



CENTRAL BANK OF CYPRUS

ECONOMIC BULLETIN

JUNE 2020

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Introduction

2

Macroeconomic
Developments
and Projections

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CENTRAL BANK OF CYPRUS
EUROSYSTEM

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ABBREVIATIONS

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

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Introduction

The euro area displays an economic contraction of unprecedented depth and speed. The corona pandemic and the subsequent measures taken to limit its spread have dramatically reduced economic activity in all euro area countries and around the world. Aiming to further monetary easing in the face of the current economic crisis and increased uncertainty, the Governing Council (GC) of the European Central Bank (ECB), with the participation of the Governor of the Central Bank of Cyprus (CBC), has decided on a number of measures to support the euro area economy. Among other measures, on 18 March 2020 the GC introduced a new temporary asset purchase programme of private and public sector securities of an overall envelope of €750 billion. This new Pandemic Emergency Purchase Programme (PEPP) was increased by €600 billion on June 4, 2020. Also, on 30 April 2020 the GC decided to reduce the interest rate on targeted longer-term refinancing operations (TLTRO III) during the period from June 2020 to June 2021 and, at the same time, to conduct a new series of non-targeted Pandemic Emergency Longer-Term Refinancing Operations (PELTROs)¹.

It is anticipated that these measures, together with a number of large fiscal stimulus and other measures taken by national governments and other European institutions, will further support the conditions for a faster recovery. They are expected to help maintain a smooth supply of credit to the real economy, to support the income of

households and businesses and to sustain employment levels. In particular, the PEPP programme is expected to continue to have a positive impact on government bond yields, facilitating easier access for euro area member countries to this particular market.

The Cypriot economy was hard hit by the pandemic in 2020Q1 with growth slowing to 0,9%, although the economic impact will be much more pronounced in 2020Q2 due to the drastic measures to limit the spread of the virus. The vital tourism sector was particularly hard hit, with a direct impact on the number of tourist arrivals due to the travel restrictions that have been in place since mid-March. The Economic Sentiment Indicator fell in April, reaching its lowest level since 2013, mainly due to sluggish business confidence.

Despite the above, although economic activity slowed significantly, it nevertheless remained on a positive course and rose by 0,8% (seasonally adjusted data) on an annual basis in the 2020Q1, as the impact mainly affected only the second half of March. Still, this figure constitutes the worst annual performance since 2015Q1. According to the preliminary estimate of the Statistical Service of Cyprus (Cystat), the slowdown in GDP mainly reflected the impact of the Covid-19 containment measures, which suspended non-essential activities. The deceleration in the GDP growth rate is mainly attributed to the sectors: "Hotels and Restaurants", "Manufacturing", "Arts, Entertainment and Recreation", "Other Service Activities" and "Construction".

On a quarterly basis, the economy shrank

1. Details for these and for all other measures taken by the ECB, are given in the "Key ECB interest rates and interventions" section of this Bulletin. Furthermore, it is noted that, at the monetary policy meeting on 04 June 2020, which took place after the cut-off date of this Economic Bulletin, the Governing Council of the ECB took further steps to relax monetary policy. For more details of the decisions of the Governing Council of the ECB (dated 04 June 2020), see the ECB's website below: <https://www.ecb.europa.eu/press/pr/date/2020/html/ecb.mp200604~a307d3429c.en.html>

by 1,3% in 2020Q1 after expanding by 1% in 2019Q1. 2020Q1's performance was the worst since 2013Q2.

For the year as a whole and according to the CBC's baseline scenario² estimates, as discussed in Section 3, a 7,3% decline in GDP is projected. The sectors of "Hotels and Restaurants" and "Arts, Entertainment and Recreation" are expected to record the most significant decline in activity. Inflation has also been revised downwards, to -0,5% in 2020 compared to 0,5% in 2019, mainly due to significant declines in energy and industrial product prices excluding energy.

It should be noted that the baseline scenario is accompanied by an extremely high degree of uncertainty due to the unforeseen evolution of the pandemic and its effects. Therefore, the CBC, in the context of the Eurosystem exercises, has carried out two further scenario assessments (mild and extreme), with the aim of covering a wider range of possible outcomes. In these additional scenarios, the recession is estimated at -5,6% and -9,9% in the mild and adverse cases, respectively, while in all 3 scenarios a gradual recovery is estimated in 2021.

The main differences in the scenarios lie in the working assumptions in relation to the course of the pandemic. In the mild scenario it is assumed that the virus is successfully controlled without recurrence and the economy returns to normality faster. In the baseline scenario, the assumption is that the pandemic is partially addressed, with some restrictions remaining in place. On the contrary, the adverse scenario assumes

recurrence of the virus with a second wave of cases towards the end of 2020. It is noted that in all three scenarios the Eurosystem's working hypothesis, that a medical solution (antidote or vaccine) is discovered in 2021, is adopted.

In order to mitigate the scale of the economic contraction in Cyprus and to avoid a significant increase in unemployment, the government has enacted relief measures for businesses and households that will last until June and possibly further beyond. These fiscal packages to address the crisis in Cyprus, with the consequent significant increase in public debt and the budget deficit, were urgent and necessary. It should be noted, however, that the amount of fiscal stimulus is limited as the sustainability of public finances is a key factor for returning to normality.

The restrictive measures imposed by the government to limit the spread of the pandemic inevitably affected the fulfilment of the financial obligations of households and businesses and the demand for new financing. These developments affected the plans of credit institutions for 2020 and hampered the continuation of efforts to further deleverage their balance sheet from non-performing loans. In addition, the difficulty of households and businesses in serving their financial obligations due to the pandemic has created the need for actions by both European and national authorities.

The CBC, as the competent authority for the financial stability of the country, acted immediately by considering the following two key elements: first the support of the real

2. Due to the great uncertainty as to the evolution of the pandemic, the CBC's current forecasts for macroeconomic data can be considered as different scenarios for which different working assumptions have been adopted, mainly related to the unknown epidemiological situation both in Cyprus and abroad. As it would be confusing to analyse all three scenarios, the CBC, like the ECB, analyses in depth only the baseline scenario (Section 3), whose estimates are also considered to be the CBC's current key forecasts.

economy, households and businesses, through the banking sector, and second, the protection of the country's financial stability and banking sector.

In particular, the CBC, acted swiftly and in a timely manner in cooperation with the European authorities (European Central Bank and European Banking Authority) on the need to demonstrate flexibility with regard to prudential regulations and requirements. As a consequence of the above, certain measures and decisions were taken to facilitate the support of the economy by the banking institutions. In particular, in order to facilitate the granting of new short-term credit facilities, the CBC amended its relevant directive and at the same time issued a circular in order to provide partial relaxation in the prerequisites for the approval of short-term new loans. In addition, the CBC's Board of Directors gave its consent to the Ministry of Finance to issue the Decrees on the implementation of the suspension of the payment of loan instalments. It is important to note that the CBC was actively involved in the design of the relevant Legislation and Decrees. At the same time, the decision to temporarily ease the capital requirements in order to give banks the option to provide new credit facilities is a key element expected to relieve thousands of households and businesses and, at the same time, to help the banking sector to minimise the negative effects of the pandemic.

The CBC anticipates banks to continually assess the quality of their loan portfolios in order to identify borrowers with higher credit risk. In this respect, the CBC has issued a

recommendation to banks and credit-acquiring companies to complete loan restructurings enabling the viable borrowers to return to full economic activity. The CBC recommended restructurings to be completed without additional charges while the full understanding of the revised terms of the restructured contracts by borrowers is particularly important.

However, the existence of strategic defaulters, who may be using the crisis as an excuse, should be treated decisively by banking institutions and the state. At the same time, the change in consumer behaviour may also result in specific business opportunities, which may require new funding. At this point banks should undertake their role as intermediaries for the provision of funds from savers to investors. Banks' business and capital plans also need to be reviewed to reflect the new economic conditions.

The health crisis is complex and its development and duration remains highly uncertain. Both the banking system and the real economy are called upon to operate under extraordinary circumstances of great uncertainty. Within this framework, vigilance is of almost importance so that the negative impact of the pandemic on the financial conditions and on the NPEs progress made so far is minimised.

Given the fact that the evolution of the economy largely depends on the banking sector and that the banking sector depends almost entirely on the economy, it should be ensured that any measures taken facilitate the proper functioning of the above two-way

relationship. Also, the fact is, that due to the 2013 crisis there are still specific fiscal and banking sector limitations. The fiscal and monetary support measures should therefore be prudent and constantly adjusted taking into account the budget and the banking sector's limitations, the course of economic activity and the existing legal framework. The way forward therefore requires prudence, realism and very careful planning.

Macroeconomic Developments and Projections

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1. International Environment: main developments

- *Dramatic deterioration in global economic activity since the beginning of 2020, due to the COVID-19 pandemic and the subsequent containment measures.*
- *Deceleration in global inflation during the most recent months of 2020 due to the adverse implications of COVID-19 pandemic.*
- *Collapse of international oil demand and consequently in the price of oil since the beginning of 2020 due to the dramatic deterioration of international economic activity.*
- *Lower euro area headline and core inflation compared with 2019 corresponding levels.*
- *Interest rates reduction by the Federal Reserve and the Bank of England, and ECB engaging in further monetary expansion.*

1.1 External developments

Economic growth³

From the beginning of 2020, the COVID-19 pandemic has caused a dramatic deterioration in world economy and trade. The results of the drastic measures taken by governments to limit the spread of the pandemic have resulted in a sharp decline in economic activity. Other factors, which also affect economic activity, particularly in the emerging economies, include a sharp reduction in commodity prices, significant tightening of financial conditions and substantial capital outflows.

3. The GDP forecast is calculated as the average of latest forecasts from: The European Commission (European Economic Forecast, Spring 2020) and the International Monetary Fund (World Economic Outlook, April 2020).

The rapid deterioration in economic activity was met with forceful policy measures. Central banks that had room to reduce interest rates did so immediately, while some have also expanded asset purchases. Liquidity strengthening policies have also been adopted, aiming at smoother functioning of financial markets. At the same time, governments have enacted large fiscal packages, with the composition of such packages skewed towards loan guarantees and income support measures.

Global trade fell sharply, due to the supply chain disruptions and the widespread demand shock. In the first quarter of 2020, virus-related supply disruptions in China affected international trade, especially in Asian countries strongly interconnected with China through regional value chains. However, once the situation has turned into a pandemic, production disruptions spread probably weighting on global trade for some time.

In the euro area, the pandemic and the measures to contain its spread have led to an economic fallout of unprecedented range, depth and speed. Survey indicators for consumer and business sentiment indicate an even greater contraction in economic activity and a significant deterioration in labour market conditions during the second quarter of 2020. Given the high uncertainty surrounding the ultimate extend of the economic contraction, growth scenarios prepared by ECB staff suggest that euro area GDP could fall anywhere between 5% and 12% this year, depending on the duration of the containment measures and the success of policies to mitigate the economic conse-

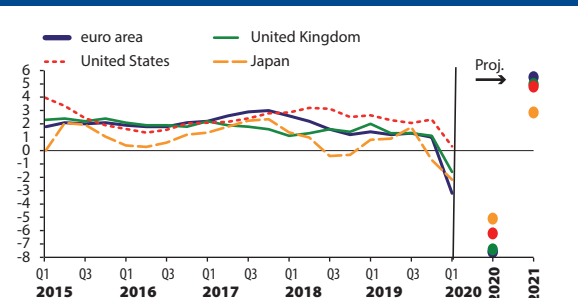
quences for businesses and workers. A similar picture is portrayed by the growth scenarios produced by the European Commission and the IMF with a baseline scenario of a fallout of -7,6% for 2020 (**Chart A.1**). As the containment measures are gradually lifted, these scenarios predict a recovery in economic activity, with GDP growing by 5,5% in 2021, although the speed and scale of the recovery remain very uncertain.

Determined to continue to support the euro area economy in the face of the economic disruption and increased uncertainty, euro area governments, as well as the ECB and other European institutions directly acted with measures aimed at alleviating the economic impact of the pandemic.

In the US, containment measures are expected to lead to a significant reduction in economic activity in the first half of 2020, particularly in the second quarter. Preliminary estimates for the first quarter suggest a GDP contraction of -4,8%. This constitutes the largest decline in GDP since the global financial crisis, when GDP fell by 8,4% in the last quarter of 2008. This assessment is based on partial data and is subject to further revisions. The increase in unemployment is expected to be dramatic, particularly in the first half of 2020, reflecting plunging consumer confidence and expenditure. As a result, in the first half of the year, US GDP is expected to fall by more than during the global financial crisis and reach, according to estimates of foreign analysts, -6,2% for the whole of 2020 (**Chart A.1**). Due to this situation, the US Congress agreed on fiscal support, while on the monetary side, the

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.

Federal Reserve proceeded with interest rate cuts and further monetary expansion. As a result, GDP is expected to increase by 4,8% in 2021.

Incoming data for the United Kingdom suggest that the outbreak of the epidemic had a significant negative effect on an already slowing economy. GDP is expected to fall by 7,4% (**Chart A.1**, p. 15) in 2020. Mitigation policies were swift and strong. The government introduced a series of fiscal and other support measures while the Bank of England cut interest rates and announce further monetary expansion. As a result, GDP is expected to rise by 5% in 2021.

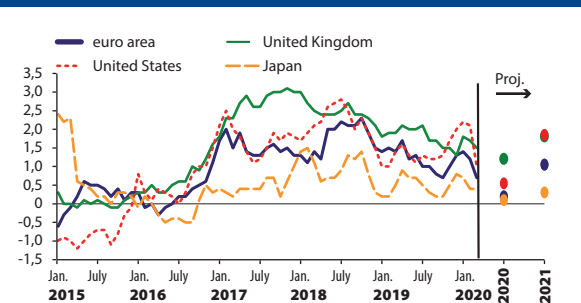
Inflation⁴

Global inflation decelerated as a result of the COVID-19 pandemic, especially in March and April 2020. The trend of global inflation is directly linked to the path of global economic activity and the consequent sharp fall in oil prices following the drop in global demand for oil.

According to the projections of international organisations and analysts, which at the moment are surrounded by high uncertainty due to the developments related to the pandemic, inflation in selected major advanced countries such as the US, UK, Japan and the euro area, is expected to fluctuate at much lower levels in 2020 compared with 2019 (**Chart A.2**). These projections mainly reflect the expected global recession, the significant drop in demand as well as the considerably lower, on average, oil prices. The aforemen-

4. Inflation projections are estimated as the average of the most recent projections from: The European Commission (European Economic Forecast, Spring 2020) and the IMF (World Economic Outlook, April 2020).

CHART A.2 Inflation in selected countries



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.

tioned downward pressures are expected to override any price increases in some products due to disruptions or shortages in the supply chain. As for 2021, inflation in most of the aforementioned developed countries is expected to recover, mainly driven by the upward base effect in energy prices and the projected global recovery in economic activity.

Exchange rates

The euro exchange rate against the major international currencies continued to record a general downward trend since the beginning of the year and up to the cut-off date of this Economic Bulletin (**Chart A.3**). The weakening of the euro reflects the increased uncertainty and the different timing of the main economic effects of the pandemic. Specifically, since the beginning of the year and up to the 15 May 2020, the euro depreciated by 3,3% against the US dollar and 3,9% against the Japanese yen. On the contrary, the euro has appreciated by 4,5% against the pound sterling due to the particularly high economic uncertainty prevailing in the United Kingdom (pandemic and Brexit).

Oil

Brent crude oil price fell by 51% in the 1 January- 15 May 2020 period compared to the corresponding period of 2019, mainly due to the sharp collapse in demand associated with the pandemic (**Chart A.4**). On 12 April 2020, the OPEC group announced plans to restrict oil supplies, but these are unlikely to fully

CHART A.3 Euro exchange rate against selected currencies

(weekly data, 2000=100)

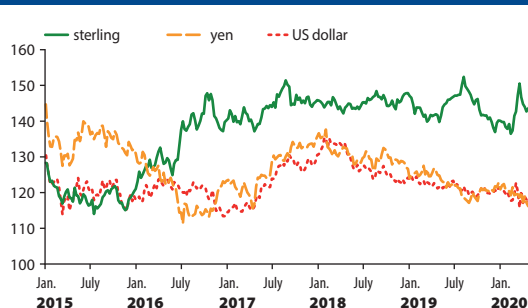
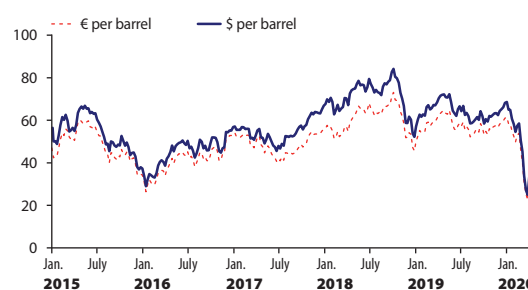


CHART A.4 Closing prices of oil (Brent)

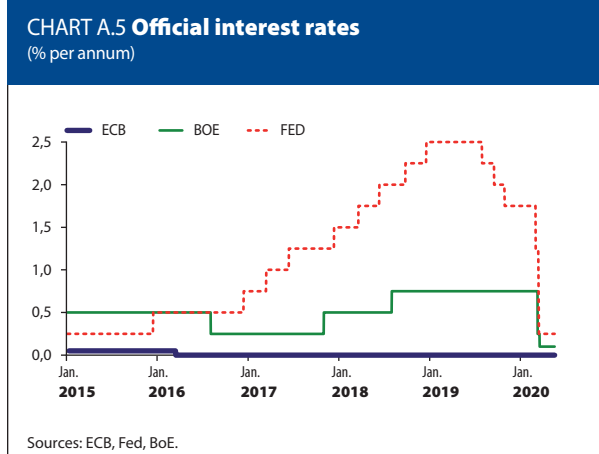
(weekly data)



offset the loss in demand in the near term. The International Energy Agency expects a reduction in the global oil demand for the first time in a decade, predicting a fall of -9,3% for the whole of 2020.

International key interest rates

On 3 March 2020, the Federal Reserve of the United States (Fed) cut the target range for the federal funds rate by 50 basis points to between 1% to 1,25% (**Chart A.5**). On 16 March 2020, the Fed cut this range by another 100 basis points to 0%-0,25% due to the economic impact of the pandemic and clarified that it would maintain interest rates at this level as long as the crisis lasts. The Bank of England also cut interest rates as a measure to support the economy and alleviate the effects of the pandemic. Specifically, on 11 March, the Bank of England cut interest rates to 0,25% from the 0,75%, subsequently reduced further on 19 March at the historic low of 0,1%, warning that the pandemic will lead to a "sharp and large" economic shock. The ECB, on the other hand, continued to maintain the interest rate on the main refinancing operations as well as the interest rates on the marginal lending facility and on the deposit facility unchanged (since September 2019) at 0,00%, 0,25% and -0,50% respectively. At the same time, however, it has adopted a more expansionary monetary policy through the adoption of further non-conventional measures (see next section).



1.2 Monetary developments in the euro area

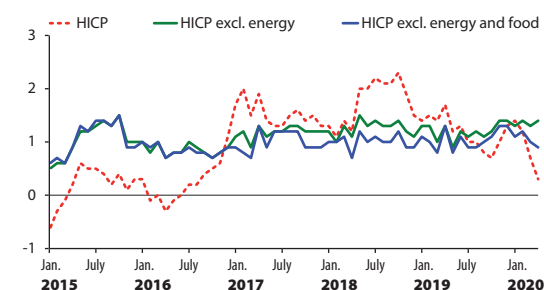
Inflation

According to the latest available data, euro area HICP inflation decelerated to 0,3% in April 2020 compared with 0,7% in March 2020, considerably affected by the negative developments of the pandemic (**Chart A.6**). In particular, the deceleration was mainly due to the higher decreases in the prices of energy on the back of a steep fall in oil demand. At the same time, increases in non-energy industrial goods prices continued to remain at very low levels, partly due to weak demand. As a result, both headline inflation and inflation excluding energy and food (core inflation) have been persistently subdued, reaching 0,9% and 1,0%, respectively, in the first four months of 2020.

Given the latest available data as well as the negative developments in the global economy, HICP inflation is expected to fluctuate at very low levels in 2020, and at relatively subdued, albeit higher levels, in 2021. More specifically, the most recent euro area inflation projections by international organisations and analysts converge to 0,2% for 2020 and around 1,1% in 2021. The ECB has adopted an ongoing expansionary monetary policy mostly due to the extremely subdued inflation in the euro area.

Over the medium term, a headline inflation is expected to gradually increase, mainly supported by the continued ECB's expansionary monetary policy as well as the projected recovery in economic growth.

CHART A.6 Inflation in the euro area
(annual change, %)



Source: Eurostat.

Reference rates and ECB intervention

The ECB, amid rising downside risks to inflation and the global economy, as described above, announced at its most recent monetary meetings (March and April 2020) a significant and targeted comprehensive expansionary monetary policy package. The new measures, along those already in place, are expected to support liquidity and financing conditions for households, non-financial corporations and banks and to contribute to the preserving of the smooth provision of credit to the real economy. More specifically, at its monetary policy meeting on 12 March 2020, the Governing Council of the ECB proceeded with the adoption of a new package of non-standard monetary policy measures⁵. Analytically, the Governing Council decided:

- To conduct, temporarily, additional Longer-Term Refinancing Operations (LTROs) in order to provide immediate liquidity support to the euro area financial system. These new LTROs will provide liquidity on favourable terms so as to bridge the period until the “Targeted Longer-Term Refinancing Operations III” (TLTRO III) operation launches in June 2020.
- In the context of TLTRO III operations, considerably more favourable terms will be applied during the period from June 2020 to June 2021.
- A temporary envelope of additional net asset purchases of €120 billion will be

5. For more and precise details on the particular decisions of the Governing Council of the ECB (12 March 2020), see the ECB website link below:
<https://www.ecb.europa.eu/press/pr/date/2020/html/ecb.mp200312~8d3aec3ff2.en.html>

added until the end of the year, ensuring a strong contribution from the private sector purchase programmes. In combination with the existing Asset Purchase Programme (APP), this will support favourable financing conditions for the real economy in times of heightened uncertainty.

- Reinvestments of the principal payments from maturing securities purchased under the APP will continue, in full, for an extended period of time.

At an “extraordinary” monetary policy meeting on 18 March 2020, the Governing Council of the ECB proceeded with the adoption of an additional package of non-standard monetary policy measures⁶. Analytically, the Governing Council decided:

- To launch a new temporary asset purchase programme due to the pandemic, namely the “Pandemic Emergency Purchase Programme (PEPP)” with an overall envelope of 750 billion, in order to address the unprecedented situation the euro area is facing. The PEPP is temporary and will allow the ECB to safeguard the transmission of monetary policy and ultimately its capacity to deliver price stability in the euro area.
- To expand the range of eligible assets under the corporate sector purchase programme (CSPP).
- To ease the collateral standards by adjusting the main risk parameters of the collateral framework.

At its monetary policy meeting on 30 April

6. For more and precise details on the particular decisions of the Governing Council of the ECB (18 March 2020), see the ECB website link below:
https://www.ecb.europa.eu/press/pr/date/2020/html/ecb.pr200318_1~3949d6f266.en.html

2020, the Governing Council of the ECB also decided⁷:

- To further ease the conditions on the Targeted Longer-Term Refinancing Operations (TLTRO III).
- To conduct a new series of non-targeted Pandemic Emergency Longer-Term Refinancing Operations (PELTROs) so as to support liquidity conditions in the euro area financial system and contribute to preserving the smooth functioning of money markets by providing an effective liquidity backstop.
- PEPP purchases will continue to be conducted in a flexible manner over time, across asset classes and among jurisdictions.
- The net purchases under the asset purchase programme (APP) will continue at a monthly pace of €20 billion, together with the purchases under the additional €120 billion temporary envelope until the end of the year.

Regarding standard monetary policy measures, the ECB kept its key interest rates unchanged during the first five months of 2020, to 0,00%, 0,25% and -0,50% for the main refinancing operations, marginal lending facility and deposit facility, respectively. The

7. For more and precise details on the particular decisions of the Governing Council of the ECB (30 April 2020), see the ECB website link below:

<https://www.ecb.europa.eu/press/pr/date/2020/html/ecb.mp200430~1eaa128265.en.html>

In addition, it is noted that at its monetary policy meeting on 04 June 2020, which took place after the deadline for updating the data for the current Economic Bulletin, the Governing Council of the ECB decided on the adoption of further accommodative monetary policy measures. Among others, it decided to increase the total envelope of the Pandemic Emergency Purchase Program (PEPP) by € 600 billion to € 1,350 billion. For more and precise details on the particular decisions of the Governing Council of the ECB (04 June 2020), see the ECB website link below:

<https://www.ecb.europa.eu/press/pr/date/2020/html/ecb.mp200604~a307d3429c.en.html>

Governing Council of the ECB expects that the above-mentioned key interest rates of the ECB will remain at their present or lower levels until the inflation outlook robustly and sufficiently converges to its medium-term price stability target, while at the same time, this convergence is consistently reflects in core inflation dynamics.

The aforementioned monetary policy measures, both standard and non-standard, have as their main objective the return of euro area inflation back to sustainable levels and in line with the medium-term target of below, but close to, 2% as well as the indirect support of the euro area economy in this highly uncertain and recessionary economic environment.

Concerning the EONIA rate and the new short-term rate “€STR”, these remained relatively unchanged from the beginning of 2020 until mid-May, since the ECB’s key interest rates did not change during the period under review (**Chart A. 7**). As a result, on 18 May 2020 (latest available data) the EONIA rate and the €STR stood at -0,46% and -0,54%, respectively.

Credit expansion: loans

Loans to the euro area private sector have continued to record positive growth rates during 2020Q1, expanding by 4,9% as in March 2020 compared with 3,5% in February 2020 (**Chart A.8**). The acceleration was driven by loans to non-financial corporations which recorded an annual increase of 5,4% in March 2020 compared with an annual increase of 3% in February 2020. The decision of most euro

CHART A.7 ECB reference rates and short term interbank rates

(% per annum, daily data)

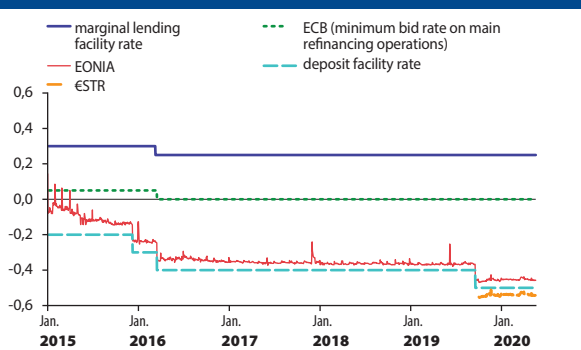
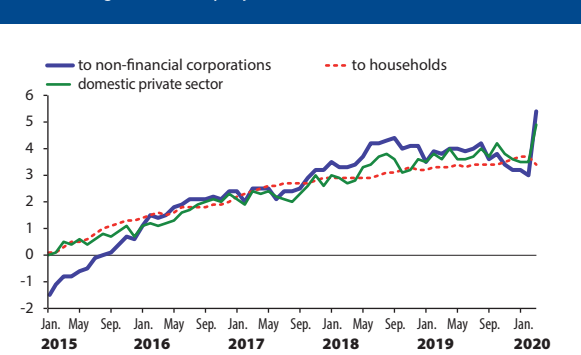


CHART A.8 Loans to the private sector: euro area

(annual change %, seasonally adjusted data)



area countries to grant government guarantees on loans, as a response to the pandemic, supported the abovementioned annual growth increase. In contrast to the non-financial corporations credit growth developments, the annual growth rate of euro area households loans decelerated to 3,4% in March 2020 from 3,7% in February 2020.

According to the results of the April 2020 euro area Bank Lending Survey (BLS), an increase in net loan demand by enterprises was recorded in the euro area during 2020Q1, mainly driven by firms' emergency liquidity needs on account of the coronavirus pandemic and the lockdown of large parts of the economy. In contrast, net loan demand for loans by households was adversely affected by the decrease in consumer confidence on the back of negative developments in economic activity and the growing downside risks related to the pandemic. In particular, net loan demand by households for housing purchases recorded a lower increase in 2020Q1 compared with 2019Q4, while net loan demand by households for consumption and other lending purposes registered a decrease compared with the previous quarter. At the same time, credit standards for loans to both enterprises and households were tightened.

Furthermore, as per April 2020 expectations for 2020Q2, and despite the significant heterogeneity in participating banks' replies due to the high uncertainty related to the pandemic, BLS participating banks overall indicated that the expected credit standards for loans to enterprises to ease considerably. This was probably due to the ECB's targeted monetary policy measures and the various

financial/ liquidity support measures introduced by governments. In contrast, credit standards for loans to households were expected to tighten in 2020Q2 compared with 2020Q1. Net loan demand by enterprises was expected to further increase in 2020Q2 compared with 2020Q1, while net loan demand by households for all loan categories was expected to decrease considerably in 2020Q2 compared with 2020Q1.

Finally, it should be noted that the ECB's latest measures appear to have a catalytic role in encouraging euro area banks to grant new lending to enterprises and households in the euro area, thus supporting the real economy in the midst of ongoing negative developments related to the pandemic crisis.

2. Domestic Environment: main developments

- *Significant deceleration in domestic HICP inflation during the first four months of the year, mainly due to sizeable negative implications related to COVID-19 pandemic and decreases in energy prices.*
- *Deceleration in the annual growth rates of domestic private sector deposits.*
- *Decrease in new lending in 2020Q1 and deleveraging of net loans⁸.*
- *Further decrease in NPFs⁹ in 2019 reflecting “organic” reductions, including repayments, successful restructurings and loan write offs, as well as debt-for-asset swaps.*
- *Continuation of the favourable low domestic interest rate regime, with further small decreases in both lending and deposit rates.*

8. New lending and capitalisation of interest minus repayments.

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

- Significant deceleration in the GDP growth rate due to the pandemic and the restrictive measures adopted to curtail its spread.
- Interruption of the downward trend in unemployment due to the impact of the pandemic on the labour market.
- Reversal of the growth trend of the real estate market due to the pandemic, which showed signs of slowing down even before the pandemic appeared.
- Significant increase in the government debt-to-GDP ratio in March 2020 compared with December 2019, reflecting the impact of the pandemic.

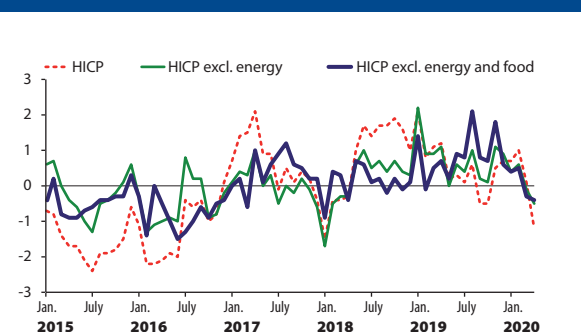
2.1 Domestic Prices, Monetary Aggregates and Labour Costs

Prices

The Harmonised Index of Consumer Prices (HICP) recorded an annual decrease of 1,2% in April 2020 compared with an increase of 1,2% in the corresponding month of 2019. This development was mainly attributed to decreases in the prices of all HICP main sub-categories, apart from services and processed food prices. With regard to the first four months of 2020, HICP inflation decelerated to 0,1% from 1,3% in the corresponding period of 2019 (**Chart A.9** and **Table A.1**). In general, the abovementioned developments in domestic HICP reflected the unprecedented negative effects of the coronavirus pandemic on domestic economic activity and total demand.

More analytically, during the first four months of 2020, non-energy industrial goods

CHART A.9 Inflation in Cyprus
(annual change, %)



Source: Eurostat.

TABLE A.1 Inflation in Cyprus

	Weights ⁽¹⁾	Annual change, %				
		Jan.-Apr. 2019	Jan.-Apr. 2020	Apr. 2019	Mar. 2020	Apr. 2020
HICP	1000,00	1,3	0,1	1,2	0,1	-1,2
Unprocessed food	50,04	11,6	1,3	5,1	1,4	-4,4
Processed food	169,68	0,7	0,2	1,1	0,4	0,4
Energy	78,11	1,6	0,5	2,9	2,1	-10,5
Services	466,96	1,2	0,9	1,8	0,3	0,1
Non-energy industrial goods	235,2	-0,5	-1,6	-1,4	-1,3	-1,3
HICP excluding energy	921,88	1,3	0,1	1,1	-0,1	-0,5
HICP excluding energy and food	702,16	0,6	0,1	0,7	-0,3	-0,4

Source: Eurostat.

(1) Based on the weight for 2020.

prices continued to register significant annual decreases. During the first two months of the year, the said decreases were mainly driven by increased domestic competition. During March-April 2020, the prices of this inflation category were also negatively affected by effects of the pandemic. Moreover, in April 2020, energy prices had a significant negative contribution to the domestic HICP. This development was mainly stemming from the significant drop in international oil prices, as a result of the steep collapse in the global demand for oil amid the pandemic. In addition, the Electricity Authority of Cyprus (EAC) proceeded with a 10% decrease in the price of electricity initially for the period April - May 2020 in an effort to alleviate some of the negative effects of the Covid-19 pandemic, thus posing further downward pressures to energy inflation. It is noted that the increases recorded in energy prices during the first months of 2020, especially in the prices of main fuels (petrol and diesel), were partly due to the increased share of biofuel into standard fuels from 5% to 7,3% introduced in January 2020 as well as to a base effect.

The, on average, increases in food and services prices had a positive, albeit, weak contribution to the headline inflation during the first four months of the year. It should be mentioned that during March-April 2020, services prices¹⁰ recorded a significant deceleration due to the drop in demand in the

10. It is noted that due to the pandemic, the prices of services were significantly affected during the data collection process for the month of April, since for various tourism-related sub-categories there were no actual data available and thus, estimates were used instead. For more details concerning the data collection for HICP during Covid-19 pandemic, see the relevant Cystat website link below: [https://www.mof.gov.cy/mof/cystat/statistics.nsf/all/86B536861FA9A6BCC2258500003E349A/\\$file/Harmonized_Index_of_Consumer_Prices-Apr20-EN-200520.pdf?OpenElement](https://www.mof.gov.cy/mof/cystat/statistics.nsf/all/86B536861FA9A6BCC2258500003E349A/$file/Harmonized_Index_of_Consumer_Prices-Apr20-EN-200520.pdf?OpenElement)



aftermath of the recent covid-19 pandemic-related lockdown measures.

In light of the above, core inflation (inflation excluding energy and food prices) decelerated to 0,1% during the first four months of 2020 compared with 0,6% in the corresponding period of 2019 (**Chart A.9** and **Table A.1**, p. 26). The deceleration in core inflation gives rise to concerns as it shows that the general price trends excluding the impact of exogenous and volatile factors and components, such as the prices of energy and food is on a downward trend.

Monetary Aggregates^{11,12}

The unprecedented events and the extraordinary conditions created by the coronavirus pandemic throughout the spectrum of the economy, are also expected to affect the domestic banking system. As Cyprus reported its first coronavirus cases in early March 2020, the effects of the pandemic are expected to be more pronounced in the monetary aggregates data of 2020Q2, particularly in the months of April and May.

In general, the decline in deposits in 2020Q1 is mainly attributed to the further reduction of deposit interest rates together with the additional expansionary monetary policy package of the ECB in September 2019, as well as to press reports over the potential imposition of a negative interest rate or charges on certain deposits. Deposits also appear to have been affected by the

11. For a detailed explanation of the methodology and technical analysis of monetary aggregates, see Technical Notes on p.73..

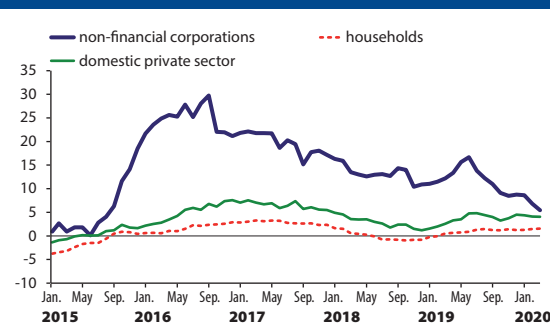
12. The analysis on monetary aggregates (deposits and loans) in this section of the *Economic Bulletin* focuses on domestic residents excluding SPEs. SPEs are included in the non-residents category.

suspension of flights in March 2020, which caused a major blow to tourism revenues. At the same time, was recorded a decline in outstanding loans, mainly of non-financial corporations, indicating that some of the withdrawn deposits of non-financial corporations were used for loan repayments. The decrease in new loan contracts also contributed to the deleveraging of loans observed in 2020Q1.

More specifically, domestic private sector deposits recorded an annual growth of 4,1% in March 2020 compared with 4,5% in December 2019 and 2,6% in March 2019 (**Chart A.10**). The slowdown recorded since December 2019 is mainly due to the withdrawal of deposits by domestic non-financial corporations. These outflows, which began in September 2019, are likely to be attributed to the combination of press reports regarding the intention of some banks to impose a negative interest rate or charges on certain deposits and of the ECB's decision in September 2019 to reduce the deposit facility rate from -0,40% to -0,50%. This decision led to a further reduction in the EURIBOR interest rate, with a consequent decline in the already very low domestic deposit rates. Non-residents deposits, on the other hand, which by their nature are highly volatile, remained at negative levels. In particular, the annual growth rate of non-residents deposits stood at -7,5% in March 2020 compared with -6,8% in December 2019 and -12,9% in March 2019 (**Chart A.11**).

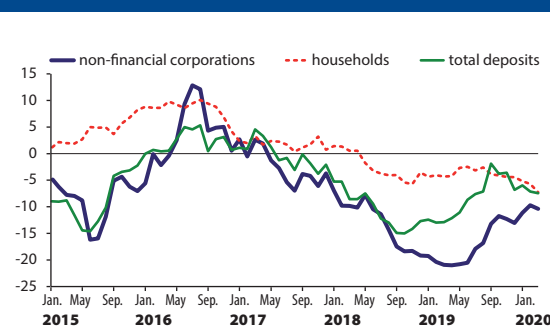
The first available total deposits data for April 2020 indicate contained deposit outflows. In part, this was a natural conse-

CHART A.10 Deposits of the domestic private sector
(annual change, %)



Source: CBC.

CHART A.11 Deposits of non-residents: Cyprus
(annual change, %)



Source: CBC.

quence of the sharp decline in economic activity due to the pandemic, the diminished tourism revenues, increased liquidity needs of affected corporations for working capital and reduced wages given the lower, than the level of wages, government support.

During 2020Q1, the decline in deposits was also reflected in a decline in net loans (new lending and capitalisation of interest minus repayments), mainly to non-financial corporations partly due to increased repayments. This could be an indication that part of the withdrawn deposits of non-financial corporations were used for loan repayments.

Additionally, new lending to the non-financial private sector¹³ in 2020Q1 recorded a decrease compared with the corresponding period of 2019 contributing to the decline in net loans. Net loans to the domestic private sector recorded an annual decrease of 0,7% in March 2020 compared with an annual increase of 0,3% in December 2019 and 1,5% in March 2019. In detail, the annual growth rate of loans to domestic non-financial corporations stood at -1,6% in March 2020, while for households it was positive and reached 0,5% (Chart A.12). For households, housing loans recorded a positive growth of 0,9% in March 2020, while consumer credit and other lending recorded negative growth rates of -0,3% and -0,2%, respectively (Table A.2).

The quality of the banks' loan portfolio continued to improve in 2019 (last available data for December 2019) but at a slower pace than the previous year. In 2018, NPFs¹⁴ decreased by €10,3 billion, mainly due to the reclassification of part of the NPFs as debt instruments held for sale as well as non-

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

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

CHART A.12 Loans to the domestic private sector (annual change, %)

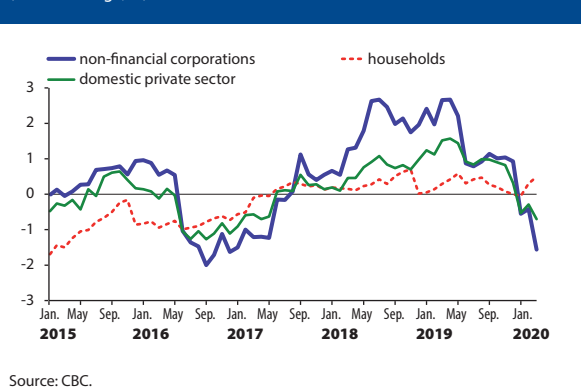


TABLE A.2 Loans to domestic households ^{(1),(2)}

	Outstanding balance as % of total ⁽³⁾	Annual percentage change					
		2018 Dec.	2019 Mar.	2019 Jun.	2019 Sep.	2019 Dec.	2020 Mar.
Domestic households	100,0	0,0	0,3	0,3	0,3	0,0	0,5
1. Consumer credit	13,4	1,4	0,9	0,5	0,8	0,1	-0,3
2. Lending for house purchase	66,8	-0,3	0,1	0,4	0,2	0,3	0,9
3. Other lending	19,8	0,3	0,6	0,2	0,0	-1,1	-0,2

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.

recurring factors, such as the transfer of CCB's NPFs out of the banking system. In 2019, there was a further decrease of €1,3 billion in NPFs, reaching €9 billion, through “organic” reductions. These included repayments, successfully restructured NPFs reclassified as performing loans, loan write-offs and debt-for-asset swaps. Despite the reductions in NPFs, the ratio of NPFs to total facilities continues to be very high compared with the EU average, standing at 27,9% in December 2019.

The April 2020 BLS results for Cyprus (Table A.3) indicated that the banks’ lending criteria remained broadly unchanged at the strict levels reached in the fourth quarter of 2014. Specifically, in 2020Q1 credit standards for granting loans remained unchanged for both households and enterprises. As regards net loan demand, given that the first cases of the pandemic in Cyprus were announced on 9 March 2020, this was only partially affected in 2020Q1 with a more pronounced impact evident in the participating banks’ expectations for loan demand in 2020Q2. In particular, net demand both for housing loans and consumer credit and other lending by households remained unchanged in 2020Q1 compared with the previous quarter, despite the favourable interest rate environment and increased consumer confidence. Net loan demand for enterprises, on the other hand, increased compared with the previous quarter. The increased demand for loans by enterprises is in line with the historically low interest rate environment as well as with the increased liquidity needs in March 2020 to cover fixed expenses given the reduction in

TABLE A.3 Summary of BLS results

Summary of BLS results April 2020 (tensions)	Cyprus		euro area	
	2020 Q1	2020 Q2 (expectations)	2020 Q1	2020 Q2 (expectations)
Credit standards for loans				
Enterprises	Unchanged	Unchanged	Tightening	Easing (considerably)
Households				
- Housing loans	Unchanged	Tightening	Tightening	Tightening
- Consumer credit and other lending	Unchanged	Tightening	Tightening	Tightening
Demand for loans				
Enterprises	Increase	Unchanged	Increase (considerably)	Increase (considerably)
Households				
- Housing loans	Unchanged	Decrease	Increase	Decrease (considerably)
- Consumer credit and other lending	Unchanged	Decrease	Decrease	Μείωση (considerably)

Source: CBC, ECB (SDW).

Note: The results of the table above list the changes in credit standards and loan demand that occurred in the last three months (in this case 2020Q1) and the changes that are expected for the next three months (i.e. 2020Q2). The measure used for the statistical analysis of this survey is the diffusion index for the case of Cyprus, while for the euro area is the net percentage methodology.

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revenues from the coronavirus-related restrictive measures. Regarding banks' expectations for 2020Q2, credit standards for loans to enterprises are expected to remain unchanged. However, it is worth noting that there was high heterogeneity among participating banks' responses, which reflects the uncertainty over the impact of the pandemic and the related government support measures. On the other hand, participating banks expect to tighten credit standards for loans to households. For the same period, net demand by households for housing loans, consumer credit and other lending is expected to decrease for the first time since 2014Q4, due to the restrictive measures and the expected economic impact of the pandemic. In general, net demand for loans by enterprises is expected to remain on average unchanged, but with significant variations in banks' responses.

Interest rates

In general, the downward trend in interest rates in Cyprus continued in 2020Q1, as a result of the ongoing expansionary monetary policy of the ECB and the further expansionary measures adopted in September 2019. The combination of excess liquidity of banks, however, in conjunction with the ECB's negative overnight deposit rate, led certain domestic banks to charge negative interest rates on large deposits or impose liquidity fees on certain deposits as from March 2020.

Analytically, the average interest rate¹⁵ for new household deposits continued its downward trend reaching 0,11% in March

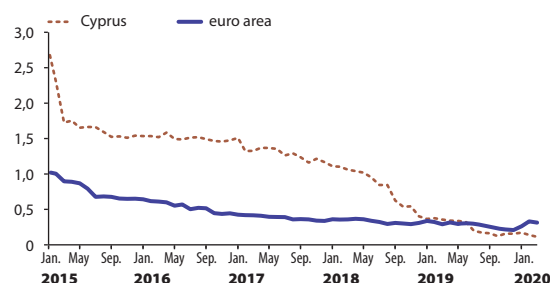
15. Average interest rate with an agreed maturity of up to one year.

2020 from 0,16% in September 2019 (**Chart A.13**). It is noted that, since July 2019 domestic deposit interest rates are lower than the respective euro area interest rates, which stood at 0,31% in March 2020 compared with 0,11% in Cyprus. The average interest rate on deposits for NFCs in March 2020 declined to 0,10% compared with 0,24% in 2019Q4 (**Chart A.14**). Indicatively, between March 2019 and March 2020, the spread between domestic and euro area deposit rates for households and NFCs declined by 27 and 20 basis points, respectively, and stands at -20 basis points for households and 19 basis points for NFCs.

With respect to lending rates, the domestic average interest rate on new loans to households for house purchase¹⁶ decreased to 2,10% in March 2020 compared with 2,20% in March 2019 and 2,11% during the second half of 2019 (**Chart A.15**). The interest rate for consumption loans remained constant at low levels and specifically stood at 2,99% in March 2020. The cost of new lending by domestic MFIs to euro area NFCs for amounts of up to €1 million, also declined from 3,27% in March 2019 to 3,21% in 2020Q1 and then further to 3,18% in March 2020 (**Chart A.16**, p. 34). It is noted that, despite the low interest rates environment, new lending to domestic non-financial private sector recorded a decline since the beginning of the year (see Section Monetary Aggregates).

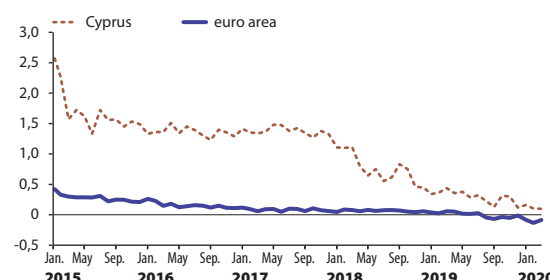
During the period March 2019 – March 2020, the spread between domestic and euro area lending rates for housing loans increased by 11 basis points and for NFCs by 10 basis points, reaching 71 and 138 basis points, respectively. The higher spread reflects the

CHART A.13 MFI interest rates on euro-denominated deposits (new business) by euro area households⁽¹⁾
(% per annum, period averages)



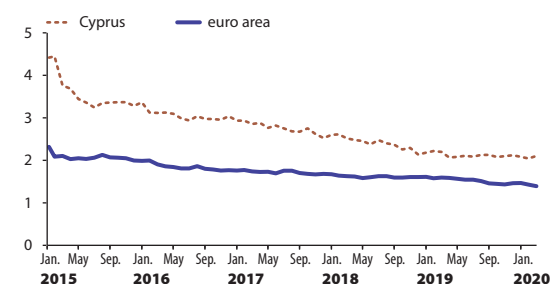
Sources: SDW (ECB), CBC.
(1) With agreed maturity up to 1 year.

CHART A.14 MFI interest rates on euro-denominated deposits (new business) by euro area non-financial corporations⁽¹⁾
(% per annum, period averages)



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

CHART A.15 MFI interest rates on euro-denominated housing loans (new business) to euro area households⁽¹⁾
(% per annum, period averages)



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

16. Euro-denominated loans from Cyprus MFIs with an initial rate fixation of up to one year.

increased risks faced by domestic banks, due to the high level of NPFs.

For the rest of the year, the uncertainty with respect to the effects of the pandemic, both on the real economy and on the banking sector, may lead to domestic banks increasing lending rates to cover up for the potentially higher risk of loans becoming non-performing. At the same time, it could lead to a reduction in the provision of new loans to the private sector, in particular to households.

Labour costs

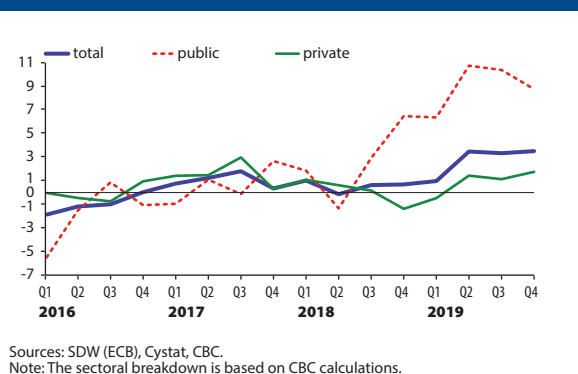
Although no data is available for 2020, the outbreak of the pandemic is expected to have a negative impact on labour costs despite compensatory measures taken to support jobs and incomes. Examples of such schemes include special allowances to affected workers employed in businesses subject to full or partial suspension of their operations as a result of the pandemic, which are in force until mid-June 2020.

A significant increase in labour costs is recorded in 2019. In particular, nominal compensation per employee increased by 2,9% in 2019, following a small rise of 0,5% in the previous year (**Chart A.17**). The rise in labour costs, especially as of 2019Q2, mainly reflects the increase in contribution rates towards the GHS. Specifically, compensation per public sector employee registered a significant increase of 9,1%, whilst the private sector recorded a small rise of 1%. In addition to the impact owing to the GHS, developments in compensation per public sector employee are attributable to the ongoing

CHART A.16 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 A.17 Nominal compensation per employee by sector
(annual change, %)



gradual restitution of crisis-era cuts in wages and pensions, in effect as of July 1, 2018, and, more generally, due to wage increases owing to promotions. Developments in nominal compensation per private sector employee are attributable to the impact of GHS, as wages registered a small decline. From a sectoral point of view, the aforementioned increase emanates from the sectors of trade, transportation, hotels and restaurants, information and communication as well as financial and insurance activities. The rise in the ultimate sector is attributable to the finalisation of the banking sector collective agreements, with retroactive application as of beginning of 2019.

At the same time, price developments in 2019 increased households' purchasing power, with real compensation per employee¹⁷ recording an annual rise of 2,5%, following a drop of 1,1% in the previous year (Chart A.18). Productivity, calculated as the change in real GDP per employed employee, recorded a marginal annual increase of 0,1% during the year under consideration while it remained unchanged in 2018 (Chart A.18).

The aforementioned significant rise in labour costs in 2019 is reflected in developments in the unit labour cost index, an important competitiveness indicator for an economy vis-à-vis competitor economies. This indicator, which is determined by the difference in nominal compensation per employee growth and productivity growth, recorded an annual increase of 2,8% in 2019, essentially due to unchanged productivity growth, following a rise of 0,6% in the previous year (Chart A.19a). However, and

17. It should be noted that the deflator used is that of private consumption rather than the CPI.

CHART A.18 Productivity and real compensation per employee
(annual change, %)

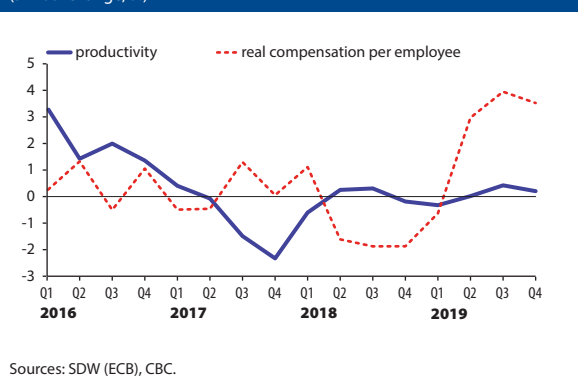
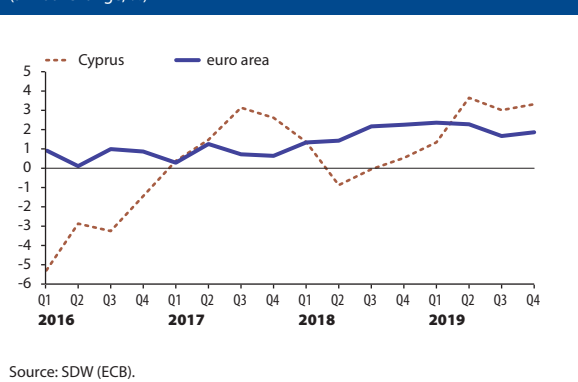


CHART A.19(a) Unit labour costs: Cyprus and the euro area
(annual change, %)



despite the significant increase recently observed, significant cumulative wage cuts since 2012 and beyond the crisis, helped maintain the competitiveness of the Cyprus economy over the long term. In particular, the index recorded a cumulative drop of 13,4% in the period 2013-2016 and, despite the small increases recorded since then, remains at lower levels compared with the euro area index as of 2019, **Chart A.19b**).

2.2 Domestic Competitiveness and the Balance of Payments

Effective exchange rate

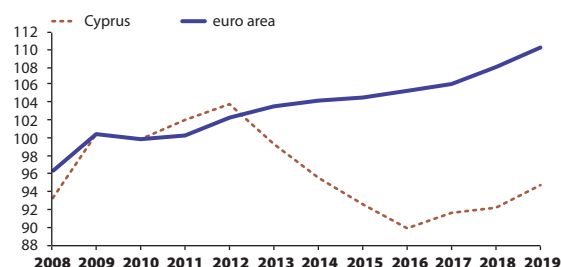
Chart A.20 shows the effective exchange rate (EER) index of the euro in Cyprus, in nominal (NEER) and real (REER)¹⁸ terms, as calculated by the IMF. Both indices weakened in 2019 and up to the first two months of 2020. In March, the aforementioned indices strengthened, a trend that did not continue in April. Overall, the trend of the REER index, as well as, the widening of the gap between the NEER and REER indices was influenced by developments in the nominal value of the euro, but most importantly by domestic developments, and in particular 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 and a lower REER in Cyprus compared with competing

18. The effective exchange rate index in Cyprus in real terms (REER) is calculated on a monthly basis by taking into account the trade relations between Cyprus and its 26 main trading partners (countries).

CHART A.19(b) Unit labour costs: Cyprus and the euro area

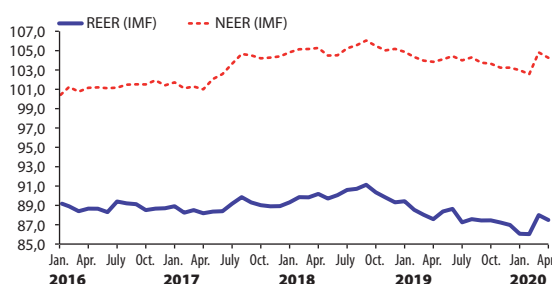
(index 2010=100)



Source: SDW (ECB).

CHART A.20 Real and nominal effective exchange rates (IMF weights)

(base year 2010 = 100)



Source: IMF.

countries, suggest that domestic exports tend to be more price competitive. In general, inflation is related to, among other factors, both variables mentioned above and therefore, also reflects the degree of competitiveness of the Cyprus economy. The adoption of measures affecting salaries and other benefits both in the public and private sectors, in the period of the financial crises, has reduced unit labour costs for the whole economy, and retained them at lower levels than in the euro area, thus maintaining competitiveness and supporting the recovery of the Cyprus economy in the medium term.

Balance of payments¹⁹

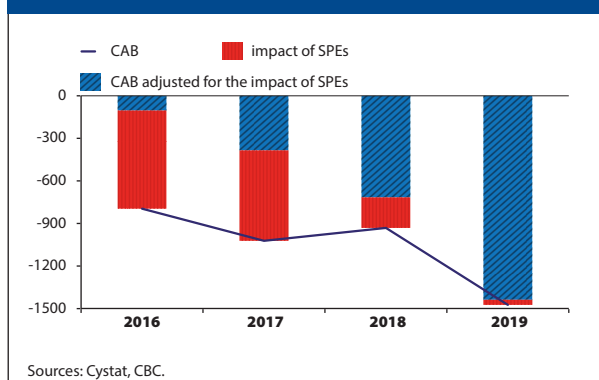
In 2019, the current account deficit deteriorated, reaching €1.473,5 million (-6,7% of GDP), compared with a deficit of €931,2 million (-4,4% of GDP) in the previous year (Table A.4 and Chart A.21). This development is mainly attributed to the widening of the deficit in the primary income account and, to a lesser extent, to the reduction in the surplus of the services balance. The current account deficit, adjusted for the impact of SPEs, also worsened and reached €1.438,2 million (-6,6% of GDP), compared with -€715,9 million (-3,4% of GDP) in 2018 (Table A.4 and Chart A.21). It is noted that the current account deficit in 2019 does not deviate much from the adjusted one, since the net effect of non-financial SPEs on the balance of goods in 2019, was offset by the adjustment (in terms

TABLE A.4 Balance of payments (main categories)

	2018 (€ million)	2019 (€ million)	Change (€ million)
Current account balance	-931,2	-1.473,5	-542,3
Current account balance adjusted for the impact of SPEs	-715,9	-1.438,2	-722,3
Goods and services balance	166,2	-30,8	-197,0
Trade balance	-4.672,9	-4.714,2	-41,4
Exports of goods	3.608,3	3.032,9	-575,4
of which:			
exports of goods - SPEs	1.460,4	998,2	-462,2
Imports of goods	8.281,2	7.747,2	-534,0
of which:			
imports of goods - SPEs	2.089,4	1.298,7	-790,7
Services balance	4.839,1	4.683,4	-155,7
Exports of services	11.836,2	12.321,7	485,5
Imports of services	6.997,1	7.638,3	641,2
Primary income (net)	-744,4	-1.170,6	-426,2
Secondary income (net)	-353,0	-272,1	80,9
Current account balance (% of GDP)	-4,4	-6,7	
Current account balance adjusted for the impact of SPEs (% of GDP)	-3,4	-6,6	

Sources: Cystat, CBC.

CHART A.21 Current account balance (CAB) (€ million)



Sources: Cystat, CBC.

19. 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.

of depreciation and tonnage tax) in reinvested earnings.

More specifically, the trade deficit of goods increased in 2019, reaching €4.714,2 million, compared with a deficit of €4.672,9 million in 2018, despite the improvement recorded from SPEs transactions. Exports of goods (excluding SPEs exports) decreased mainly due to a one-off factor (termination of aircraft leasing by Cobalt in 2018, given its closure). On the contrary, net exports of goods under merchanting and exports of domestic goods increased (**Table A.4**, p. 37). Moreover, imports for home consumption increased, driven by the growth in private consumption and investment.

Imports of intermediate inputs increased significantly, while oil imports decreased due to the decline of oil prices. In 2020, imports for home consumption are projected to decrease due to the expected contraction in domestic demand (see *Macroeconomic Forecasts*, p. 59).

The surplus of the service balance decreased in 2019 and reached €4.683,4 million compared with €4.839,1 million in the previous year. This was mainly due to the proportionally larger increase recorded in imports of services compared with the rise recorded in exports of services (**Table A.4**, p. 37). Exports of services are considered to be important, for analysis purposes, as Cyprus is a tourist destination and a business centre. In 2020, the spread of the pandemic and the restrictive measures taken by the Republic of Cyprus and other states are expected to have a negative impact on exports of services and especially in the tourism sector.



In 2019 exports of services (Table A.5) recorded an annual increase of 4,1% (€485,5 million), mainly driven by the category of telecommunications, computer and information services (€306 million). The aforementioned category increased, due to the rise in the turnover of the companies operating in the sector. Similarly, increases in the corresponding category of imports can also be attributed to the above factor. Other business services (€53,3 million), financial services (€25,9 million) and transport (€12,5 million), also increased. The travel category, which includes revenues from tourism, recorded a small decrease of €27,2 million, resulting from the 2% drop in per person expenditure, since the number of tourist arrivals recorded increases. Current developments and more recently available data on tourism, are described in the subsequent sub-section (see Tourism p. 41).

At the same time, imports of services increased by 9,2% (€ 641,2 million) in 2019, mainly from the category of telecommunications, computer and information services (€637,8 million), as explained above. Other main categories of imports that increased are transport (€ 92,3 million) and travel (€ 20,8 million), while other business services decreased (€ 37,1 million) (Table A. 5).

The primary income account (which mainly includes income from employment and investment) recorded a larger deficit than in the previous year, of the order of €1.170,6 million. The widening in the primary income account is exclusively associated with developments in direct investment income (from a net receivable balance of € 231

TABLE A.5 Services balance (main categories)
(€ million)

	2018	2019	Change
Services balance	4.839,1	4.683,4	-155,7
Exports of services	11.836,2	12.321,7	485,5
<i>of which:</i>			
Transport	3.113,3	3.125,7	12,5
Travel	2.939,5	2.912,3	-27,2
Financial services	2.992,4	3.018,3	25,9
Telecommunications, computer and information services	2.022,3	2.328,3	306,0
Other business services	225,7	279,0	53,3
Imports of services	6.997,1	7.638,3	641,2
<i>of which:</i>			
Transport	1.822,5	1.914,8	92,3
Travel	1.316,3	1.337,1	20,8
Financial services	1.386,8	1.388,6	1,8
Telecommunications, computer and information services	1.051,7	1.689,5	637,8
Other business services	629,5	592,4	-37,1

Source: CBC.

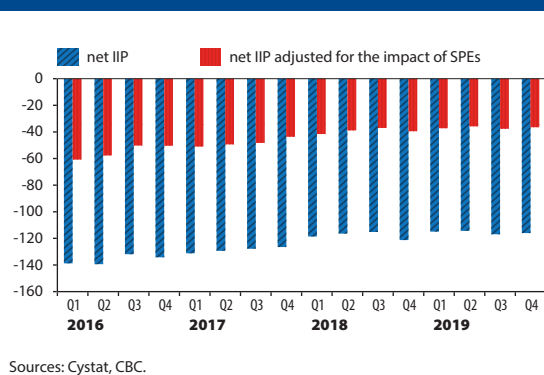
million, to a net payable balance of €379 million). This mainly reflects the better performance of Cypriot companies with foreign ownership in 2019 compared with 2018. The deficit in the secondary income account (which mainly includes current transfers) declined, mainly due to the increase in the amount raised by the government from European funds (Table A.4, p. 37).

The current account deficit in 2019, was mainly covered by transactions of the private sector and to a lesser extent by government borrowing.

The net International Investment Position (IIP) in 2019 was negative standing at - €25,5 billion (-116% of GDP) (Chart A.22). The IIP was negatively affected 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 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 substantial risk to the Cypriot financial system.

Adjusted for the impact of SPEs, the net IIP in 2019 improved by 79,6 percentage points, standing at -€8 billion or -36,5% of GDP, compared with -€8,4 billion or -39,5% of GDP in 2018 (Chart A.22). It is noted that, in 2019, the net IIP as a percentage of GDP was close to the threshold set by the European Commission.

CHART A.22 Net International Investment Position (IIP)
(as a percentage of GDP)



Tourism

Tourism constitutes one of the most important pillars of the Cyprus economy, and has been significantly affected by the restrictive measures taken by the Cypriot government and by many other countries, in order to control the spread of the pandemic. More specifically, from 15 March 2020, the Republic of Cyprus prohibited the entry of various categories of individuals, including tourists, in Cyprus territory, while all hotel units ceased their operations. It is certain, that the current year's tourism performance will be negatively affected. For this purpose, efforts are being made to mitigate the negative effects, by taking measures to support the sector and promote the Cypriot tourist product (see Macroeconomic Forecasts, p. 59).

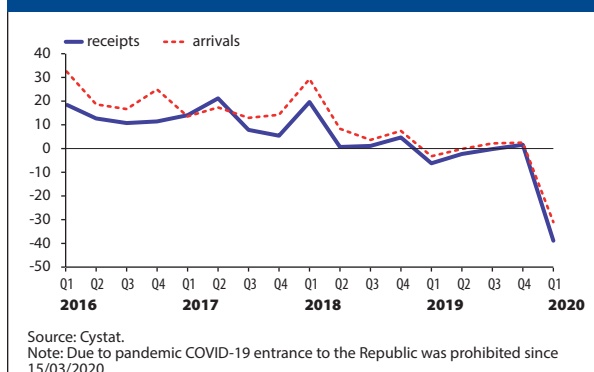
More specifically, in 2019, tourist arrivals recorded a more moderate growth of only 1% and reached 4 million tourists, following four consecutive years of significant increases (Table A.6 and Chart A.23). Tourist arrivals during the summer months (July and August), which have bigger weights in the year, contributed to the reversal of the negative trend observed in the first half of 2019 to positive growth rates. Regarding individual markets, arrivals from the United Kingdom increased marginally by 0,2% reaching 1,3 million tourists, despite the bankruptcy of the British Thomas Cook in September 2019. Large increases were recorded from Israel and Ukraine. On the contrary, arrivals from other important markets, such as Russia decreased by 0,2% reaching 0,8 million tourists. Arrivals from Germany decreased by 19,9%, being

TABLE A.6 Tourism

	Tourist arrivals (thous.)	Tourist receipts (€ million)	Expenditure per person (€)
2018	3.938,6	2.710,6	688,2
2019	3.976,8	2.683,0	674,7
annual % change	1,0	-1,0	-2,0
2018 Jan. - Apr.	357,5	188,6	527,6
2019 Jan. - Apr.	246,6	115,3	467,6
annual % change	-31,0	-38,9	-11,4

Note Due to pandemic COVID_19 entrance to the Republic was prohibited since 15/03/2020.
Source: Cystat.

CHART A.23 Tourist arrivals and receipts
(annual change, %)



negatively affected by the closing down of two airlines. Arrivals from Greece and Sweden also dropped.

In 2019, revenues from tourism recorded a decrease of the order of 1%, affected by the 2% decrease in per capita expenditure. This development is mainly attributed to the decrease in the average length of stay from 9,2 days to 9,0 days, since the daily per capita expenditure increased slightly, by 0,4% (**Table A.6**, p. 41).

On the basis of available data for the first three months of 2020, tourist arrivals and revenues declined by 31% and 38,9%, respectively (**Table A.6** and **Chart A.23**, p. 41) driven by the significant reductions recorded in March. This is due to the closing down of airports and the cancellation of all international flights, to and from Cyprus, as from 15 March 2020. This action caused a greater impact in the following months, with near tourist arrivals in April and May. The airports are scheduled to reopen on 9 June 2020, but with various conditions and for different categories of countries. It is noted that Cyprus' two largest tourist markets, the United Kingdom and Russia, due to their epidemiological picture, have not been included in the list of countries from which tourists will be accepted either in the first phase (9 – 19 June) or in the second (from 20 June). As regards hotels, these are scheduled to reopen on 1 June.

Cyprus took measures on time and responded fast and efficiently against the pandemic, maintaining its reputation as a safe destination. It is ranked high in the list, among the safest countries in the world for someone

to visit in the summer of 2020. The fact that Cyprus' major competitor destinations, such as Turkey and Egypt, did not deal effectively with the virus, is considered to be an advantage for Cyprus. Also, the restoration of Cyprus' air connectivity with existing and new destinations is important, as well as the advertising and promotion of Cyprus as a safe destination.

For the period following the virus, the ongoing efforts to support further and upgrade the tourist product are noted, through hotel renovations and new infrastructure, such as the construction of marinas and luxurious hotels. Furthermore, with the construction of the casino resort by 2022, increased tourist arrivals are expected from existing and new markets.

2.3 Domestic Demand, Production and the Labour Market

Quarterly national accounts²⁰

As of mid-March 2020, the Cyprus government gradually introduced important restrictive measures, which included, inter alia, restrictions on the movement of citizens both within Cyprus and across borders as well as the closing of businesses across various sectors, in order to protect citizens from the pandemic. As a result, these measures led to an abrupt shutdown or a significant deceleration in economic activity, particularly in the sectors of hotels and restaurants, manu-

20. With the introduction of the ESA 2010 and BPM6 statistical methods, total exports and imports of Cyprus as well as gross fixed capital formation include, inter alia, the transfer of economic ownership of mobile transport equipment (mainly ships) by SPEs, which affect the aforementioned GDP expenditure sub-categories. However, given the double entry accounting system they do not affect the level and growth rate of GDP.

facturing, arts, entertainment and recreation, other service activities and construction. Based on the most recent preliminary (seasonally adjusted) data, GDP recorded a positive, albeit a significantly decelerated, growth rate of 0,8%²¹ in 2020Q1, following a year-on-year increase of 3,2% in the previous quarter.

The disruption in economic activity is expected to halt the positive trends recorded in the Cyprus economy to date. Based on the detailed data available until 2019Q4, GDP recorded an annual increase of 3,2% in 2019 compared with 4,1% in the previous year (Table A.7). The annual growth of 3% in private consumption reflected the increase in household disposable income owing to the rise in employment and wages, in particular as of 2019Q2 (see Labour Costs, p. 34). Public consumption increased significantly by 11,3% due to the increase in intermediate consumption (see Domestic fiscal developments) and, to a lesser extent, the rise in compensation of employees (see Labour costs, p. 34). The annual increases registered in gross fixed capital formation (0,1%) as well as in exports and imports of goods and services (2% and 1,5%, respectively) were largely influenced by the transactions of SPEs.

Adjusted for the impact of SPEs, it emerges that GDP growth in 2019 was due to the significant rise in private and public consumption and, to a lesser extent, the increase in gross fixed capital formation. Gross fixed capital formation slowed in 2019, following a significant increase in 2018, owing to the completion of various construction

TABLE A.7 National accounts in real terms by category of expenditure
(annual change, %)

	2016	2017	2018	2019
GDP	6,7	4,4	4,1	3,2
Private consumption	4,4	4,5	3,3	3,0
Public consumption	-0,9	2,1	3,5	11,3
Gross fixed capital formation	48,9	24,1	-6,6	0,1
Exports of goods and services	7,2	8,7	4,6	2,0
Imports of goods and services	9,0	12,8	2,4	1,5

Source: Cystat.

21. According to Cystat, it is essential to note that the various limitations on data sources, resulting from the COVID-19 pandemic, suggest that future revision of the Flash Estimate may be of a greater magnitude than usual (positive or negative).

projects. Net exports, after adjusting for the impact of SPEs, contributed negatively to the 2019 GDP growth rate. More specifically, exports recorded a significant annual increase in 2019 compared with a marginal decline in 2018, mainly due to the significant increase in revenues from the telecommunications, computer and information services sector, which was partially offset by a reduction in exports of goods (see Balance of Payments). Growth in imports accelerated even further in 2019, following the rise observed in 2018, primarily due to the increase in imports for services (especially telecommunications, computer and information services) and, to a lesser extent, for goods (see Balance of Payments, p. 36).

From a sectoral point of view, economic growth in 2019 was relatively broad-based (Table A.8). The sector with the most important contribution to GDP growth was construction (with the contribution of the aforementioned sector amounting to 0,8 percentage points). The sectors of trade, transportation, hotels and restaurants (0,7 percentage points) as well as professional, scientific and administrative activities (0,5 percentage points) also contributed positively to GDP growth. A negative contribution was recorded only by the financial and insurance activities sector (0,5 percentage points), mainly as a result of the sale of NPF portfolios by banks to non-financial institutions as well as due to the ongoing deleveraging of loans through organic reductions.

Recent economic indicators document the negative impact of the pandemic on the Cyprus economy. GDP growth closely follows

TABLE A.8 Weighted contributions to real GDP growth by economic activity
(percentage points)

	2016	2017	2018	2019
GDP (%)	6,7	4,4	4,1	3,2
Construction	0,9	0,9	1,3	0,8
Trade, transportation, hotels and restaurants	1,7	1,8	1,2	0,7
Financial and insurance activities	-0,9	-0,7	-1,3	-0,5
Professional, scientific and administrative activities	0,7	0,4	0,6	0,5
Other sectors ⁽¹⁾	4,4	2,0	2,3	1,7

Source: Cystat.

Note: (1) Main sectors included are those of agriculture, manufacturing, public administration, education and health as well as information and communication.

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developments in the Economic Sentiment Indicator (ESI), which point to the abrupt suspension of the previously observed positive GDP path for the Cyprus economy. Specifically, the ESI reached 74,5 in April 2020 compared with 110,2 in April 2019 and 108,5 in December 2019 (**Table A.9**). In general, the decline in the index especially since March 2020, is mainly due to the deterioration in the business climate in services, retail, manufacturing as well as the decline in consumer confidence. Following an annual drop of 52,6% in April, consumption of electricity recorded a further decrease until May 14, 2020 (prior to the rise in temperatures), which is consistent with the foreseen contraction in both private consumption and investment. In addition, VAT receipts (as compiled on a cash basis and which include relevant returns) registered a significant annual decrease of 18,9% in March 2020, reflecting the significant impact on economic activity owing to the imposition of restrictive measures and the closure of businesses following the outbreak of the pandemic.

The deterioration in private consumption is captured in various economic indicators. The turnover index of retail trade fell by 1,4% in March 2020 following a year-on-year increase of 11,5% the previous month (**Chart A.24**). Regarding credit card payments, spending by Cypriot cardholders in Cyprus (adjusted for payments associated with government services and for petroleum products) recorded a year-on-year decrease of 6,9% in April compared with a rise of 11% the previous month (**Chart A. 25**). During the first

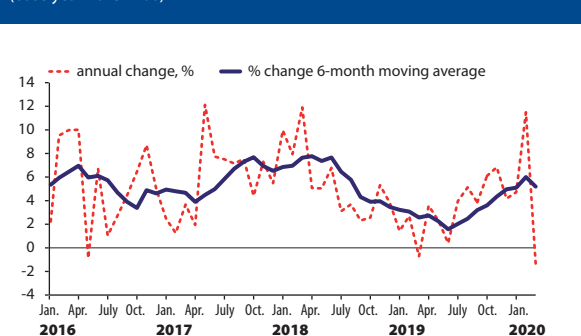
TABLE A.9 Business and consumer surveys: confidence indicators

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

	2019 June	2019 Sep.	2019 Dec.	2020 Mar.	2020 Apr.
ESI	109,7	111,7	108,5	101,4	74,5
Industry	9	7	8	3	-43
Services	24	33	24	6	-48
Consumer	-8	-4	-7	-23	-33
Retail trade	2	-3	-5	-5	-25
Construction	-4	-3	2	-9	-9

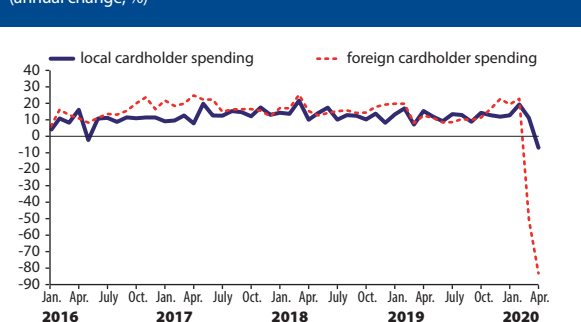
Source: European Commission.
Note: Seasonally adjusted data.

CHART A.24 Retail sales (excluding motor vehicles)
(base year 2015=100)



Source: Cystat.

CHART A.25 Credit card spending in Cyprus
(annual change, %)



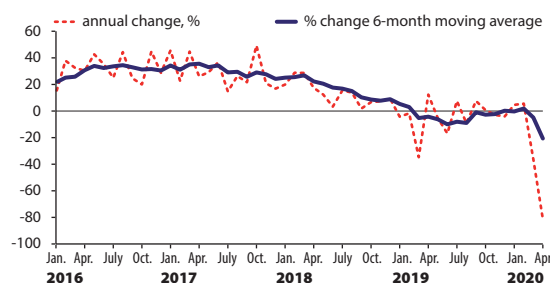
Sources: JCC Payments System Ltd, CBC.
Note: The data does not include payments associated with government services and petroleum products.

two weeks of May, there was a further annual decline in credit card payments. Significant annual reductions by 36,2% and 81,3% in March and April, respectively, were recorded in motor vehicle registrations, in the context of deteriorating consumer confidence (**Chart A.26**).

The pandemic also had a significant impact on investment, with various real estate indicators demonstrating that activity in the construction sector as well as demand for real estate declined significantly following the outbreak of the pandemic (see Real estate sector and **Table A.10**, p. 51). It is noted that in the first phase of the lifting of restrictions on various economic sectors, construction sites reopened. Overall, construction activity is expected to recover relatively quickly due to the large and multi-year projects that have already begun, some of which are of foreign interest. These projects include renewable energy generation infrastructure, various residential, commercial and mixed developments, marinas, hotel units and the casino-resort.

In relation to external demand for services, tourist receipts recorded an annual decrease of -73,5% in March, due to the imposition of travel restrictions (see Tourism, p. 41). At the same time, spending by foreign credit cardholders in Cyprus recorded annual declines of 50,6% and 83,2% in March and April, respectively (**Chart A.25**, p. 46). In the field of professional services, the available data relate only to the first two months of the year and point to a continuous annual decrease of 18,3% as regards applications for new company registrations in Cyprus. This development may be related to the more

CHART A.26 Registration of motor vehicles



Source: Cystat.

stringent supervisory measures adopted in relation to shell companies. The outbreak of the pandemic is expected to negatively affect the relevant data as of March 2020, partly due to the shutdown in economic activity and the deterioration in the business climate.

As previously mentioned, there has been a decrease in new loan contracts to the non-financial private sector, especially to non-financial corporations in 2020Q1 compared with the corresponding quarter of the previous year (see Monetary aggregates, p. 28). This led to a negative rate of change in loans to non-financial corporations in 2020Q1, while households continued to record a low but positive annual rate of change, partly supporting economic growth (**Chart A.12**, p. 30). The suspension of loan repayments between March 2020 and end-2020, aiming to strengthen the liquidity position of households and businesses amid the pandemic, is expected to mitigate the envisaged declines in private consumption and investment for the current year. In the coming years, a gradual recovery in new lending is foreseen, which by 2022 is expected to outperform loan repayments, thus contributing positively to the GDP path.

Real estate and construction sector

The real estate sector in Cyprus is showing a deceleration in the upward trend recorded in previous years. The slowdown in real estate demand which started in the second half of 2019, specifically after the application of the stricter criteria for the Cyprus Investment Program, continued during the first months of

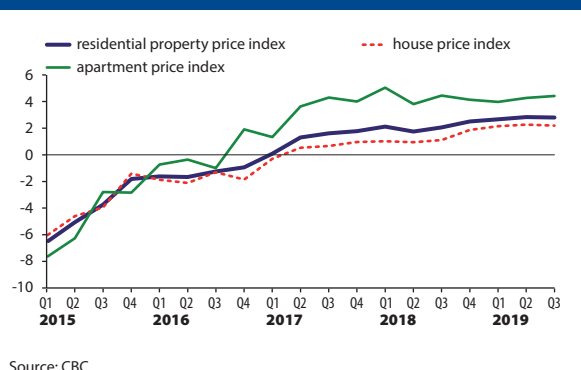
2020 and worsened in March and April due to the pandemic. The restrictive measures also affected the construction activity as well as the expectations of the participants in the real estate market. The prices of residential properties until the end of 2019 show modest increases, with the exception of areas affected by specific factors, such as the coastal front of Limassol and Larnaca. However, according to preliminary unpublished data from the CBC, house price increases slowed further in 2020Q1. It remains questionable to what extent factors that have helped significantly in the recovery of the sector in the past, such as real estate demand from abroad, new domestic credit and the course of unemployment, will continue to fuel the real estate market after the recovery of the economic activity.

The contribution of the construction sector to domestic GDP growth is slowing down. Specifically, it amounted to 1,3 and 0,8 percentage points in 2018 and 2019, respectively, while activities related to real estate management amounted to 0,8 and 0,1 percentage points of GDP in 2018 and 2019, respectively. In addition, according to data from Cystat, investment in dwellings amounted to € 1.589,7 million in 2019, compared with € 1.235,5 million in 2018, as well as investment in other buildings and construction amounted to €996,9 million in 2019 compared with € 992,2 million in 2018. Based on the above, it can be inferred that construction activity in Cyprus, despite the fact that it relates to a large extent to residential projects, it also relates to productive projects such as marinas, offices,

shopping malls, hotels, projects in renewable energy sources which increase the potential GDP. In addition, given the significant increase already recorded in 2019 and the subsequent impact of the pandemic on the sector in 2020, the aforementioned trend in housing projects is not expected to continue in 2020.

According to available data from the CBC's Residential Property Price Index (RPPI), real estate prices increased in 2019Q4. In particular, residential property prices increased in 2019Q4 by 0,3% on a quarterly basis and by 2,2% on an annual basis (**Chart A.27**). The varying increases per type of residential property (houses and apartments) and per district observed in previous quarters continued during 2019Q4 as well. The largest increases were recorded in apartment prices in the districts of Limassol and Larnaca, by 7,6% and 7,4%, respectively. According to a detailed analysis of the available raw data, large increases are observed in specific areas of both Limassol and Larnaca. In specific coastal areas of Limassol, apartment prices recorded a cumulative increase in the period 2015 - 2018 between 17% - 28% (depending on the selected area). The corresponding increases in apartment prices for the same period in the rest of Limassol ranged only between 3% - 7%. The large increase in prices in coastal areas began to spread in other non-coastal areas of Limassol in 2019. Apartment prices in the aforementioned non-coastal areas increase approximately by 6,4% in a year, compared with a 10% increase in the same period in the specific coastal areas. Regarding Larnaca, the increase in apartment

CHART A.27 House and Apartment price indices
(annual change, %)



prices in the city's main coastal front for the period 2017 - 2019 was estimated between 13% - 25% (depending on the area selected), with the largest part of the increases recorded in 2019. For the entire district of Larnaca, the average annual increase in apartment prices in the period 2017-2019 was only 4,1%. According to preliminary and unpublished data from the CBC, the increases in residential property prices continued to slow down in 2020Q1.

The house price index of Cystat, which presents different results compared with the respective index of the CBC due to the fact that it is based on a different methodology and is compiled on the basis of transactions data, recorded a quarterly decrease by 5,9% and 3,7% in 2019Q3 and 2019Q4, respectively. On an annual basis, the aforementioned index recorded an increase of 2,3% in 2019Q3 and a decrease of 4,8% in 2019Q4.

According to more recent data, demand for real estate was significantly affected by the outbreak of the pandemic, although the negative trend had already begun before the appearance of the corona-virus. Specifically, according to sales contracts data from the Department of Lands and Registry (DLS), the sales showed an annual decrease of 3,1% and 11,4% in January and February 2020, respectively. Sales also recorded annual reductions of 33,4% and 79,6% in March and April, respectively (**Table A.10**). A similar picture is evident in the number of sales to local and foreign buyers (**Table A.10**), which show that demand was affected for both local and foreign buyers. It is a fact that the restrictive measures due to the pandemic

TABLE A.10 Real estate sector
(annual change, %, unless otherwise stated)

	Jan.-Apr. 2019	Jan.-Apr. 2020	Apr. 2019	Mar. 2020	Apr. 2020
Sales contracts (total)	23,0	-35,5	61,4	-33,4	-79,6
Sales contracts (locals)	37,0	-35,8	90,9	-25,1	-85,4
Sales contracts (foreigners)	9,2	-35,2	31,6	-42,4	-71,1
Building sentiment indicator (average of index)	-10,1	-5,6	-9,6	-9,1	-9,3
Property price expectations for the next 3 months (average of index)	16,1	7,2	21,0	9,8	-9,0
Price index of construction materials	1,6	-0,5	1,6	-0,6	-0,6

Sources: Cystat, DLS, European Commission.

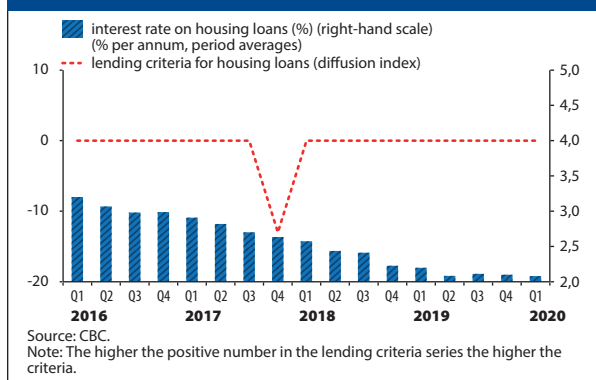
highlighted the need for electronic means of conducting real estate transactions, as the lack of this possibility has greatly affected the completed transactions.

According to CBC's Monetary and Financial Statistics, pure new housing loans fell by 13,4% and 26,9% year-on-year in 2019Q4 and 2020Q1, respectively, reflecting the reduced demand for real estate. It is noted that, according to Bank Lending Survey, demand for lending for house purchase remained unchanged in 2020Q1, with a decrease expected in 2020Q2 (Table A.3, p. 31). Demand for lending in the coming quarters is expected to depend to a large extent on the course of unemployment as well as on developments in the environment of hitherto low interest rates (Chart A.28).

Construction activity continued to record an upward trend throughout 2019, with the index of production in construction for buildings, published by Cystat, recording an annual increase of 13,6% in 2019Q4. It is noted that there is still no data available for 2020 in order to assess the impact of the pandemic on construction activity. Although the number of authorised building permits in the first two months of 2020 recorded an annual increase of 5,6%, the effects of the pandemic are expected to affect construction activity in the medium term, as some projects are likely to be postponed. Many potential buyers may also postpone the decision to buy a property for the future due to market uncertainty, which will inevitably have an impact on the sector.

According to the European Commission's Business and Consumer Surveys, the market

CHART A.28 Lending criteria and interest rate on housing loans

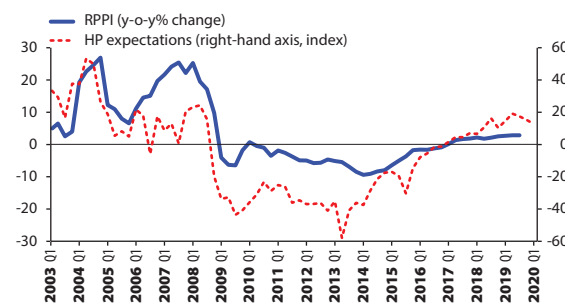


expects a decrease in real estate prices, index of expectations for property prices for the next three months reached -9,0 in April 2020 compared to an average of 12,6 in the first quarter of 2020 (**Chart A.29**). The reversal of the positive sentiment in the real estate sector is also recorded by other relevant indicators included in these surveys. However, conditions in the real estate sector are expected to normalise in the medium-term future, as demand from abroad returns and the course of domestic economic activity normalises.

Labour market

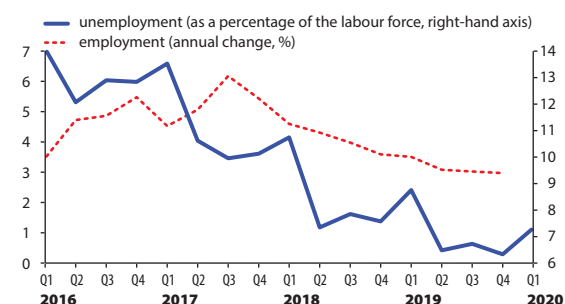
The pandemic interrupted the steady recovery that has been observed in the labour market until recently. Although there are no employment data available from National Accounts for 2020, a negative impact is expected from the outbreak and spread of the virus, in line with the LFS data relating to the first quarter of the current year. Based on the available National Accounts data relating up to 2019Q4, and in line with the GDP path, employment growth decelerated, reaching 3,1% in 2019, following a rise of 4,1% in the previous year (**Chart A.30**). The rise in employment emanated mainly from the sectors of trade, transportation, hotels and restaurants, construction as well as professional, scientific and administrative activities. According to the LFS, the increase in 2019 is mainly due to employment of non-Cypriots, especially in hotels and construction where staff shortages have been recorded. LFS data for 2020Q1 point to a continuous rise in employment of non-Cypriots. Total hours

CHART A.29 Residential property price index (RPPI) vs House Price Expectations for the next three months



Sources: CBC, BCS European Commission.

CHART A.30 Unemployment and employment



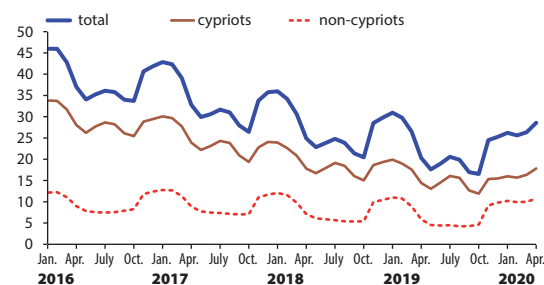
Source: Cystat (LFS).

worked rose by 2,9%, following an annual increase of 3,4% in 2018. Hours worked per employed person dropped by 0,2% in the year under consideration following a decrease of 0,7% in 2018.

The effects of the pandemic are reflected in the data on registered unemployment, with the interruption of the previously observed downward trend clearly visible in the April data²². In particular, the number of registered unemployed (**Chart A.31**) increased by 40,7% on a year-on-year basis (from 20.315 to 28.591 individuals). According to EUROSTAT, the harmonised unemployment rate (seasonally adjusted data) reached 6,7% in March 2020 relative to 7,6% in the corresponding month of the previous year, but rose sharply compared with 5,8% in February 2020. On the other hand, the LFS data up until 2020Q1 capture the previously observed downward trend in the unemployment rate, reaching 7,3% of the labour force compared with 8,8% in 2019Q1 (**Chart A.30**, p. 53). The decrease in unemployment in 2020Q1 is attributable to the drop in the number of unemployed Cypriots. Another positive point is that, the unemployment rate in Cyprus has been below the euro area average since 2019Q2, according to seasonally adjusted data. At the same time, the youth unemployment rate fell to 14,5% in 2020Q1 compared with 19,8% in the corresponding quarter of the previous year, but this only constitutes about 1,1

22. According to information by the Department of Labour, the comparison of the data of the months March and April 2020 with the data of the previous months is not considered safe. This is due to the implementation by the Public Employment Service of the extraordinary measures announced by the Ministry of Labour, Welfare and Social Insurance for automatic renewals of registered unemployed and new registrations of unemployed people without their physical presence in order to avoid the spread of coronavirus.

CHART A.31 Registered unemployment
(number of unemployed, thousands)



Source: Cystat.

percentage points of the overall unemployment rate for the quarter in question.

An important parameter associated with the analysis of labour market developments relates to the path of long-term unemployment given that, in periods of persistent high unemployment, the long-term unemployed find it harder to re-integrate into employment. According to the most recent CYSTAT data on the number of registered unemployed, a rise of 547 individuals was recorded in April 2020 compared with the corresponding month of the previous year. Although small, the aforementioned increase halted the downward trajectory of the number of long-term unemployed observed since December 2014. According to LFS data, the unemployment rate with a duration of six months and over remained virtually unchanged in 2020Q1 (3,1%) compared with the corresponding quarter of the previous year (**Chart A.32**). Overall, the available economic data capture the negative impact owing to the outbreak of the virus upon the labour market, which interrupted the previously observed recovery path. It should be noted that the measures adopted are expected to mitigate to some extent the adverse repercussions of the pandemic on the labour market.

2.4 Domestic Fiscal Developments

The pandemic and the containment measures for citizens as well as the mandatory suspension of business operations for various economic activities, have significantly affected public finances too. The necessary

CHART A.32 Unemployment by duration
(as a percentage of the labour force)



measures to support the economy have increased public expenditure, while the steep interruption in economic activity has an impact on public revenues. The effect of the spread of the pandemic on public finances is expected to be reflected mainly on 2020Q2, data.

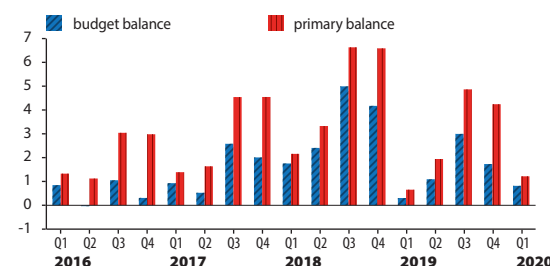
For the first quarter of the year, according to data by Cystat, the budget balance was at a surplus of 0,8% of GDP compared with a surplus of 0,3% of GDP in the corresponding quarter of 2019 (Chart A.33 and Table A.11). The quarter of the previous year was affected by a €285 million one-off impact on government expenditure (“other capital expenditure” in Table A.11). In particular, this one-off impact was a result of last year’s amendment of the Income Tax Law of 2002, related to the accounting treatment of accumulated tax losses transferred to a credit institution from another credit institution²³. Adjusting the data for this impact, the surplus of last year’s first quarter would have been at 1,6% of GDP.

In 2017-2018, the annual growth in revenue was significantly higher than the annual growth in expenditure (Chart A.34, p. 57), allowing for the realisation of significant surpluses in this period. This trend was reversed in 2019, mainly due to the aforementioned amendment of the Income Tax Law. For 2020Q1, due to the base effect of this one-off impact, government expenditure recorded a negative growth rate.

In more detail, the budget balance of 2020Q1 was affected by the increase in social contributions and sales (10,4% and 28,9% respectively, compared with the first quarter

CHART A.33 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 2015Q4 (€175 million) and for 2018Q3 (€1,5 billion) do not include the fiscal impacts associated with the Cyprus Cooperative Bank (CCB).

TABLE A.11 Accounts of general government

	Jan.-Mar. 2019 (€ million)	Jan.-Mar. 2020 (€ million)	Change %
EXPENDITURE			
Intermediate consumption	149,9	288,4	92,4
Compensation of employees	594,7	641,4	7,9
Social transfers	610,4	647	6,0
Interest	76,8	80,1	4,3
Subsidies	9,6	10,4	8,3
Other current expenditure	153,3	154,7	0,9
Gross fixed capital formation	38,6	83,3	115,8
Other capital expenditure	295,9	13,1	-95,6
Total expenditure	1.929,2	1.918,4	-0,6
Total expenditure as a % of GDP	8,8	9,6	
REVENUE			
Taxes on production and imports	759,5	750,6	-1,2
Current taxes on income, wealth, etc	494,7	500,8	1,2
Social contributions	517,9	571,7	10,4
Other current resources	44,2	44,1	-0,2
Sales	128,5	165,6	28,9
Capital transfers received	46,4	45,4	-2,2
Property income	4,8	4,4	-8,3
Total revenue	1.996,0	2.082,6	4,3
Total revenue as a % of GDP	9,1	10,4	
Primary balance	143,6	244,3	
Primary Balance as a % of GDP	0,7	1,2	
Surplus (+) / Deficit (-)	66,8	164,2	
Surplus (+) / Deficit (-) % of GDP	0,3	0,8	

Sources: Cystat, CBC.

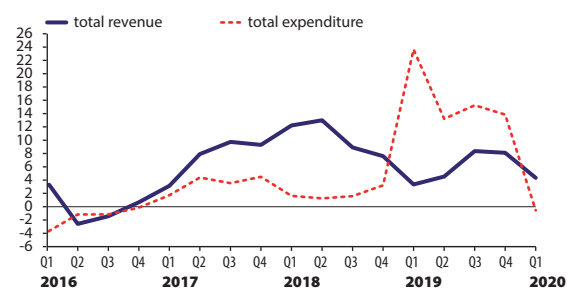
23. Currently, the amendment affects the treatment of income tax losses of Laiki Bank that were transferred to Bank of Cyprus in 2013, as part of Laiki's resolution.

of 2019, Table A.11, p. 56), due to the implementation of the GHS. Public expenditure decreased compared with the corresponding period of 2019 due to the aforementioned one-off impact, however, this decrease was significantly offset by the increase in intermediate consumption (92,4%), compensation of employees (7,9%) and gross fixed capital formation (115,6%). The increase in intermediate consumption mainly reflects GHS-related expenditure, as GHS was not in effect in the corresponding period of 2019. The increase in employees' compensation mainly reflects the gradual restitution of public wages. To a lesser extent, it reflects the granting of increments, the payment of cost-of-living allowance, and higher contributions of the State as an employer due to the introduction of GHS contributions from March 2019.

Government debt (Chart A.35) it stood at 106,6% of GDP in March 2020, recording an increase higher than 10 percentage points compared with December 2019 (95,5% of GDP). This is mainly due to the significant contraction expected in GDP in 2020. In nominal terms, the increase amounted to around €560 million, as it was affected by the issuance of government bonds in January (€1,75 billion) which was partly offset by the repayment of a matured ten-year bond (€700 million) and the early repayment of the IMF loan (€717 million) in February. Government debt is expected to further increase in the second quarter of the year due to the dual issuance of EMTNs in April, totalling €1,75 billion, and the issuance of a domestic bond in the same month, amounting to €1,25

CHART A.34 Total revenue and expenditure of the general government

(cumulative for the period as from Q1, annual change, %)

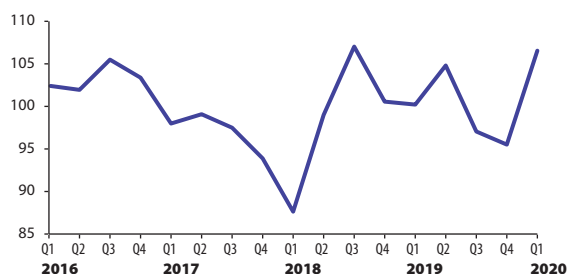


Sources: Cystat, CBC.

Note: Total expenditure for 2015Q4 (€175 million) and for 2018Q3 (€1,5 billion) do not include the fiscal impacts associated with the Cyprus Cooperative Bank (CCB).

CHART A.35 General government consolidated gross debt

(as a percentage of GDP)



Sources: Cystat, CBC.

billion. The purpose of the April issuances was to cover the financing needs created by the pandemic and to create a cash buffer in accordance with the Public Debt Management Law of 2012.

Following the projected increase in 2020, public debt is expected to decline significantly in the coming years, reflecting the estimates for the recovery of the economy. It is noted that the rating agencies expect a significant reduction in government debt, thus any derailment, other than the needs created by the pandemic, will have a serious impact on the credibility of fiscal policy. A significant development in 2020 is the substantial interest by investors for the dual issuance of a ten-year (€1 billion) and a twenty-year (€0,75 billion) bond in January, with extraordinary low interest rates, 0,625% and 1,25% respectively. In contrast, the dual issuance in April attracted relatively low demand, however, given the current juncture, interest rates can be considered quite satisfactory.

The government, in an effort to mitigate the negative effects of the pandemic on the economy, has implemented large fiscal measures that mainly affect government expenses. The overall envelope of the measures may exceed €1 billion or 5% of GDP. The largest share of these fiscal measures relates to the employment support schemes, while other important measures relate to direct subsidies to small and medium-sized enterprises, support to the health system and support to households for special leaves of absence from work (e.g. for vulnerable groups or for the care of children).



3. Macroeconomic forecasts for the Cyprus economy

- *Negative GDP growth rate in 2020 due to the pandemic and gradual recovery in the years 2021-2022, amid unprecedented uncertainty.*
- *Significant contraction in domestic demand and, to a lesser extent, net exports in 2020, with a gradual recovery in the coming years.*
- *Negative inflation in 2020, mainly due to the negative consequences of the pandemic but also due to the significant drop in oil prices.*
- *Subdued price rises in the coming years, despite the foreseen positive economic growth rates and the gradual wage increases.*
- *Slightly downside risks in relation to the baseline scenario for GDP and inflation for the period 2020-2022.*

Given the unprecedented uncertainty in relation to the evolution and impact of the pandemic, the Eurosystem Central Banks have developed three (mild, baseline, severe) as opposed to one scenario, as usual. Significant sources of uncertainty include the epidemiological picture over the medium term, the effectiveness of existing measures to reduce the spread of the pandemic, the magnitude and duration of their effects, the timing when a vaccine becomes available and the extent of permanent GDP losses. In particular, the mild scenario adopted by the Eurosystem foresees that the virus is successfully contained due to timely availability of a vaccine and assumes that the virus does not re-emerge. In the severe scenario, the virus is not successfully

contained, with a second wave emerging, thus necessitating the need to introduce new tough restrictive measures. Efforts to curb the spread of the virus are expected to affect the GDP course to a greater magnitude than in the baseline scenario until the vaccine becomes available by mid-2021. Therefore, the permanent loss in the GDP level is higher than in the baseline scenario. According to the mild and severe scenarios, the recession in 2020 is expected to reach -5,6% and -9,9% respectively, while in the baseline scenario to stand at -7,3%. The risks of deviating from the baseline GDP forecasts for the years 2020-2022 are slightly to the downside. Admittedly, the various limitations on data sources resulting from the pandemic, suggest that future revision of the GDP flash estimate for 2020Q1 may be of a greater magnitude than usual (positive or negative). Finally, it should be noted that the analysis that follows focuses on the baseline scenario.

The CBC's updated forecasts for GDP point to a deterioration in the economic outlook for the period 2020-2022 compared with those published in the December 2019 *Economic Bulletin*. The significant downward revision in GDP for 2020 is attributable to the impact of the outbreak and spread of the virus, in conjunction with the closure of businesses operating across various economic sectors, with adverse effects on the business climate and consumer confidence. It is also due to the significant downward revision in external demand, owing to the effective closure of the country's borders, with a negative impact on both exports of services, especially tourism, as well as on the real estate sector. It must be

pointed out that the upward revision in the economic growth rates for 2021 and 2022 (base effect and partial coverage of GDP losses) compared to the previous forecasts is not able to compensate for the significant GDP loss foreseen in 2020. As such, real GDP at end-2022 is expected to reach lower levels than those projected in December 2019.

The updated HICP inflation forecasts have been revised down for the years 2020 and 2021 compared with those published in December 2019. Compared with the headline HICP inflation projections, the HICP inflation excluding energy and food prices (core inflation) forecasts have been revised downward to a greater extent relative to those published in December 2019 and for the entire projection horizon.

National Accounts²⁴

In 2020, the Cyprus economy is projected to record a significant contraction of 7,3%, despite the implementation of compensatory measures totalling approximately 5% of GDP (Table A.12).

The GDP decline is mainly due to the drop in domestic demand. Private consumption is expected to contract by 8,6%, following a 3% increase in 2019, owing to the reductions in employment and wages, which are partly offset by the implementation of compensatory measures to support jobs and incomes (Table A.12). Due to the imposition of

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

	2019	2020f	2021f	2022f
GDP	3,2	-7,3	5,6	4,1
Private consumption	3,0	-8,6	4,2	3,4
Public consumption	11,3	12,9	-0,1	1,5
Gross fixed capital formation	0,1	-12,0	5,9	4,7
Exports of goods and services	2,0	-19,2	10,9	6,3
Imports of goods and services	1,5	-17,0	7,5	5,0

Sources: Cystat, CBC.

24. Due to the volatility in imports and exports of mobile transport equipment (ships and aircraft), it is extremely difficult to forecast the aforementioned series. Therefore, it is assumed that the level of transactions associated with these series for the period 2020-2022 remains broadly fixed at the 2019 level. Consequently, the rate of change in imports and exports as well as in gross fixed capital formation adjusted for the impact of these transactions does not differ relative to the unadjusted series.

restrictive measures and the closure of various companies, a more significant contraction in private consumption is foreseen relative to the disposable income of households, thus positively affecting their savings ("forced savings"). Uncertainty in relation to employment and incomes is expected to also lead to "precautionary savings", even after the restrictive measures are fully lifted. Gross fixed capital formation is projected to record a significant annual decline of 12% in 2020, mainly owing to the deterioration in the business climate, with some companies postponing and / or cancelling some of their investment plans (**Table A.12**, p. 61). A significant acceleration of 12,9% is projected in public consumption, mainly due to the rise in spending related to the purchase of health services by the GHS in light of the implementation of its second phase (intermediate consumption) and, secondly, due to the ongoing gradual restitution of crisis-era wage cuts (see Quarterly National Accounts and **Table A.12**, p. 61). In the context of the implemented measures to address the effects of the pandemic, there has been a strengthening of the health sector with equipment and staff, which also explains the significant acceleration in public consumption.

Net exports are also expected to contribute negatively to the rate of economic growth in 2020. Exports of goods and services are foreseen to record a significant drop by 19,2% in 2020, following a 2% rise in 2019 (**Table A.12**, p. 61). This is due to the sharp decline in tourism revenues due to restrictions on air transport, and, to a lesser extent, due to the maritime sector owing to negative

developments in the external environment (see Balance of Payments, p. 36). On the positive side, the Deputy Ministry of Tourism's strategy to support the sector through the adoption of a specific action plan and the promotion of Cyprus as a safe tourist destination for the summer period of 2020, aim at attracting 30% of last year's arrivals. The restart of the tourism sector has already commenced (with the opening of hotels as of June 1 and airports as of June 9), with measures such as the provision of financial incentives to airlines to restore the connectivity of Cyprus with existing and new destinations being in the stage of evaluation. Imports of goods and services are projected to record a significant decrease of 17% in 2020, following a rise of 1,5% in 2019 (**Table A.12**, p. 61). The decline is mainly due to imports of goods for domestic consumption, relating to investment and private consumption, as well as the fall in imports of various services.

The suspension of loan instalments until end-2020 is expected to support the liquidity of households and businesses, thus partly offsetting the projected contraction in private consumption and investment due to the pandemic. The resumption of loan repayments as of 2021, following the expiration of the relevant moratorium, is expected to strengthen efforts to reduce the level of private debt. In the period 2021-2022, the low historical interest rates are also expected to stimulate demand for new loans by businesses and households, while the improvement in the economic climate and the rise in consumer confidence is expected

to support an expansion in new lending. As a result, the rate of change in net loans is expected to return to an upward trend for households as of 2021, whilst for businesses as of 2022. NPFs are not expected to be particularly affected by the pandemic during 2020, due to the temporary suspension of loan instalments until end-2020, in the context of banking authorities' decisions (European Central Bank, Single Supervisory Mechanism and European Banking Authority) aiming to provide flexibility as regards the existing rules framework for non-performing loans. In 2021, NPFs are expected to increase due to the inability of borrowers who have been significantly affected by the pandemic to serve their loan repayments.

For the years 2021 and 2022, positive GDP growth rates of 5,6% and 4,1%, respectively, (**Table A.12**, p. 61) are foreseen, mainly driven by the recovery in domestic demand and, to a lesser extent, net exports. In particular, private consumption is expected to rise by 4,2% in 2021 and by 3,4% in 2022, owing to the rise in disposable income, which is partly offset by the expected resumption of loan repayments following the moratorium that is in force until end-2020 (**Table A.12**, p. 61). Gross fixed capital formation is projected to increase by 5,9% in 2021 and 4,7% in 2022 due to the gradual completion of large and multi-year projects that have already begun, some of which are of foreign interest (**Table A.12**, p. 61). The projects cover the areas of energy, tourism, transport, residential properties as well as the casino-resort (see Quarterly National Accounts, p. xx). The latter is a major project that, with its operation, will

enrich the tourist product, further lengthen the tourism season and create new jobs. A marginal decrease of 0,1% in 2021 and a small increase of 1,5% in 2022 is projected for public consumption, mainly reflecting the completion of the gradual implementation of GHS in 2020 (**Table A.12**, p. 61).

Net exports are expected to contribute positively to economic growth in 2021 and 2022. More specifically, exports are projected to increase by 10,9% in 2021 and 6,3% in 2022 (**Table A.12**, p. 61). The sectors of tourism, transport (especially sea transport) as well as telecommunications, computer and information services are expected to contribute positively to the export outlook. Efforts are being made to support the shipping sector due to the pandemic, e.g. extension of the deadline for payment of the tonnage tax and the annual registry maintenance fee. In addition, the recent vote by Parliament relating to the legal framework for issuing credit notes and guarantees worth €80 million for the benefit of consumers and travel organisers in cases of cancellation of contracts is expected to provide support to the tourism sector also the following year. The ongoing recovery projected in 2022 for the tourism sector is also linked to the foreseen operation of the casino-resort²⁵. At the same time, total imports, which are significantly affected by imports for consumer, intermediate and capital goods, are expected to recover in the period 2021-2022, in conjunction with the improvement in domestic demand (**Table A.12**, p. 61).

25. Due to the outbreak of the pandemic, the operation of the casino resort is expected to commence as of early 2022 in the June 2020 forecasts, with the baseline scenario including only a partial impact from its operation, as was the case with the December 2019 forecasts.

Compensation, productivity and the labour market

The reversal of the positive developments in the GDP path is also reflected in employment trends. Employment is projected to record an annual decrease of 3% in 2020 following a 3,1% rise in 2019 (**Table A.13**), with the measures to support workers mitigating the decline in employment. In the period 2021-2022, employment is projected to register positive growth rates, around 2,3% per year (**Table A.13**).

The declining path that has been recorded in the unemployment rate in recent years is foreseen to reverse in 2020, reaching 8,3% of the labour force. The rise in unemployment is relatively small compared with the GDP contraction, owing to the effectiveness of adopted measures to support jobs and to strengthen the liquidity position of businesses (e.g. temporary suspension of VAT payments for three months and loan instalments up to end-2020). On the positive side, the unemployment rate is already lower than the euro area average (see Labour Market, p. 53) and is projected to return to a downward trend, reaching 7,3% in 2021 and 6,5% in 2022 (**Table A.13**).

The relatively small reduction in nominal compensation per employee in 2020 (1,9%) reflects the adoption of measures to support incomes of affected employees in the private sector, in conjunction with the increase in relevant compensation per employee in the public sector, mainly due to the ongoing gradual restitution of crisis-era cuts in wages and pensions (see Labour Costs, p. 34). The

TABLE A.13 Labour market projections

(annual change, %, unless otherwise indicated)

	2019	2020f	2021f	2022f
Compensation per employee	2,9	-1,9	2,1	2,2
Unit labour costs	2,8	2,7	-0,9	0,5
Productivity	0,1	-4,5	3,1	1,8
Total employment	3,1	-3,0	2,4	2,3
Unemployment rate (% of labour force)	7,1	8,3	7,3	6,5

Sources: Cystat, CBC.

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aforementioned decline in nominal compensation per employee includes the effect of the rise in social contribution rates towards the GHS, which has been suspended for three months as part of the package of measures to support employers. In terms of wages in 2020, a larger decrease is expected in the private sector in conjunction with a more modest increase in the public sector (**Table A.13**, p. 66). In the coming years, small annual increases are envisaged in nominal compensation per employee of the order of 2,1% in 2021 (includes the effect of the increase in the contribution rates towards the GHS for the first five months of the year in question) and 2,2% in 2022 (**Table A.13**, p. 66).

Productivity is expected to decline significantly in 2020, following a basically nil growth rate in 2019. This development is due to the fact that the pandemic is expected to affect the rate of GDP growth to a greater extent than the rate of employment growth, in light of the measures adopted to support employees. In the coming years, productivity is projected to record positive rates of change of 3,1% in 2021 and 1,8% in 2022 (**Table A.13**, p. 66).

Unit labour costs are expected to fluctuate during the forecast period, mainly due to the aforementioned significant changes in productivity (**Table A.13**, p. 66). The productivity decline in 2020 and, to a lesser extent, the reduction in nominal compensation per employee, lead to a significant increase in unit labour costs in the year under consideration. For 2021, an annual decrease of 0,9% is forecasted, while a modest increase of 0,5% is expected in 2022. A similar path is also

foreseen for the relevant euro area indicator. As such, the unit labour costs index in Cyprus maintains its comparative advantage relative to the rest of the euro area owing to reductions in wages observed in the past and, by consequence, the improvement in competitiveness recorded in previous years (see Labour Costs, p. 34).

Inflation

Prices are expected to decline in 2020. Specifically, HICP inflation is expected to reach -0,5% compared with 0,5% in 2019 (**Table A.14**), mainly as a result of the negative repercussions of the pandemic on economic activity. On one hand, the reductions in energy prices, as a result of the sharp decline in international demand for oil due to the spread of the pandemic, are expected to generate further downward pressures on domestic inflation. In addition, HICP inflation is expected to continue to be negatively affected by the ongoing projected reductions in the non-energy industrial goods prices (see Prices, p. 26). On the other hand, the aforementioned declines are partially offset by the foreseen rises in food and services prices. Core inflation, i.e. HICP inflation excluding energy and food, is projected to reach -0,3% in 2020 compared with 0,9% in 2019.

For the period 2021-2022, gradual increases in prices are envisaged, whilst remaining at subdued levels. HICP inflation is expected to rise to 0,7% in 2021 and to 1,1% in 2022, mainly driven by the projected increases in services prices, due to the positive trends in private consumption. It is also

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

	2019	2020f	2021f	2022f
HICP	0,5	-0,5	0,7	1,1
HICP excluding energy and food	0,9	-0,3	0,7	0,9

Sources: Cystat, CBC.

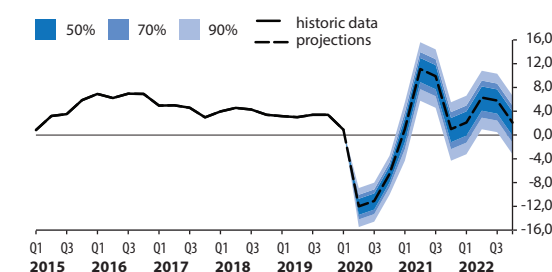
attributable to rises energy prices in line with the most recent assumptions for oil prices incorporated in the forecasts. In addition, HICP inflation is foreseen to be positively affected by the rebound in wages. At the same time, core inflation is projected to return to its previous positive path, reaching 0,7% in 2021 and 0,9% in 2022.

Risk assessment of macroeconomic forecasts²⁶

The expected GDP path, as presented in **Table A.12** (p. 61), as well as the HICP and core inflation projections (**Table A.14**, p. 68) underpin the baseline economic scenario. The confidence intervals associated with the baseline forecasts for GDP and HICP, which capture the probabilities of deviating from the corresponding baseline scenarios are outlined in **Charts A.36** and **A.37**, respectively. Possible deviations with respect to the baseline forecast for core inflation are shown in **Chart A.38**. The following paragraphs analyse both downside and upside risks to GDP and inflation, with a risk assessment summary presented in **Table A.15** (p. 70).

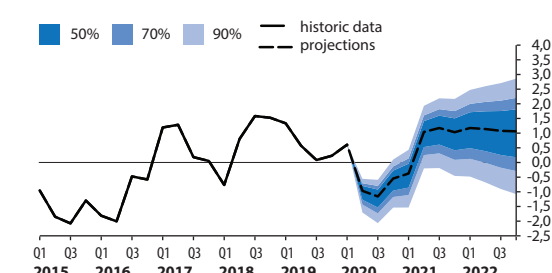
The risks of deviating from the baseline GDP forecasts for 2020 are slightly downward (downside risks), in view of uncertainty, especially in relation to the course of air traffic flows and tourism. For the period 2021-2022 the risks are also assessed to be slightly downwards (downside risks) and are associated with a possible resurgence of the virus and the imposition of a second round of restrictive measures. They are also linked to a possible weakening of borrowers' solvency,

CHART A.36 Real GDP fan chart
(annual change, %)



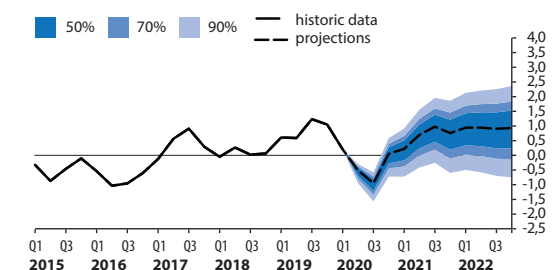
Source: CBC.

CHART A.37 HICP fan chart
(annual change, %)



Source: CBC.

CHART A.38 HICP excluding energy and food fan chart (core inflation)
(annual change, %)



Source: CBC.

26. For further information regarding the methodology of the risk assessment of macroeconomic projections, see *Economic Bulletin*, June 2015, p. 67.

which might translate into a rise in NPFs. By consequence, this could lead to losses in the banking sector and to a worsening of credit conditions, constraining to some extent the granting of new loans, consumption and investment. Downside risks are also associated with worse than foreseen prospects in relation to the external environment, either due to a more severe recession or due to a slower than expected economic recovery. In this context, a number of pre-existing economic vulnerabilities should be noted, in particular the continued and / or further imposition of restrictive measures on international trade, as well as the possibility of non-finalisation of a trade agreement between the UK and the EU by end-2020. In addition, possible need to adopt contractionary fiscal measures following the tackling of the virus in order to strengthen public debt sustainability may slow down growth prospects over the medium-term, despite the positive impact on the Republic of Cyprus' sovereign rating. Possible upward deviations from the baseline scenario for GDP (upside risks) are linked to a faster than expected availability of a vaccine against the virus, which could allow for the removal of social distancing measures and an improvement in the economic climate earlier than originally envisaged. In particular, an improvement in consumer confidence and the business climate could lead to a higher than foreseen implementation rate of investment plans and a more favourable tourism performance. Finally, upward risks are associated with higher than envisaged absorption of available funds from the

TABLE A.15 Summary of risk assessment

Risk	GDP (2021-2022)	Inflation (2021-2022)
Faster than expected availability of a vaccine against the virus	++	++
Greater than expected absorption of funds from EU support package	++	++
Weakening borrowers' solvency impacting NPFs and credit conditions	-	-
Possibility of higher than foreseen oil prices	-	+
Weaker-than-foreseen outlook as regards the external environment	-	-
Adoption of contractionary fiscal measures aimed at strengthening public debt sustainability	-	-
Resurgence of the virus	-	-
Overall assessment	-	-

Source: CBC.

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

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European support package for workers and businesses proposed for euro area Member States.

Risks in relation to inflation for 2020 are slightly downward (downside risks), in line with the GDP risks. For the years 2021-2022 risks are also assessed to be on the downside, as is also the case with risks to GDP. Possible downward deviations from the baseline scenario (downside risks) are associated with a possible resurgence of the virus as mentioned above for GDP. They are also linked to a possible deterioration in domestic credit conditions, via a possible increase in NPFs. In addition, a deeper than foreseen recession and / or a slower economic recovery regarding the external environment could put negative pressure on prices. In this context, the geopolitical developments mentioned above in relation to GDP pose a significant downside risk for inflation, due to the negative impact on demand that is expected to outweigh the direct impact on inflation from the imposition of restrictive trade measures and tariffs. Possible adoption of contractionary fiscal measures, in particular on the expenditure side, in order to strengthen public debt sustainability, may have a negative effect on inflation in the medium-term via the negative impact on economic activity. Potential upward deviations from the baseline scenario (upside risks) for inflation relate to a faster than expected availability of a vaccine to effectively deal with the virus, in line with GDP risks. By consequence, better than envisaged implementation of various investment plans and services performance could have a

positive effect on inflation. Finally, higher oil prices than originally envisaged constitutes an upward risk. Reflecting the balance of risks for GDP, risks to core inflation are also slightly to the downside.

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(A) Domestic monetary aggregates

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.

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