represent mainly deposits by non-residents in Cyprus, as well as loans granted by foreign institutions to residents. There is no negative trend in assets, which represent mainly deposits placed by residents abroad or loans granted by resident institutions to non-residents. Assets increased to €53.482 million in 2012.

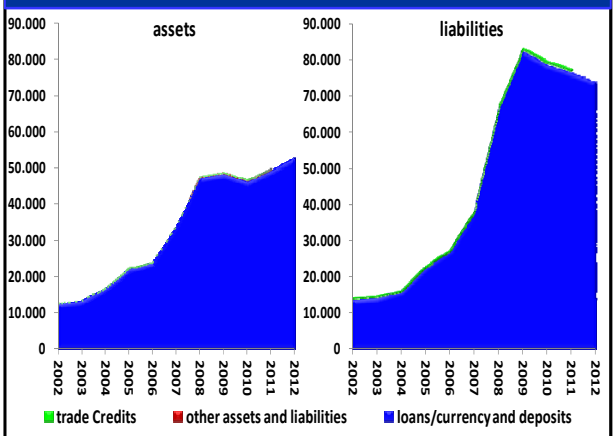
CHART 21 Other investment stocks 2002-2012
(€ million)



Source: Central Bank of Cyprus.

The main financial instruments included in the other investment category are reported in **Chart 22**. These include loans/currency and deposits, trade credits and "other" assets and liabilities. In both assets and liabilities the great majority of other investment concerned loans/currency and deposits. While assets in this category increased to €52.915 million by the end of 2012, liabilities dropped to €74.082 million.

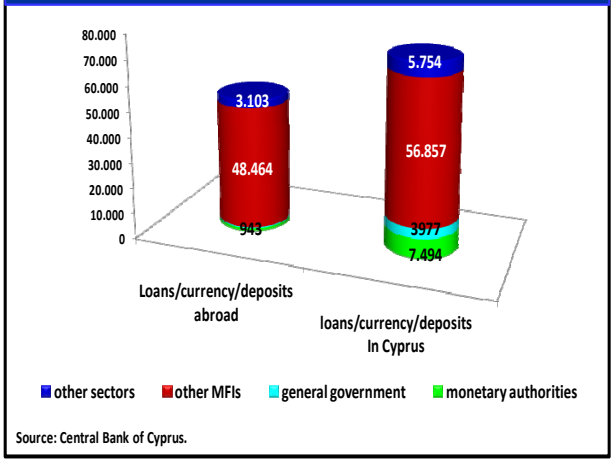
CHART 22 Other investment assets and liabilities 2002-2012
(€ million)



Source: Central Bank of Cyprus.

Since loans /currency and deposits constitute the most important category of instruments, they are further analysed by investor type in **Chart 23**. In 2012, MFIs owned most of the loans/currency and deposit assets abroad (€48.464 million). For loans/currency and deposits in Cyprus (liabilities), the respective amount (placed by non-residents with residents MFIs) was €56.857 million. Furthermore, an amount equal to €7.494 million in liabilities was attributed to the target account of the monetary authorities.

CHART 23 Loans, currency and deposits 2012
(€ million)

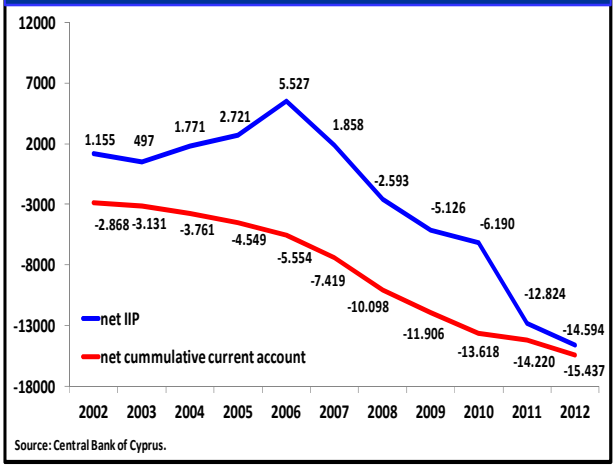


Source: Central Bank of Cyprus.

3. INTERNATIONAL INVESTMENT POSITION

The negative balance in the net IIP increased to €14.594 million in 2012. Further deterioration was also observed in the cumulative net current account deficit, which increased to €15.437 million. The negative position in the net IIP is mainly driven by the liability positions in other and foreign direct investment. Other investment remains the most important component of the IIP. In 2012, other investment assets increased to €53.482 million while other investment liabilities decreased to €74.653 million. MFIs constitute the main investment group in this category. They are the major holders of other investment assets abroad, but also account for the majority of other investment liabilities towards non-residents.

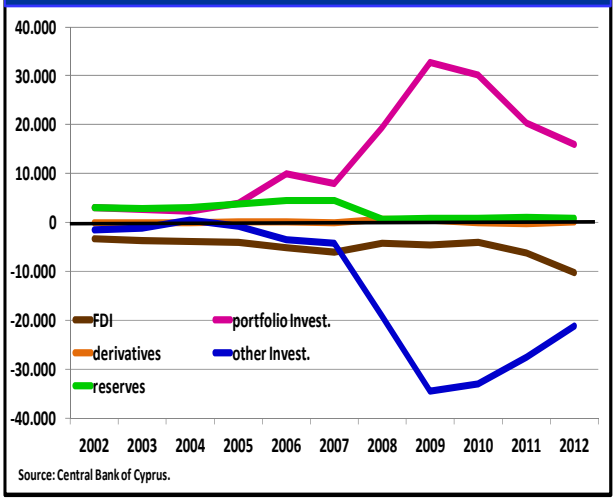
CHART 24 Cyprus's net cummulative current account and net IIP, 2002-2012
(€ million)



Source: Central Bank of Cyprus.

Cyprus's liabilities towards the rest of the world remain significantly higher than foreign assets owned by its residents. The negative balance in the net IIP increased to €14.594 million in 2014 (**Chart 24**). Further deterioration is also observed in the cumulative net current account deficit, which increased to €15.437 million. The IIP may not reflect fully the developments in the current account because changes in market prices, exchange rates, reclassifications and other volume changes affect the value of the external assets and liabilities.

CHART 25 Net IIP stocks by category 2002-2012
(€ million)

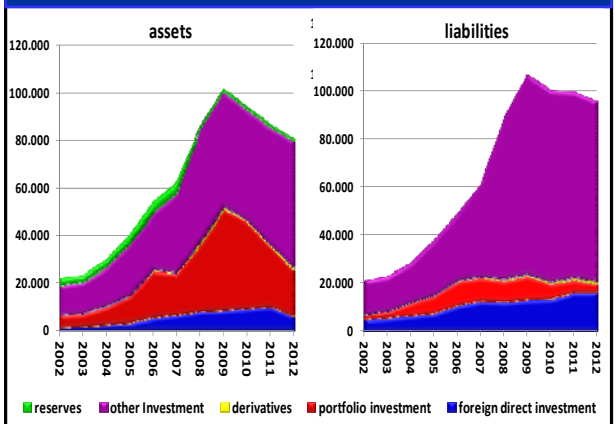


Source: Central Bank of Cyprus.

As shown in **Chart 25** (p.10), the negative IIP position is mainly due to the net liability positions in other and foreign direct investment. Despite an improvement observed in net other investment (its net liability position decreased to €21.171 million in 2012), there was a parallel deterioration in portfolio investment assets, which decreased from €20.378 million in 2011 to €15.975 million in 2012.

The net IIP positions with respect to portfolio and other investment changed significantly in 2009. This was due to an increase in deposits placed by non-residents (other investment liabilities) with the local monetary financial institutions, which were then placed on long-term debt investment positions abroad (portfolio investment assets).

CHART 26 International investment position assets and liabilities 2002-2012 (€ million)

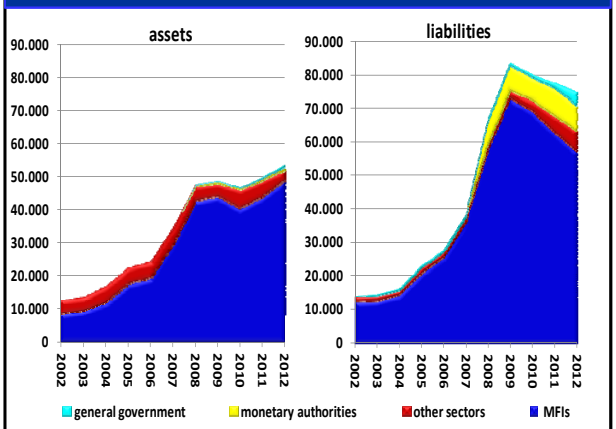


Source: Central Bank of Cyprus.

In order to gain more insights into the changes of the portfolio and other investment positions, these are further analysed in **Charts 26** and **27**. There was also a small downward shift in reserves in 2008. This was due to a change in the compilation methodology, ushered in with Cyprus's accession to the euro area. As a result, reserves in euro and claims on other euro area countries were transferred to other parts of the financial account (mainly in the form of "other" and portfolio investment).

Assets and liabilities are presented analytically by component in **Chart 26**. In both cases other investment provided the highest contribution. Other investment assets increased to €53.482 million in 2012, while other investment liabilities decreased to €74.653 million. Portfolio investment decreased in both assets and liabilities (to €19.447 and €3.472 million respectively). Since 2007, the share of foreign direct investment in liabilities is increasing, while that of portfolio investment is decreasing.

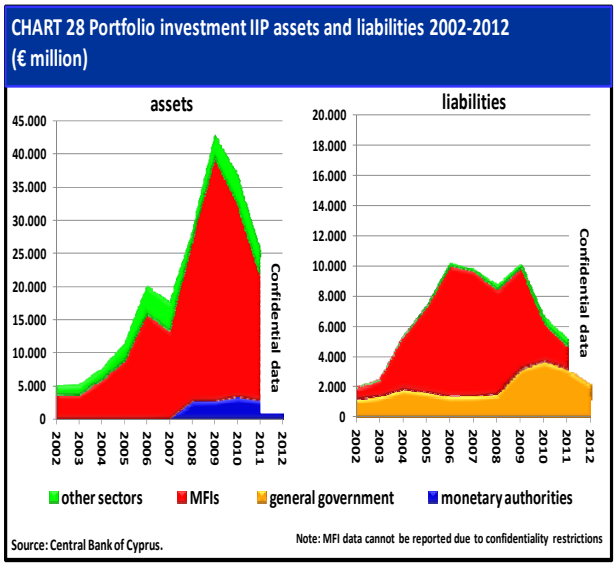
CHART 27 Other investment IIP assets and liabilities 2002-2011 (€ million)



Source: Central Bank of Cyprus.

Since other investment constitutes the most important component of the IIP, it is further analysed by sector in **Chart 27**. The main driver of the developments in other investment is the MFI sector. MFIs in Cyprus are by far the most important holders of other investment assets abroad, but also account for the majority of other investment liabilities towards non-residents. MFI assets increased from €43.600 million in 2011 to €48.598 million in 2012, while MFI liabilities decreased from €62.677 million in 2011 to €56.889 million in 2012.

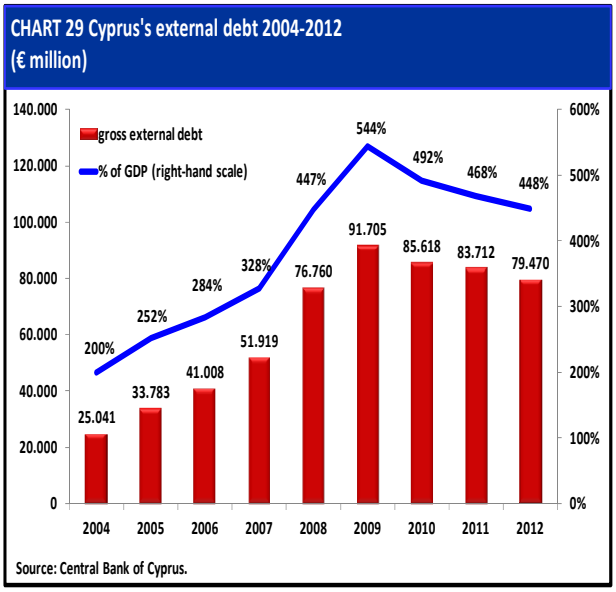
Chart 28 concentrates on portfolio investment. It is worth pointing out that the great majority of assets in this category are owned by MFIs. In liabilities, most securities held by non-residents in 2012 were issued by the general government and amounted to €2.095 million. In 2011 these amounted to €3.161 million.



4. EXTERNAL DEBT[1]

Cyprus's gross external debt declined for the third consecutive year, closing at €79.470 million by the end of 2012. This corresponds to 448,5% of GDP. Historically, Cyprus's gross external debt consists mostly of short-term lending. MFIs continue to be the major holders of external debt (71,8%). It mostly consists of deposits placed by non-residents in Cyprus.

Cyprus's gross external debt, declined for the third consecutive year, closing at €79.470 million (**Chart 29**). This corresponds to 448,5% of the country's GDP. The total amount of debt increased significantly after 2007. Cyprus joined the euro area in January 2008. This facilitated foreign lending and provided residents with access to more favourable lending terms. As a result, the country's gross external debt as a percentage of GDP increased to 447,4%. With the beginning of the global financial crisis and the worsening of the macroeconomic conditions in the country, this trend was reversed.

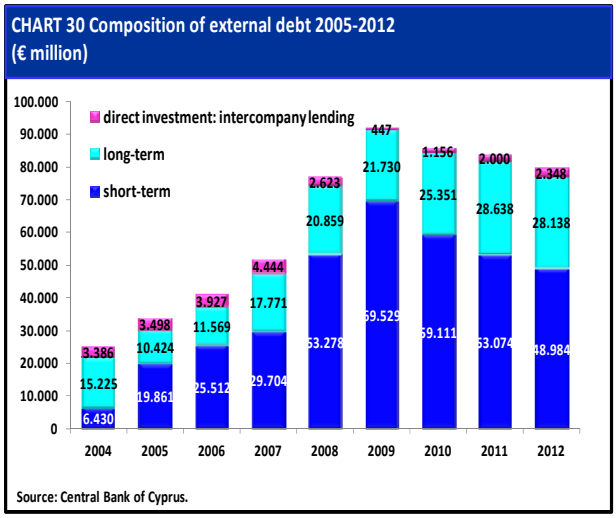


Gross external debt can be divided into three main categories (**Chart 30,** p.13):

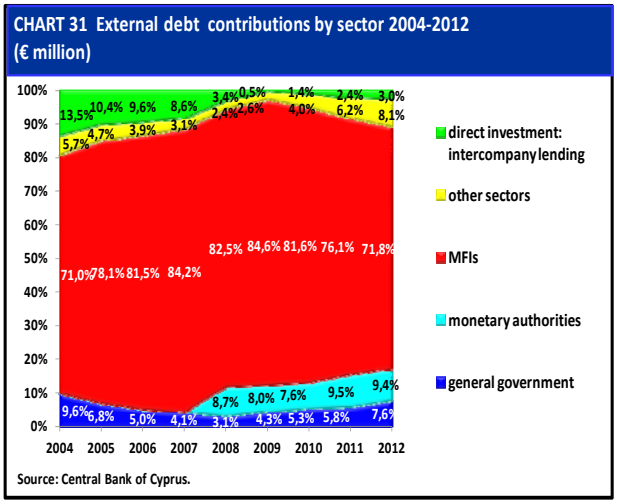
(i) long-term debt
(ii) short-term debt
(iii) direct investment intercompany lending.

Historically, Cyprus's gross external debt consists mostly of short-term debt. Following a five year period of consecutive increases (2004-2009), short-term lending started to decline after 2009 when it reached €69.529 million. By the end of 2012 it amounted to €48.984 million. In contrast, long-term debt and direct investment intercompany lending continued to increase even after 2009, reaching €28.138 and €2.348 million, respectively.

[1] External debt includes, among other things, non-resident deposits, which are covered by strict prudential regulations issued by the Central Bank of Cyprus. The regulations require MFIs to maintain a substantial part of their non-resident deposits in liquid assets. Prudential regulations regarding foreign currency deposits are even stricter.



A more in depth look at the composition of external debt in terms of sectors is presented in **Chart 31**. MFIs continue to be the major holders of external debt with a share of 71,8% in 2012 and an average share of 79% during the period 2002-2012. All the other sectors have contributions below the 10% threshold. The monetary authorities increased their contribution after Cyprus joined the euro area in 2008.



Given the importance of the MFI sector for Cyprus's economy, **Chart 32** takes a closer look at the external debt component of MFIs. Short-term debt consists mostly of currency and deposits, placed by non-residents in Cyprus. For 2012, these amounted to €37.562 million. With regards to long-term debt, the following amounts were recorded in 2012: loans decreased to €7.846 million, currency and deposits increased to €8.665 million, and bonds and notes decreased to €172 million.