



CENTRAL BANK OF CYPRUS

# ECONOMIC BULLETIN

DECEMBER 2022

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NICOSIA - CYPRUS

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EUROSYSTEM

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## ABBREVIATIONS

BLS	Bank Lending Survey	GHS	General Health System
BoE	Bank of England	HICP	Harmonised Index of Consumer Prices
BPM	Balance of Payments and International Investment Position Manual	IIP	International Investment Position
CA	Current Account	IFRS	International Financial Reporting Standard
CBC	Central Bank of Cyprus	IMF	International Monetary Fund
CCB	Cyprus Cooperative Bank	LFS	Labour Force Survey
CPPI	Commercial Property Price Index	MFIs	Monetary Financial Institutions
Cystat	Statistical Service of the Republic of Cyprus	NEER	Nominal Effective Exchange Rate
DLS	Department of Lands and Surveys	NACE	Statistical classification of economic activities in the European Union
ECB	European Central Bank	NFCs	Non-Financial Corporations
EER	Effective Exchange Rate	NGEU	Next Generation EU
EONIA	Euro Overnight Index Average	NPFs	Non-Performing Facilities
ESA	European System of Accounts	OPEC	Organisation of the Petroleum Exporting Countries
ESI	Economic Sentiment Indicator	PEPP	Pandemic Emergency Purchase Programme
ESMA	European Securities and Markets Authority	QE	Quantitative Easing
ESTR	Euro short-term rate	REER	Real Effective Exchange Rate
EU	European Union	RPPI	Residential Property Price Index
EURIBOR	Euro Interbank Offered Rate	SDW	Statistical Data Warehouse
Eurostat	Statistical Office of the European Union	SPEs	Special Purpose Entities
FED	Federal Reserve	UK	United Kingdom
FOMC	Federal Open Market Committee	US	United States of America
GDP	Gross Domestic Product		

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## Governor Introduction

The year 2022 was marked by unprecedented challenges. The economic optimism that followed the end of the acute phase of the pandemic was unfortunately disrupted by the outbreak of the war in Ukraine, which caused new and unprecedented negative effects on inflation and global economic activity. In 2023, the main challenges expected to persist primarily stem from the economic consequences of the prolonged war in Ukraine, which will continue to impact energy markets as well as production and trade chains.

The Cypriot economy showed significant resilience in 2022 due to strong fundamental economic data, which greatly helped in addressing the aforementioned negative geopolitical and economic developments. Specifically, the GDP recorded significant growth of 6% in the first nine months of 2022. This can be attributed to higher-than-expected activity in the tourism industry, the non-dependence of the Cypriot economy on Russian natural gas, and the very limited exposure of the Cypriot banking sector to the Russian economy. Additionally, this growth was significantly supported by new lending to the non-financial private sector and by foreign direct investment, as a result of the inflow of a large number of foreign companies within the framework of the Strategy for Attracting Companies to Activate and/or Expand their Activities in Cyprus ("international head-quarters"). In particular, in the information and communication sector, where the majority of these companies operate, contribution to the GDP was almost doubled, accounting for 1.3 percentage points during

the first nine months of 2022, compared to a contribution of 0.7 percentage points for the entire year of 2021. According to the latest forecasts of the CBC in December 2022, the growth trajectory of the Cypriot economy in 2023 is expected to remain positive (2.5%) despite the deteriorating external environment reflecting the prolonged energy crisis in Europe, and the also anticipated gradual correction of inflationary pressures affecting households and businesses in 2023, while the investments and structural reform projects under the Recovery and Resilience Plan are expected to have a positive contribution.

In 2022, inflation in Cyprus, influenced by geopolitical developments, and as recorded by the Harmonised Index of Consumer Prices (HICP), remained at very high levels but maintained a single-digit growth rate, reaching an average of 8.2% during the period of January-October 2022, compared to 1.8% in the corresponding period of 2021, but showing a decelerating trend in the last few months. Inevitably, the noteworthy increases in energy prices in Cyprus had significant indirect upward effects on other categories of the HICP, such as food prices, non-energy industrial goods and services. It should also be noted that the reopening of the economy with the lifting of pandemic restrictions led to an increase in demand, especially in the services sector, which also contributed to inflationary pressures. Inflationary pressures were further reinforced by the annual depreciation of the euro against the US dollar by approximately 11% in 2022, which was partially passed on to consumer prices. Based on these developments, according to the latest CBC forecasts, domestic inflation is



expected to increase to 8.1% in 2022 compared to 2.3% in 2021. In 2023, the HICP is expected to slow down to 3.3% compared to 2022.

The energy crisis and the ongoing extremely high uncertainty remain significant risks for 2023, affecting both inflation and the external and domestic economic environment of the Cypriot economy. A major challenge for energy inflation is the replenishment of natural gas reserves for the winter of 2023, especially if China intensifies competition for increased imports of liquefied natural gas.

Under these challenges, policymakers are called upon to perform an extremely difficult task. In response to the high inflation and based on the upward-revised inflation outlook, the Governing Council of the European Central Bank has decided on a series of interest rate hikes, which are expected to increase further in order to reach levels that ensure the timely return of inflation to our medium-term target of 2%. To achieve the price stability objective, coordination between monetary and fiscal policies is deemed necessary. Fiscal support measures should be temporary, targeted towards vulnerable households and businesses, and adjusted to maintain incentives for reduced energy consumption. Conversely, any horizontal fiscal measures are likely to exacerbate inflationary pressures, which would hinder the achievement of the price stability goal from the monetary policy perspective.

Additionally, and in relation to the adoption of targeted fiscal measures, the implementation of structural reforms remains necessary as they constitute the key pillars of

policy to strengthen the supply side of the economy and improve the framework within which businesses and consumers operate. Concrete examples include the adoption of the EU Services Directive and active national policies to strengthen the labour market and reduce unemployment. Furthermore, policies to support digital and green transitions, for which funding is available from the EU under the €1.2 billion Recovery and Resilience Plan, are significant in the effort to shape a supportive business environment. Consequently, the implementation of such measures that enhance the business environment promotes a better distribution of resources in the economy, strengthens competition, and enhances market productivity, achieving stable and sustainable growth. Additionally, the existence of an effective insolvency framework, in conjunction with judicial system reform, for the active management of non-performing loans ensures the mitigation of increased risks associated with high levels of private debt. Lastly, in the context of mitigating the impact of rising borrowing costs, the significant contribution of the supervisory tool of the CBC for the debt service-to-net income ratio is noted. This tool aims to protect the borrower by ensuring that they have sufficient disposable income before taking on a loan.

The banking sector has built resilience in recent years, which it was called upon to face first the health crisis and then geopolitical developments. Credit institutions continue to possess sufficient supervisory capital to absorb potential future unexpected losses, with the common equity tier 1 ratio standing

at 18.0% in September 2022 compared to the corresponding European ratio of 15.0%. Additionally, the Cypriot banking sector has strong liquidity reserves, with the Liquidity Coverage Ratio reaching 320% in November 2022, significantly surpassing the minimum supervisory requirement of 100%. It is also significantly higher than the corresponding European ratio of 162.5%.

Regarding non-performing loans in the banking sector, they have decreased by 90.5%, from €28.4 billion in December 2014 to €2.7 billion in October 2022, mainly due to actions taken by the major banks. However, the Non-Performing Loans (NPL) index as of October 31, 2022, stood at 10.5% and remains significantly higher than the European Union's average of 1.8%. Additionally, the risk of deterioration in the asset quality of banks is real, as the Russian invasion of Ukraine has affected various aspects of the economic chain. Therefore, it is important to intensify efforts to reduce the NPLs of smaller banks, demonstrating progress similar to that of larger banks, which should continue their positive trajectory in this sector, while they should simultaneously implement prudent practices and closely monitor their portfolios to promptly identify borrowers facing financial difficulties and provide sustainable restructuring without delays, with the ultimate goal of preventing new defaults.

Of course, it should be noted that, at least in the short-term horizon, as banks enter the new interest rate environment, are expected to record increasing profits, which should be subject to proper and prudent management.

By implementing comprehensive policies and procedures, banks should closely monitor their portfolios and timely recognize provisions to safeguard their capital reserves in case the quality of their portfolios deteriorates. Additionally, decisions regarding dividend distribution should be made cautiously based on a well-informed capital plan that adequately considers the uncertain economic environment.

Equally important is the stability of the relevant legislative framework, which affects banks, the cost of future borrowing, and billion-dollar investments in the country. Simultaneously, ensuring the existence of an integrated framework for managing NPLs is essential for promoting timely intervention and cooperation between borrowers and credit institutions. As I have mentioned repeatedly, the goal should be to find timely appropriate and sustainable restructuring solutions. Undoubtedly, sustainable restructuring solutions provide both businesses and households with the ability to meet their obligations. This way, the banks' balance sheets are not burdened with new defaults, while the smooth operation of businesses continues uninterrupted, limiting bankruptcies and, by extension, contributing to the smooth functioning of the economy.

In conclusion, despite the negative geopolitical developments, the Cypriot economy registered high GDP growth rates in 2022, while the growth prospects for the coming years remain positive. However, an important prerequisite, in addition to maintaining the country's fiscal stability, is the

continuous modernization and adaptability of our economic and banking model to the developments in the European and global economy. In this direction, the Recovery and Resilience Plan represents a historic opportunity for Cyprus. The successful

implementation of the structural reforms provided by this Plan, particularly regarding green development and digital transformation, will be the key to increasing productivity and creating a more sustainable and resilient Cypriot economy.

## **(A) International Environment: macroeconomic and financial developments**

- *Aiming at returning the excessively high inflation to the medium-term target of 2%, the European Central Bank increased its key interest rates by a total of 250 basis points in the second half of 2022<sup>1</sup>.*
- *In the rest of the developed economies, with the exception of Japan, interest rate increases continued, with the aim of reducing inflation.*
- *The energy crisis, higher uncertainty, weakening global economic activity and tighter financing conditions have had a negative impact on forecasts for international economic growth in 2023.*

Following the Russian invasion of Ukraine and the subsequent sanctions against Russia, the prices of basic goods, particularly oil and food, rose significantly. As a result of the large increase in commodity prices, central banks around the world proceeded with interest rate hikes.

Until the data cut-off date, the Federal Reserve had raised its key interest rates to 4.25%-4.50%, up from 0.00-0.25% at the beginning of 2022. Similarly, the Bank of England raised interest rates to 3.5% from 0.25% in January 2022, while the ECB raised all of its key rates over the year, with the deposit facility rate now standing at 2.0%, compared with -0.5% at the beginning of the year. The only exception is the Bank of Japan, which kept interest rates steady.

Due to the significant increase in interest rates in the US, economic growth in 2022 is expected to be lower, with the most recent

1. The 50bps rate hikes decided on December 15, 2022 by the ECB and the Bank of England and on December 14, 2022 for the Federal Reserve, are included, even though they are beyond the data cut-off date for this *Economic Bulletin*.

forecasts of international organizations<sup>2</sup> showing GDP growth of 1.7% compared to 3.3% in the June forecast (**Chart A.1**). In contrast, interest rate increases were smaller in the UK and the euro area, and hence GDP growth rates in 2022 are forecast to have stood at higher levels (3.9% and 3.2% respectively). This reverses in 2023 with international organizations predicting higher growth in the US than in other economies. However, economic growth in 2023 is expected to be lower by almost 2 percentage points in the euro area, compared with previous forecasts. Similarly, growth is forecast to be around 1.4% lower in the US, and 1.7% lower in the UK, where a recession is expected.

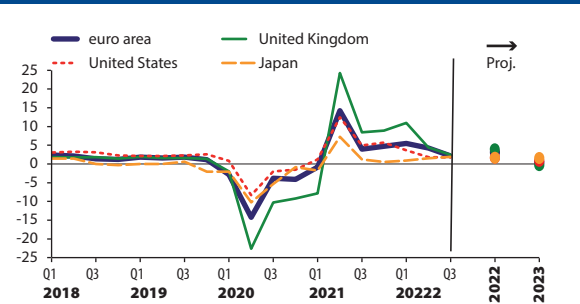
Inflationary pressures remain in the euro area, the UK and Japan. In the US, following the aggressive interest rate hikes, inflation appears to be declining but continues to move at very high levels. With the expected decline in oil and other commodity prices from late 2022 onwards, coupled with the resolution of supply chain disruptions and a reduction in freight rates, inflation is expected to be significantly lower in 2023, even though higher compared to the June 2022 forecasts. More specifically, according to the most recent forecasts of international organizations, in 2023 inflation is expected to fall to 3.5% from 8% this year in the US, while it is forecast to decrease to 5.9% in the euro zone, compared to 8.4 % in 2022 (**Chart A.2**). In the UK and Japan, inflation in 2023 is expected to remain roughly at the same level as in 2022.

Regarding the market's long-term inflation expectations in the euro area, the "5Y5Y ILS

2. The GDP and inflation forecasts for each economy are calculated as the average of the most recent forecasts from the European Commission (European Economic Forecast, Autumn 2022) and the International Monetary Fund (World Economic Outlook, October 2022).

**CHART A.1 GDP in selected countries**

(annual change %, seasonally adjusted %)

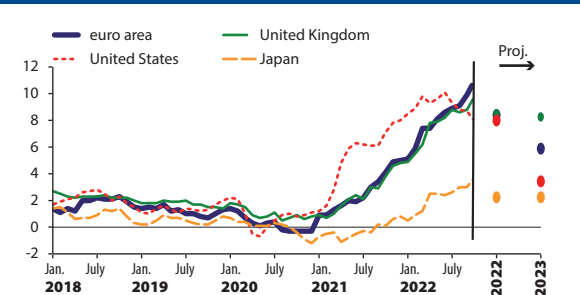


Source: Eurostat.

Note: The projections are for the year and are calculated as averages of the most recent projections from the European Commission and the IMF.

**CHART A.2 Inflation in selected countries**

(annual change, %)



Sources: Eurostat, SDW (ECB).

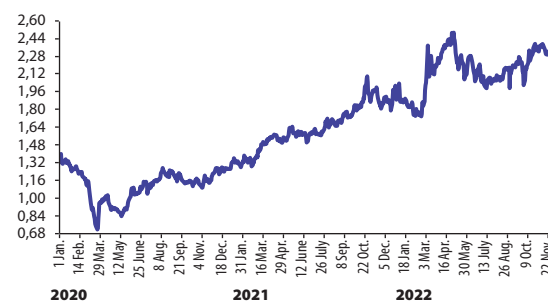
Note: The projections are for the year and are calculated as averages of the most recent projections from the European Commission and the IMF.

rate" (Inflation-Linked Swaps (ILS) rate after five years with a five-year horizon), stood at 2.32% on 24 November 2022 (the last date the statistics were updated), about the same as in May 2022 (**Chart A.3**). The "5Y5Y ILS rate" is used as a benchmark to measure expected inflation over a five-year horizon, starting five years from now. The stabilization of inflation expectations shows that the inflationary pressures are not expected to persist beyond the ECB's medium-term target and indicate increased market confidence in central banks and monetary policy changes.

Given increases in key ECB interest rates and the continued rise in inflation, ten-year government bond yields of euro area member-states continued to rise (**Chart A.4**). For example, the yield on German ten-year government bonds rose from 1.03% on 18 May 2022 to 1.85% on 24 November 2022. Increases were also evident in the other euro countries, to a different extent, also based on the country-specific macroeconomic developments. The Governing Council of the ECB continues to monitor developments in the global and domestic economy to maintain monetary flexibility and reduce inflation in the euro area to the 2% target.

**CHART A.3 Market-based indicator of longer-term inflation expectations**

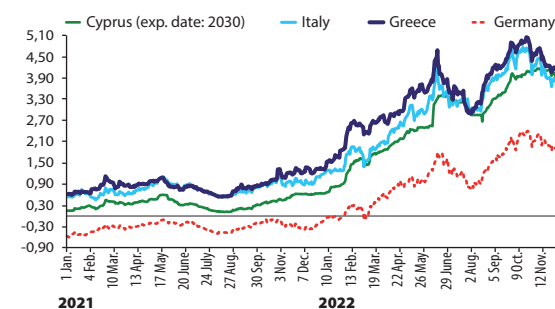
(five-year rate five years ahead "5Y5Y ILS rate", annual change in %)



Source: Bloomberg.

**CHART A.4 Selected ten-year "10YR" or proxies for "10YR" euro area sovereign bond yields**

(in %)



Sources: Bloomberg, ECB.

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## (B) Domestic Environment



- *Significant rebound in GDP growth by 6% in the first nine months of 2022, despite the continuation of the Russian invasion of Ukraine.*
- *During the first ten months of 2022, domestic HICP inflation registered, on average, a substantial rise, reaching 8,2%, primarily due to the energy crisis and the consequent unprecedented increase in the prices of the main energy commodities (or products) but also from the ongoing disruptions in supply chains related to the pandemic.*
- *Residential property prices recorded an acceleration of 6,3% in 2022Q3, largely due to the increased construction costs and the elevated demand, mainly from local buyers.*
- *Recent developments after the war in Ukraine do not seem to have, for the time being, affected the labour market.*
- *The outbreak of the war between Russia and Ukraine is expected to affect mostly tourism, although European markets seem to make up for much of the loss of Russian tourists. Other exports of services are also affected but to a lesser extent, as headquartering policies continue to attract high tech business to register in Cyprus.*
- *Slowdown in the total deposits annual growth since March 2022, reflecting the impact of RCB's phasing out its banking operations and the full repayment of its depositors.*
- *Credit growth of the domestic private sector remained robust in the first half of 2022, showing signs of a slowdown since July 2022, mainly reflecting banks' tighter lending policy aiming at sustainable new lending.*

- *Gradual upward trend in domestic lending rates has been recorded since the beginning of 2022. The increase in lending rates was more pronounced in the second half of the year, on the back of ECB's monetary policy normalisation and tighter financing conditions.*
- *Government debt-to-GDP ratio decreased in September 2022 compared with its level in September 2021, mainly due to the strong economic recovery and to a lesser extent the decrease in government's cash reserves.*
- *The government budget balance recorded a surplus of 2,2% of GDP in the first nine months of 2022, reflecting the continued improvement in economic activity and the labour market.*

## 1. Economic Activity

According to preliminary data by Cystat, which were available as per relevant cut-off date of this *Economic Bulletin*, in 2022Q3 GDP registered continued annual growth of 5,5% from 2021Q2. This was due to favourable developments in services, especially in hotels and restaurants, transportation, information and communication, trade, as well as arts, entertainment and recreation. It is noted that, based on the National Accounts data for 2022Q3, the consequences of the Russian invasion of Ukraine are manageable, although in the near future, they may become more evident, in some sectors. In the first nine months of 2022, GDP increased by 6% compared with 6,6% in the corresponding period of 2021.

Based on detailed data, available with the

cut-off date of this Economic Bulletin, in 2022H1 (Table A.1), a significant recovery in GDP by 6,3% was recorded, mainly due to the increase in private consumption and inventories. More specifically, private consumption increased by 7,4%, as a result of the gradual recovery of the level of disposable income and consumption behaviour, after a long period of restraint and restrictions imposed during the pandemic. The increase in inventories remains a European phenomenon and is related to disruptions in supply chains and the increases in commodity and oil prices. Investments recorded an annual growth of 6,4%, however adjusted for the impact of Special Purpose Entities (SPEs), they recorded a slight increase owing to the decrease in housing investments, despite the continued implementation of major infrastructure projects by the private sector. Public consumption increased marginally by 0,7%, primarily due to a base effect, relating to the rise in expenditure for the purchase of health services by the GHS in the corresponding period of 2021 (see Fiscal Developments). The growth in total exports by 19,9%, which does not differ substantially when the data are adjusted for the impact of SPEs, emanated from the large rise in exports of telecommunications, computer and information services. Also, the significant recovery in tourism, which reached 83% of 2019 levels, in 2022H1 (see Balance of Payments), contributed positively. At the same time, the increase in total imports by 25,5%, which is similar when the data are adjusted for the impact of SPEs, reflected the rise in imports of services and to a larger

**TABLE A.1 GDP by expenditure category**

(real terms, annual change, %)

	2018	2019	2020	2021	2021 H1	2022 H1
GDP	5,6	5,5	-4,4	6,6	5,7	6,3
Private consumption	5,1	3,9	-6,8	4,5	4,9	7,4
Public consumption	3,6	11,9	11,6	6,6	9,7	0,7
Gross fixed capital formation	-4,9	6,9	4,5	-4,2	26,8	9,4
Exports of goods and services	7,2	8,7	2,2	13,6	4,1	19,9
Imports of goods and services	4,3	9,5	3,2	9,0	5,3	25,5

Source: Cystat.

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extent, the increase in imports of goods for private consumption and investment.

From a sectoral perspective (Table A.2), the GDP recovery in 2022H1 emanated from increased activity observed across all sectors except construction (-0,2 percentage points), affected by, among other factors, the compression of demand, as a result of significant increases in construction costs. The sectors with the largest contribution to GDP were trade, transportation, hotels and restaurants by 3 percentage points, arising from the continued recovery recorded by the sectors, after the pandemic period and the lockdowns. A smaller contribution was recorded by the information and communication sector (1,4 percentage points), as well as, the category of financial and insurance activities (0,6 percentage points), supported by the influx of foreign companies (headquartering) active in the technology sector. The sectors of professional services, manufacturing, as well as the arts, entertainment and recreation, each contributed by 0,4 percentage points.

Available qualitative indicators (soft data) for 2022Q4, point to a decelerated GDP growth rate. In particular, the GDP path closely follows developments in the Economic Sentiment Index (ESI) (Chart A.5), as well as its sub-indicators (Table A.3), which provide early signals of the economic impact of the Russian-Ukrainian war. So far, the Cypriot economy exhibits resilience, and the effects of the invasion are expected to become more pronounced in 2023H1. Specifically, ESI reached 100,6 in the period October to November 2022, on average a slight increase compared with 99,1 in 2022Q3, but decreased

**TABLE A.2 GDP by economic activity**

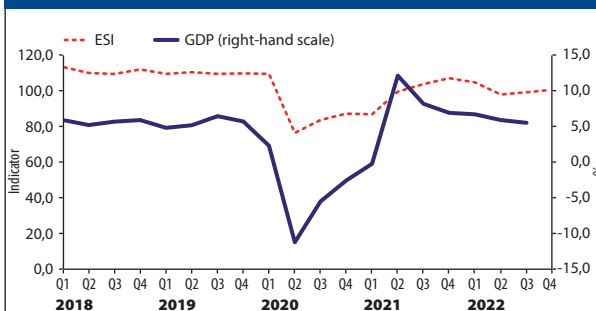
(weighted contribution to the overall annual change, percentage points)

	2018	2019	2020	2021	2021 H1	2022 H1
GDP (%)	5,6	5,5	-4,4	6,6	5,7	6,3
Construction	0,9	0,8	-0,4	0,5	0,9	-0,2
Trade, transportation, hotels and restaurants	2,3	0,9	-6,8	2,5	0,4	3,0
Information and communication						
Financial and insurance activities	-1,4	-0,2	2,4	1,1	1,5	0,6
Professional, scientific and administrative activities	1,2	0,8	-0,3	0,5	0,6	0,4
Other sectors <sup>(1)</sup>	2,2	2,0	-0,5	1,3	1,5	1,1

Source: Cystat.

(1) Main sectors included are those of agriculture, manufacturing, public administration, education and health, as well as arts, entertainment and recreation.

**CHART A.5 Annual GDP growth and Economic Sentiment Indicator index**



Sources: Cystat, European Commission

Note: The figures for the fourth quarter refer to the period October and November.

**TABLE A.3 Business and consumer surveys: confidence indicators**

(for sub-indices: difference between percentage of positive answers and percentage of negative answers, period average)

	2021 Q3	2021 Q4	2022 Q1	2022 Q2	2022 Q3	2022 Oct.-Nov.
ESI	103,7	107,0	104,6	97,9	99,1	100,6
Industry	-9,9	-3,1	-2,2	-11,0	-6,4	-8,4
Services	25,4	33,9	25,4	11,9	9,7	13,1
Consumer	-19,9	-20,3	-23,6	-34,5	-33,0	-31,5
Retail trade	-6,3	-3,0	-4,2	-11,1	-12,1	-7,5
Construction	-16,5	-14,1	-17,5	-19,5	-17,6	-18,5

Source: European Commission.

Note: Seasonally adjusted data.

compared with 107 in 2021Q4 (Table A.3, p. 20). The underlying sub-indicators (Table A.3, p. 20) from the Economic Sentiment Surveys for the period October to November 2022, show an improvement in the services and retail trade. Despite the recorded improvement in the ESI, the 2022 projection for GDP growth was more conservative in the CBC December 2022 projections (see Macroeconomic forecasts).

## 2. Prices (Inflation, real estate prices, labour costs)

### Inflation

The domestic Harmonised Index of Consumer Prices (HICP) reached 8,6% in October 2022 compared with 4,4% in the corresponding month of 2021. With regard to the period January-October 2022, HICP inflation significantly increased, on average, by 8,2% compared with 1,8% in the corresponding period of 2021 (Chart A.6a and Table A.4).

In general, the sharp rise in domestic HICP inflation during the first ten months of 2022, is mainly attributed, similar to the euro area inflation dynamics, to exogenous factors which are primarily related to the unprecedented adverse consequences of the Russian invasion of Ukraine, especially in energy prices but also in food prices (Table A.4). Moreover, during the period January-October 2022, the remaining components of the HICP also recorded significant annual increases (Table A.4) largely driven by the ongoing disruptions in the supply chain due to the continuing negative consequences of

CHART A.6a Inflation in Cyprus (HICP)  
(annual change, %)

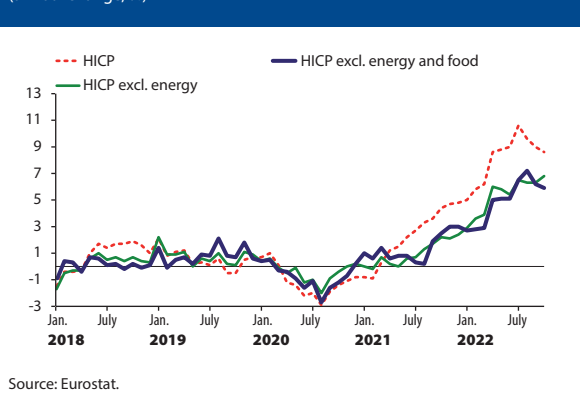


TABLE A.4 Inflation in Cyprus  
(annual change, %)

	Weights <sup>(1)</sup>	Jan.-Oct. 2021	Jan.-Oct. 2022	Oct. 2021	Sep. 2022	Oct. 2022
HICP	1000,00	1,8	8,2	4,4	9,0	8,6
Total Food prices, of which:	209,75	-0,2	7,1	1,1	7,3	9,9
(i) Unprocessed food prices	47,89	0,3	10,1	3,4	1,4	10,3
(ii) Processed food prices	161,86	-0,4	6,1	0,4	9,1	9,7
Energy prices	97,05	11,3	34,7	27,1	34,3	25,6
Services prices	448,37	1,1	5,3	2,8	7,1	6,3
Non-energy industrial goods prices	244,83	1,3	4,1	2,2	4,3	5,1
HICP excluding energy	902,95	0,7	5,4	2,2	6,3	6,8
HICP excluding energy and food	693,2	1,0	5,0	2,5	6,2	5,9

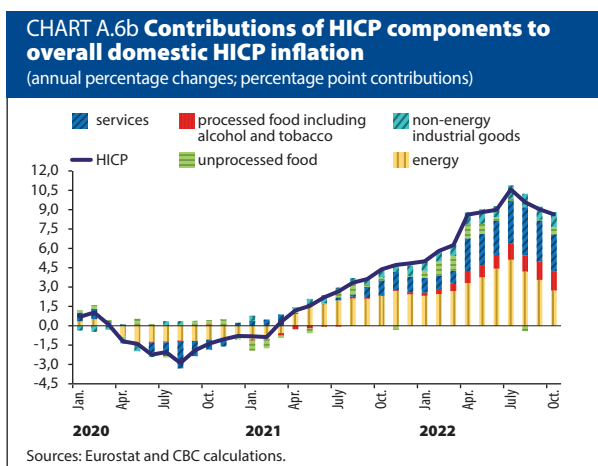
Source: Eurostat.  
(1) Based on the weight for 2022.

the pandemic amid the recovery in demand as well as due to the significant indirect effects from the sizeable increases in energy prices due to the war. It should also be mentioned that during the period under review inflationary pressures also stemmed from the depreciation of the euro against the US dollar compared with the corresponding period of 2021.

As already mentioned, the unprecedented, on average, increase in energy prices during the period January-October 2022 was mainly due to the developments related to the Russian invasion of Ukraine. More analytically, these developments have resulted in exceptional surging in the prices of oil and natural gas in international markets during the first ten months of 2022, an increase which has significantly passed on to the domestic prices of electricity, main fuels as well as in gas prices. Indicatively, energy prices, which constitute the leading factor to the soaring trend of domestic HICP inflation (Table A.4, p. 21), had, on average, 43% share on HICP during the first ten months of 2022 (Chart A.6b).

Food prices (processed and unprocessed) had also a significant upward contribution to the domestic HICP during the period January-October 2022. This development is mainly driven by the sizeable increases in their production cost due to factors also related to the severe consequences of the Russia-Ukraine war (rising input costs stemming from sizeable increases in the prices of energy, wheat, fertilisers and oil products).

Beyond the aforementioned developments in energy and food prices, the rapid rise in



inflation in both Cyprus and the rest of the euro area during the period under review continues to be largely driven by the disruptions and shortages in the supply chain of international trade as well as by global substantial increases in transportation and freight costs, (albeit recently easing) in the aftermath of the effects of the pandemic which have been significantly intensified on account of the war. In addition, the recent restrictive “lockdowns” measures in China have created further supply bottlenecks issues. At the same time, the sizeable recovery in demand has resulted in the ongoing imbalance between supply and demand. In turn, during the first ten months of 2022 there were, on average, considerable upward pressures in the prices of various key sub-categories of non-energy industrial goods “NEIG” inflation, such as motor cars, furniture and fittings and major household electrical appliances.

Furthermore, services prices also recorded a significant growth rate during the period January-October 2022. This development mainly reflected the strong recovery in demand for travelling and other tourism-related services such as restaurants and cafes and accommodation services in line with the significant relaxation of covid-19 measures globally (“reopening effect”). It should be mentioned that, the most volatile sub-category of services inflation, namely “passenger by air”, registered, on average, sizeable yearly increases during the period under review. This development seems to be related, on one hand, to the recovery in demand for travelling, and, on the other hand, to the up to now “limited supply” of airline



travel from/to Cyprus as well as to the increased fuel cost for airplanes. At the same time, it is noted that the significant increases of both energy and food prices also posed considerable indirect upward pressures in the prices of the said key sub-categories of services inflation.

Regarding inflation excluding energy and food prices (core inflation), this continued to fluctuate at elevated levels, standing, on average, at 5,9% in October 2022 compared with 2,5% in the corresponding month of 2021. Concerning the first ten months of 2022, core inflation recorded, on average, a yearly increase of 5,0% compared with 1,0% in the corresponding period of 2021 (**Chart A.6a** and **Table A.4**, p.21) in light of the aforementioned developments in non-energy industrial goods and services prices.

Finally, it is worth mentioning that, despite the great uncertainty and volatility surrounding developments in domestic inflation due to the ongoing war, as from August 2022 onwards, the domestic HICP, although it continues to remain at very high levels, has been recording a decelerating trend (**Table A.4** and **Chart A.6b**, p.21) which is not the case for the euro area. This is mainly driven by the developments in domestic energy prices on account of the fall in the price of Brent crude oil in conjunction with the impact of the targeted government mitigating measures (on main fuels and electricity prices) taken due to the war.

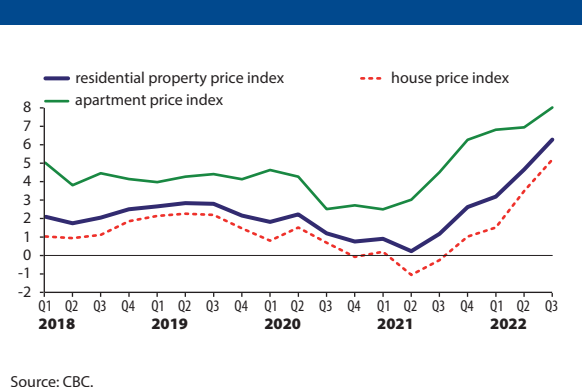
### **Construction sector and real estate prices**

In 2022, the construction sector in Cyprus experienced a decline. According to National



Accounts data, in the first half of 2022, residential investment (in real terms) amounted to €774,6 million compared with €826,8 million over the corresponding period in 2021. In addition, the index of construction activity, published by CyStat, recorded an annual decrease of 6,5% over the first half of 2022, demonstrating the decrease in the construction activity. According to European Commission's Business and Consumer Surveys, expectations on the employment in the construction sector over the next three months recorded a positive sign for the first time in November 2022 after nine months of negative recordings, demonstrating the decreased activity over the recent past until today, while leaving hope for a recovery in the activity. As far as demand is concerned, this is mainly driven by the local market but a gradual enhancement of the transactions by foreigners has been observed (**Chart A.7**). According to data on the sales contracts of the Department of Lands and Surveys (DLS), real estate transactions at a Pancyprian level, recorded an annual increase of 36,2% over the first ten months of 2022. This increase corresponds to an annual increase of 18,0% and 71,3% in the sales to domestic and foreign buyers, respectively (**Table A.5**), with domestic buyers still representing the largest share of buyers.

According to the CBC's Monetary and Financial Statistics, in 2022Q3 new housing loans decreased by 12,3% and 6,7% on an annual and quarterly basis, respectively (€238,8 million in 2022Q3 compared with €273,0 million in 2021Q3 and €256,1 million in 2022Q2). In addition, according to the

**CHART A.7 House and Apartment price indices**

**TABLE A.5 Real estate sector**

(annual change, %, unless otherwise stated)

	Jan.-Oct. 2021	Jan.-Oct. 2022	Oct. 2021	Sep. 2022	Oct. 2022
Sales contracts (total)	21,6	36,2	-14,4	26,6	28,5
Sales contracts (locals) <sup>(1)</sup>	29,4	18,0	-22,4	4,5	22,7
Sales contracts (foreigners)	9,0	71,3	0,8	64,0	37,1
Building sentiment indicator (average of index) - Cyprus	-18,8	-18,6	-12,9	-15,6	-22,1
Building sentiment indicator (average of index) - Euroarea	32,1	84,9	68,9	90,2	86,5
Price index of construction materials	9,6	18,3	16,9	16,2	14,3

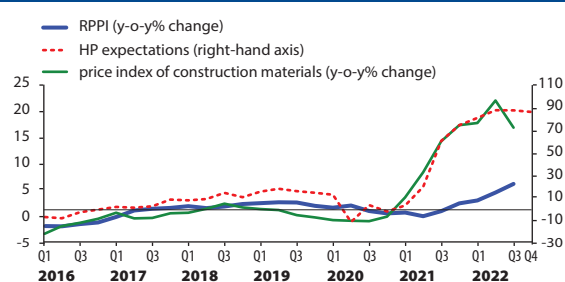
Sources: Cystat, DLS, European Commission.

(1) The number of sales contracts to Cypriots results from CBC calculations.

same source, in 2022Q3, the interest rate on new housing loans increased to 2,72% from 2,19% in 2021Q3. It is noted that lending criteria remained stable at the same strict levels compared with 2022Q2. The decrease in pure new housing loans that has been recorded in 2022Q2 and 2022Q3, compared with the corresponding period in 2021, might reflect both the termination of the state aid scheme of interest rate subsidy concerning mortgage loans and the gradual increase in the interest rates initiated by ECB. The aforementioned developments are expected to negatively impact demand for housing from locals, to some extent. According to European Commission's Business and Consumer Surveys, expectations on the employment in the construction sector over the next three months recorded a positive sign for the first time in November 2022 after nine months of negative recordings, demonstrating the positive path that the construction sector is expected to follow. On the other hand, the building sentiment remains comparatively constant at negative levels over the last eleven months of the current year (Table A.5, p. 25).

The increase in the prices of construction materials contributes significantly to the volatility of prices. The index of construction materials, published by CyStat, records increases over the last quarters (Chart A.8), even though it seems to have been stabilised in 2022Q3, possibly following the international trend of price decreases in the main construction materials, albeit with a time lag. Indicatively, according to the aforementioned data from CyStat, mineral prices recorded a

**CHART A.8 Residential property price index (RPPI), Price Index of Construction Materials and House Price (HP) Expectations for the next three months**



Sources: CBC, European Commission  
Note: The figures for the fourth quarter refer to the period October and November.

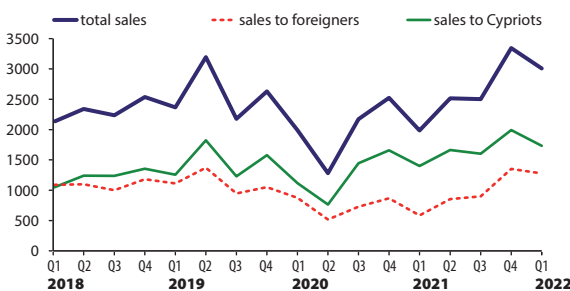
quarterly decrease of 2,9% in 2022Q3, even though on an annual basis they continue recording decelerations.

In 2022, residential prices in Cyprus recorded an acceleration (**Chart A.9**). Specifically, according to the available data of the Residential Property Price Index (RPPI) of CBC, over the first three quarters of 2022, residential prices recorded an annual increase of 4,7% on average (compared with 0,8% over the corresponding period in 2021), reflecting an annual increase of 7,3% in apartment prices and 3,4% in house prices over the same period. The acceleration of residential prices is attributed to the increased construction cost<sup>3</sup>, and to a lesser extent, to the promotion of investments and incentives for international headquartering of high-tech companies. The commercial property prices, moving in parallel with residential property prices, also recorded annual increases over the first two quarters of 2022. According to data on the property price index of RICS Cyprus, shop, warehouse and office prices recorded an annual increase in the first half of 2022 by 1,8%, 2,3% and 2,1%, respectively. The aforementioned path, which seems to extend further in 2022Q3, is also confirmed by the unpublished commercial property price indices of CBC.

Despite the acceleration of residential property prices in Cyprus over the last quarters, the cumulative increases stand at significantly lower levels compared with the Eurozone. Specifically, residential property prices in the Eurozone have increased in total by 19,3% from 2020Q1 (when the disruptions in the supply chains have first started, leading

3. Further analysis is provided in the 2022Q2 Residential Property Price Index report (Box), available at: <https://www.centralbank.cy/el/publications/residential-property-price-indices>

**CHART A.9 Number of sales contracts**  
(annual change, %)



Source: CBC.

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to general price increases) until 2022Q2, compared with 5,9% in Cyprus over the same period. At the same time, the upward path of price expectations over the next three months, published by European Commission's Business and Consumer Surveys, has halted, albeit remaining at high levels. Specifically, the index has reached 86,9 on average in 2022Q3 compared with 87,1 in 2022Q2 (**Chart A.8**, p. 26), hovering around similar levels in October 2022 (86,5, **Table A.5**, p. 25), reflecting market expectations that the acceleration in property prices will not continue in the future.

All in all, real estate market records an acceleration in residential property prices, as a result of the increased construction costs and the decrease in construction activity. The further credit tightening that is anticipated and the erosion of income due to inflation are expected to have a dampening effect on real estate property demand while a possible stabilisation and/or decrease in the prices of the construction materials is expected to contribute towards the normalisation of property price growth rates. The fact that real estate is seen as a safe haven in times of high inflationary expectations is expected to provide support. The attraction of foreign professionals and their families to Cyprus as part of international headquartering also supports the real estate demand.

### **Labour Costs**

Labour costs (expenditure per employee) in 2022 are still recovering. The increase in labour costs in the first half of 2022 is mainly

a consequence of the increase in hours worked per person employed (2.6%), and to a lesser extent of the increase in labour costs per hour worked (2.1%).

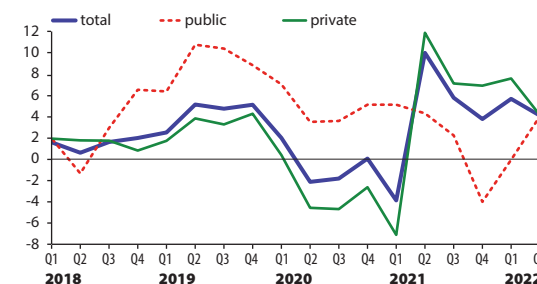
In more detail, nominal expenditure per employee recorded an increase of 4.8% in the first half of 2022, followed by a 3% increase in the corresponding half-year (**Chart A.10**). Public expenditure recorded growth of 2%, while a larger increase of 5.7% was recorded in the private sector. The expenditure per employee in the public sector is mainly the result of the continued phasing out of the reductions in salaries and pensions adopted in the years of crisis. In the private sector, this increase was mainly due to increases in wages in the commercial, transport, hotel and restaurant sectors and, to a lesser extent, in professional and financial services sectors.

The real expenditure per employee<sup>4</sup> in the first half registered a sharper decrease of 5.9%, after a drop of 3.4% in the corresponding half of 2021, affected by the significant inflationary pressures which limited the purchasing power of households (**Chart A.11**).

In terms of productivity, which is calculated as the change in real GDP per employed person, the relative index recorded an increase of 4.3% in the reporting period compared to an increase of 4.8% in the first half of 2021. The increase in this index in the first half of 2022 is due to the continued and stable growth of GDP which exceeds that of employment (**Chart A.11**). The significant growth in GDP is due to the reopening of the economy compared to the negative impact on economic activity in the corresponding period last year due to lockdowns.

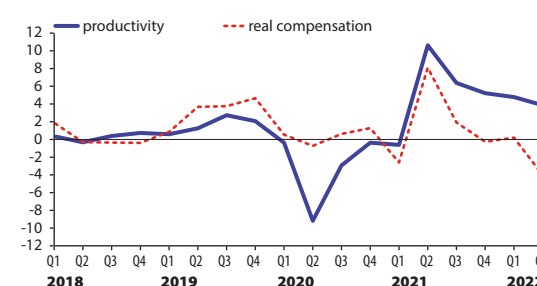
4. It is noted that the private consumption deflator is used, rather than the CPI deflator.

**CHART A.10 Nominal compensation per employee by sector**  
(annual change, %)



Sources: SDW (ECB), Cystat, CBC.  
Note: The sectoral breakdown is based on CBC calculations.

**CHART A.11 Productivity and real compensation per employee**  
(annual change, %)



Sources: SDW (ECB), CBC.

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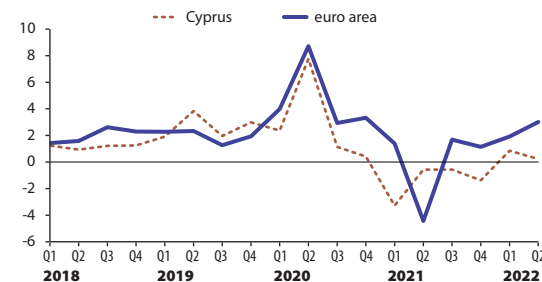
The recovery in expenditure per employee as well as in productivity translates into a slight increase in unit labor costs by 0.5% (**Chart A.12a**), which is an important indicator of competitiveness against competing economies. Despite the recently observed increase, significant cumulative wage reductions since 2013 as well as post-crisis help in the long term to maintain the competitiveness of the Cypriot economy. In particular, the indicator recorded a cumulative decrease of 13.2% in 2013-2016 and, despite annual increases recorded since then, it continues to be lower against the euro area since 2013 (around 21 percentage points in the first half of 2022) (**Chart A.12b**).

### 3. Labour market

The developments in relation to the invasion of Ukraine by Russia have not yet materially affected the labour market in Cyprus. Indeed, the continuing influx of foreign companies to operate and/or expand their activities in Cyprus (international headquartering) is intertwined with the influx of foreign labour. The resilience observed in recent years in the labour market following the outbreak of the pandemic has been ensured by the adoption of economic measures by the State, helping to contain both the worsening unemployment and the shrinking employment during the pandemic. It is noted that the measures since the end of 2021 were lifted due to a significant improvement in the economic environment.

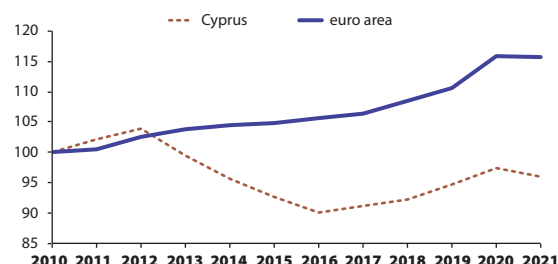
According to the latest available labour market statistics during first half of 2022,

**CHART A.12a Unit labour costs: Cyprus and the euro area**  
(annual change, %)



Source: SDW (ECB).

**CHART A.12b Unit labour costs: Cyprus and the euro area**  
(index 2010=100)



Source: SDW (ECB).

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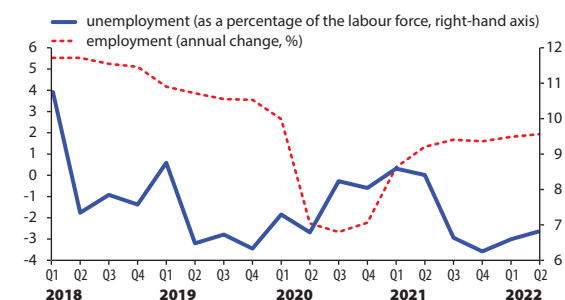
employment recorded a gradual recovery which stood at 1.9% compared to 0.9% in the corresponding period of 2021 (**Chart A.13**). The increase in employment came mainly from the Trade, Accommodation, Construction, Professional Services and Information and Communication sectors. According to the results of the Economic Sentiment Surveys, the expectations of staff employment over the next three months have not been significantly affected, despite the invasion of Ukraine.

Hours worked per employee increased by 2.6% in the first half of 2022, compared to 3.4% last year. It is noted that a significant annual increase in hours worked per employee since the second quarter of 2021 (10.2%) was recorded, in line with a significant recovery in GDP growth, with a continued positive trend, thus demonstrating the limited likelihood of later hysteresis effects.

The negative impact of Russia's invasion of Ukraine on unemployment figures for the first half of the year is limited. According to Labour Force Survey (LFS) data, unemployment stood at 6.7% in the first half of 2022 compared to 8.5% in the corresponding period last year (**Chart A.13**).

In relation to unemployment developments by age group (**Chart A.15a**, p. 32), the 25-34 age group has the largest contribution with 2.5 percentage points to the overall unemployment rate of 6.7% for the first half of 2022. A smaller contribution to the overall unemployment rate comes from young people aged 15-24 with 1.4 percentage points. The unemployment rate among young people aged 15-24 decreased to 17.7%

CHART A.13 Unemployment and employment



Source: Cystat (LFS).



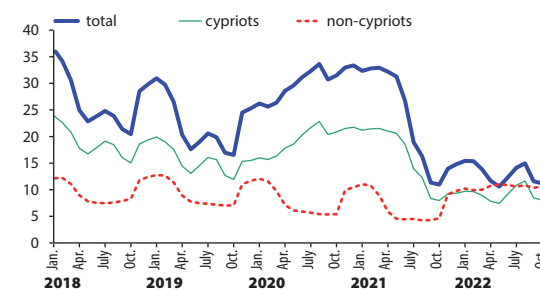
in the 2022 period under review, compared to 18.2% last year.

Recent Cystat data on registered unemployment showed a continued downward trend, which is visible from June 2021 (**Chart A.14**) until August 2022, with the most recent data for October this year showing a slight annual increase of 1.9% (from 10,974 to 11,183 people). In addition to the significant impact of the GDP recovery, it should be noted that the significant reductions recorded in the registered unemployment data since June 2021 were expected due to the end of automatic renewals of registered unemployed and new registrations of unemployed without physical presence. The previous system was introduced as of March 2020 to avoid the spread of the coronavirus.

An important parameter in the analysis of labour market developments is the continuing fall in long-term registered unemployment, where it registered a drop of 1,026 people in October 2022 compared to the corresponding month last year. At the same time, according to the comparatively more representative of the labour market situation in the LFS, the unemployment rate of over six months has decreased in the second quarter of 2022 to 3.5% compared to 5% in the corresponding quarter last year (**Chart A.15b**). These figures are encouraging, since they suggest that the long-term unemployed are gradually being reintegrated into employment.

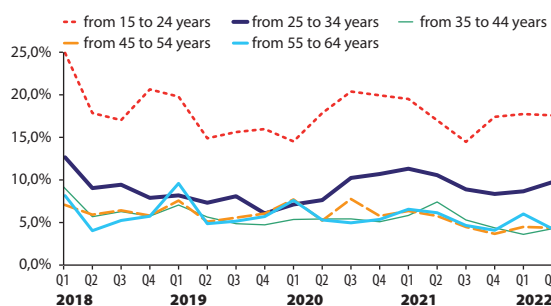
With regard to the question of a possible generalized shortage in the labour market, this does not seem to be the case as, according to data from the Labour Force Survey (LFS), the

**CHART A.14 Registered unemployment**  
(number of unemployed, thousands)



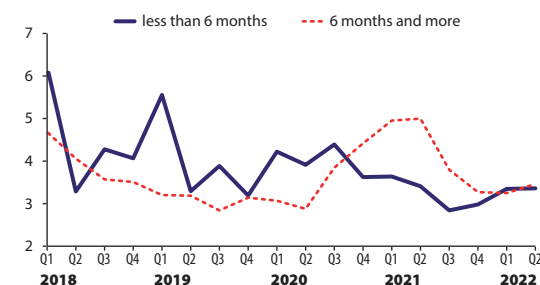
Source: Cystat.

**CHART A.15a Unemployment rate by age group**  
(as a percentage of the labour force)



Source: Cystat (LFS).

**CHART A.15b Unemployment by duration**  
(as a percentage of the labour force)



Source: Cystat (LFS).



influx of foreign labour is continuing, which can meet the staffing needs of companies. In addition, the survey showed a strong increase in job vacancies by almost 5,000 people in the first half of 2022. This reflects partly the strong economic recovery and continued resilience in the labour market, where long-term unemployed people can be absorbed gradually into the labour force, given the enhanced capacity of Public Employment Services to place unemployed people in job vacancies. As regards the correlation between job vacancy and unemployment, there is some mismatch in demand and the provision of skills in the labour market. This seems to be related to recent surveys by the Cyprus Employers and Industrialists Federation, which show a certain narrowness in the labour market, which however focuses on specific sectors and professions (housing, cleaning staff and generally unskilled staff).

#### 4. Balance of payments<sup>5</sup>

The current account deficit reached €1.847,4 million (-14,4% of GDP) in 2022H1, compared with a deficit of €1.287,5 million (-11,3% of GDP) in the corresponding period of 2021 (Table A.6 and Chart A.16). These developments are a result of both temporary and structural reasons. Among temporary factors, we note the effect of inflationary pressures on imported goods and the erosion of tourists' disposable income. Structural factors include the influx of foreign companies via the Scheme of

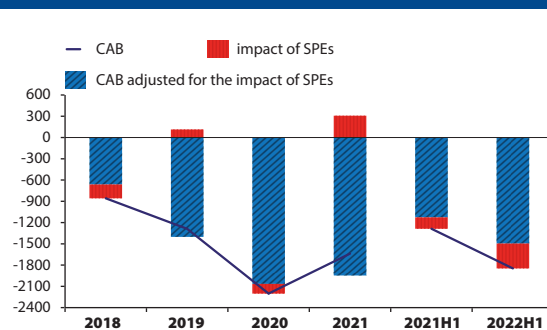
5. The external statistics data are significantly affected by the classification of SPEs as residents of Cyprus and, in particular, by those which are considered as economic owners of mobile transport equipment (mainly ships). The transactions of SPEs do not affect nor are affected substantially by the domestic economic cycle.

TABLE A.6 Balance of payments (main categories)

	2021H1 (€ million)	2022H1 (€ million)	Change (€ million)
<b>Current account balance</b>	<b>-1.287,5</b>	<b>-1.847,4</b>	<b>-559,9</b>
<b>Current account balance adjusted for the impact of SPEs</b>	<b>-1.127,8</b>	<b>-1.497,1</b>	<b>-369,3</b>
<b>Goods and services balance</b>	<b>-258,1</b>	<b>-838,7</b>	<b>-580,6</b>
<b>Trade balance</b>	<b>-2.349,4</b>	<b>-3.333,6</b>	<b>-984,2</b>
Exports of goods	1.418,0	1.903,0	485,0
of which:			
Exports of goods - SPEs	329,6	356,9	27,3
Imports of goods	3.767,4	5.236,6	1.469,2
of which:			
Imports of goods - SPEs	681,3	895,2	213,9
<b>Services balance</b>	<b>2.091,3</b>	<b>2.494,8</b>	<b>403,6</b>
Exports of services	7.739,2	9.474,9	1.735,7
Imports of services	5.647,9	6.980,1	1.332,2
<b>Primary income (net)</b>	<b>-810,0</b>	<b>-853,0</b>	<b>-43,0</b>
<b>Secondary income (net)</b>	<b>-219,4</b>	<b>-155,7</b>	<b>63,7</b>
<b>Current account balance (% of GDP)</b>	<b>-11,3</b>	<b>-14,4</b>	
<b>Current account balance adjusted for the impact of SPEs (% of GDP)</b>	<b>-9,9</b>	<b>-11,7</b>	

Sources: Cystat, CBC.

CHART A.16 Current account balance (CAB) (€ million)



Sources: Cystat, CBC.

international headquartering and of commerce businesses that carry a significant footprint in the local economy. The deterioration of the deficit was mainly attributed to the goods balance, given inflationary pressures, and to a lesser extent to the primary balance. Despite the weak external demand and the consequences of the Russian invasion, the increase of the surplus in the services balance partly offset the deterioration of the current account deficit. Adjusted for the impact of SPEs, the current account deficit deteriorated to €1.497,1 million (-11,7% of GDP), compared with €1.127,8 million (-9,9% of GDP) in the corresponding period of 2021 (**Table A.6**, p. 33 and **Chart A.18**, p. 38). The total lift of travel restrictions related to covid-19 played a critical role in the above-mentioned developments for the first half of 2022, given that these restrictions had been in place in the first half of 2021. The consequences of the Russian invasion in Ukraine and the ensued sanctions on Russia did not significantly affect the current account balance in the first half of 2022, though a noteworthy impact is anticipated in the second half of the year and beyond.

In particular, the goods deficit increased to €3.333,6 million in 2022H1, compared with a deficit of €2.349,4 million in the corresponding period of the previous year, due to the larger increase in the imports of goods relative to the exports of goods. The Russian invasion of Ukraine and the ensued sanctions on Russia caused a spike in commodity prices (e.g. oil and grains), as well as the prices of inelastic goods, such as animal feed, leading

to an overall increase in the imports of goods, primarily for domestic consumption. The biggest increase was recorded in the categories of fuel, intermediate and consumption goods.

The services surplus reached €2.494,8 million in 2022H1, compared with €2.091,3 million the corresponding period of the previous year, mainly due to the larger increase in the exports relative to the imports of services (Table A.7). Exports of services and tourism exports in particular, play a key role in analysing the Cypriot economy. As a prominent tourist destination and business centre, Cyprus relies heavily on the supply of services. Net exports of services in the Information, Communications and Telecommunications (ICT) sector increased by €292,2 million, due to the continued influx of foreign companies that set up or expand their operations in Cyprus (international headquartering).

The travel sector saw a major recovery in 2022H1, following the lift of covid-19 related restrictions on international travel, that were in place during 2020-21. More specifically, the surplus in travel stood at €415,0 million in the first half of 2022, versus €92,2 million and €451,9 million in the corresponding periods of 2021 and 2019, respectively. Thus, it appears that the Russian invasion in Ukraine and the sanctions imposed on Russia did not particularly hurt tourism in the first half of 2022. The loss of the Russian market was offset to a large extent by the increase in travel from European markets. Nevertheless, the adverse effects from the Russian invasion in Ukraine and the subsequent slowdown in

**TABLE A.7 Services balance (main categories)**  
(€ million)

	2021H1 (€ million)	2022H1 (€ million)	Change (€ million)
<b>Services balance</b>	<b>2.091,3</b>	<b>2.494,8</b>	<b>403,6</b>
<b>Exports of services</b>	<b>7.739,2</b>	<b>9.474,9</b>	<b>1.735,7</b>
of which:			
Transport	1.632,6	1.667,0	34,3
Travel	359,8	951,0	591,2
Financial services	2.616,5	2.830,3	213,9
Telecommunications, computer and information services	1.850,6	2.731,6	881,0
Other business services	694,6	665,6	-29,0
<b>Imports of services</b>	<b>5.647,9</b>	<b>6.980,1</b>	<b>1.332,2</b>
of which:			
Transport	938,2	1.091,2	153,0
Travel	267,6	536,0	268,4
Financial services	1.516,6	1.784,3	267,7
Telecommunications, computer and information services	1.398,6	1.987,5	588,9
Other business services	1.058,5	1.160,7	102,2

Source: CBC.

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global demand are likely to hit various service sectors in the second half of 2022 onwards, including transport, financial, other business and information technology services. On the other hand, foreign companies continue to set up and/or expand their operations in Cyprus (international headquartering), thus mitigating the aforementioned adverse effects.

In 2022H1, exports of services recorded an annual increase of 22,4% (€1.735,7 million), driven by all major categories with the exception of other business services (**Table A.7**, p. 35). In particular, ICT services recorded the largest increase of €881,0 million, due to the continued influx of foreign high-tech companies. Travel revenue, which include tourist revenue, increased by €591,2 million. Current developments and latest data on tourism are analysed in the next subsection (see Tourism). Financial services increased by €213,9 million given the expansion of investment firms. While transport increased by €34,3 million, other business services declined by €29,0 million.

Meanwhile, imports of services increased by 23,6%, or €1.332,2 million, with positive contributions from all service categories (**Table A.7**, p. 35). The major increases were in ICT (€588,9 million), travel (€268,4 million), financial (€267,7 million) and transport (€153,0 million) service categories.

The deficit in the primary income account (which mainly includes income from employment and investment) widened by €43,0 million in the first half of 2022, compared with the corresponding period of the previous year, and reached €853,0 million.

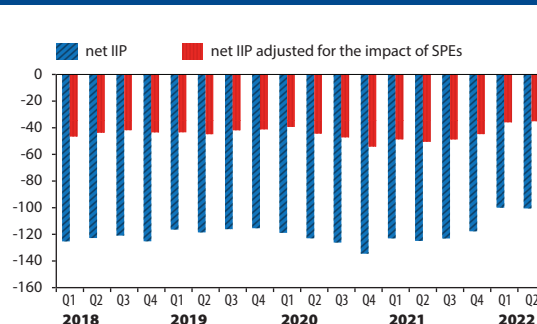
This development is mainly associated with the income from direct investments and more specifically, to the larger decrease in income inflows from abroad towards Cypriot residents, compared to the income outflows from Cyprus towards foreign residents. The latter part includes outflows to foreign-owned credit acquiring companies, as well as to foreign owned trade businesses. The deficit in the secondary income account (which mainly includes current transfers) was reduced by €63,7 million and stood at €155,7 million, as a result of the increased capital inflows from various funds of the European Union (**Table A.6**, p. 33).

Significant inflows were recorded in the financial account in 2022H1, primarily due to the decrease in net assets owned by the private sector.

The net international investment position (IIP) stood at -€27,6 billion (-100,6% of GDP) in 2022H1, (**Chart A.17**). The IIP was negatively impacted by the inclusion of the economic transfer of mobile transport equipment (mainly ships) by SPEs registered in Cyprus. These companies have significant financial liabilities, in particular loans, which are mainly associated with the purchase of ships. While these loans have a direct impact on the net IIP, the respective non-financial real assets (ships) do not, thus creating an imbalance in the figures reported. As these companies are financed almost entirely by non-domestic banks, they do not constitute a risk to the Cypriot financial system.

Adjusted for the impact of SPEs, the net IIP improved by 65,5 percentage points, standing at -€9,6 billion or -35,1% of GDP at the end of

**CHART A.17 Net International Investment Position (IIP)**  
(as a percentage of GDP)



Sources: Cystat, CBC.

the first half of 2022, compared with -€10,8 billion or -44,8% of GDP at the end of 2021 (Chart A.17, p. 37). It is noted that the improvement in net IIP as a percentage of GDP, was driven by a strong GDP recovery in the first half of 2022.

## Tourism

Tourism constitutes one of the most important pillars of the Cypriot economy. It is on a rapid pace of recovery, following the severe blow it suffered because of the pandemic, and despite the loss of the Russian tourist market, the second largest after Great Britain, after the imposition of sanctions following Russia's invasion in Ukraine.

Based on available data for the first ten months of 2022, tourist arrivals reached 2,9 million, recording an annual increase of 73,9% (Table A.8 and Chart A.18a). The increase in arrivals was most notable during the summer months. Since those months carry the biggest weight for the whole year, total tourist arrivals for the first ten months of 2022 reached 79,6% of the corresponding level in 2019. The major tourism export markets were the UK with 1,1 million tourists, followed by Israel with 241 thousand and Germany with 172 thousand tourists. Other significant improvements in tourist flows were recorded for France, Poland and the Scandinavian countries.

Tourist revenues increased in the first eight months of 2022 and stood at €1.617 million, compared with €777.0 million in the corresponding period of the previous year (Table A.8 and Chart A.18b). This development was driven by the increase in tourist

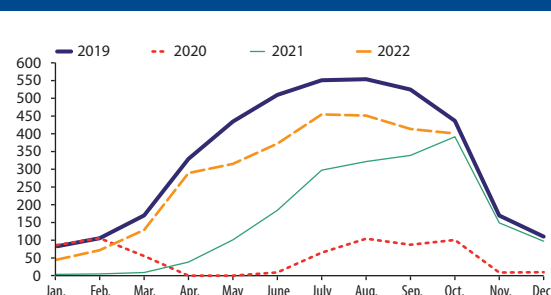
**TABLE A.8 Tourism**

	Tourist arrivals (thous.)	Tourist receipts (€ million)	Expenditure per person (€)
2019	3.976,8	2.683,0	674,7
2020	631,6	392,0	620,6
2021	1.936,9	1.513,6	781,5
annual % change			
2019-2020	-84,1	-85,4	-8,0
2020-2021	206,7	286,1	25,9
2020 Jan. - Aug.	960,2	777,0	809,2
2021 Jan. - Aug.	2.127,2	1.617,1	760,2
annual % change	121,5	108,1	-6,1

Source: Cystat.

Note: Due to pandemic COVID-19 entrance to the Republic was prohibited for the period 15/3-8/6/2020 and since then there was a gradual lifting of the restrictive measures.

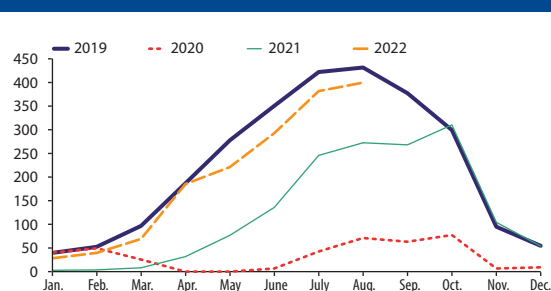
**CHART A.18a Tourist arrivals**  
(number of persons, thousands)



Source: Cystat.

Note: Due to pandemic COVID-19 entrance to the Republic was prohibited for the period 15/3-8/6/2020 and since then there was a gradual lifting of the restrictive measures

**CHART A.18b Receipts from tourism**  
(€ million)



Source: Cystat.

Note: Due to pandemic COVID-19 entrance to the Republic was prohibited for the period 15/3-8/6/2020 and since then there was a gradual lifting of the restrictive measures

arrivals, though it was dampened by a 6,1% decrease in per capita expenditure, given the shorter duration of stay, relative to 2021. It is noted that per capita expenditure per day during the third quarter of 2022, period for which data is available, increased by 15,1% and stood at €87,08, compared with the corresponding period of the previous year.

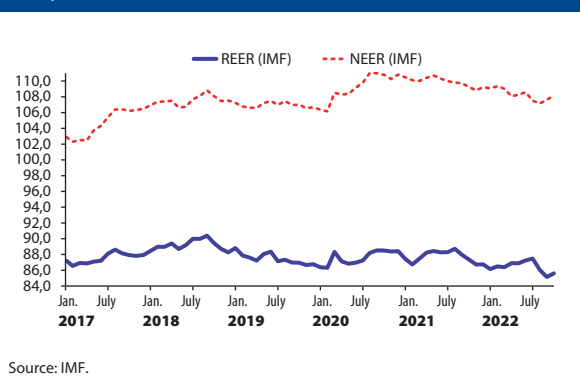
Factors that contributed to the revival of the tourist industry include, among others, aviation incentive schemes that target the improvement of air connectivity and the development of new routes, government measures to support domestic tourism, and the extension of the tourist season. Other important developments include hotel renovations and new infrastructure building, such as the construction of luxury hotels, marinas and the casino-resort. Furthermore, the National Tourism Strategy 2030 goals include the promotion of rural, mountainous and remote areas as tourist destinations (e.g. Christmas villages).

Despite the uncertainty around the length and outcome of the Russian invasion in Ukraine and the related imposed sanctions, the outlook on tourism remains positive for 2023, such that by early 2024, it will have fully recovered to the record levels of 2019 (see Macroeconomic Forecasts).

### Effective exchange rate

Chart A.19 shows the effective exchange rate (EER) index of the euro in Cyprus, in nominal (NEER) and real (REER) terms, as calculated by the IMF. Between January and October 2022, both indices appear to have

**CHART A.19 Real and nominal effective exchange rates (IMF weights)**  
(base year 2010=100)





weakened. It is noted that although the REER index was increasing in the first seven months of the year, it then declined sharply. Overall, the trend of the REER index and the widening gap between the NEER and REER indices were influenced by the developments in the nominal value of the euro against other currencies, but also by domestic developments, such as, the lower inflation recorded in Cyprus compared with its trading partners.

The REER index, the inflation rate, as well as the unit labour costs that have been analysed in the previous section, are important measures of the competitiveness of an economy. Lower unit labour costs (see Labour Costs, p.30) and a lower REER in Cyprus compared with competing countries suggest that domestic exports tend to be more price competitive. In general, inflation is related to, among other factors, the variables mentioned above and therefore reflects the degree of competitiveness of the Cyprus economy.

## **5. Financing conditions and credit developments<sup>6,7</sup>**

The domestic financial sector has exhibited significant resilience to geopolitical tensions in times of widespread uncertainty, amid the protracted energy crisis and inflationary pressures. The negative impact of Russia's invasion of Ukraine to the banking sector has been contained due to its ongoing consoli-

6. For a detailed explanation of the methodology and technical analysis of monetary aggregates (deposits and credit growth), see Technical Notes on p. 66.

7. The analysis on deposits and credit growth in this section of the Economic Bulletin focuses on domestic residents excluding SPEs. SPEs are included in the non-residents category unless otherwise stated.



dation efforts, as well as the healthy and stable position the banking sector was already standing at the outbreak of the war.

Regarding deposits, the upward trend observed in 2021 during the acute phase of the pandemic continued in the beginning of 2022, however, Russia's invasion in Ukraine created new conditions. In particular, the deceleration in the total deposits annual growth observed since March 2022, was mainly driven by the ceasing of RCB's banking operations and the subsequent money return to its depositors. It should be noted that RCB was the only bank in Cyprus that was directly affected by Russia's invasion in Ukraine and the ensuing sanctions.

Nevertheless, the proactive and coordinated actions of CBC and ECB have safeguarded depositors, the entire banking system and consequently the financial stability of the country.

Specifically, the annual growth rate of domestic private sector<sup>8</sup> deposits reached 2,7% in September 2022 compared with 5,8% at the end of 2021 and 4,9% in September 2021, with the sectoral breakdown exhibiting mixed trends. In particular, domestic non-financial corporations' annual growth declined to 4,6% in September 2022 from 9,9% in December 2021 and 7,2% in September 2021. The slowdown observed is mostly related to the aforementioned developments with RCB Bank but also due to a base effect. On the other hand, domestic household deposits continued their upward trend reflecting the strong economic activity and the continuous improvement in employment, which reinforced households'

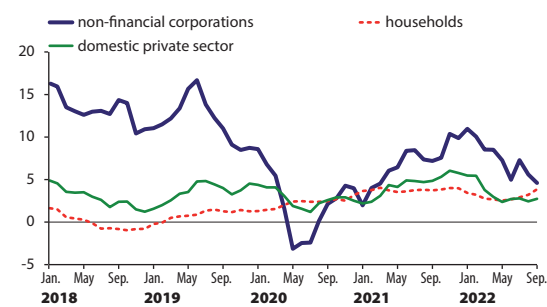
8. Domestic private sector refers to non-MFIs domestic residents, excluding SPEs and central government.

saving capacity. Specifically, domestic households' deposits annual growth rate stood at 3,9% in September 2022 compared with 4,0% in December 2021 and 3,7% in September 2021 respectively (**Chart A.20**). It should be noted, that monthly deposit flows for non-financial corporations and households were quite robust in the period June-September 2022, despite the fact that soaring food and energy prices weigh on firms' cash buffers and households' real disposable income. The built up of deposits in recent months possibly reflects precautionary motives amid elevated uncertainty over the economic outlook.

At the same time, non-residents deposits<sup>9</sup>, which typically exhibit high volatility, returned to negative territory similarly to the period prior to the acute phase of the pandemic. Specifically, the annual growth rate fell to -6,3% in September 2022 compared with 4,9% in December 2021 and 0,8% in September 2021, mostly reflecting the impact of RCB's phasing out its banking operations (**Chart A.21**). Nevertheless, the direct exposure of the domestic banking sector to Russia and Ukraine is standing at very low levels, both in terms of deposits and loans, limiting the risk associated with Russian firms.

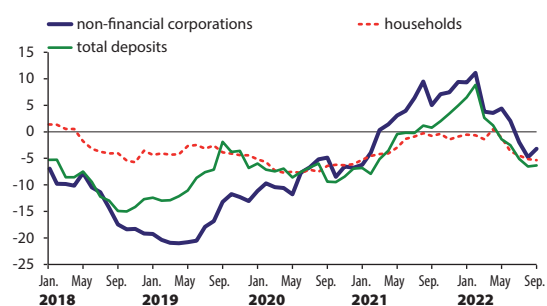
As regards credit developments, the banking sector's strong liquidity has enabled banks to continue financing the real economy despite their tighter lending policy, which aims at safeguarding new lending sustainability. Specifically, new lending to the non-financial private sector<sup>10</sup>, which recovered in 2021 supported by the government's interest rate subsidy scheme for new business and housing loans, increased

**CHART A.20 Deposits of the domestic private sector**  
(annual change, %)



Source: CBC.

**CHART A.21 Deposits of non-residents: Cyprus**  
(annual change, %)



Source: CBC.

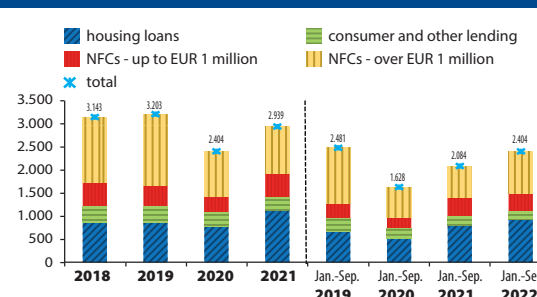
9. Including SPEs.

10. New loan contracts (euro-denominated) to euro area non-financial corporations and households.

further in the first half of 2022 despite the expiry of the scheme (December 2021). As of July 2022, this momentum has moderated reflecting the increased uncertainty in the geopolitical and economic environment, banks' tighter credit standards, rising interest rates and the negative impact of inflation on households' real disposable income and corporate profit margins.

Nevertheless, overall, new lending to the non-financial private sector in the first nine months of 2022 was elevated compared with the first nine months of 2021, almost reaching the corresponding period of 2019 levels, before the coronavirus pandemic and the current geopolitical and energy crisis. Specifically, it reached €2,4 billion in the first nine months of 2022, compared with €2,1 billion and €2,5 billion in the same period of 2021 and 2019, respectively (Chart A.22). In particular, new housing loans in the first nine months of 2022 amounted to €932 million, surpassing the corresponding levels of 2019 and marking a historic high since the data are available (end 2014). This development may partly reflect the significantly increased construction costs. At the same time, new lending to non-financial corporations in the first nine months of 2022 reached €1,3 billion compared with €1,1 billion in the same period of 2021. New lending to non-financial corporations for amounts up to €1 million in the first nine months of 2022 has exceeded the levels of the same period of 2019. This possibly relates to increased financing needs for working capital as the increase in energy costs and raw materials prices as well as the supply chain disruptions increase enter-

**CHART A.22 Volumes of pure new loans (euro-denominated) to euro area non-financial corporations and households<sup>(1)</sup>**  
(€ million)



Source: CBC.

1. Pure new loans include all new loan contracts within the reference period.

prises' operating costs. On the contrary, increased uncertainty due to the successive crises and the rising interest rates seems to contain enterprises' new lending for large investment projects. In the first nine months of 2022, new lending to non-financial corporations for amounts over €1 million remained below the corresponding pre-pandemic period of 2019 level, although it was elevated compared with the previous year. Specifically, it reached €0,9 billion in the first nine months of 2022 compared with €0,7 billion and €1,2 billion in the same period of 2021 and 2019, respectively.

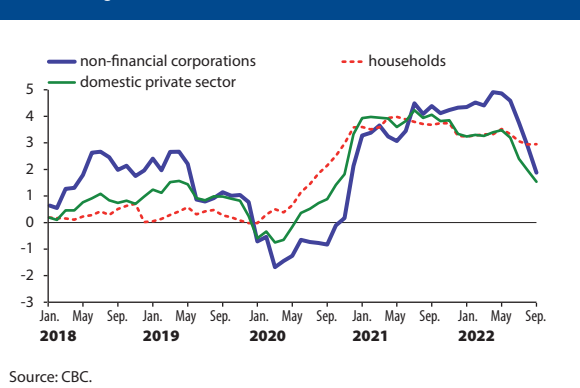
The increase in new lending supported the annual growth rate of net loans<sup>11</sup> to the domestic private sector<sup>12</sup> in the first half of 2022, which broadly remained at the elevated positive levels recorded since December 2020. The moderation in new lending observed since July 2022 coupled with some specific early loan repayments, possibly due to the rising interest rates, contained the annual growth rate of net loans in the third quarter of 2022.

Specifically, the annual growth rate of net loans to the domestic private sector decelerated as from July 2022 standing at 1,5% in September 2022, compared with 3,2% in June 2022 and 3,3% in December 2021. In more detail, the annual growth rate of the domestic non-financial corporations net loans in September 2022 stood at 1,9%, while that of domestic households stood at 3,0% (**Chart A.23**). Regarding the categories of loans to households, housing loans maintained their momentum with no particular signs of deceleration, recording an annual increase of

11. New lending plus capitalisation of interest minus repayments.

12. Domestic private sector refers to non-MFIs domestic residents, excluding SPEs and general government.

**CHART A.23 Loans to the domestic private sector**  
(annual change, %)



5,6% in September 2022. On the other hand, both consumer credit and other lending to households record negative annual growth rates. As evidenced from the most recent Bank Lending Survey (see below), rising interest rates, the further deterioration in consumer confidence and the rise in prices which constrained households' disposable income, have reduced the demand for these loans. Specifically, consumer credit recorded an annual decrease of 0,4% in September 2022. Similarly, the annual growth rate of other lending to households, which remains negative since May 2021, stood at -7,1% in September 2022 (Table A.9).

According to the Bank Lending Survey<sup>13</sup>, we are undergoing a period of reduced supply and, at the same time, decreased demand for loans. In these times of heightened economic uncertainty and rising interest rates, banks are tightening their lending policy, despite a net decline in demand, aiming to prevent new non-performing facilities.

Specifically, according to the latest Bank Lending Survey (October 2022) (Table A.10), credit standards for loans to enterprises tightened further in 2022Q3. According to the Survey, banks' perception of increased risk related to the general economic situation and outlook, borrowers' creditworthiness and the collateral demanded, as well as their reduced risk tolerance contributed to the tightening of credit standards for business loans in 2022Q3. Similarly, credit standards for all categories of loans to households also tightened in 2022Q3. In the current uncertain environment, banks continued to refer to heightened risk perceptions related to the

**TABLE A.9 Loans to domestic households**<sup>1)(2)</sup>

	Outstanding balance as % of total <sup>(3)</sup>	Annual percentage change					
		2021 June	2021 Sep.	2021 Dec.	2022 Mar.	2022 June	2022 Sep.
Domestic households	100,0	3,9	3,7	3,3	3,3	3,3	3,0
1. Consumer credit	11,7	2,5	2,0	1,0	0,5	0,5	-0,4
2. Lending for house purchase	75,2	5,3	5,2	5,0	5,5	5,7	5,6
3. Other lending	13,1	-0,3	-1,1	-2,3	-4,1	-5,3	-7,1

Source: CBC.

(1) Sectoral classification is based on ESA 2010.

(2) Including non-profit institutions serving households.

(3) As at the end of the last month available. Figures may not add up due to rounding.

**TABLE A.10 Banking Lending Survey (BLS)**

Summary of BLS results - October 2022	Cyprus	
	2022Q3	2022Q4 (expectations)
<b>Credit standards for loans</b>		
Enterprises	Tightening	Tightening
Households		
- <i>Housing loans</i>	Tightening	Tightening
- <i>Consumer credit and other lending</i>	Tightening	Tightening
<b>Demand for loans</b>		
Enterprises	Decrease	Decrease
Households		
- <i>Housing loans</i>	Decrease	Decrease
- <i>Consumer credit and other lending</i>	Decrease	Decrease

Source: CBC.

13. Detailed analysis of the survey results for Cyprus is available on the CBC website (Central Bank of Cyprus - Bank Lending Survey).

general economic situation and outlook, the housing market prospects and borrowers' creditworthiness as the main factor contributing to the tightening.

According to banks' expectations for 2022Q4, credit standards in Cyprus are expected to further tighten for all loan categories of households and, to a greater extent, for loans to enterprises.

At the same time, according to the Survey, net loan demand in Cyprus by both enterprises and households continued to decline in 2022Q3. The net decrease in demand for business loans is mainly attributed to reduced demand for fixed investment financing, reduced financing needs for mergers, acquisitions or corporate restructuring and the level of interest rates. As noted above, in this uncertain environment enterprises seem to postpone their investment plans. Additionally, a decrease in demand for debt restructurings was also reported. It is worth noting that despite the net decrease in enterprises' loan demand over the last two quarters, the demand for business loans for inventories and working capital continued to increase possibly reflecting, as mentioned above, the increased liquidity needs due to rising energy and raw materials costs as well as the supply chain disruptions. As regards households, demand for housing loans, consumer credit and other lending continued to decline. The decline in demand for housing loans is attributed by the surveyed banks to the rising interest rates, declining consumer confidence and, to a lesser extent, the less favourable housing market outlook. Similarly, the decline in

demand for consumer credit and other lending is mainly attributed to lower consumer confidence and the level of interest rates as well as the decreased spending on durable consumer goods.

According to banks' expectations for 2022Q4, net loan demand in Cyprus is expected to continue to decrease by both enterprises and households for all loan categories.

As regards the quality of the banks' loan portfolio, the balance of NPFs<sup>14</sup> in 2022 continued its downward trend, despite the successive crises of the pandemic and Russia's invasion of Ukraine, albeit at a slower pace. This development follows the significant NPFs decrease recorded in recent years mainly due to sales / transfers of loan portfolios to credit acquiring companies and loan write-offs. It is noted that loans transferred to credit acquiring companies continue to weigh on the economy through the high private debt (see below). Specifically, in August 2022 (latest available data) the outstanding amount of NPFs in the banking sector stood at €2,8 billion (10,9% of total loans) compared with €3,0 billion (11,0% of total loans) at the end of 2021 and €5,1 billion (17,7% of total loans) at the end of 2020. Developments to date have not triggered significant new inflows of NPFs. However, following the pandemic, there has been an increase in the proportion of loans identified as having increased credit risk (stage 2 loans). Developments in households' disposable income and in firms' profit margins will determine their ability to smoothly service their debt going forward. Therefore, and on the basis of the CBC's relevant recommen-

14. All credit institutions operating in Cyprus (domestic operations only).



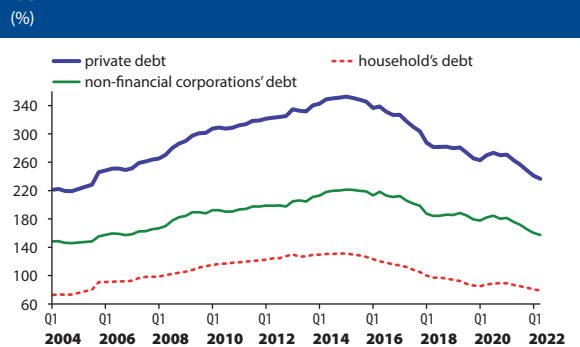
dations, banks' further close monitoring and proactive restructurings are imperative.

In terms of the total debt of the domestic non-financial private sector<sup>15</sup>, the sector's debt to GDP ratio remains high despite its downward trend. The sale of loans to credit acquiring companies has contributed to the correction of banks' balance sheets, but these loans still remain part of private debt<sup>16</sup>. The settlement of the debt held by credit acquiring companies will play a key role in the further de-escalation of private debt and its reduction to the threshold set under the European Commission's macroeconomic imbalances procedure. Specifically, the domestic non-financial private sector debt to GDP ratio continues its downward trajectory since early 2015 (**Chart A.24**) mainly due to the increase in nominal GDP (denominator) and loan write-offs. The ratio's downward trend temporarily reversed in 2020 due to the pandemic related decline in economic activity. Specifically, private debt to GDP since its peak at the end of March 2015 decreased by a total of 116 percentage points (-33%) standing at 236,5% at the end of June 2022 (latest available data) compared with 248,5% at the end of 2021 and 352,5% at the end of March 2015.

Following the ECB's interest rate normalisation process, the historically low interest rate environment observed in Cyprus the past five years has come to an end. A gradual upward trend in lending rates has been observed since the beginning of 2022,

15. The domestic non-financial private sector consists of domestic non-financial corporations (including Special Purpose Entities (SPEs)) and domestic households.
16. All loans are recorded in nominal values (maximum legal obligation of borrowers) regardless of whether or not they are performing and whether they have been purchased at a discount.

**CHART A.24 Private non-financial sector debt as a % of GDP<sup>(1)</sup>**  
(%)



Sources: CBC, Cystat.  
(1) The private non-financial sector consists of the non-financial corporations and the households.



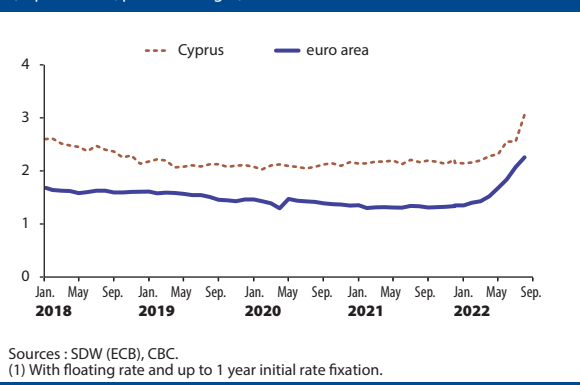
reflecting the increased perception of risk by banks, the tightening of credit standards as evidenced by the Bank Lending Survey, as well as ECB's monetary policy tightening, in the face of the prolonged energy crisis and inflationary pressures.

Monetary policy normalisation process and the subsequent higher interest rates environment improves banks' net interest income and enhances their profitability, as a large share of new loans in Cyprus are at a floating rate. On the other hand, it is clear that the increased financing costs adversely affect real disposable income, especially for low-income households, and put firm's margins under strain, exerting pressures on the private debt servicing capacity.

Briefly, the average interest rate on new euro-denominated loans from Cyprus MFIs to both households and non-financial corporations with an initial rate fixation of up to one year, recorded an upward trend in the first nine months of 2022. Indicatively, in September 2022 the average interest rate on new loans to households stood at 3,06% for house purchase, 3,59% for consumer credit and 3,03% for other lending, recording increases of 85, 69 and 62 basis points respectively since the beginning of the year. It should be noted that all three categories recorded interest rates that are among the highest in recent years. At the end of December 2021, the said interest rates stood at 2,21%, 2,90%, 2,41%, respectively (Chart A.25).

The average interest rate on new loans to non-financial corporations of up to and over €1 million recorded a similar trend reaching 4,13% and 3,69% respectively at the end of

**CHART A.25 MFI interest rates on euro-denominated housing loans (new business) to euro area households<sup>(1)</sup>**  
(% per annum, period averages)



September 2022, compared with 3,25% and 2,84% in December 2021 (**Chart A.26**).

During the period December 2021-September 2022 the spread between domestic and euro area lending rates for housing loans decreased by 7 basis points, while for non-financial corporations for loans up to €1 million increased by 10 basis points, reaching 80 and 163 basis points, respectively.

Regarding deposit rates, these remained relatively stable and close to their historically low levels during the period under review. The high excess liquidity held by domestic banks and consequently their reduced interest in attracting new deposits have contributed to the maintenance of low deposit rates in Cyprus so far. It is noted that the Liquidity Coverage Ratio of the Cyprus banking system is particularly high, one of the highest in the EU.

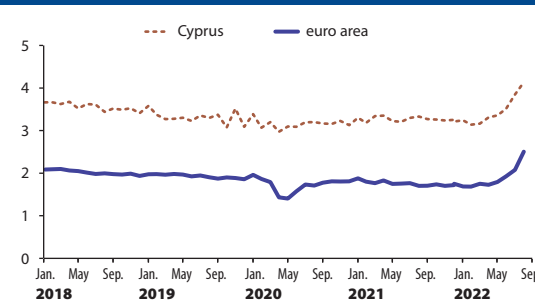
The domestic average interest rate<sup>17</sup> on new household deposits increased slightly to 0,11% in September 2022 from 0,06% in December 2021 and September 2021 respectively (**Chart A.27**). The average interest rate<sup>18</sup> on new deposits for non-financial corporations reached -0,09% in September 2022 from 0,02% and 0,11% in December and September 2021 respectively (**Chart A.28**). The decrease observed in September 2022 is attributed to the methodology used to calculate the weighted average interest rates for the entire banking system.

Following the change in ECB's monetary policy stance and the subsequent increase of the deposit facility rate, banks are no longer obliged to pay negative interest rates for deposits currently held at the ECB due to their

17. Average interest rate with an agreed maturity of up to one year.

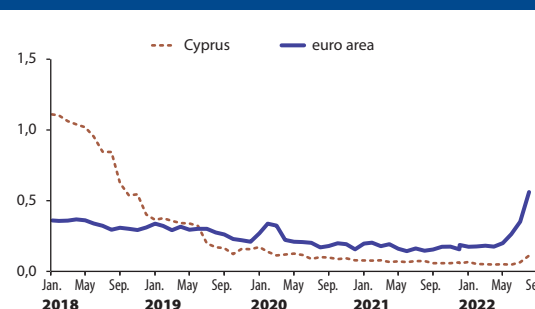
18. Average interest rate with an agreed maturity of up to one year.

**CHART A.26 MFI interest rates on euro-denominated loans (new business) up to €1 million to euro area non-financial corporations<sup>(1)</sup>**  
(% per annum, period averages)



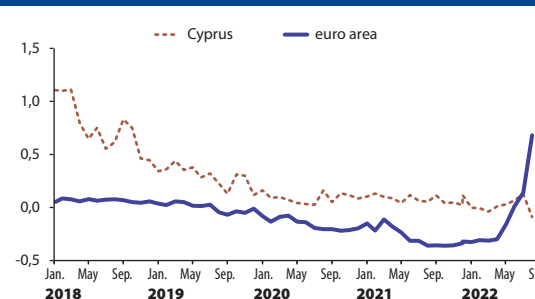
Sources: SDW (ECB), CBC.  
(1) With floating rate and up to 1 year initial rate fixation.

**CHART A.27 MFI interest rates on euro-denominated deposits (new business) by euro area households<sup>(1)</sup>**  
(% per annum, period averages)



Sources: SDW (ECB), CBC.  
(1) With agreed maturity up to 1 year.

**CHART A.28 MFI interest rates on euro-denominated deposits (new business) by euro area non-financial corporations<sup>(1)</sup>**  
(% per annum, period averages)



Sources: SDW (ECB), CBC.  
(1) With agreed maturity up to 1 year.

excess liquidity. In the near future, the successive increases in ECB's policy rates are expected to have a positive impact on deposit rates, as the rise in the interest rate environment will gradually be passed through to bank deposit rates as well.

Summing up, banks in Cyprus maintain their profit margins between lending and deposit rates for both non-financial corporations and households, with monetary policy normalisation having a positive effect on their net interest income. However, rising financing costs could adversely affect the financial position of firms and households in the medium term, with consequent effects in bank's loan portfolio quality. Nevertheless, the stability of the banking sector is supported by its strong capitalisation which provides cushion against some weakening in asset quality. At the same time, the strong economic growth of the Cyprus economy has limited the consequences of the adverse geopolitical events. Nevertheless, the domestic financial sector is faced with significant challenges leaving no room for complacency, while the need to reduce private debt becomes imperative in order to mitigate the negative consequences of any further increases in interest rates.

## 6. Fiscal Developments

The continued economic recovery had a favourable impact on fiscal outcomes, as reflected by the increase in tax revenue and social contributions. Furthermore, inflationary pressures seem to have a positive impact on the budget balance, at least in the short-term.

The complete impact of inflation on public finances is expected to emerge with a time lag, due to the ex-post adjustment of wages and pensions of the public sector, the rising cost of purchasing goods, services and raw materials, and the indirect impact on households' purchasing power and subsequently on economic activity. In addition, the expiration of most pandemic-related economic support measures, which in 2021 amounted to approximately 2.9% of GDP, has a favourable impact on fiscal outcomes of 2022<sup>19</sup>.

The Russian invasion of Ukraine and most importantly the energy crisis and the subsequent increase in wholesale energy prices forced the government to take additional measures to protect consumers. Government measures to protect consumers and businesses from the adverse impact of the surge in prices are expected to reach around 0.7% of GDP in 2022<sup>20</sup>. Nevertheless, these are not capable to reverse the positive picture of public finances for 2022.

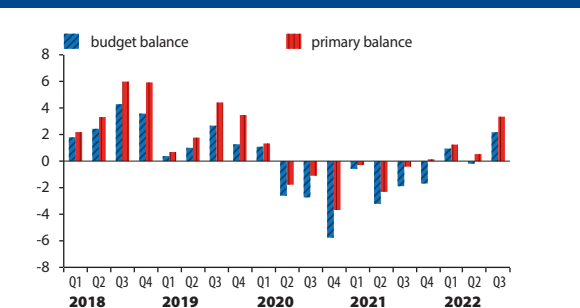
According to CyStat data, the budget surplus reached at 2,2% of GDP in the first nine months of 2022, compared with a budget deficit of 1,9% of GDP in the corresponding period of 2021 (Chart A.29 and Table A.11). The primary surplus reached at 3,3% of GDP for the same period, compared

19. The pandemic-related economic support measures are expected to amount to approximately 0,4% of GDP in 2022, and relate mainly to healthcare support.

20. Most of the support measures relate to reductions in indirect taxes on electricity (VAT reduction) and fuel (excise duty reduction), and electricity tariff subsidies. The latter provides a subsidy of electricity tariffs depending on consumption bands so as to maintain, to some extent, the incentive to reduce energy consumption. As stated in the June 2022 Economic Bulletin, the objective of supporting vulnerable households and businesses should be aligned with incentives to reduce the use of fossil fuels, while safeguarding the sustainability of public finances.

CHART A.29 Budget and primary balances of the general government

(cumulative for the year as from Q1 as a percentage of GDP)



Sources : Cystat, CBC.

Note: The budget and primary balance for 2018Q3 do not include the fiscal impacts of the measures associated with the Cyprus Cooperative Bank (CCB) (€1,5 billion).

TABLE A.11 Accounts of general government

	Jan. - Sep. 2021 (€ million)	Jan. - Sep. 2022 (€ million)	Change %
<b>EXPENDITURE</b>			
Intermediate consumption	663,4	803,7	21,1
Compensation of employees	2.087,8	2185,9	4,7
Social transfers	2.733,2	2971,9	8,7
Interest	353,9	321,4	-9,2
Subsidies	543,3	60,8	-88,8
Other current expenditure	444,1	451,3	1,6
Gross fixed capital formation	362,2	438,4	21,0
Other capital expenditure	94,0	139,5	48,4
<b>Total expenditure</b>	<b>7.281,9</b>	<b>7.372,9</b>	<b>1,2</b>
<b>Total expenditure as a % of GDP</b>	<b>30,3</b>	<b>26,8</b>	
<b>REVENUE</b>			
Taxes on production and imports	2.469,7	2.885,9	16,9
Current taxes on income, wealth, etc	1.626,5	2.005,3	23,3
Social contributions	1.938,4	2.218,1	14,4
Other current revenue	153,5	160,7	4,7
Sales	446,6	466,1	4,4
Capital transfers received	97,5	137,2	40,7
Property income	96,2	97,8	1,7
<b>Total revenue</b>	<b>6.828,4</b>	<b>7.971,1</b>	<b>16,7</b>
<b>Total revenue as a % of GDP</b>	<b>28,4</b>	<b>29,0</b>	
<b>Primary balance</b>	<b>-99,6</b>	<b>919,6</b>	
<b>Primary Balance as a % of GDP</b>	<b>-0,4</b>	<b>3,3</b>	
<b>Budget Surplus (+) / Deficit (-)</b>	<b>-453,5</b>	<b>598,2</b>	
<b>Surplus (+) / Deficit (-) % of GDP</b>	<b>-1,9</b>	<b>2,2</b>	

Sources: Cystat, CBC.

with a deficit of 0,4% of GDP in the corresponding period of 2021.

In detail, public revenue increased by 16,7% in the first nine months of 2022 compared with the corresponding period of the previous year, reflecting significant increases in all core revenue categories. Revenue from taxes on production, current taxes on income and social contributions increased by 16,9%, 23,3% and 14,4%, respectively, compared with the first nine months of 2021 (**Table A.11**, p. 52). The increase in revenue from taxes on production reflects the strong recovery in economic activity, as well as the impact of the increase in prices of goods and services, which did not seem to have a significant impact on aggregate demand in 2022.

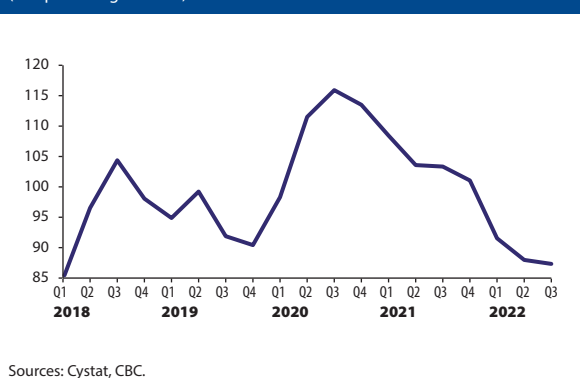
The increase in revenues from current taxes on income and social contributions reflects the improvement in the labour market and the increase in nominal wages; although this was to a lesser extent than the increase in consumer prices, resulting in less favourable impact for these revenue categories compared to the impact on taxes on production. Furthermore, due to the progressivity of the income tax system, the impact of wage growth on income tax revenue appears to be stronger than the impact on revenue from social contributions. Moreover, a significant increase in corporate tax revenues was recorded, reflecting favourable developments in firms' operating profits. In addition, it appears that structural factors continue to improve tax compliance, such as the Decree on the obligation to accept card payment methods, the implementation of the GHS and more effective tax audits.

Public expenditure recorded an increase of 1,2%, compared with the corresponding period of the previous year, reflecting the significant increase in social payments (8,7%) and to a lower extent the increase in intermediate consumption (21,1%), government investment (21%) and compensation of employees (4,7%) that continuous to be affected by the gradual restitution of public sector wages. The aforementioned increases were partly offset by the expiration of wage subsidisation schemes and direct subsidies to businesses and self-employed (**Table A.11**, p. 52, subsidies).

As regards government debt (**Chart A.30**), it stood at 87,3% of GDP in September 2022, recording a decrease of around 16 percentage points compared to September 2021. This is mainly due to the strong economic recovery and to a lesser extent the use of cash reserves to repay maturing debt.

Public debt-to-GDP ratio is expected to decline significantly in the coming years, reflecting the estimates for the continued recovery in economic activity and primary surpluses. It is noted that rating agencies expect a significant reduction in government debt; thus, any derailment will have a serious impact on the credibility of fiscal policy.

**CHART A.30 General government consolidated gross debt**  
(as a percentage of GDP)



## (C) Macroeconomic Forecasts for the Cyprus Economy<sup>21</sup>

21. Forecasts and assumptions have been prepared taking into account economic developments and available data until the 30th of November 2022.

- *Strong GDP growth by 5,8% is expected in 2022, due to the continued inflow of foreign companies and the ongoing recovery in tourism. A deceleration in growth is expected over 2023-2025 due to the earlier than expected economic recovery and the worsening of the external environment.*
- *The GDP trajectory over 2022-25 is mainly driven by the recovery of domestic demand and, to a lesser extent, from net exports.*
- *A relatively limited impact in the labour market owing to Russia's invasion of Ukraine is expected, with unemployment continuing to decline in the coming years, reaching 5,5% in 2025.*
- *A sharp rise in inflation is foreseen for 2022, driven mainly by significant increases in energy prices and the broadening of inflationary pressures in other categories, partly due to ongoing problems in supply chains. A partial correction is expected in 2023, driven by the gradual decline in oil and food prices, while in 2024 and 2025 inflation is expected to hover close to the 2% target.*
- *Relative to the baseline scenario, risks to GDP are slightly to the downside and for inflation slightly to the upside risks over 2023-25.*

The macroeconomic forecasts presented in this *Economic Bulletin* were prepared in the context of the Eurosystem's forecast exercises using common assumptions. Despite Russia's ongoing invasion of Ukraine and the energy crisis, the recovery path of the Cyprus economy has not been adversely affected to a large extent so far. However, given the expected deterioration in the



external environment and the only gradual normalisation of inflationary pressures, a notable impact on GDP growth is forecasted for 2023, with a slight pick-up in growth over 2024-25. Compared with the June 2022 forecasts, the common assumptions in the updated projections are partially differentiated as follows:

First, problems in supply chains are relatively shorter-lived than previously envisaged. In particular, full normalisation of supply chain problems is expected in mid- as opposed to end-2023.

Second, the projections take into account the downward revision of the external environment, as a result of Russia's ongoing invasion of Ukraine and the energy crisis in Europe.

The CBC's updated GDP forecasts have been revised upwards for 2022 (by 3,1 percentage points), due to the better than expected results in trade and tourism-related activities as well as the continued inflow of foreign companies, particularly in the technology sector. For 2023-24, the downward revision in growth amounts to 1,1 and 0,6 percentage points, respectively, owing to the earlier than previously expected recovery and the worsening in the external environment. The downward revision in 2024 is relatively small, given the significant support to economic activity expected from the absorption of the EU's Recovery and Resilience Fund (RRF).

Regarding inflation, the CBC's updated HICP forecasts point to a significant upward revision for 2022 and, to a lesser extent, for 2023 (by 1,1 and 0,5 percentage points,

respectively), while a small downward revision (by 0,2 percentage points) is expected for 2024. The revisions in 2022 are mainly due to the significant increases in energy prices, as well as the broadening of inflationary pressures in the categories of food, services and to a lesser extent industrial goods excluding energy. A slightly faster than previously envisaged normalisation of inflationary pressures in mid-2023 is foreseen due to a gradual correction of supply chain bottlenecks and the expected decline in oil prices. The revision for 2024 is due to the downward revision of energy prices.

### Economic Activity

GDP is expected to register significant growth in 2022 by 5,8% (**Table A.12**), following a strong rise by 6,6% in 2021. This is driven by the better than expected performance of the trade and tourism-related sectors, as well as the significant influx of foreign companies to the island. The projected economic growth is supported by a rise in domestic demand, while a negative contribution is expected from net exports, as a result of the increase in imports in view of the strong domestic demand path and despite the significant recovery in tourism.

Domestic demand is foreseen to demonstrate resilience owing to the pipeline of ongoing investment projects as well as the utilisation of savings. Specifically, the significant 7,8% rise projected in private consumption for 2022 is due to the relative resilience recorded in consumer sentiment following the deterioration observed with the

**TABLE A.12 National accounts projections in real terms**  
(annual change, %)

	2021	2022f	2023f	2024f	2025f
GDP	6,6	5,8	2,5	3,1	3,1
Private consumption	4,5	7,8	1,9	1,9	2,1
Public consumption	6,6	3,7	1,1	2,5	1,9
Gross fixed capital formation	-4,2	6,9	3,1	6,5	6,2
Exports of goods and services	13,6	12,5	3,5	3,0	2,8
Imports of goods and services	9,0	16,3	2,9	2,8	2,5

Sources: Cystat, CBC.

outbreak of Russia's invasion of Ukraine, and despite the large price increases that lead to a drop in the level of real disposable income (**Table A.12**, p. 58). The utilisation of savings significantly support private consumption, as is the case with the fiscal measures aimed at alleviating consumers' energy bills and which amount to around 0,5% of GDP. Gross fixed capital formation is expected to register an annual increase of 6,9% in 2022 owing to a base effect, with a slowdown in the relevant growth rate compared to 2021 expected when the data is adjusted for the impact of Special Purpose Entities (SPEs). This is driven by the contraction in residential investments, owing to a compression in housing demand as a result of the significant rise in construction costs, which is offset by the continued implementation of large and multi-year infrastructure projects by the private sector (**Table A.12**, p. 58). The deceleration in public consumption growth to 3,7% is mainly due to a base effect owing to increased spending in 2021 for the purchase of health services by the GHS.

Exports of goods and services are expected to rise by 12,5% in 2022 (**Table A.12**, p. 58), mainly as a consequence of the significant growth in ICT services exports (see Balance of Payments), which actually exceed the revenues from tourism. The better than expected recovery path of the tourism sector compared with the June 2022 forecasts should be noted, with the loss of Russian tourists largely covered by markets such as the United Kingdom as well as European markets, which have shown significant momentum (see Balance Payments). The rise

in exports of financial and other business services also contributes to the rise in total exports. The significant increase in imports of goods and services by 16,3% (**Table A.12**, p. 58) reflects the path in the volume of imports relating to petroleum products and goods for private consumption and investment, in the context of pent-up demand, as well as the rise in the volume of services imports needed to provide the respective exports. The increase in imports (as well as exports) of services reflects the significant influx of foreign companies to the island as mentioned above.

GDP growth is expected to slow down to 2,5% in 2023 and to 3,1% per annum over 2024-25 (**Table A.12**, p. 58), driven by the continued, albeit decelerating, recovery in domestic demand and net exports, especially for 2023. A significant slowdown in private consumption is forecasted to around 2% per annum in the period 2023-25 (**Table A.12**, p. 58), owing to a base effect and the projected gradual rise in the savings rate above the average observed before the health crisis. This reflects the need to repay loans. Gross fixed capital formation, following a projected slowdown to 3,1% in 2023 owing to the impact of the adverse external environment, is expected to register strong growth of 6,5% and 6,2% in 2024 and 2025, respectively, due to new projects to be financed by the RRF, the gradual completion of large and multi-year infrastructure projects that are ongoing, as well as the commencement of new infrastructure projects (**Table A.12**, p. 58). These projects cover the sectors of energy, tourism and

transport, and include the casino-resort as well as the marina and port in Larnaca. A further slowdown in public consumption to 1,1% is expected in 2023 due to a base effect in intermediate consumption, which largely offsets the rise in wages mainly due to the impact of the automatic cost of living adjustment (COLA). A further rise by 2,5% and 1,9% is expected in 2024 and 2025, respectively, mainly owing to the increases in public sector wages. It should be noted that the gradual restitution of wages in the public sector will be completed in 2023 (see Labour Costs), while a further increase in contribution rates towards the Social Insurance Fund will be implemented in 2024.

Net exports are expected to contribute positively to GDP growth in the coming years, especially in 2023. Exports are forecasted to register an increase of 3,5% in 2023, 3% in 2024 and 2,8% in 2025 (**Table A.12**, p. 58), with a particular contribution from ICT services, financial services as well as tourism. Due to uncertainty regarding the course of Russia's invasion of Ukraine as well as the impact of inflationary pressures on the disposable income of tourists from the main markets, full normalisation of the tourism sector is envisaged in 2024, and despite the better than expected results for 2022. The foreseen recovery in tourism is also linked to the expected operation of the casino-resort<sup>22</sup>. Total imports are expected to increase by 2,9% in 2023, 2,8% in 2024 and 2,5% in 2025, in line with the domestic demand path (**Table A.12**, p. 58).

22. The operation of the casino-resort is expected in 2023Q2, with only a partial effect of its operation in the years 2023 onwards included, as in previous forecasts.

## Compensation, productivity and the labour market

So far, the available quantitative data point to a relatively limited impact of Russia's invasion of Ukraine on the Cypriot labour market, which is consistent with European Commission qualitative indicators of firms' employment expectations. Employment is projected to grow by 1,9% in 2022 and slow to 0,9% in 2023, in line with the deceleration in GDP. In the years 2024-25, an increase by approximately 1,3% per annum is expected (Table A.13).

Unemployment is expected to decline to 6,7% of the labour force in 2022, from 7,5% in 2021. It is projected to decline further in the coming years, with unemployment converging ever closer to full employment conditions, reaching 5,5% in 2025. The slight upward revision of the unemployment rate for the years 2023 and 2024 relative to the June 2022 projections is consistent with the downward revision of GDP, with a continued economic recovery nonetheless.

An increase by 4,8% is expected in nominal compensation per employee in 2022, following a 3,8% increase in 2021 (Table A.13). A significant rise by 7,5% is envisaged in 2023, while increases of 4,7% and 4,4% are foreseen in 2024 and 2025, respectively, reflecting the granting of higher COLA which is based on the previous year's inflation as well as the relatively larger increases that are envisaged in collective agreements owing to the path of prices. The ongoing correction in the labour market, converging closer to full employment conditions in 2025, does not lead to a wage-

**TABLE A.13 Labour market projections**

(annual change, %, unless otherwise indicated)

	2021	2022f	2023f	2024f	2025f
Compensation per employee	3,8	4,8	7,5	4,7	4,4
Unit labour costs	-1,4	1,0	5,7	2,9	2,6
Productivity	5,3	3,8	1,7	1,8	1,8
Total employment	1,3	1,9	0,9	1,3	1,3
Unemployment rate(% of labour force)	7,5	6,7	6,5	5,9	5,5

Sources: Cystat, CBC.

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price spiral, despite the incorporation of higher wage increases.

Productivity growth, following a significant recovery by 5,3% in 2021 due to a base effect and the effects of the pandemic, is projected to continue its recovery, registering an increase of 3,8% in 2022, with smaller growth rates expected in the period 2023-25 by approximately 1,8% per annum (**Table A.13**, p. 62).

Unit labour costs are foreseen to register a further increase in the period 2022-25 by approximately 12 percentage points in cumulative terms (**Table A.13**, p. 62), mainly due to the projected increases in nominal compensation per employee. A relatively similar cumulative rise is expected to be recorded in the relevant eurozone index. However, unit labour costs in Cyprus maintain a comparative advantage in relation to the rest of the eurozone due to past reductions in wages and, by consequence, due to the improvement in competitiveness (see Labour Costs).

## Inflation

HICP inflation is expected to reach 8,1% in 2022 compared with 2,3% in 2021 (**Table A.14**), mainly a result of the steep increases in energy prices but also due to the broadening of inflationary pressures in the categories of services, food and, to a lesser extent, non-energy industrial products owing to ongoing problems in supply chains. At the same time, core inflation is forecasted to reach 5% in 2022 compared with 1,3% in 2021.

In the period 2023-25, HICP inflation is expected to slow to 3,3%, 1,7% and 1,8%,

**TABLE A.14 HICP projections**  
(annual change, %)

	2021	2022f	2023f	2024f	2025f
HICP	2,3	8,1	3,3	1,7	1,8
HICP excluding energy and food	1,3	5,0	2,9	2,2	2,1

Sources: Cystat, CBC.

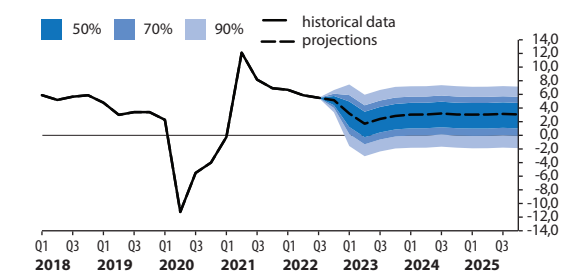
respectively, affected by the gradual correction in energy prices, according to the working assumptions for oil and food prices. Core inflation is forecasted to reach 2,7%, 2,2% and 2,1% in the period 2023-25, respectively, in the context of a gradual normalisation of inflationary pressures in the other subcategories of the HICP due to the gradual correction of supply chains problems.

### Risk assessment of macroeconomic forecasts<sup>23</sup>

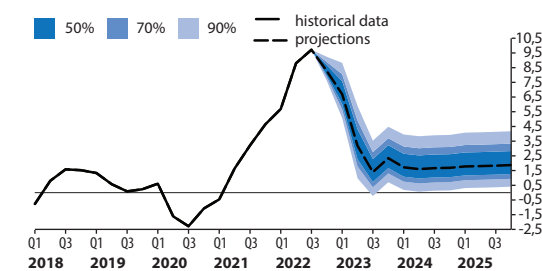
The expected GDP path (Table A.12), as well as the HICP and the core inflation projections (Table A.14) represent the baseline scenario. The probabilities of deviating from the baseline scenario for GDP and HICP are outlined in **Charts A.31** and **A.32** respectively. Possible deviations in the forecast of core inflation are presented in **Chart A.33**. A summary of the risk assessment relating to possible deviations from the baseline scenario is presented in **Table A.15** (p. 65).

The risks of deviation of the GDP forecasts from the baseline scenario for the period 2023-25 are assessed overall to be tilted slightly to the downside. Downside risks include a worse than expected outlook for the external environment as well as larger and/or more persistent lagged effects from elevated energy prices. Domestic risks include tighter than anticipated financing conditions, which may affect domestic demand. They are also associated with a negative impact from possible materialisation of a wage-price spiral, for the years 2024-25 in particular. Downside risks are also associated with a lower than

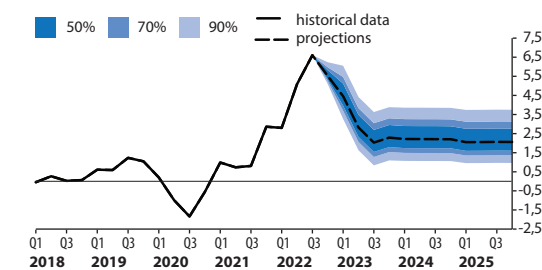
**CHART A.31 Real GDP fan chart**  
(annual change, %)



**CHART A.32 HICP fan chart**  
(annual change, %)



**CHART A.33 HICP excluding energy and food fan chart (core inflation)**  
(annual change, %)



23. For further information regarding the methodology of the risk assessment of macroeconomic projections, see *Economic Bulletin*, June 2015, p. 6.



expected impact from absorption of funds available for investments under the RRF. Upside risks include a higher than expected performance in services exports, due to the continued influx of foreign companies to the island, particularly in the technology and non-bank services sectors.

Risks to HICP inflation for the period 2023-25 are assessed overall to be slightly on the upside. Upside risks mainly emanate from larger and/or more persistent lagged effects from elevated energy prices. More broadly, upside risks may arise from higher than expected demand-side pressures. For the years 2024-25 in particular, a possible wage-price spiral as well as possible higher long-term inflation expectations constitute the main upside risk. Downside risks are associated with less favourable than expected financing conditions via the negative impact on domestic demand. Finally, risks to the baseline scenario for core inflation are also assessed to be slightly on the upside, as is the case with HICP inflation.

TABLE A.15 Summary of risk assessment

Risk	GDP (2023-2025)	Inflation (2023-2025)
Lower than expected impact from absorption of funds from EU support package	-	-
Larger and/or more persistent lagged effects from elevated energy prices	-	+
Worse than foreseen impact on domestic economic outlook as a result of external environment developments	-	-
Better than foreseen impact on services exports despite the ongoing Russian-Ukrainian war	+	+
Possible materialisation of a wage-price spiral	-	+
Tighter than foreseen financing conditions	-	-
<b>Overall assessment</b>	-	+

Source: CBC.

Note: the following symbols cover the spectrum of risks: ++, +, =, -, --.

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### (A) Domestic monetary aggregates (deposits and credit growth)

All monetary aggregates' data exclude the CBC.

On 1 July 2008, a new definition of residents of Cyprus entered into force (Statistical Purposes Directive, 2008). As a result, MFIs reclassified a large number of organisations or customers' businesses with limited or no physical presence in Cyprus, known as 'special purpose entities (SPEs)', from non-residents to residents. The effect of this change is excluded from the monetary and financial statistics series presented in this publication, which reports domestic residents data excluding SPEs. For purposes of normalisation and comparability of monetary time series, data have been further processed by the CBC's Economic Analysis and Research Department.

The calculation of annual percentage changes is based on the methodology used by the ECB. More specifically, the growth of monetary aggregates is calculated based on the monthly differences in outstanding amounts adjusted for amounts that do not arise from transactions, such as reclassifications/other adjustments, revaluation adjustments and exchange rate adjustments, so as to reflect changes due to net transactions.

The above methodology has been adopted since the December 2009 edition of the *Economic Bulletin*. In previous editions of the *Bulletin*, the growth rate of monetary variables was calculated as the annual

percentage change of outstanding balances at the end of the period. Details of the methodology can be found in the *Monetary and Financial Statistics*, published by the Statistics Department of the CBC, which is available on the CBC website.

### (B) Balance of Payments

The present statistical collection system adopted as of June 2014, is based on the methodology of International Monetary Fund (BPM6), which has also been adopted by the EU, as well as on additional requirements and the level of detail required by both the Statistical Service (Eurostat) and the European Central Bank (ECB).

The adoption of BPM6 by the external statistics of the Cyprus took place in June 2014. In October 2014 was the first publication of the data. The published data for BoP, IIP and external debt cover the period from 2008 to date.

The application of new manuals provided the opportunity to adopt broader changes and revisions to improve the coverage and quality of the statistics of the external sector. Specifically, in addition to the incorporation in all external statistics produced and published of the special purpose entities that are registered / incorporated in Cyprus, the CBC has also upgraded the collection systems and compiling statistics of the external sector, giving greater emphasis to the application of new research and the use of available administrative sources.

## (C) National Accounts

In June 2014 Cystat implemented the new statistical standards for the historical data series since 1995. The ESA 2010 replaces ESA 1995 and is based on the System of National Accounts (ESA) 2008 which is in the process of being implemented worldwide. The aim is to adapt the national accounts to the current economic environment, advances in methodology and changing user needs. Regarding the sectoral classification, ESA 2010 provides a clearer separation between non-financial corporations and corporations that are not directly engaged in the non-financial activities. In particular, holding companies of non-financial corporations and other so-called captive financial institutions as well as certain Special Purpose Entities (SPEs) are now classified under a new category. In parallel, the investment funds sector is now separated from the remaining part of other financial intermediaries and insurance companies are shown separately from pension funds. The ESA 2010 has also adopted changes to the financial accounts.

More details on the methodology of compiling the balance of payments and the national accounts are available in Box 1, p. 51, of the December 2014 *Economic Bulletin* and on the website of the CBC.