



CENTRAL BANK OF CYPRUS

ECONOMIC BULLETIN

JUNE 2024

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Macroeconomic
Forecasts for the
Cypriot Economy

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ABBREVIATIONS

BLS	Bank Lending Survey	IIP	International Investment Position
CA	Current Account	LFS	Labour Force Survey
CBC	Central Bank of Cyprus	MFIs	Monetary Financial Institutions
COLA	Cost of Living Allowance	NACE	Statistical classification of economic activities in the European Union
Cystat	Statistical Service of the Republic of Cyprus	NFCs	Non-Financial Corporations
DLS	Department of Lands and Surveys	NGEU	Next Generation EU
ECB	European Central Bank	NPFs	Non-Performing Facilities
ESI	Economic Sentiment Indicator	RPPI	Residential Property Price Index
EU	European Union	RRF	Recovery and Resilience Fund
EURIBOR	Euro Interbank Offered Rate	SDW	Statistical Data Warehouse
Eurostat	Statistical Office of the European Union	SPEs	Special Purpose Entities
GDP	Gross Domestic Product	SSF	Social Security Fund
HICP	Harmonised Index of Consumer Prices		

Governor Introduction

The Cypriot economy continues to exhibit remarkable growth, demonstrating resilience and positive prospects in a global economic environment filled with challenges.

In the first quarter of 2024, the Gross Domestic Product (GDP) growth rate exceeded expectations, while unemployment dropped to 6%, the lowest level since 2009. Domestic inflation declined to 2.2% in the first five months of the year, close to the ECB's medium-term target of 2%, showing a significant improvement compared to 5.4% in the same period of the previous year. Additionally, the fiscal surplus in 2023 was the highest recorded since 2007.

The recent upgrades of Cyprus' credit rating by Credit Rating Agencies confirm the upward trajectory of the economy. In their evaluations, the rating agencies noted the improvement in fiscal performance, the strong economic growth, and the robustness of our banking system. The positive performance of Cyprus' economy is also reflected in recent reports by the International Monetary Fund and the European Commission.

Domestic Economic Developments

According to the latest available data, the GDP recorded a higher-than-expected annual growth of 3.5% in the first quarter of 2024. This reflects, among other factors, the gradual normalisation of the economic impact from the ongoing sanctions against Russia and the limited impact from the conflict in the Middle East.

The GDP growth for 2024 is expected to reach 3%, compared to 2.5% in 2023, primarily driven by investments and private consum-

ption. Exports are anticipated to grow at a slower pace than imports, due to the ongoing Russia-Ukraine war impact on professional services, even though the impact is constrained, and the expected loss of Israeli tourists. However, these effects are expected to wane in the medium term, supporting growth through market diversification for tourism, financial, and professional services. Additionally, the growth in turnover of foreign interest companies in the technology sector that have established operations in Cyprus in recent years will continue to support GDP.

According to the latest Central Bank of Cyprus (CBC) forecasts of June 2024, GDP growth is projected to be 3.1% and 3.2% for 2025 and 2026, respectively. Over the 2024 to 2026 period, the projected GDP growth is primarily driven by domestic demand, which will be supported by an increase in households' real disposable income due to the expected reduction in inflation, rising wages, and labour market resilience. Significant contributions are expected from large private investments and projects focused on digital and green development, as well as reform projects under the Recovery and Resilience Plan. No substantial negative impact on investments is anticipated from the conflict in the Middle East. Although private consumption is expected to increase at a slower pace, it will remain a key driver of economic growth due to labour market resilience and the recovery of real disposable income.

Inflation (HICP) in Cyprus, according to the latest CBC forecasts as of June 2024, is expected to decline to 2.1% in 2024, compared to 3.9% in 2023. This decline mainly reflects developments in energy prices, the continued lagged effect of the ECB's single (restrictive) monetary policy, and the easing of inflationary pressures from

past supply chain disruptions. Further reductions in HICP are projected to 1.9% and 1.8% for 2025 and 2026, respectively. The expected trajectory of HICP is anticipated to enhance citizens' purchasing power and create a more favourable environment for businesses and economic growth. Core inflation is also expected to decrease further compared to 2023 (3.8%), reaching 2.5%, 2.1%, and 2.0% for 2024, 2025, and 2026, respectively. This is primarily due to the continued impact of the euro area's single monetary policy and the normalisation of external inflationary pressures.

Developments in the banking sector

Despite the continuous challenges, the Cyprus banking system continues its positive course, which is reflected in the main supervisory indicators. The Common Equity Tier 1 ratio at the end of the first quarter of 2024 stood at 21,5%, compared to the European ratio which was 15,9% in March 2024, while the Liquidity Coverage Ratio stood at 341% in March 2024, a rate much higher than the minimum supervisory requirement. At the same time, the Non-Performing Loans (NPLs) continue to decline, with their percentage, as to the banks' consolidated loan portfolio, standing at 7,3% at the end of March 2024.

In addition, as a result of the increased interest rates, the Banks continue to report an increase in their profitability in the first quarter of 2024. A substantial part of this resulting from the excess liquidity of banks being placed with the ECB. In particular, during the three months ending 31 March 2024, the Cyprus banking system reported profits of €345m.

Despite this remarkable performance, there is no room for complacency as the banking system is faced with an increased number of risks that also require appropriate management. The geopolitical developments, the climate change as well as the important and unpredictable sector of technology, constitute key supervisory priorities in the recent years which Banks need to manage in order to preserve their strength, resilience and competitiveness. To this end, the further strengthening of corporate governance is a key prerequisite.

Conclusion

The Cypriot economy remains robust and competitive, due to the continuous improvement of the services sector, the attraction of foreign investments, the support for small and medium-sized enterprises, the prudent fiscal management, and the positive progress observed in the banking system. To ensure stable and flexible growth trajectory, the continuation of structural changes under the Recovery and Resilience Plan is essential. These include digitalisation in public administration, improvement of the educational system, and promotion of green development. These reforms will enhance competitiveness, create new job opportunities, and ensure sustainable growth for future generations.

Christodoulos Patsalides
Governor
Central Bank of Cyprus

(A) Domestic Environment

- In 2024Q1, the Cyprus economy recorded a stronger-than-expected annual GDP growth of 3,5%, exhibiting resilience and flexibility to negative external factors.
- During the first four months of 2024, domestic inflation (HICP) continued, on an annual basis, its decelerating course.
- In April 2024, HICP inflation reached 2,1%, while core inflation (inflation excluding energy and food prices) to 1,8%.
- Residential property prices increased on a year-on-year basis by 7,8% in 2024Q1, recording small deceleration compared with previous quarter.
- The labour market continues to demonstrate resilience despite geopolitical tensions.
- Moderation in the domestic private sector deposits annual growth was recorded since the second half of 2023 and throughout the first quarter of 2024, yet remaining positive.
- Loans to the domestic private sector continued to record negative annual growth rates, suggesting increased loan repayments amid tighter financial conditions.
- Domestic average lending rates stabilised in the first months of 2024 at the high levels prevailed in 2023, following the increases recorded over the previous year and a half.
- Deposit rates remained relatively stable in the first quarter of 2024, following the upward trend recorded mainly in the second half of 2023.
- The government budget balance recorded a surplus of 1,8% of GDP in the quarter of 2024, compared with a surplus of 1,3% of GDP in the respective period of 2023.
- The government debt-to-GDP ratio declined in March 2024 compared to its level in

March 2023, due to the continued economic growth and the relative strong primary surplus.

1. Economic Activity

According to the most recent preliminary data published by Cystat that was available at the relevant cut-off date of this *Economic Bulletin*, in 2024Q1 GDP recorded a stronger-than-expected year-on-year growth, reaching 3,5%, exhibiting a gradual normalisation of the economic impact of the ongoing sanctions against Russia and the limited impact from the Middle East conflict.

The available analytical data for 2023 point to a slowing GDP recovery, reaching 2,5%, following an increase of 5,1% in 2022 (Table 1). GDP growth in 2023 was driven mainly from the rise in domestic demand, and primarily from private consumption and to a lesser extent from investment, with the annual growth rates reaching 4,2% and 4,4%, respectively. The rise in the real disposable income of households and the continued implementation of large private investment projects contributed positively to GDP growth. Also, increases were recorded in public investment and public consumption, due to the rise in compensation of public employees (see part 6 - Fiscal Developments). It should be noted that net exports contributed negatively to GDP growth as a result of: a) the decrease in the exports of financial services, due to the sanctions against Russia, that surpassed the ongoing increase in tourist revenues (see part 4 - Balance of Payments) and b) to the simulta-

TABLE 1 GDP by expenditure category
(real terms, annual change, %)

	2019	2020	2021	2022	2023
GDP	5,5	-3,4	9,9	5,1	2,5
Private consumption	3,9	-6,4	5,6	8,6	4,2
Public consumption	12,2	11,1	7,6	3,1	2,3
Gross fixed capital formation (GFCF)	6,9	5,7	0,0	8,3	12,5
GFCF excl. ships and airplanes	12,7	-0,2	10,4	7,1	4,4
Exports of goods and services	8,7	1,6	21,6	13,6	-1,2
Imports of goods and services	9,5	3,2	15,4	18,3	1,7

Source: Cystat.

neous rise in the imports of goods for home consumption and investments (see part 4 - Balance of Payments).

From a sectoral perspective, the GDP recovery in 2023 (Table 2) emanated mainly from increased activity in the sectors of trade, transportation, hotels and restaurants with a contribution of 1,3 percentage points, linked to the rise in private consumption and developments in tourism. A smaller contribution came from the information and communication sector (0,5 percentage points), supported by the expansion of companies of foreign interests in the technology sector. The manufacturing and the construction sectors also contributed positively (by 0,1 and 0,2 percentage points, respectively). On the contrary, the sectors of professional and financial services contributed negatively (each sector by -0,1 percentage points) due to the sanctions, albeit a gradual normalisation was recorded in 2023, due to the diversification of the relevant exports towards other markets.

The latest available soft data for 2024Q2 point towards positive developments in GDP. As captured by the Economic Sentiment Index (ESI) (Chart 1) as well as its sub-indicators (Table 3), the Cyprus economy exhibits resilience, with limited impact from the Middle East conflict. Specifically, the ESI in the period April to May 2024 reached 103,4, very close to 102,7 in 2024Q1 (Table 3). According to the underlying sub-indicators (Table 3), consumer confidence deteriorated, while business confidence in construction registered an improvement.

TABLE 2 GDP by economic activity
(weighted contribution to the overall annual change, percentage points)

	2019	2020	2021	2022	2023
GDP (%)	5,5	-3,4	9,9	5,1	2,5
Construction	0,8	-0,3	0,1	-0,2	0,2
Trade, transportation, hotels and restaurants	0,9	-6,5	5,2	2,4	1,3
Information and communication	1,2	1,4	1,4	1,5	0,5
Financial and insurance activities	-0,2	2,4	1,4	0,2	-0,1
Professional, scientific and administrative activities	0,8	-0,2	0,8	0,4	-0,1
Other sectors ⁽¹⁾	2,2	-0,1	1,1	0,7	0,7

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

CHART 1 Annual GDP growth and Economic Sentiment Indicator index



Sources: Cystat, European Commission.
Note: Data for 2023Q2 refer to the months of April and May.

TABLE 3 Business and consumer surveys: confidence indicators
(for sub-indices: difference between percentage of positive answers and percentage of negative answers, period average)

	2023 Q1	2023 Q2	2023 Q3	2023 Q4	2024 Q1	2024 Apr.-May
ESI	105,4	105,0	105,4	104,4	102,7	103,4
Industry	-2,5	0,7	2,0	-0,9	-2,3	0,2
Services	24,9	21,0	25,6	23,9	17,5	18,7
Consumer	-19,2	-23,7	-24,7	-25,3	-24,3	-26,1
Retail trade	-0,7	1,1	2,0	-0,2	-2,8	-4,8
Construction	-15,6	-12,4	-9,6	-2,6	-4,2	-1,7

Source: European Commission.
Note: Seasonally adjusted data.

2. Prices

Inflation

The domestic Harmonised Index of Consumer Prices (HICP) reached 2,1% in April 2024 compared with 1,6% in March 2024 and 3,9% in April 2023. The increase in April 2024 compared with March is mainly due to the withdrawal of government mitigating measures in April 2024 (Table 4). Regarding the period January-April 2024, HICP inflation decelerated to 2% compared with 5,9% in the corresponding period of 2023 (Chart 2a and Table 4). The downward course of HICP inflation during the first four months of 2024 is mainly driven by the impact of the single monetary policy of the ECB for the euro area countries which continues to exert a lagged dampening effect along with the developments in energy and non-energy industrial goods prices as well as due to domestic government mitigating measures.

More analytically, during the period January-April 2024, energy prices (Chart 2b) registered, on average, an annual decrease of 0,7% compared with an annual increase of 9,2% during the corresponding period of 2023 (Table 4) mainly on account of the government mitigating measures related to main fuels and electricity prices until March 2024. At the same time, non-energy industrial goods “NEIG” prices also recorded an annual decrease of 0,2% during the first four months of the year compared with an annual increase of 6% in the corresponding period of 2023 mainly attributed to the substantial normalisation of exogenous inflationary pressures

TABLE 4 Inflation in Cyprus

(annual change, %)

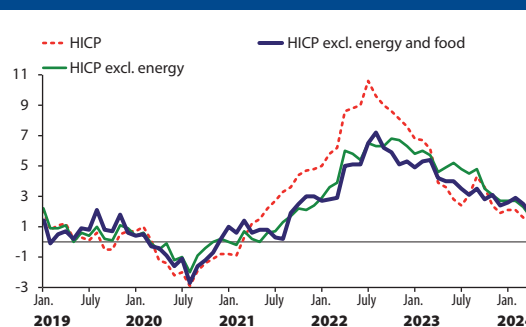
	Weights ⁽¹⁾	Jan.-Apr. 2023	Jan.-Apr. 2024	Apr. 2023	Mar. 2024	Apr. 2024
HICP	1000,00	5,9	2,0	3,9	1,6	2,1
Total Food prices,						
of which:	222,41	6,9	2,1	5,8	1,8	1,3
(i) Unprocessed food prices	50,08	-1,4	2,2	-2,2	3,1	-0,5
(ii) Processed food prices	172,33	9,6	2,1	8,4	1,5	1,9
Energy prices	101,71	9,2	-0,7	-1,7	-3,9	6,4
Services prices	444,42	4,4	3,8	3,4	4,2	2,9
Non-energy industrial goods prices	231,47	6,0	-0,2	5,7	-0,6	-0,4
HICP excluding energy	898,29	5,5	2,3	4,6	2,3	1,6
HICP excluding energy and food	675,88	5,0	2,4	4,2	2,5	1,8

Source: Eurostat.

(1) Based on the weight for 2024.

CHART 2a Inflation in Cyprus (HICP)

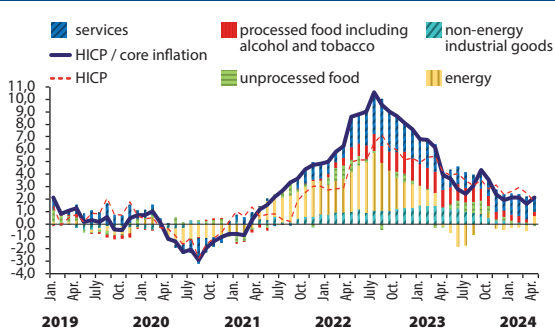
(annual change, %)



Source: Eurostat.

CHART 2b Contributions of HICP components to overall domestic HICP inflation

(annual percentage changes, percentage point contributions)



Sources: Eurostat and CBC calculations.

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that affected domestic prices in the last years and the dampening effect of the single monetary policy of the ECB on demand. Food prices (processed and unprocessed food prices) recorded a significant slowdown, registering a yearly increase of 2,1% during the period January-April 2024 compared with a yearly increase of 6,9% during the corresponding period of 2023 (Table 4, p. 14) mainly related to the domestic government mitigating measures associated with the main food sub-categories. Finally, during the period January-April 2024, services prices, albeit registered a deceleration, remained at high levels, recording an annual increase of 3,8% compared with an annual increase of 4,4% in the corresponding period of 2023 (Table 4, p. 14). Domestic demand (especially the private consumption), the increases in wages and profit margins for firms are factors that still maintain services prices at high levels.

Regarding domestic inflation excluding energy and food prices (core inflation), this registered, on average, a yearly increase of 2,4% during the period January-April 2024 compared with, on average, 5,0% in the corresponding period of 2023 (Chart 2a, p. 14 and Table 4, p. 14) mainly due to the aforesaid developments in NEIG prices. In April 2024, core inflation slowed down significantly to 1,8% compared with 2,5% in March 2024 and 4,2% in April 2023.

Construction sector and real estate prices

During the first four months of 2024 the demand for real estate, as reflected in the number of sales contracts of DLS, continued to be at high levels. According to these data,

transactions of real estate in Cyprus recorded an annual increase of 4,1% during the first four months of 2024. This increase reflects an annual increase of 19,8% and 13,3% in sales to locals and foreign buyers, respectively (Table 5). The deceleration in the growth rate of total transactions stems from the decrease in transactions from foreigners (Chart 3). The Building Sentiment Indicator over the first four months of 2024 (Table 5) remains at a lower negative level compared with the respective period of 2023.

Even though demand for real estate from locals continues to increase, this trend does not seem to be supported that much from lending, given that new housing loans are decreasing, as a result of the increase in the mortgage interest rates. Specifically, according to the Monetary and Financial Statistics of CBC, during the first four months of 2024, new housing loans decreased by 7,4% on average, compared with the respective months of 2023, while the average mortgage interest rate during the first four months of 2024 increased by 5%, compared with 3,9% in the respective months of 2023.

Residential property prices in Cyprus continued their upward trend during 2024Q1 (Chart 4), albeit at a decelerating trend. Specifically, according to available data of CBC's RPPI, in 2024Q1 residential property prices recorded an annual increase of 7,8% compared with 8,3% in 2023Q4. Apartment prices recorded higher annual increase in 2024Q1 (13,9%) compared with house prices (4,7%), which reflects the higher demand for apartments¹. As far as the

1. Greater analysis for real estate transactions by type and district is available in the quarterly reports of Residential Property Price Index of CBC, which is published in CBC's website. For example, Chart 6 in the published report of RPPI for 2023Q4, indicates the greater demand for apartments compared to houses.

TABLE 5 Real estate sector

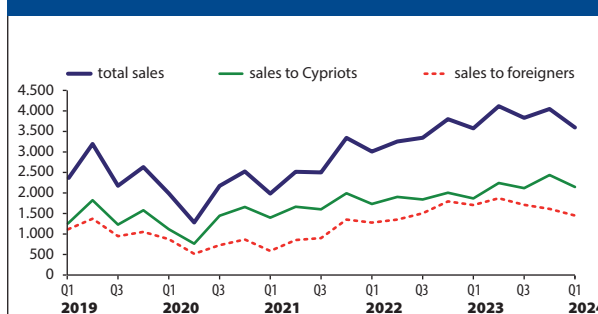
(annual change, %, unless otherwise stated)

	Jan.-Apr. 2022	Jan.-Apr. 2023	Apr. 2022	Mar. 2023	Apr. 2023
Sales contracts (total)	20,8	4,1	27,1	-7,0	14,6
Sales contracts (locals) ⁽¹⁾	8,9	19,8	12,0	8,1	34,4
Sales contracts (foreigners)	37,3	-13,3	50,3	-24,0	-8,1
Building sentiment indicator (average of index)	-14,9	-2,8	-12,8	1,4	-4,7
Property price expectations for the next 3 months (average of index)	79,2	61,5	74,2	65,6	64,0
Price index of construction materials	7,4	-1,9	2,8	-1,7	-1,6

Sources: Cystat, DLS, European Commission.

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

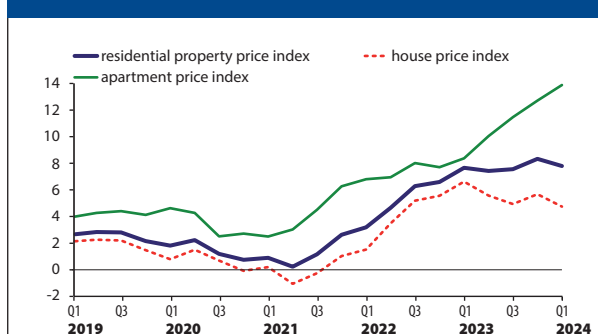
CHART 3 Number of sales contracts



Source: Department of Lands and Surveys.

CHART 4 House and Apartment price indices

(annual change, %)



Source: CBC.

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construction cost is concerned, the price index of construction materials, which is published by CYPSTAT, recorded a decrease of 2% on an annual basis in the first four months of 2024 (Chart 5 and Table 5, p. 16), thus relieving to some extent the upward pressure on property prices.

The index of property price expectations for the next three months, which is published in the Business and Consumer Survey of the European Commission, was at lower levels over the first four months of 2024 compared with the respective months in 2023 (Chart 5 and Table 5, p. 16), reflecting the decreased expectations for continued increases in property prices.

Labour Costs

Labour costs (compensation per employee) in 2023 continue to recover, mainly due to a 5.3% increase in labour costs per hour.

The nominal compensation per employee increased by 5.4% in 2023, following 1.1% increase in the previous year (Chart 6). Private sector expenditure increased by 3.7%, mainly due to salary increases in trade, transportation, hotels, and restaurants, and to a lesser extent in the professional and financial sectors. The public sector recorded a larger increase of 10.5%, mainly due to the payment of the Cost of Living Allowance (COLA) and the final stage of the restitution of public sector wages, which were implemented in December 2022.

The real compensation per employee² recorded an increase of 2.4% in 2023, after a decrease of 5.1% in 2022, due to the significant

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

CHART 5 Residential property price index (RPPI), Price Index of Construction Materials and House Price (HP) Expectations for the next three months

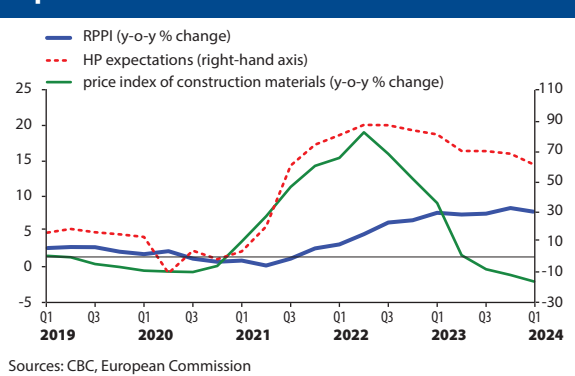
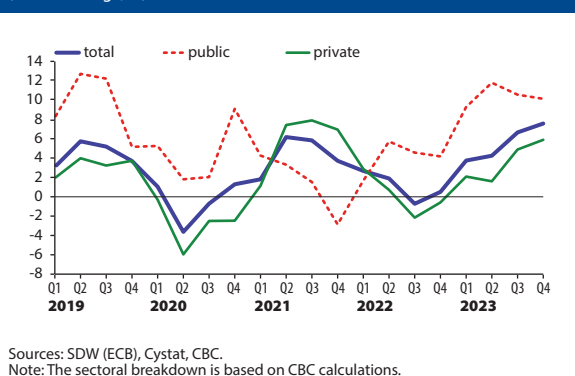


CHART 6 Nominal compensation per employee by sector (annual change, %)

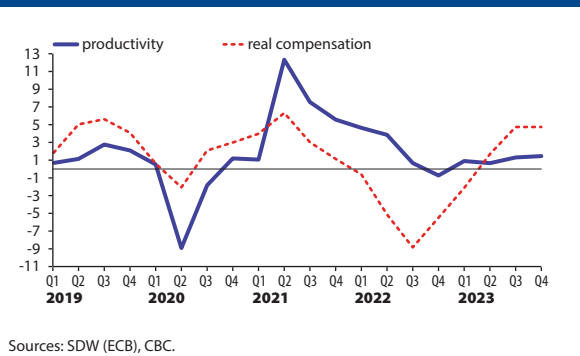


correction of inflationary pressures (Chart 7). Labour productivity, defined as the change in real GDP per employed person, increased by 1.0% in 2023, compared to a 2.0% increase in 2022 (Chart 7).

The recovery in compensation per employee and productivity led to a 4.6% increase in unit labour cost, which is an important indicator of competitiveness (Chart 8a). Despite the recent increase, the significant reductions in wages since 2013 support competitiveness of the Cypriot economy. Specifically, the index recorded a cumulative decrease of 13.8% from 2013 to 2016, despite annual increases since 2022, remaining lower than the Eurozone since 2013 (approximately 29 points in 2023) (Chart 8b).

CHART 7 Productivity and real compensation per employee

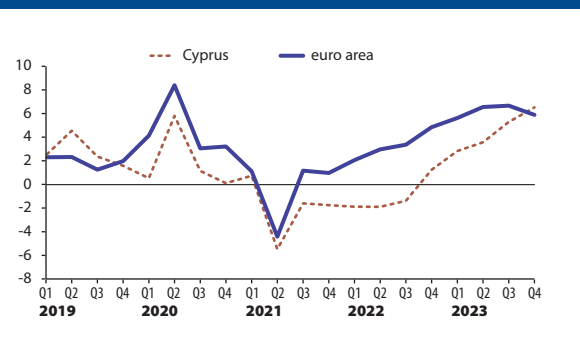
(annual change, %)



Sources: SDW (ECB), CBC.

CHART 8a Unit labour costs: Cyprus and the euro area

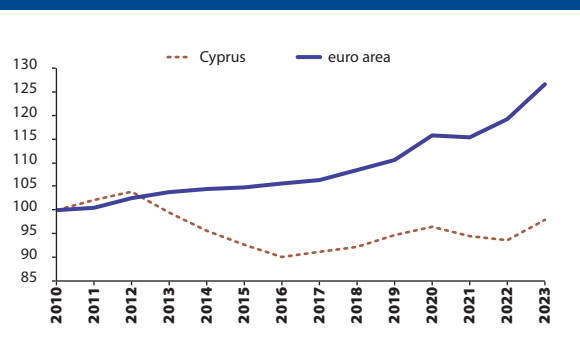
(annual change, %)



Source: SDW (ECB).

CHART 8b Unit labour costs: Cyprus and the euro area

(index 2010=100)



Source: SDW (ECB).

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Developments in the Unit Corporate Profit Index of the Cyprus economy

Corporate profits and wages (part of corporate costs) are important components of the final selling price of goods and services in an economy. Businesses set the prices of the goods and services they offer at a level above cost, including the desired profit, in order to achieve a return on their capital. In recent years there has been a significant increase in the profit margin of companies affecting the final price of goods and services and thus the path of inflation.

This Box is based on a CBC Working Paper¹ and analyses developments in the unit corporate profit index in the Cyprus economy by sector, using National Accounts data. This corporate profitability index is based on National Accounts data² at sectoral level and relates to quarterly estimates, based on specific assumptions as regards the net operating surplus of businesses as a share of the Gross Value Added (GVA) of each sector³. It should be noted that the estimates at the sectoral level may mask heterogeneous developments at the company level.

Chart 1 (p. 20) points to an increase in the unit corporate profit index for the whole economy from the second half of 2021, following the lockdowns and the closure of the economy due to the

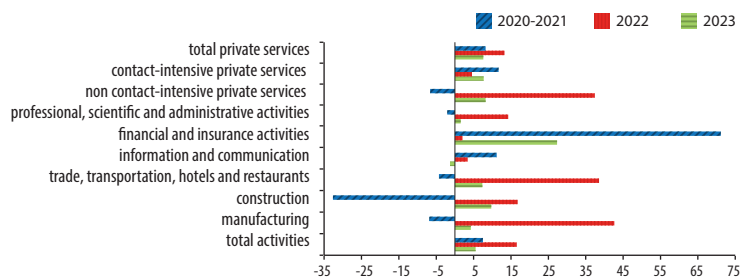
pandemic, and especially in 2022, a year of high inflationary pressures both in Cyprus and in the rest of the euro area. Specifically, despite upward pressures in the prices of imported goods and services (e.g. high prices of energy, raw materials and intermediate services), which pushed up costs of production, companies significantly increased their profitability in 2022, linked to the significant rise in the final prices of goods and services as a result of strong demand-side pressures due to the economic reopening following the 2020/2021 lockdowns. As regards developments in 2023, a correction is recorded in the unit corporate profit index compared to previous years, in a context of a gradual normalisation of the rate of price increases in the Cyprus economy, linked to a weakening of excess demand and the continuing lagged impact of the tight monetary policy.

Regarding the sectoral composition of the overall index (**Chart 1**, p. 20), significant heterogeneity is recorded across economic sectors⁴. For example, the increase in the relevant index of contact-intensive private services in 2022 is mainly due to developments in the sector of trade and activities related to tourism and leisure. By extension, this reflects excess demand for travel and the diversification of tourism markets following the loss of the Russian market due to the Ukraine invasion. The contain-

1. CBC Working Paper 2024-1: Analysis of company profitability in Cyprus: the case of the unit profit metric, 2024-01.pdf (centralbank.cy)
2. This indicator may change with revisions in the National Accounts data.
3. To this end, the index uses quarterly data by sector for the gross operating surplus that are adjusted for mixed income (mainly includes earnings of the self-employed) and capital depreciation (this constitutes a cost for companies).
4. The high contact intensity private services category includes the sectors of trade, transportation, hotels and restaurants as well as arts, entertainment and recreation. The category of private services with low contact intensity includes the sectors of information and communication, financial and insurance activities, real estate activities and professional services, thus excludes public services (i.e. it excludes the sectors of public administration and defence, education and health).

CHART 1 Index of unit profits at sectoral level

(% change over indicated period)



Sources: Cystat, author calculations.

ment of the relevant unit corporate profit index in 2023 could be attributed, in part, to rising competition among hoteliers owing to the operation of new units and, according to market participants, to the provision of accommodation services via Airbnb platforms as well as an increase in the number of tourists reported to take their holidays in the occupied areas. In 2024, the expected loss of Israeli tourists due to the ongoing conflict in the Middle East (see Tourism, p. 27), could further limit corporate profits in this sector via relatively contained demand, leading to a further decline in the relevant unit corporate profit index.

In relation to the construction sector, it appears that higher construction costs were passed on to residential property prices in 2022 (see Construction sector and real estate prices, p. 15) and, at the same time, there was also a rise in the relevant unit corporate profit index. It should be noted that the rise in the relevant index was recorded following declines over the

previous two years, as a result of the economic effects of the pandemic and the lockdowns, as well as the termination of the Cyprus Investment Programme (CIP) on November 1, 2020. The increase in profitability in the construction sector in 2022 may also be linked to demand-side pressures both from the domestic and foreign markets. Demand from domestic buyers is linked, inter alia, with investments for buy-to-let purposes, while from foreigners it is associated with the influx of foreign labour in the context of the registration of companies of foreign interests in Cyprus (headquartering). The decline in the unit corporate profit index of the construction sector at lower levels in 2023 compared with 2022 could be attributed to the still elevated construction costs in Cyprus (despite signs of correction already observed), combined with a decrease in foreign demand (reduction in the number of sales contracts filed by foreign buyers, see Construction sector and real estate prices, p. 15), thus reflecting

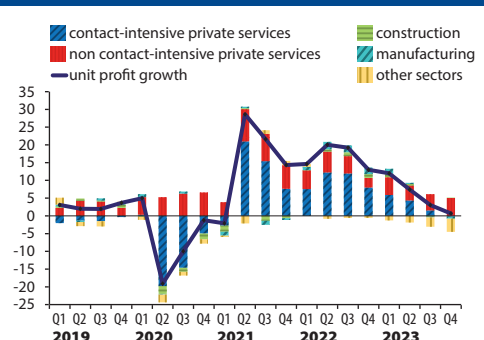
the need to absorb part of the cost from corporate profits. In addition, there has been a noticeable shift in preferences towards apartments and smaller houses, which contributed to the containment of overall revenues and, by extension, profits of the construction sector.

The unit corporate profit index of the financial and insurance activities sector registered decelerating growth in 2023 compared with 2020-21. The significant contribution of the non-banking segment of the sector in question to GDP growth, especially in the years 2020-21, should be noted, which appears to have led to the rise in the unit corporate profit index for the overall sector over those years. This picture was reversed over 2022-23 due to the sanctions against Russia, with a relevant contraction in the turnover of this sub-sector, in turn associated with downward pressures on its profitability. The contribution of the banking segment to the unit corporate profit index of the financial and insurance activities sector was significant in 2023, due to the difference between lending and deposit rates. During 2024, the gradual and slow rise in deposit rates, in connection with possible de-escalation of lending rates following the reduction in base rates by the ECB, is expected to lead to a containment of bank profitability and, by extension, to a containment of the unit corporate profit index for the sector of financial and insurance activities.

It is worth noting the *weighted contribution* of the various economic

CHART 2 Weighted contributions to unit profit growth

(y-o-y change %, percentage points)



Sources: Cystat, author calculations.
Note: The category "other sectors" includes agriculture and public services.

sectors to the total economy index of unit corporate profit on a quarterly basis (Chart 2), in order to assess relevant dynamics. The sharp recovery in the total economy index from the second quarter of 2021 was largely due to private services, especially those with a high contact intensity (i.e. trade, tourism and leisure-related activities). At the same time, it should be noted that this recovery covered previous losses recorded between the second quarter of 2020 and the first quarter of 2021 due to the pandemic and lockdowns. Moreover, it is interesting to note that the growth rate of the unit corporate profit index of private services with low contact intensity continued to be in positive territory even during the pandemic years, thus leading to a containment of the decline in the index for the total economy.

To conclude, the analysis in this Box documents that demand-supply mismatches across various economic sectors following the outbreak of the pandemic,

especially in contact-intensive services, allowed many companies to raise their prices, thus leading to high profitability especially during 2022, in an environment of excess demand following the lockdowns. However, the unit corporate profit index declined to lower levels in 2023 and, in line with the gradual correction of price pressures in the economy, corporate profits absorbed some of the wage growth registered in particular from the second half of 2023 (see Labour Costs, p. 17). The slowdown in GDP growth contributed to this trend (see Economic Activity, p. 12) linked to the continued lagged impact of

the tight monetary policy and the weakening of excess demand that arose in 2022 due to the economic reopening following the 2020/2021 lockdowns. In 2024, economy-wide corporate profits are expected to absorb the envisaged further rise in wages, in conjunction with a continued correction of inflationary pressures (see Macroeconomic Forecasts, p. 38). At the same time, potentially higher and/or more persistent than foreseen corporate profits in some economic sectors, particularly within services, pose an upside risk to the inflation outlook (see Macroeconomic Forecasts, p. 38).

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3. Labour market

The labour market in Cyprus remains resilient despite the impacts of the war in Ukraine and the conflict in the Middle East.

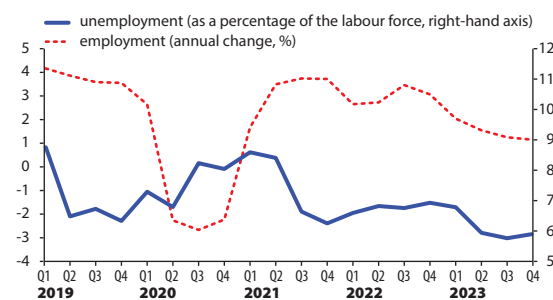
According to the latest statistical data, the recovery in employment continued in 2023, although at a slower pace, recording an annual growth rate of 1.5%, compared to 3.0% in 2022 (Chart 9). The increase in employment mainly came from the sectors of trade, transportation, hotels, and restaurants, with smaller contributions from the professional services, manufacturing, and information and communication sectors. Meanwhile, according to LFS data, unemployment decreased to 6.1% in 2023, compared to 6.8% in 2022 (Chart 9). This is the lowest level in the past fourteen years, when it was at 5.4% in 2009.

Working hours per employed person rose by 1.8% in 2023, compared to 4.1% in 2022, with the deceleration resulting from the larger increase in employment relative to working hours.

The CYSTAT data on registered unemployed show a continuous decline since June 2021 (Chart 10), with the most recent figures (April 2024) indicating an annual decrease of 17.2% (from 11,284 to 9,343 people). This is attributed to the ongoing resilience of the labour market, due to the expected GDP recovery.

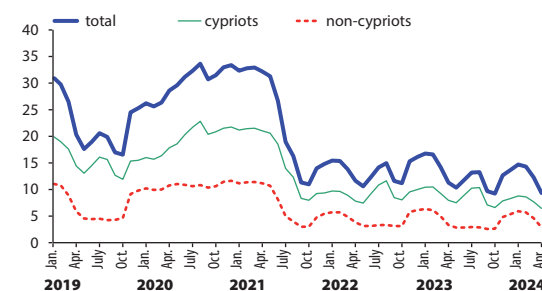
Regarding unemployment by age group (Chart 11a), people aged between 25-34 contribute the most to the overall unemployment rate (6.1%), with 2.0 percentage points for 2023. The unemployment rate for this specific age group decreased to 7.5% in 2023,

CHART 9 Unemployment and employment



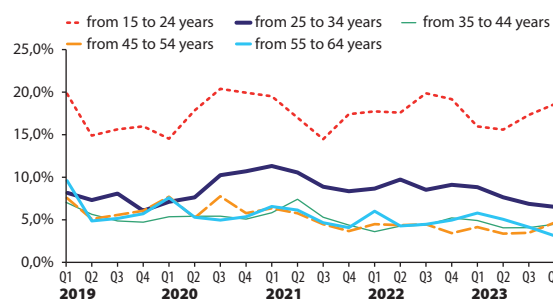
Source: Cystat (LFS).

CHART 10 Registered unemployment (number of unemployed, thousands)



Source: Cystat.

CHART 11a Unemployment rate by age group (as a percentage of the labour force)

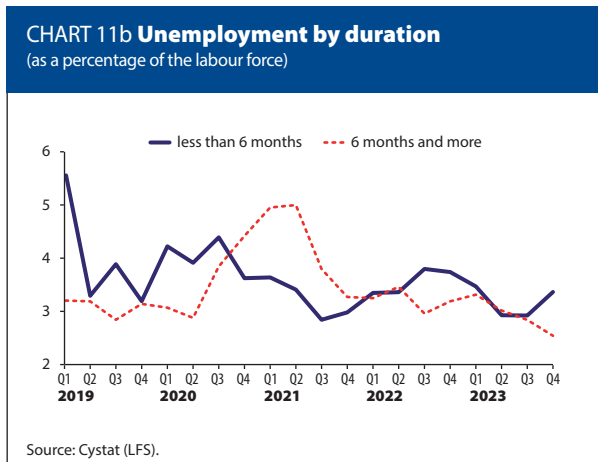


Source: Cystat (LFS).

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compared to 9.0% in 2022. An important factor in the labour market analysis is the stabilization of long-term unemployment at low levels, remaining at 2.5% in the fourth quarter of 2023 (**Chart 11b**), reflecting the stability in the labour market.

The LFS data indicate that the inflow of foreign labour continues, allowing businesses to meet their staffing needs. Additionally, LFS records a significant increase in job vacancies in 2023, mainly in the tourism industry, reflecting strong economic recovery and ongoing resilience in the labour market.



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4. Balance of payments³

4.1 Balance of Payments⁴

The current account deficit widened to €3.607,2 million (-12,1% of GDP) in 2023, compared with a deficit of €2.202,7 million (-7,9% of GDP) in 2022 (Table 6). The deterioration was due to the deficits in the balance of goods and the primary income account. The surplus in the balance of services partially offset the overall effect. Adjusted for the impact of SPEs, the current account deficit recorded a deterioration also, standing at €3.434,2 million (-11,5% of GDP) in 2023, compared with €2.540,9 million (-9,1% of GDP) in 2022 (Chart 12).

In more detail, the trade deficit of goods worsened by €1.142,1 million and reached €7.115,2 million in 2023. Specifically, net imports of goods by SPEs (mainly ships), that do not impact the domestic economy, increased by €491,0 million. Additionally, the increased demand observed during the economic reopening following the pandemic continued, leading to an increase in imports for home consumption. The largest increase was recorded in the transport equipment and consumer goods categories, while the category of intermediate goods recorded a decrease compared with 2022 due to the normalisation in the prices of raw materials and energy.

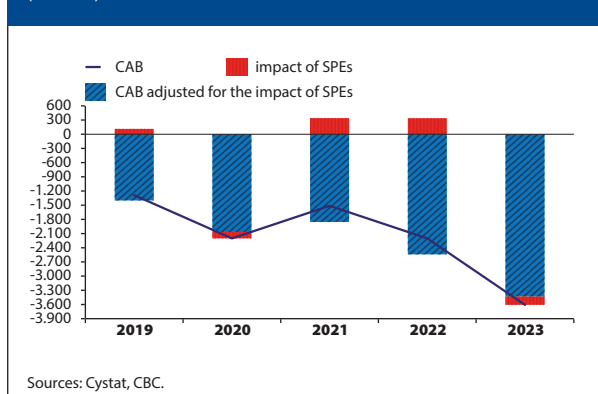
3. The external statistics data are significantly affected by the classification of SPEs as residents of Cyprus and, in particular, by those which are considered as economic owners of mobile transport equipment (mainly ships). The transactions of SPEs do not affect nor are affected substantially by the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

TABLE 6 Current Account Balance (main categories)

	2022 (€ million)	2023 (€ million)	Change (€ million)
Current account balance	-2.202,7	-3.607,2	-1.404,4
Current account balance adjusted for the impact of SPEs	-2.540,9	-3.434,2	-893,3
Goods and services balance	88,3	-273,7	-362,0
Trade balance	-5.973,1	-7.115,2	-1.142,1
Exports of goods	4.581,5	4.346,4	-235,1
of which:			
Exports of goods - SPEs	1.377,3	1.349,4	-27,8
Imports of goods	10.554,6	11.461,6	907,0
of which:			
Imports of goods - SPEs	1.422,4	1.885,6	463,2
Services balance	6.061,5	6.841,5	780,0
Exports of services	21.817,2	22.287,3	470,1
Imports of services	15.755,7	15.445,8	-309,9
Primary income (net)	-2.087,7	-3.010,7	-923,0
Secondary income (net)	-203,4	-322,7	-119,3
Current account balance (% of GDP)	-7,9	-12,1	
Current account balance adjusted for the impact of SPEs(% of GDP)	-9,1	-11,5	

Sources: Cystat, CBC.

CHART 12 Current account balance (CAB) (€ million)



The surplus of the services balance increased by €780,0 million and reached €6.841,5 million in 2023 (Table 7). More specifically, exports of services increased by €470,1 million while imports of services decreased by €309,9 million. With regards to exports, a significant increase was recorded in the travel (€568,9 million) and transport (€232,5 million) categories. A smaller increase relative to past years was recorded in the exports of Telecommunications, Computer and Information services (ICT), (€196,1 million). By contrast, exports of financial and other business services recorded a decrease of €555,0 million and €43,1 million, respectively, mainly as a result of the sanctions against Russia. The decrease in imports of other business (-€563,8 million), financial (-€334,9 million) and ICT services (-€236,1 million), which are directly linked to the aforementioned decrease in their respective sector's exports, contributed positively to the services balance.

In the primary income account, which mainly includes income from dependent work and investments, the deficit widened by €923,0 million in 2023 and reached €3.010,7 million (Table 6, p. 25). The widening of the deficit was primarily due to the strong profitability of local banks attributed to foreign shareholders-investors. The deficit in the secondary income account, which mainly includes current transfers, widened by €119,3 million in 2023.

The net International Investment Position (IIP) stood at -€28,7 billion (-96,4% of GDP) at the end of 2023 (Chart 13). Adjusted for the impact of SPEs, net IIP stood at -€10,8 billion, or -36,4% of GDP.

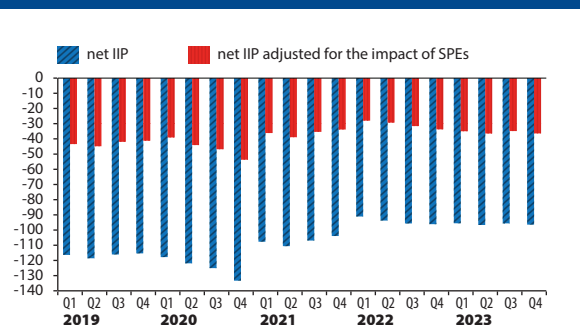
TABLE 7 Services balance (main categories)

(€ million)

	2022 (€ million)	2023 (€ million)	Change (€ million)
Services balance	6.061,5	6.841,5	780,0
Exports of services	21.817,2	22.287,3	470,1
<i>of which:</i>			
Transport	3.952,9	4.185,4	232,5
Travel	2.737,3	3.306,1	568,9
Financial services	5.243,8	4.688,8	-555,0
Telecommunications, computer and information services	6.894,7	7.090,8	196,1
Other business services	1.688,3	1.645,2	-43,1
Imports of services	15.755,7	15.445,8	-309,9
<i>of which:</i>			
Transport	2.693,1	2.970,5	277,4
Travel	1.295,2	1.668,9	373,7
Financial services	3.170,4	2.835,5	-334,9
Telecommunications, computer and information services	4.504,1	4.268,0	-236,1
Other business services	3.205,0	2.641,3	-563,8

Source: CBC.

CHART 13 Net International Investment Position (IIP)
(as a percentage of GDP)



Sources: Cystat, CBC.

4.2 Tourism

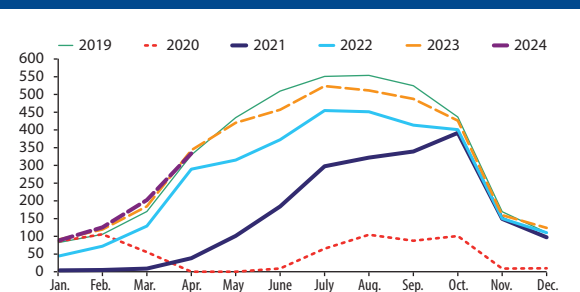
The tourism sector recovered significantly in 2023, despite the loss of the Russian market following the outbreak of war in Ukraine, as well as the significant decline in arrivals of Israeli tourists after the Middle East conflict broke out in October 2023. For the full year 2023, tourist arrivals reached 3.8 million, marking an annual increase of 20.1% (Chart 14). This amounts to 97% of the 2019 level, the record year of arrivals before the pandemic. Most arrivals came from the United Kingdom with 1,3 million tourists, followed by Israel with 411 thousand and Poland with 274 thousand tourists. Based on more recent data, arrivals in the first four months of 2024 recorded an increase of 1,7%, compared with the corresponding period of 2023 (Table 8).

Tourism revenues in 2023 recorded an annual increase of 22.6% and reached €2.990,6 million (Chart 15). The aforementioned increase in tourist arrivals and the increase in per capita expenditure by 2,1% contributed positively to this development, even if the average duration of tourist stay declined to 8,5 days in 2023 from 9,8 days in 2022. For the first two months of 2024, tourist revenue recorded an increase of 7,9%, compared with the corresponding period of 2023 (Table 8).

Due to uncertainty regarding the duration and outcome of the Russian-Ukrainian war and the conflict in the Middle East, it is expected that the performance of the tourism sector in 2024 will hover slightly below the levels of 2023. Key factors for the further

CHART 14 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.

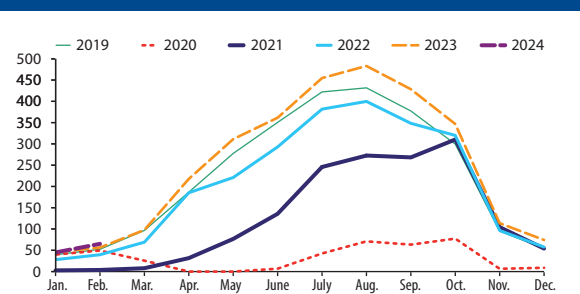
TABLE 8 Tourism

	Tourist arrivals (thous.)	Tourist receipts (€ million)	Expenditure per person (€)
2022	3.201,1	2.439,2	762,0
2023	3.845,7	2.990,6	777,6
annual % change	20,1	22,6	2,1
2023 Jan. - Feb.	209,6	102,2	487,5
2024 Jan. - Feb.	213,0	110,3	517,9
annual % change	1,6	7,9	6,2
2023 Jan. - Apr.	736,6	n/a	n/a
2024 Jan. - Apr.	748,8	n/a	n/a
annual % change	1,7	n/a	n/a

Source: Cystat.

CHART 15 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.

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development of the sector will include the expansion of air connectivity and new routes, extending the tourist season and duration of visitors stay, and promoting outdoor, mountainous, and remote areas as alternative tourist destination choices.

5. Financing conditions and credit developments^{5,6}

The domestic financial sector remains resilient despite the multiple exogenous shocks, thus continuing to finance businesses and households, significantly contributing in economic growth.

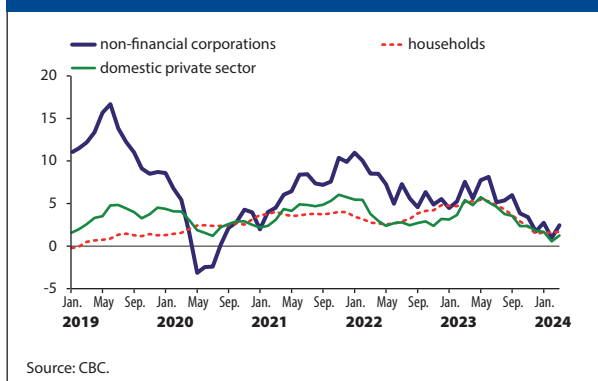
5.1 Deposits

The annual growth rate of domestic private sector⁷ deposits moderated since the second half of 2023 and decelerated to 1,3% in March 2024, compared with 5,4% in March 2023.

The significant financial cushions accumulated by the private sector in previous years, especially during the pandemic, may have been gradually utilised to counteract the increased cost of living. In addition, part of the liquidity buffers seem to have been utilised towards loan repayments possibly influenced by the increases in lending rates, with this trend being more pronounced among non-financial corporations. More specifically, domestic NFCs' deposits annual growth decelerated to 2,4% in March 2024 compared with 7,6% in March 2023, while domestic households' deposits growth stood at 1,7% in March 2024, compared with 5,2% in March 2023 (Chart 16). Despite this moderation, it is noteworthy that both households and NFCs

5. For a detailed explanation of the methodology and technical analysis of monetary aggregates (deposits and credit growth), see Technical Notes on p. 48.
6. 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.
7. Domestic private sector refers to non-MFIs domestic residents, excluding SPEs and central government.

CHART 16 Deposits of the domestic private sector
(annual change, %)



continue to register positive deposit growth. This resilience is possibly supported by to the robust economic growth of the Cyprus economy and the positive developments in employment.

Non-resident deposits⁸ continued their downward trend, recording negative annual growth rates since the second half of 2022, mainly reflecting the impact of sanctions imposed to Russia and the directives for the prevention of money laundering. Specifically, their annual growth rate stood at -6,5% in March 2024 compared with -5,9% in March 2023 (Chart 17).

5.2 Lending

Turning to credit developments, the resilience of new lending to the domestic non-financial private sector⁹ in 2023 persisted into 2024Q1 (Chart 18), despite high interest rates, tight credit standards, and subdued demand. Specifically, new lending to the non-financial private sector in 2023 remained at the 2022 levels (€3,3 billion). In 2024Q1, new lending slightly increased to €785 million, compared with €756 million in 2023Q1.

Regarding the underlying sub-categories, new lending to NFCs in 2023 slightly surpassed 2022 levels, reaching €1,921 million from €1,856 million in 2022, primarily driven by increased working capital financing needs while loans for long-term investment projects were limited to a small number of large enterprises. In 2024Q1, the volume of new business loans continued to increase, totalling €462 million, compared with €448 million in the same period of the previous

8. Including SPEs.

9. New loan contracts (euro-denominated) to euro area NFCs and households.

CHART 17 Deposits of non-residents: Cyprus
(annual change, %)

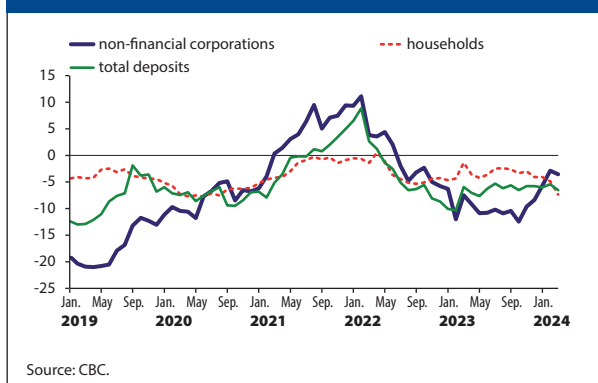
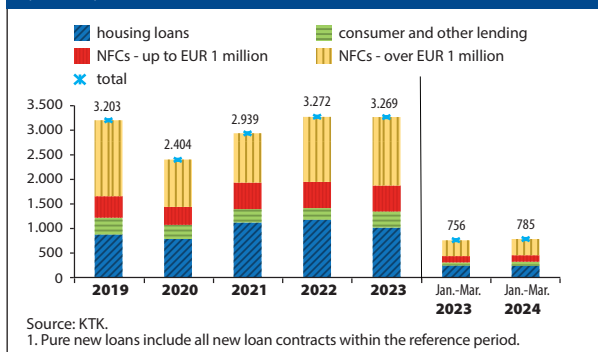


CHART 18 Volumes of pure new loans (euro-denominated) to euro area non-financial corporations and households⁽¹⁾
(€ million)



year. According to the latest BLS¹⁰, conducted in January and April 2024, despite a continued decline in the overall demand for business loans, there was a rise in demand for financing fixed investments for the first time since 2021Q4, indicating increased confidence in the economic outlook.

As regards households, new consumer credit and other lending also increased in 2023 and 2024Q1 compared to the corresponding periods of the previous year. Specifically, in 2023, this lending amounted to €332 million up from €238 million in 2022, and in 2024Q1 to €85 million from €64 million in 2023Q1. This increase may reflect households' increased liquidity needs amidst higher prices. Additionally, it may be partly linked to consumers' shift to hybrid and electric vehicles due to elevated energy prices. New lending to households for housing purposes has stabilised since mid-2022, despite the tightening of the euro area monetary policy. Housing loans seem to have been partly supported by banks' promotion of loan products with longer initial rate fixation periods, responding to borrowers' need for loan instalment stability. Increased demand for photovoltaic systems may also have played a role in the resilience of new housing loans. In 2024Q1, new housing loans amounted to €238 million compared with €244 million in 2023Q1.

Despite the resilience in new lending, net loans¹¹ to the domestic private sector¹² have recorded negative annual growth rates over

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

11. New lending plus capitalisation of interest minus repayments.

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

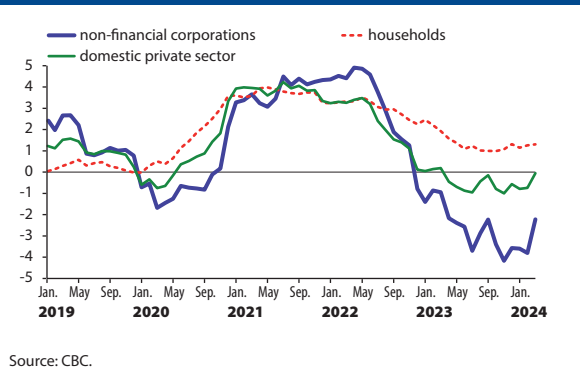
the past twelve months. In March 2024, the annual growth rate of net loans to the domestic private sector stood at -0,1%, a slight improvement from -1,0% in November 2023, the lowest level since 2017.

The negative growth rates were mainly driven by net loans to domestic NFCs, which have exhibited negative annual growth since December 2022, reaching -2,2% in March 2024 (Chart 19). This indicates that business loan repayments have exceeded new lending. Loan repayments may be a strategic financial management move by some sufficiently liquid NFCs, in response to increased borrowing costs.

The deceleration in the annual growth rate of net housing loans observed since mid-2022 continued into 2024Q1. The annual growth rate declined to 1,8% in March 2024 from 2,1% in December 2023 and 5% in December 2022 (Table 9). The continued slowdown in housing loan growth is consistent with the stabilisation of new lending to households for housing purposes and seems to partly reflect increased repayments due to higher borrowing rates. Conversely, the annual growth rate of net consumer credit accelerated significantly from mid-2023, reflecting the robust corresponding new lending. Specifically, in March 2024, an annual increase of 5,3% was recorded compared with 0,2% in March 2023. The annual growth rate of net other lending to households remained negative at -5,7% in March 2024, suggesting that repayments continue to exceed new loans.

Banks maintain strict loan approval criteria. This, combined with timely restructurings or renegotiations of loans to ensure borrowers' repayment capacity, seems to have prevented

CHART 19 Loans to the domestic private sector
(annual change, %)



Source: CBC.

TABLE 9 Loans to domestic households⁽¹⁾⁽²⁾

	Outstanding balance as % of total ⁽³⁾	Annual percentage change					
		2022 Dec.	2023 Mar.	2023 June	2023 Sep.	2023 Dec.	2024 Mar.
Domestic households	100,0	2,3	1,9	1,1	1,0	1,3	1,3
1. Consumer credit	11,3	-2,1	0,2	0,2	2,9	5,0	5,3
2. Lending for house purchase	78,3	5,0	4,0	2,9	2,2	2,1	1,8
3. Other lending	10,4	-8,0	-7,9	-8,5	-8,0	-7,0	-5,7

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.

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a new influx of NPFs so far. According to banks' expectations for 2024Q2, as recorded in the latest BLS¹³ (April 2024), credit standards for loans to both enterprises and households are expected to remain unchanged from the previous quarter's tight levels (Table 10).

The quality of banks' loan portfolios continues to improve, with NPFs¹⁴ at €1,8 billion in March 2024, the lowest since 2014 when the NPFs definition was harmonised across the EU. The reduction of NPFs in 2023 was primarily organic, through loan repayments and write-offs. However, in previous years, a substantial share of NPFs had been transferred/sold to credit acquiring companies (CACs). These loans continue to weigh on the real economy, as they remain part of private debt, limiting its short-term reduction capacity.

Nevertheless, the domestic non-financial private sector¹⁵ debt-to-GDP ratio has maintained a downward trajectory since 2015Q1, primarily due to the nominal GDP growth and loan write-offs (Chart 20). Specifically, the debt as a percentage of GDP decreased significantly from 352% at its peak in 2015Q1 to 199% at the end of 2023. Excluding SPEs¹⁶, private debt falls to 149% of GDP at the end of 2023. A further significant reduction in private debt is expected with the resolution of the debt held by CACs. However, based on projected GDP growth, tight credit standards and subdued credit flows, this downward trend is expected to continue.

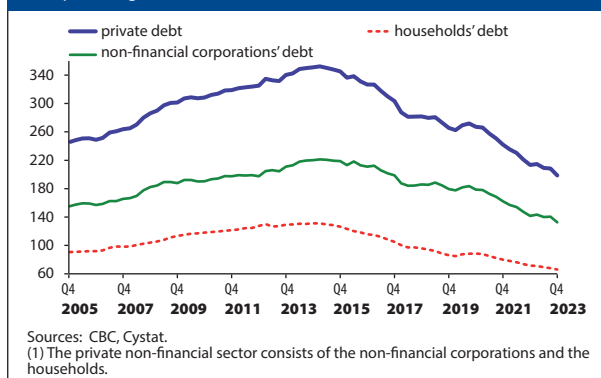
13. Detailed analysis of the survey results for Cyprus is available on the CBC website (Central Bank of Cyprus - Bank Lending Survey).
14. See tables with aggregate non-performing loans data of the Supervision Division on the CBC website (Central Bank of Cyprus - Aggregate Cyprus Banking Sector Data).
15. The domestic non-financial private sector consists of domestic NFCs (including SPEs) and domestic households.
16. Special Purpose Entities (SPEs) are enterprises which, although registered / incorporated in Cyprus, have little or no relation to the domestic real economy.

TABLE 10 Banking Lending Survey (BLS)

Summary of BLS results - April 2024	Cyprus	
	2024Q1	2024Q2 (expectations)
Credit standards for loans		
Enterprises	Tightening	Unchanged
Households		
- Housing loans	Unchanged	Unchanged
- Consumer credit and other lending	Unchanged	Unchanged
Ζήτηση για δάνεια		
Enterprises	Decrease	Unchanged
Households		
- Housing loans	Decrease	Unchanged
- Consumer credit and other lending	Decrease	Decrease

Source: CBC.

CHART 20 Private non-financial sector⁽¹⁾ debt as a % of GDP (as a percentage of GDP)



Sources: CBC, Cystat.

(1) The private non-financial sector consists of the non-financial corporations and the households.

5.3 Interest rates

The tightening of the ECB's monetary policy and the unprecedented increases of its key interest rates in speed and intensity, from July 2022 to September 2023, have significantly affected domestic bank interest rates.

Average lending rates have stabilised in the first months of 2024, after the strong upward trend recorded over the previous year and a half, for both NFCs and households. However, it is worth noting that the adjustment in NFCs lending rates was faster compared to the corresponding interest rate on new loans to households for house purchase.

In particular, given that the majority of NFCs loans are linked to the Euribor interbank market rate, they recorded fast adjustments in line with the increases recorded in the ECB policy rates. In March 2024, the average interest rate on new loans to NFCs¹⁷ of up to and over €1 million stood at 5,52% and 5,88%, respectively, compared with 5,60% and 5,29% in March 2023, respectively (Chart 21).

The increase in new housing lending rates has been more contained compared with NFCs lending rates and with a time lag. This development can be attributed to the fact that a large share of housing loans are linked to banks' base rates. These in turn are partly based on deposit rates in Cyprus, which are also lagging behind in the relevant adjustment. The average interest rate on new loans to households for house purchase¹⁸ stood at 4,75% in March 2024 compared with 4,67% in March 2023 (Chart 22).

17. New business with initial interest rate fixation up to one year.

18. New business with initial interest rate fixation up to one year.

CHART 21 MFI interest rates on euro-denominated loans (new business) up to €1 million to euro area non-financial corporations⁽¹⁾
(% per annum, period averages)

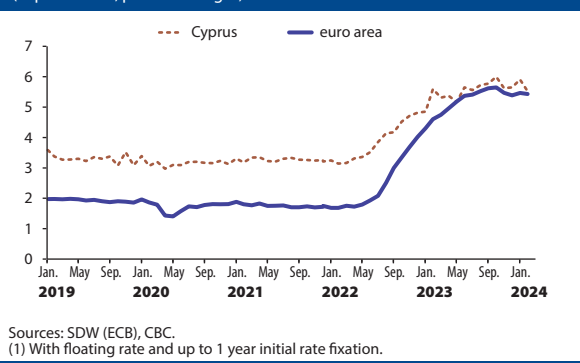
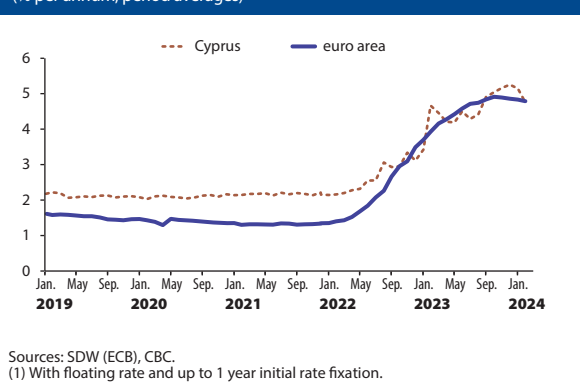


CHART 22 MFI interest rates on euro-denominated housing loans (new business) to euro area households⁽¹⁾
(% per annum, period averages)



It is worth noting that the offering by banks of financing products with a fixed interest rate for the first years or for the entire duration of the loan, has led to an increase in the proportion of new loans to households and NFCs with longer initial rate fixation periods.

Deposit interest rates remained relatively stable in the first three months of 2024, following an upward trend mainly in the second half of 2023. The average interest rate¹⁹ on both new household and NFCs deposits stood at 2,24% in March 2024, compared with 0,47% and 1,12%, respectively, in March 2023 (Charts 23 and 24).

CHART 23 MFI interest rates on euro-denominated deposits (new business) by euro area households⁽¹⁾
(% per annum, period averages)

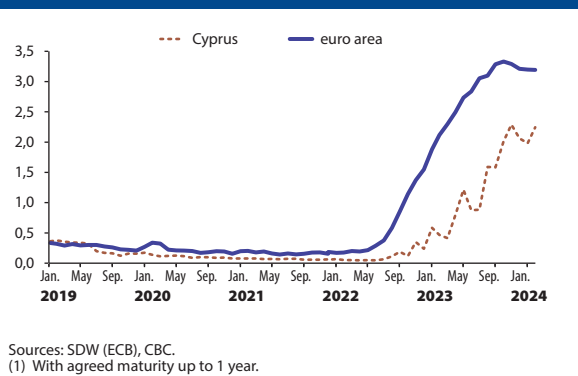
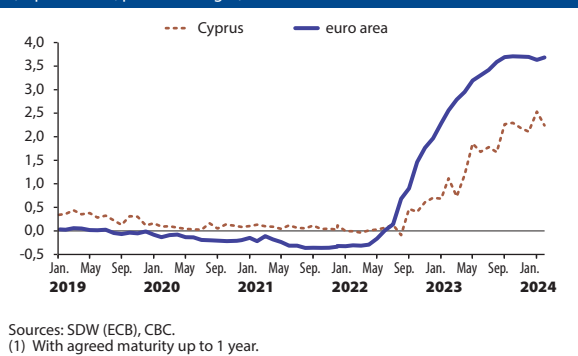


CHART 24 MFI interest rates on euro-denominated deposits (new business) by euro area non-financial corporations⁽¹⁾
(% per annum, period averages)



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

6. Fiscal Developments

According to CyStat data, the government budget balance stood at 1,8% of GDP in the first quarter of 2024, compared with a surplus of 1,3% of GDP in the same quarter of 2023 (Chart 25 and Table 11). The primary surplus in the first quarter of 2024 reached 2,0% of GDP, compared with a surplus 1,5% of GDP in the corresponding period of 2023 (Chart 25).

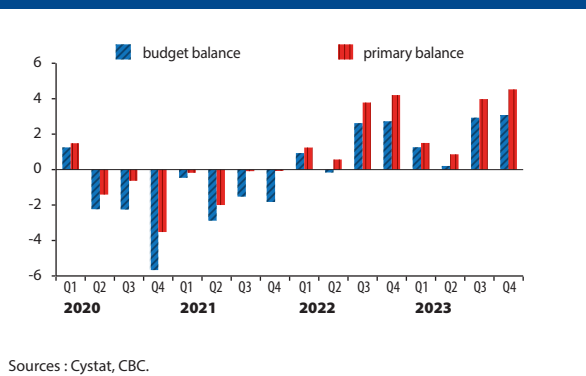
Public revenues increased by 13.5% in the first quarter of 2024 compared with the corresponding period of 2023 (Table 11), mainly due to the increase in revenues from current taxes (17.4%) and social contributions (12.5%) and, to a lesser extent, from an increase in revenues from sales of goods and services (46.8%) and taxes on production (6.4%).

Public expenditure recorded an increase of 7,3% in the first quarter of 2024 compared with the corresponding period of 2023 (Table 11), mainly due to increases in the expenditure for compensation of employees (14,4%) and social transfers (7,0%). In detail, compensation of employees increased mainly due to the payment of COLA and the new pension plan for employees in the broader public sector. The impact of the new pension plan is expected to be particularly significant in the period 2024-2026²⁰. Furthermore, the increase in social benefits was due, among other reasons, to the increase in social pensions and the increased state contributions to the social security fund resulting from the 2024 increase in the relevant contribution rates.

20. This is due to the implementation of increased contributions in 2024-2026, which relate to the retroactive effect of the new pension plan – that is, contributions to cover beneficiaries of the new plan since their recruitment date (it applies to those hired after 1 October 2011).

CHART 25 Budget and primary balances of the general government

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



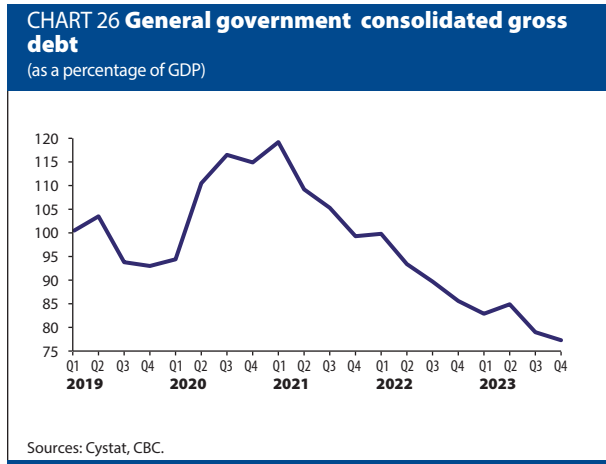
Sources : Cystat, CBC.

TABLE 11 Accounts of general government

	Jan.-Mar. 2023 (€ million)	Jan.-Mar. 2024 (€ million)	Change %
EXPENDITURE			
Intermediate consumption	249,4	270,3	8,4
Compensation of employees	789,8	903,7	14,4
Social transfers	1.013,1	1.083,7	7,0
Interest	72,1	65,3	-9,4
Subsidies	32,5	33,9	4,3
Other current expenditure	179,5	209,0	16,4
Gross fixed capital formation	165,3	117,9	-28,7
Other capital expenditure	14,5	16,9	16,6
Total expenditure	2.516,2	2.700,7	7,3
Total expenditure as a % of GDP	8,4	8,5	
REVENUE			
Taxes on production and imports	1.024,9	1.090,7	6,4
Current taxes on income, wealth, etc	779,5	915,2	17,4
Social contributions	869,6	977,9	12,5
Other current revenue	41,6	45,0	8,2
Sales	148,7	218,3	46,8
Capital transfers received	4,1	11,0	168,3
Property income	24,2	24,9	2,9
Total revenue	2.892,6	3.283,0	13,5
Total revenue as a % of GDP	9,7	10,4	
Primary balance	448,5	647,6	
Primary Balance as a % of GDP	1,5	2,0	
Budget Surplus (+) / Deficit (-)	376,4	582,3	
Surplus (+) / Deficit (-) % of GDP	1,3	1,8	

Sources : Cystat, CBC.

As regards public debt (**Chart 26**), it stood at 72,8% of GDP in March 2024, recording a decline of 6 percentage points compared with March 2023. This was due to the continued economic growth and the relative strong primary surplus. 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.



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1 Governor Introduction

2 Domestic Environment

3 Macroeconomic Forecasts for the Cypriot Economy

(B) Macroeconomic Forecasts for the Cyprus Economy²¹

21. Forecasts and assumptions take into account economic developments and available data with cut-off date the 22nd May 2024.

- *The projected GDP path over 2024-26 is mainly due to the envisaged further expansion in domestic demand as well as the recovery in external demand expected from 2025 and beyond.*
- *Limited impact from geopolitical tensions on the labour market, with the unemployment rate continuing to gradually decline to 5,3% in 2026.*
- *Compared with the baseline scenario, balanced risks for GDP in 2024 and slightly to the downside over 2025-26. Balanced risks to inflation in 2024 and slightly to the upside over 2025-26.*
- *Domestic HICP is projected to drop to 2,1% in 2024 from 3,9% in 2023, while it is expected to fluctuate below 2% in the following years, standing at 1,9% and 1,8%, in 2025 and 2026, respectively.*
- *Core inflation is also expected to decelerate to 2,5% in 2024 from 3,8% in 2023, while further deceleration is forecasted for 2025 and 2026 to 2,1% and 2%, respectively.*

The macroeconomic forecasts presented in this *Economic Bulletin* were prepared in the context of the Eurosystem exercises with common assumptions. The updated forecasts take into account possible economic impacts from the conflict in the Middle East, through direct effects, mainly associated with the path of tourism and investment, as well as indirect effects relating to the path of private consumption, due to economic uncertainty, and exports of non-tourism services, as a result of ongoing geopolitical tensions. At the same time, and based on the data available so far, any effects are limited.

Compared with the March 2024 projections, there is a slight upward revision in GDP growth by 0,2 percentage points for 2024. This is mainly due to an upward revision in domestic demand and, to a lesser extent, an upward revision in external demand, for example due to the dynamics of export-led sectors such as technology. The upward revision in GDP growth for 2024 is conservative considering the strong economic results for 2024Q1 as well as available indicators for the second quarter, while at the same time, the economic uncertainty due to the fragile external environment should be noted. Economic activity over 2024-26 is projected to be supported to a large extent by the gradual absorption of the EU’s RRF funds for investment.

Regarding HICP inflation, the small upward revision in HICP by 0,1 percentage points in 2024 compared with the March 2024 corresponding forecasts is mainly due to the projected higher energy prices and to, a lesser extent, to services prices. Concerning core inflation, the small downward revision by 0,1 percentage points compared with the March 2024 corresponding forecasts is mainly due to the latest available data related to non-energy industrial goods prices.

Economic Activity

Economic growth for 2024 is expected to reach 3%, compared with 2,5% in 2023 (Table 12). GDP is expected to grow at a slightly faster pace than in the March 2024 forecasts due to the momentum from the more favourable than expected economic results

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

	2022	2023	2024f	2025f	2026f
Real GDP	5,1	2,5	3,0	3,1	3,2
Private consumption	8,6	4,2	2,5	1,9	2,0
Government consumption	3,1	2,3	4,9	2,9	2,9
Gross fixed capital formation	8,3	12,5	-3,0	6,5	5,3
Gross fixed capital formation (excl. ships and airplanes)	7,1	4,4	5,6	6,5	5,3
Exports of goods and services	13,6	-1,2	-0,4	2,0	2,3
Imports of goods and services	18,3	1,7	-1,7	1,8	1,9

Sources: Cystat, CBC.

for 2024Q1 relating to the performance of sectors such as trade, tourism-related services (although a conservative forecast is adopted for the current year), technology and construction.

In 2025 and 2026, an increase in GDP by 3,1% and 3,2% is envisaged, respectively (Table 12, p. 40). This is mainly due to the expected further rise in domestic demand and the recovery in external demand. Domestic demand is foreseen to be supported by the rise in real disposable income of households, as a result of the expected further decline in inflation mainly due to the continued lagged impact of the single monetary policy of the euro area as well as the increase in wages and the resilience that the labour market continues to record. The projected increase in services exports reflects the expected gradual improvement in external demand, but also the dynamics of sectors such as technology and shipping, which have grown significantly in recent years via foreign investment. At the same time, it reflects the normalisation of the impact of the ongoing sanctions against Russia on the turnover of financial and professional services firms.

More specifically, for the years 2024-2026, the expected GDP expansion is mainly based on the path of domestic demand. A significant contribution is mainly expected from major ongoing private investments, as well as from projects that support the digital and green transition and other reform projects in the context of the implementation of the Recovery and Resilience Plan. Based on the available evidence, there is no significant

negative impact on investments from the conflict in the Middle East, neither via a reduction in demand, nor from the lagged impact of the tight monetary policy. Adjusting for the impact of SPEs, investment is projected to register a continued strong growth rate over 2024-26, namely 5,6%, 6,5% 2024 and 5,3%, respectively (Table 12, p. 40). Private consumption, albeit projected to decelerate to 2,5% in 2024 and to around 2% annually over 2025-26, down from 4,2% in 2023 (Table 12, p. 40), is expected to remain an important growth driver in the coming years, reflecting the resilience of the labour market and the expected recovery in real disposable income. Finally, the rise in domestic demand in 2024 is due, in part, to the 4,9% annual rise in public consumption (Table 12, p. 40) linked to an increase in public employment, according to available relevant data.

Compensation, productivity and the labour market

As far as the labour market is concerned, the available data reflect its continued resilience, with the impact of geopolitical tensions remaining limited, as shown by the European Commission's monthly surveys of employment expectations over the next three months. In line with the positive GDP trajectory, a rise in employment by 1,6% is expected for 2024 and a further increase by 1,4% annually over 2025-26 (Table 13).

Unemployment is expected to record a continued downward trend, reaching 5,7% of the labour force in 2024, down from 6,1% in 2023 (Table 13). In the coming years, it is

TABLE 13 Labour market projections
(annual change, %)

	2022	2023	2024f	2025f	2026f
Compensation per employee	1,1	5,6	6,8	3,6	3,5
Unit Labour Costs	-0,9	4,6	5,4	1,9	1,6
Productivity	2,0	1,0	1,4	1,7	1,8
Total employment	3,0	1,5	1,6	1,4	1,4
Unemployment rate (% of labour force)	6,8	6,1	5,7	5,6	5,3

Sources: Cystat, CBC.

projected to approach full employment conditions, reaching 5,3% in 2026 (Table 13, p. 42). The small downward revision in the unemployment rate in 2024 by 0,1 percentage point relative to the March forecasts reflects the favourable expectations for employment over the next three months and the upward revision in GDP growth.

Nominal compensation (includes wages and social security contributions) per employee is expected to register an increase by 6,8% in 2024, following a rise of 5,6% in 2023, and is forecasted to rise by around 3,6% annually over 2025-26 (Table 13, p. 42). The expected rise in 2024 is affected by the increase in social contribution rates towards the SSF that will apply for the next five years and also incorporates the temporary impact of retroactive contributions relating to the new pension plan of civil servants hired as of October 2011²². The wage path over 2025-26 reflects the productivity trajectory as well as the granting of COLA close to the levels observed in 2022, owing to the gradual and ongoing correction in inflation.

Productivity is forecasted to recover further in 2024 to 1,4%, after rising by 1% in 2023. In 2025 and 2026, it is expected to continue to recover by 1,7% and 1,8%, respectively (Table 13, p. 42). The expected recovery path in productivity reflects the positive economic effects of the influx of companies of foreign interest, mainly in the technology sector, as well as the gradual

22. The total amount of the relevant retroactive social contributions has been incorporated into the June 2024 forecasts equally over the period 2024-2026. Therefore, the level of total compensation (salaries and social contributions) of civil servants will be affected only within this period, with the temporary effect ending in 2027. Therefore, the growth rate of public sector compensation per employee growth (and by extension of the total economy) in 2027 is expected to slow significantly.

implementation of investments related to the absorption of funds from the EU's RRF.

Unit labour costs are expected to register a further increase over 2024-26 by 9 percentage points cumulatively (Table 13, p. 42), mainly due to the increases expected in the nominal compensation per employee, attributable largely to public sector developments in 2024. At the same time, the level of unit labour costs in Cyprus maintains a comparative advantage in relation to the rest of the euro area due to past reductions in wages observed within the context of the economic adjustment programme obligations, and by extension due to the improvement in competitiveness (see Labour Costs).

Inflation

HICP inflation is forecasted to decelerate further during the period 2024-2026 compared with 2023 figure (3.9%), and hover around the 2% medium-term target. More specifically, HICP is expected to 2,1%, 1,9% and 1,8% in 2024, 2025 and 2026, respectively. The further deceleration is expected as a result of the projected continued and full fade out of the inflationary pressures occurred in the previous years by exogenous factors stemming from the supply side as well as due to the impact of the single monetary policy which continues to exert a dampening effect in the short-term horizon but also with a time lag in the medium term horizon as well. In addition, the expected normalization in both profit margins of firms and wage increases as well as the projected decelerating course in non-energy industrial

goods prices are factors that are also expected, among others, to contribute to the slowdown in the HICP during the period 2024-2026.

Concerning core inflation, this is also projected to drop to 2,5% in 2024 compared with 3,8% in 2023. In 2025 and 2026, it is forecasted to decline further to 2,1% and 2%, respectively. These developments in core inflation are mainly projected due to the expected impact of the ECB's single monetary policy in the euro area which exerts a lagged effect in the medium-term horizon in conjunction with the projected normalisation in wages path. The anticipated full fade out of the exogenous inflationary pressures that affected non-energy industrial goods prices in the previous years is also expected to have a downward impact on the path of core inflation during the period 2024-2026. It should be noted that, services prices are expected to continue to have a “persistent” impact on core inflation in the years 2024-2026 and thus, partly contain, the slow-down in core inflation due to the aforementioned factors.

Risk assessment of macroeconomic forecasts²³

The projected GDP path, according to the baseline scenario of macroeconomic forecasts, is presented in **Table 12** (p. 40), and that of HICP and core inflation in **Table 14**. The probabilities of deviating from the baseline scenario of the forecasts for GDP and HICP are outlined in **Charts 27** and **28**, p. 46, respectively. Possible deviations in the baseline

23. For further information on the methodology of the risk assessment of macroeconomic forecasts, see *Economic Bulletin*, June 2015, p. 67.

TABLE 14 Inflation projections
(annual change, %)

	2022	2023	2024f	2025f	2026f
HICP	8,1	3,9	2,1	1,9	1,8
HICP excluding energy and food	5,0	3,8	2,5	2,1	2,0

Sources: Cystat, CBC.

forecast of core inflation are presented in **Chart 29**. A summary of the assessment of the relative risks of deviating from the baseline scenario is presented in **Table 15** (p. 47).

The risks of deviating from the GDP forecasts of the baseline scenario tend, overall, to be balanced for 2024, given also the conservative GDP growth projection for 2024, and to be slightly to the downside over 2025-26. Downside risks are mainly related to the negative impact from the ongoing geopolitical tensions and the fragile path of external demand. Also, they are linked to the formation of possibly higher energy prices due to the ongoing conflict in the Middle East and also due to decisions of oil-producing economies in relation to limiting supply. Downside risks also include possibly tighter than anticipated financing conditions, owing to a larger than anticipated impact from previous interest rate hikes, which may dampen domestic demand, as well as higher than expected wages. Finally, they are associated with a lower than foreseen impact from absorption of RRF funds available for investments. Upside risks to GDP relating to a deviation from the baseline scenario for 2024-26 are associated with higher than projected private consumption if the household saving rate does not increase as much as expected.

The deviation risks of the HICP inflation forecasts from the baseline scenario for the years 2024-2026 are overall assessed as balanced for 2024 and slightly upside for 2025 and 2026. Upside risks are mainly emanated from possible higher than expected energy prices (for instance, due to the ongoing geopolitical tensions) as well as from

CHART 27 Real GDP fan chart

(annual change, %)

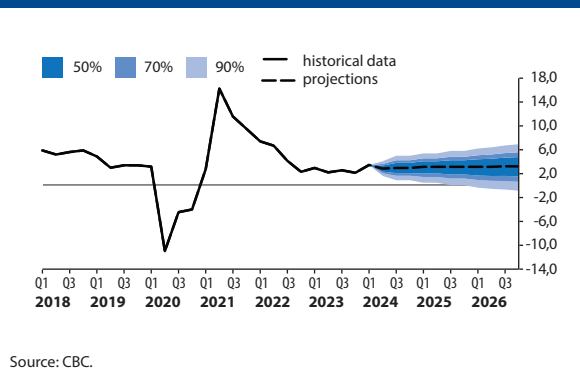


CHART 28 HICP fan chart

(annual change, %)

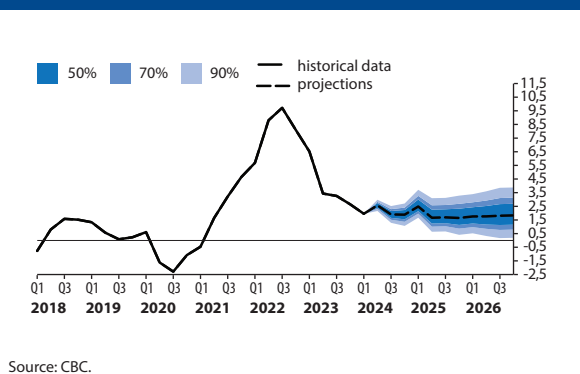
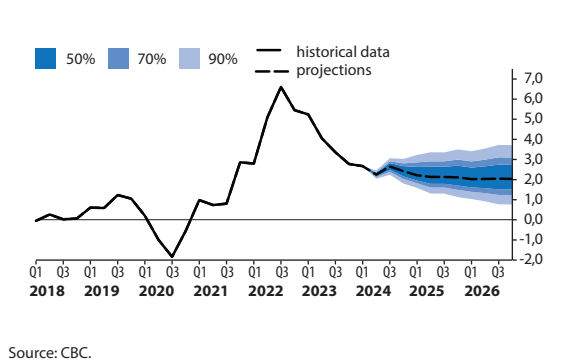


CHART 29 HICP excluding energy and food fan chart (core inflation)

(annual change, %)



consequences linked with climate change (adoption of relevant government tax policies, extreme weather-related events). Upside risks are also associated with the materialisation of higher than foreseen wage increases (which may have an upward impact on services prices), higher than expected profit margins of firms as well as due to higher than expected private consumption. On the other hand, there is a possibility that the HICP will be lower than the projection of the baseline scenario due to higher than expected decrease in domestic demand and economic activity (in general) in the event that the impact of the ECB's monetary policy turns out to be stronger than expected as well as due to increased geopolitical tensions.

TABLE 15 Summary of risk assessment: June 2024 forecasts

Risk	GDP (2024-2026)	Inflation (2024-2026)
Lower than expected impact from absorption of funds from EU NGEU support package	-	=
Higher than foreseen energy prices, e.g. due to the conflict in the Middle East, decisions of oil-producing economies in relation to limiting supply, etc.	-	+
Worse than foreseen impact on domestic economic outlook as a result of geopolitical tensions	-	-
Impacts linked with climate change (gradual adoption of green taxes, extreme weather-related events)	-	+
Wages rise more than expected	-	+
Higher than foreseen profit margins	=	+
Higher than foreseen path in private consumption	+	+
Higher than foreseen dampening effect of past monetary policy tightening on demand	-	-
Overall assessment	-	+

Source: CBC.
 Note: the following symbols cover the spectrum of risks: ++ (upside), + (slightly to the upside), = (balanced), - (slightly to the downside), -- (downside).

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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.