CENTRAL BANK OF CYPRUS

ECONOMIC BULLETIN

DECEMBER 2021

NICOSIA - CYPRUS

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EUROSYSTEM

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Note: The cut-off date for data in this *Bulletin* is 26th of November 2021.

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ABBREVIATIONS

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

Introduction

The impact caused to the Cypriot economy by the pandemic was relatively more limited compared to the initial estimates, and this is reflected in the strong recovery of economic activity in 2021. This positive outcome is partly attributed to effective fiscal support measures taken by the CBC, the ECB and other European authorities. These measures, especially those targeted at vulnerable groups of households and sectors of the economy, managed to stem significantly the extent of the negative impact of restrictive measures and the lockdown of the economy in general. The fiscal consolidation which preceded the pandemic and the significant deleveraging of bank balance sheets of businesses and households in the years before the pandemic are also factors that contributed to the better than anticipated course of the economy. These factors have created the necessary financial and fiscal leeway to handle the shock of the pandemic effectively.

More specifically, according to the most recent CYSTAT data, published after the cut-off date of the current Economic Bulletin, a significant recovery of GDP by 5,2%, was recorded in the first nine months of 2021, coming from both domestic demand and net exports. From a sectoral point of view, growth reflects the recovery in trade, transport, hotel and restaurant sectors. More generally, and despite the spread of the "Delta" mutation during the summer months, the accelerated pace of vaccinations has helped to prevent the reintroduction of strict restrictive measures, thus strengthening confidence and supporting the recovery of consumption, investment and the tourism sector.

The expected implementation of the investments and reforms included in the Recovery and Resilience Plan further enhances the prospects for GDP recovery. At the same time, the higher than usual levels of household savings observed during the lockdown periods are expected to be channelled towards real economic activity in the medium and long term.

However, the positive outlook continues to be shadowed by a significant degree of uncertainty related to the unpredictable evolution of the pandemic, including the prevalence of the "Omikron" mutation. In particular, the disruptions in production and supply chains caused to international trade, as well as the continuous upward pressures on international commodity prices, limit the growth prospects, as Cyprus' dependence on imports, especially on oil, is very high. The increased inflationary pressures recorded mainly due to the above factors, although expected to weaken from the end of 2022, have, for as long as they last, a negative impact on the purchasing power of both households and businesses, with negative potential consequences for consumer demand and investment.

The banking sector in 2021 has faced additional challenges as a result of the pandemic. Since the beginning of the pandemic and in order to face its consequences in a timely manner, the CBC has acted swiftly. In particular and in cooperation with the Ministry of Finance, the moratorium on loan repayments was issued, whereby the loan instalments of a large part of borrowers (both households and businesses) with performing loans were frozen for a period of nine months. The moratorium period ended on 31 December 2020. The amount of loans subject to the moratorium was circa €11.8 billion. The magnitude of the figure demonstrates the large protection provided to banks, businesses as well as households. However, the ongoing consequences of the pandemic and its unpredictable path increase the risks of a possible new wave of non-performing loans.

In view of the above, the CBC has repeatedly drawn the attention of credit institutions to the need for their operational readiness regarding a possible increase in the flow of applications for restructurings. In addition, banks need to accelerate the volume, processing time and procedures of restructurings in order to avoid the increase of non-performing loans on the one hand and allow viable businesses to continue operating smoothly on the other. As a result of the above interventions of the CBC, data on restructured credit facilities show a significant increase in restructurings for the first half of 2021 (€1,4 billion), compared to the corresponding half of 2020 (€0,27 billion).

In addition, the CBC developed the appropriate tools for data collection and monitoring of the loans for which the repayment of instalments should have been restarted in 2021, due to the expiration of the payment moratorium. The results so far are encouraging, given that the percentage of new loans which have become non – performing, out of the total subject to the moratorium, is below 3%. This shows that actions of the CBC towards banks on the need for operational readiness to deal with higher volumes of restructurings have had the desired result. However, since a new wave of the pandemic is underway, banks should be constantly alert and accommodative for any new restructurings.

In addition to any new NPEs, the existing ones continue to burden banks' balance sheets, despite the progress made and the reduction of non – performing loans to levels around €4,97 billion[1] at the end of August 2021 (and even close to €4 billion if we take into account the Bank of Cyprus' latest announcement for the sale of non – performing loans of approximately €0.6m). The ratio of NPEs stands at 17% banking system level[2], and despite its large decrease, it is still significantly higher than the EU average (around 2%). We should neither overlook the fact that a large part of the reduction in NPEs was absorbed by the credit acquiring companies, which are governed by the Sale of Credit Facilities and Related Matters Laws.

The implementation of the Code of Conduct for the Handling of Borrowers facing Financial Difficulties as well as the implementation of the relevant CBC Directive, taking into account the principle of proportionality, should be applied by the credit acquiring companies, following a requirement of the CBC.

In addition, the low profitability of banks due to the current environment and the competition from payment institutions create the need to enhance their efficiency, while the adjustment of their business model is also necessary. In this context, the banking sector also faces the challenge to support green investments as well as to promote digitalisation. Although in the short term these challenges create costs, the benefits will arise gradually in the long term.

1. Of all credit institutions operating in Cyprus (domestic operations only).
2. Including third country branches.

Synopsis

During the first nine months of 2021, there was a solid recovery in the global economic activity, albeit challenges and uncertainty amid the ongoing pandemic and new COVID-19 variants remain considerable. The large package of monetary and fiscal support measures and the substantial progress in vaccination rollout continue to contain significantly the negative effects of the pandemic on the global economic recovery. At the same time, significant increases have been registered in global inflation mainly due to the surge in energy prices and the upward impact of other pandemic-related factors. Longer-term inflation expectations in the euro area are moving closer, but they still remain below the ECB's medium-term price stability target.

Regarding the Cyprus economy, and according to the relevant cut-off date for the statistical data of this edition of the *Economic Bulletin*, a significant recovery in real GDP was recorded in 2021H1 by 5,1% owing to a base effect, the continuous adaptation of consumers and businesses to the new circumstances as well as the effectiveness of policy support measures. According to preliminary data published by Cystat, GDP growth reached 5,2% in 2021Q3.

From the production side, the GDP recovery over 2021H1 emanated from a rise in activity across most economic sectors, excluding that of financial and insurance activities (contribution of -0,2 percentage points). The sectors with the largest contribution to GDP growth were those of trade, transportation, hotels and restaurants (contribution of 2,2 percentage points).

Concerning inflation, the Harmonised Index of Consumer Prices (HICP) reached 1,8% during the first ten months of 2021 compared with -1,1% in the corresponding period of 2020. This development was driven by increases in energy prices, on account of the significant rise in oil price in international markets and an upward base effect, as well as the sizeable recovery in economic activity during the current year compared with 2020. Other factors related to the pandemic, for instance disruptions or shortages in the supply chain and the significant increases in transportation costs also contributed to the rise of specific HICP components, such as non-energy industrial goods and services.

Based on available data, tourist arrivals reached 46% of the 2019 level, in the first ten months of 2021, recording a better performance than originally projected. For the coming years, and especially for 2022, challenges are excessive amid the uncertainty surrounding the course of the pandemic. A gradual recovery of tourism is expected, while it is estimated to reach the 2019 level in 2024.

Residential property prices increased by 0,9% and 0,3% year-on-year in 2021Q1 and 2021Q2, respectively, driven by increased demand for apartments from domestic buyers. This trend is supported by the state's plan to partially subsidise the interest rate on new mortgages and the low-interest environment. Rising construction costs also contribute to rising prices, although not related to demand effects. In constrast, commercial property prices have been affected by the pandemic, with the prices of shops, warehouses and offices decreasing in the first half of 2021 by 5,2%, 4,3% and 0,9%, respectively.

In 2020 the policy measures to support the economy helped to contain both the deterioration in unemployment and the contraction in employment compared with the previous crisis of 2013. In 2021 there was a gradual recovery in employment, which recorded an annual increase of 0,8% in the first half of the year. Unemployment rose to 8,5% over 2021H1, however, with the publication of data for the third quarter of the year after the relevant cut-off date of this *Economic Bulletin*, it fell to 6,6%, thus pointing to the limited likelihood of hysteresis effects[3].

The Covid-19 pandemic consequences and the extensive measures adopted to contain its spread led to a notable acceleration of monetary aggregates. The annual growth rate of domestic private sector deposits recorded a significant increase of 5,3% in October 2021, compared to 2,5% in December 2020. The upward trend in private sector deposits is associated with the strengthening of both forced and precautionary savings, on the back of the lockdown measures coupled with uncertainty as regards the evolution of the health crisis. Moreover, firms' deposits increased significantly due to heightened concerns for their future revenues amid the pandemic on one hand and due to the resumption of economic activity as of 2021Q2 on the other.

Turning to credit growth and despite the termination of the loan instalments scheme and the resumption of repayments, the annual growth rate of net loans to the domestic private sector accelerated in the first ten months of 2021. Specifically, it reached 3,8% in October 2021 compared with 3,3% at the end of 2020. This was mainly as a result of the recovery of new lending to the non-financial private sector as of mid-2020. Specifically, in the first ten months of 2021 new lending to the non-financial private sector reached €2,3 billion compared with €1,9 billion in the corresponding period of 2020. The level of NPFs, within the banking system, remained broadly stable at €5 billion in the first eight months of 2021 after the decline recorded in 2020 in the midst of the pandemic. However, loans off banks' balance sheets continue to weigh on the real economy, which is why special attention is paid to reducing private debt.

Interest rates in Cyprus have remained at their lowest levels during the first nine months of 2021 compared with the last five-year period. Nevertheless slight upward pressures were observed for certain lending rates during the period under review, amid increased credit risk perception by banks which was associated with the negative impact of the pandemic. On the other hand, the ECB's continued expansionary monetary policy and its revised strategy in July 2021, contained to a great extent the upward pressures on lending rates. Specifically, the average interest rate on new loans to households for house purchase[4] increased to 2.20% in September 2021 compared with 2.16% in December 2020 and 2.12% in September 2020. The cost of new lending from domestic MFIs to euro area non-financial corporations for amounts of up to €1 million

3. Such effects include delayed impacts on unemployment, whereby the unemployment rate continues to rise even after the economy has recovered, e.g. due to loss of professional skills.
4. Euro-denominated loans from Cyprus MFIs with an initial rate fixation of up to one year.

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increased to 3.27% in September 2021 from 3.13% in December 2020 and 3.17% in September 2020. Deposit interest rates on households and non-financial corporations have not exhibited any significant changes during the period under review.

GDP is expected to expand by 5,6% in 2021, following the 5,1% increase recorded over the first half of this year. For the period 2022-24 GDP is expected to grow on average by about 3,7% per annum, due to the recovery in domestic demand and net exports. Unemployment is expected to fall in 2021H2, with an ongoing decline foreseen in the coming years, reaching 5,6% in 2024. Inflation is expected to increase significantly in 2021 and 2022 (to 2,2% and 2,5%, respectively), mainly due to the significant rises in energy prices, as well as due to supply chain bottlenecks. More modest inflation rates are expected over 2023-24 (1,2% and 1,5%, respectively), driven by the reductions in oil prices. Finally, risks in relation to the baseline projection for GDP are assessed to be balanced and to be tilted slightly upward for inflation over 2021-24.

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(A) International Environment: macroeconomic and financial developments

- *Recovery in the global economy during the first ten months of the year, albeit challenges and uncertainty amid the ongoing pandemic and new COVID-19 variants remain considerable.*
- *Monetary and fiscal support measures and substantial progress in vaccination rollout continue to significantly contain the negative effects of the pandemic on the global economic recovery.*
- *Significant increases in global inflation mainly due to the surge in energy prices and the upward impact of other pandemic-related factors.*
- *Longer-term inflation expectations in the euro area are moving closer, but still below the ECB's medium-term price stability target.*

During the first ten months of 2021, there was a solid recovery in the global economic activity compared with 2020. The ongoing monetary expansionary measures adopted by the major central banks in conjunction with the notable fiscal support have contributed decisively to the containment of the negative effects of the pandemic. The substantial progress in vaccination rollout has also given a special impetus to the global economy, thus supporting market confidence. However, the latest available data show a slowdown in global economic activity and a heterogeneity in growth potential across countries, amid continuing disruptions in the supply chain of international trade and new COVID-19 variants.

According to the most recent projections of international organisations[5], the outlook for the economic recovery in the major

5. GDP projections are estimated as the average of the most recent projections from: The European Commission (European Economic Forecast, Autumn 2021) and the IMF (World Economic Outlook, October 2021).

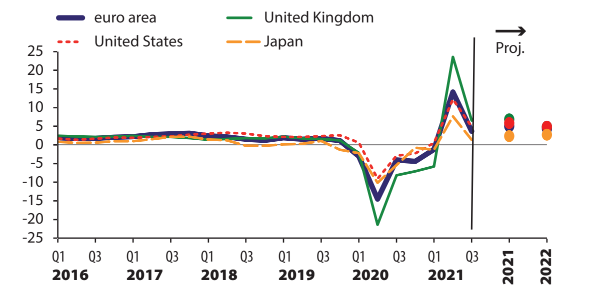
selected advanced economies, despite the ongoing uncertainty due to pandemic, has continued to remain robust for the years 2021-2022 (**Chart A.1**). In particular, GDP growth in 2021 is expected to reach around 5,0% and 5,9% for the euro area and the US, respectively, and decelerate to 4,3% and 4,8%, respectively, in 2022.

Global inflation continued to register substantial increases during the first ten months of 2021, with inflationary pressures proving stronger than initially expected. Pandemic-related factors, such as pressures on production costs due to disruptions in the supply chains, rising food prices, supply-demand imbalances and energy market imbalances are the key factors which contributed to the rise in global inflation during the period under review. Although the pandemic disruptions appear to last longer than initially anticipated, they are expected to be largely resolved in the near future when the macroeconomic environment finally normalises. According to the latest projections[6] of international organisations, inflation in selected major advanced economies, with the exception of Japan, is expected to fluctuate beyond 2% in 2021 (**Chart A.2**). In particular, inflation in 2021 is expected to hover around 2,3% and 4,3% for the euro area and the US, respectively, and 2,0% and 3,4%, respectively, in 2022.

With regards to the indicator for the euro area longer term inflation expectations (five-year rate five years ahead "5Y5Y"), this stood at 1,81% on 26 November 2021 compared with 1,26% on 31 December 2020 (**Chart A.3**). At the same time, the latest ECB

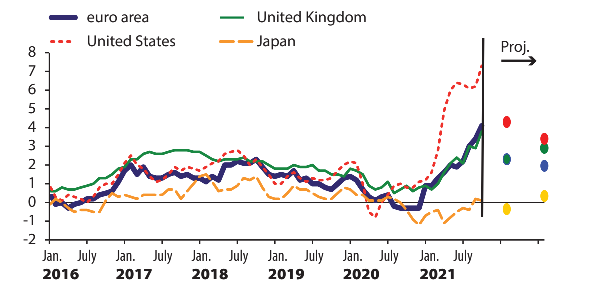
6. Inflation projections are estimated as the average of the most recent projections from: The European Commission (European Economic Forecast, Autumn 2021) and the IMF (World Economic Outlook, October 2021).

CHART A.1 **GDP in selected countries**
(annual change %, seasonally adjusted %)



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

CHART A.2 **Inflation in selected countries**
(annual change, %)



Sources: Eurostat, SDW(ECB).
Note: The projections are for the year and are calculated as averages of the most recent projections from the European Commission and the IMF.

CHART A.3 **Market-based indicator of longer-term inflation expectations**
(five-year rate five years ahead "5Y5Y", annual change in %)

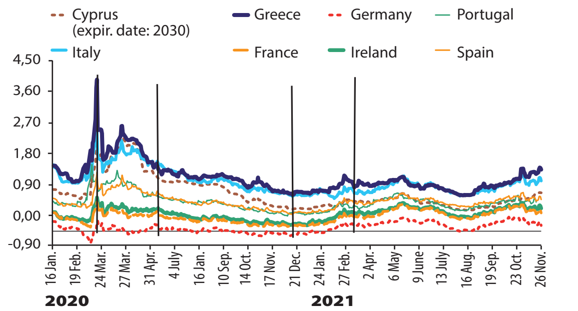
Source: Bloomberg.

Survey of Professional Forecasters for 2021Q4 showed that the survey-based indicator of longer-term inflation expectations (for 2026) reached 1,9%. In general, the upward trend of the said indicators compared with the end of 2020 appears to be mainly related to the current aforementioned developments.

Noteworthy development for the euro area has been the announcement[7] of the review of the ECB's monetary policy strategy on 8 July 2021, for the first time in 18 years. According to this new strategy, the medium-term inflation target is symmetrical at 2%. This means that negative and positive deviations of inflation from the said target are equally undesirable and it is possible that during a transitory period, inflation may be moderately above target. Non-standard monetary policy measures, such as forward guidance, asset purchases and longer-term refinancing operations will remain an integral part of the ECB's toolkit, and will be used appropriately.

The preservation of the ECB's highly expansionary and flexible monetary policy has continued to provide favourable financing conditions in all euro area countries, while making a significant contribution towards mitigating the economic impact of the pandemic. For instance, since the end of March 2020, sovereign bond purchases under the PEPP have decisively contributed to the decrease in ten-year (10YR) sovereign bond yields of euro area countries, especially the ones that were the hardest hit by the pandemic (**Chart A.4**).

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



18/03/2020: The GC of the ECB decided, among others, the launch of a new temporary asset purchase programme due to the pandemic, namely the "Pandemic Emergency Purchase Programme (PEPP)" with an overall envelope of 750 billion.

04/06/2020: The GC of the ECB decided, among others, to increase the PEPP envelope by 600bln. to 1.350 bln.

10/12/2020: The GC of the ECB decided, among others, to further increase the PEPP envelope by 500bln. to 1.850 bln. and extend it at least the end of March 2022.

11/03/2021: The GC of the ECB decided, among others, to purchase flexibly according to market conditions and with a view to preventing a tightening of financing conditions.

Source: Bloomberg.

7. For more details on the particular decisions of the Governing Council of the ECB (dated 8 July 2021), please see the ECB website link below: https://www.ecb.europa.eu/press/pr/date/2021/html/ecb.pr210708~dc78cc4b0d.en.html

In general, the preservation of favourable financing conditions in the euro area and fiscal policy support are still necessary at this stage. Reducing pandemic uncertainty and boosting confidence will underpin economic activity and safeguard medium-term price stability.

(B) Domestic Environment

- *Significant GDP recovery in 2021H1 owing to a base effect, ongoing adaptation to the new normal and the effectiveness of policy support measures.*
- *Domestic HICP inflation returned to positive levels during the first ten months of 2021 due to increases in energy prices and the ongoing imbalance between reduced supply and increased demand for goods and services.*
- *House prices increased in the first half of 2021. This trend is driven by increased local demand, particularly for apartments.*
- *Better than expected performance in the tourism sector in the summer and autumn months of 2021.*
- *Small probability of hysteresis effects owing to the significant GDP rebound and the effectiveness of policy measures to support workers.*
- *Decrease of the budget deficit reflecting the improvement in economic activity and the labour market.*
- *Total deposits increased significantly while credit to the domestic private sector supported the real economy.*
- *Decrease of government debt as percent of GDP in September 2021, compared with the corresponding level of the previous year, due to the decline in government's cash reserves and the strong economic recovery.*

1. Economic Activity

According to preliminary data published by Cystat, which were available at the relevant cut-off date of this *Economic Bulletin*, the economic recovery in 2021Q3 reached 5,2%.

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Overall, the ongoing positive GDP outcomes are attributable to the support coming from the economic policy measures and the adaptation effects demonstrated by consumers, employees and businesses to the new circumstances.

Based on detailed data available in line with the cut-off date of this *Economic Bulletin* and covering 2021H1 (**Table A.1**), the GDP recovery is driven by all GDP sub-categories, and mainly owing to the expansion in domestic demand. Private consumption increased by 2,9%, due to a significant base effect resulting from the impact of the pandemic in 2020Q2, as well as due to the gradual restoration of the level of disposable income over 2021. Investments increased significantly by 26,1% as a result of the aforementioned base effect, the ongoing completion of major infrastructure projects by the private sector, as well as the support coming from housing investments owing to the government's scheme partly subsidising the interest rate relating to new mortgages. Adjusted for the impact of Special Purpose Entities (SPEs), investments still rose, albeit by a smaller extent. Public consumption increased by 14,9%, mainly due to the increase in expenditures relating to the purchase of health services by the GHS and, secondly, due to the ongoing gradual restitution of crisis-era wage cuts (see Fiscal Developments). The growth in total exports by 1,4%, which is higher when the data is adjusted for the impact of SPEs, emanated from the increase in exports of services, due to the partial recovery of tourism (see Balance of Payments). At the same time, the increase

TABLE A.1 **GDP by expenditure category**
(real terms, annul change, %)

	2018	2019	2020	2020 H1	2021 H1
GDP	5,7	5,3	-5,2	-6,1	5,1
Private consumption	5,1	3,0	-5,0	-9,0	2,9
Public consumption	3,6	12,7	15,0	16,3	14,9
Gross fixed capital formation	-4,9	2,9	0,0	-10,7	26,1
Exports of goods and services	7,3	7,5	-5,1	0,2	1,4
Imports of goods and services	4,3	8,3	-2,5	-1,0	4,6

Source: Cystat.

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in total imports by 4,6%, with a comparable rise recorded when the data is adjusted for the impact of SPEs, mainly reflects the increase in imports of goods relating to investment and private consumption (see Balance of Payments) and, to a lesser extent, the pick-up in imports of services.

From the production side (**Table A.2**), the GDP recovery over 2021H1 emanated from a rise in activity across most economic sectors, excluding financial and insurance activities (contribution by -0,2 percentage points). The sectors with the largest contribution to GDP growth were those of trade, transportation, hotels and restaurants (2,2 percentage points) as well as construction and manufacturing (0,7 percentage points, each). A positive contribution by 0,2 percentage points was also recorded in the arts, entertainment and leisure sector, which is part of the "other sectors" category as is the case with manufacturing.

Qualitative indicators (soft data) and available quantitative indicators (hard data) relating to 2021Q4, point to the continuation of a positive GDP growth rate. Specifically, the GDP path follows developments in the Economic Sentiment Indicator (ESI), as well as its sub-indices, which provide early signals of the ongoing positive course of the Cyprus economy. Specifically, the average level of the ESI over October-November 2021 amounted to 105,4, recording a continuous increase compared with 103,8 in 2021Q3 and 84 in 2020Q4 (**Table A.3**). More specifically, the sub-indicators from the Economic Sentiment Surveys (**Table A.3**) covering October-November 2021 show an improvement in services

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

	2018	2019	2020	2020 H1	2021 H1
GDP (%)	5,7	5,3	-5,2	-6,1	5,1
Construction	0,9	0,7	-0,4	-0,7	0,7
Trade, transportation, hotels and restaurants	2,3	0,8	-4,4	-4,3	2,2
Financial and insurance activities	-1,4	-0,2	0,4	0,2	-0,2
Professional, scientific and administrative activities	1,2	0,7	-0,4	-0,4	0,4
Other sectors[1]	2,7	3,3	-0,4	-0,8	1,9

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

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

	2020 Q3	2020 Q4	2021 Q1	2021 Q2	2021 Q3	2021 Oct.-Nov.
ESI	83,9	84,0	81,8	99,6	103,8	105,4
Industry	-26,7	-28,8	-35,2	-17,3	-10,9	-7,9
Services	-45,8	-45,9	-48,5	14,6	26,5	32,5
Consumer	-27,0	-32,3	-29,8	-16,5	-19,9	-19,7
Retail trade	-27,0	-26,9	-27,8	-12,8	-6,2	-3,3
Construction	-16,5	-18,8	-23,8	-18,7	-17,9	-17,6

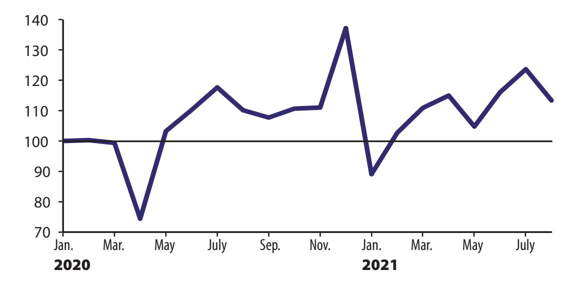
Source: European Commission.
Note: Seasonally adjusted data.

(by 6 percentage points) and, to a lesser extent, in industry and in retail trade (by about 3 percentage points, each) compared with 2021Q3. Regarding quantitative data, the turnover index of retail trade (**Chart A.5**) recorded a slowdown over the period July-August (5,9%) compared with 2021Q2, which in turn registered a significant quarterly increase (10,9%). On the positive side, the index has recovered significantly since the beginning of the year following the lifting of lockdowns as from mid-May 2021, and stands higher than pre-pandemic levels.

The positive path in private consumption is captured across various leading indicators (soft data). Regarding consumers' expectations about major purchases over the next 12 months (**Chart A.6**), in general, there has been an improvement since the beginning of 2021, however the index remains 4,6 percentage points lower than in February 2020, prior to the outbreak of the pandemic. At the same time, there is a general stabilisation of the index in terms of expectations at present, which remains however at much lower levels than prior to the crisis. Overall, and despite the fluctuations in the time series, the paths of these indicators point to positive prospects in relation to private consumption. Regarding registrations of motor vehicles (**Chart A.7**) and following the positive annual increases observed each month until April 2021, this picture reversed in the following months due to the shortages observed in the market, owing to the supply chain problems that have affected the automotive industry globally.

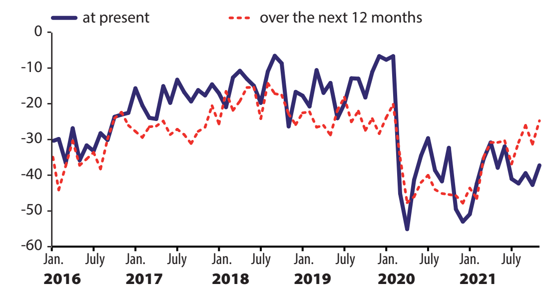
In relation to relevant construction sector and tourism indicators (see Construction Sector

CHART A.5 **Retail sales (excluding motor vehicles)**
(index of deflated turnover, Jan. 2020=100)



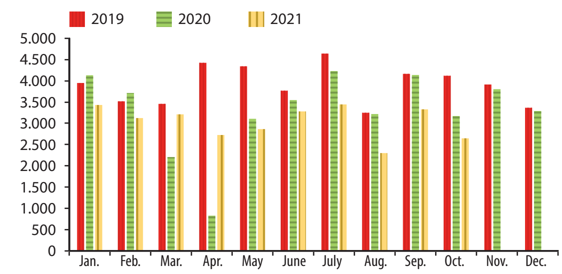
Sources: Cystat, CBC.

CHART A.6 **Consumers' assessment of major purchases**
(difference between percentage of positive answers and percentage of negative answers)



Source: European Commission.

CHART A.7 **Registration of motor vehicles**
(number of new registrations)



Source: Cystat.

and Tourism, respectively), there are continuing signs of recovery. In the real estate sector, the significant boost in housing investment, stemming mainly from domestic demand, is expected to dissipate owing to the termination of the government's interest rate subsidisation scheme relating to new housing loans at end-December 2021. However, construction activity is expected in general to continue to recover owing to the large and multi-year projects that had already begun prior to the breakout of the pandemic (see Macroeconomic forecasts). Regarding tourism developments, relevant risks owing to the emergence of the recent "Omicron" variant are expected to be mitigated by the foreseen long-term improvement in the epidemiological situation, both in Cyprus and in the main tourism markets owing to the incentives for a substantial boost in the vaccination rollout. However, full normalisation in the tourism sector is expected in 2024 (see Macroeconomic forecasts).

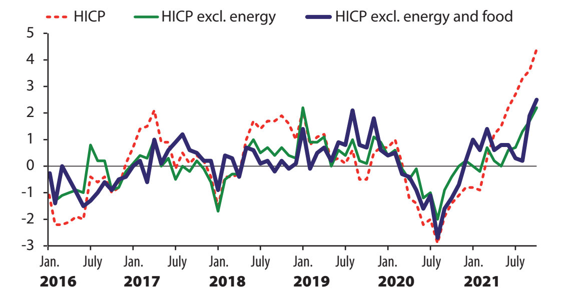
2. Prices (Inflation, real estate prices, labour costs)

Inflation

With regard to the first ten months of 2021, the domestic Harmonised Index of Consumer Prices (HICP), returned to positive levels, reaching 1,8% compared with -1,1% in the corresponding period of 2020 (**Chart A.8a** and **Table A.4**). Similarly in the euro area, the largest rise in HICP has been observed since July 2021, with domestic HICP standing at 4,4% in October 2021 compared with -1,4% in the corresponding month of 2020.

The rising domestic HICP inflation during the first ten months of 2021 largely reflected the significant increases in energy prices (**Chart A.8b**). More specifically, this was mainly stemming from the sizeable surge in oil prices and also an upward base effect, resulting in considerable increases in fuel and electricity prices. It is noted that the increase in oil prices has a much greater impact on energy prices in Cyprus compared with other euro area countries, due to the dependence of domestic electricity production on crude oil. In addition, part of the increase in the price of electricity for the period April-September 2021 was due to a base effect, as a result of the reversal of the effect of the imposed reduction in the price of electricity in the corresponding period of 2020. Moreover, the significant rise in the cost of purchasing greenhouse gas emission allowances, in accordance with the policy affecting all EU member states, also had a positive contribution to the increase of electricity price.

CHART A.8a **Inflation in Cyprus (HICP)**
(annual change, %)



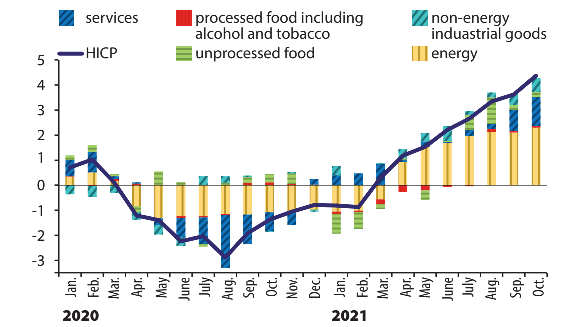
Source: Eurostat.

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

		Annual change (%)				
	Weights(1)	Jan.-Oct. 2020	Jan.-Oct. 2021	Oct. 2020	Sep. 2021	Oct. 2021
HICP	1000,00	-1,1	1,8	-1,4	3,6	4,4
Unprocessed food	54,34	2,8	0,3	6,3	3,0	3,4
Processed food	186,87	0,1	-0,4	0,7	0,3	0,4
Energy	93,48	-8,9	11,3	-13,4	25,5	27,1
Services	411,52	-1,0	1,1	-1,6	2,0	2,8
Non-energy industrial goods	253,79	-0,7	1,3	-0,2	1,9	2,2
HICP excluding energy	906,52	-0,5	0,7	-0,4	1,7	2,2
HICP excluding energy and food	665,31	-0,9	1,0	-1,2	1,9	2,5

Source: Eurostat.
(1) Based on the weight for 2021.

CHART A.8b **Contributions of HICP components to overall domestic HICP inflation**
(annual percentage changes; percentage point contibutions)



Sources: Eurostat and CBC calculations.

In addition to energy prices, rising inflation in both Cyprus and the rest of the euro area was largely due to disruptions and shortages in supply chains as well as significant increases in transportation and freight costs, globally, as a result of the pandemic. The recovery in economic activity in 2021 and the consequent increase in private consumption has created an imbalance between supply and demand. In turn, there are significant upward pressures on various key sub-categories of non-energy industrial goods inflation, such as motor vehicles, furniture and fittings, garments and major household electrical appliances.

Furthermore, during the period January-October 2021, services prices also had a positive contribution to HICP, mainly on account of the increased prices of "passenger by air" compared with the corresponding period of 2020. It is recalled that, during the period January-October 2020, "passenger by air" prices were significantly negatively affected by the imposition of restrictive measures as a result of the pandemic and the consequent sharp decline in demand. The recovering demand for travelling as well as the ongoing limited supply of airline travel from/to Cyprus during the first ten months of 2021 have restored the average prices of "passenger by air" to their pre-pandemic levels.

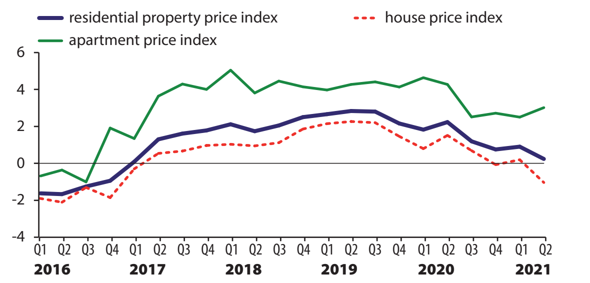
In light of the aforementioned developments, inflation excluding energy and food prices (core inflation) reached 1,0% during the first ten months of 2021 compared with -0,9% in the corresponding period of 2020 (**Chart A.8a** and **Table A.4**, p. 24).

Real estate prices and construction sector

Residential property prices in Cyprus, especially apartment prices (**Chart A.9**), recovered in the first half of 2021, while commercial property prices recorded reductions in the same period. Specifically, according to CBC RPPI available data for 2021Q1 and 2021Q2, residential property prices recorded quarterly increases of 0,5% and 0,3%, respectively. RICS Cyprus prices for shops, warehouses and offices recorded a decrease in the first half of 2021 by 5,2%, 4,3% and 0,9%, respectively. Furthermore, according to 2021Q3 preliminary data there is a continued increase in residential property prices, which is still driven by the market segment of apartments. This trend in prices is supported by the state's plan to partially subsidise the interest rate on new mortgages, the low interest rates environment in the domestic market, the promotion of foreign investment through incentives for headquartering foreign high-tech companies in Cyprus, as well as the permanent residency program through the purchase of real estate by foreign investors.

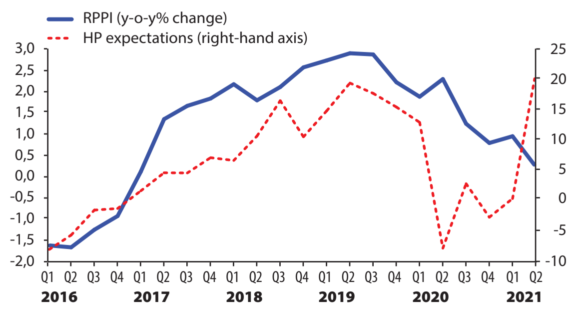
The increase in residential property prices is in line with the broader macroeconomic developments, such as the significant recovery in the GDP growth rate. More recent indicators such as the index of real estate price expectations for the next three months published in the European Commission's Business and Consumer Surveys, are in line with the sector's growth dynamics, having recorded a positive sign in the first half of 2021 (**Chart A.10**).

CHART A.9 **House and Apartment price indices**
(annual change, %)



Source: CBC.

CHART A.10 **Residential property price index (RPPI) vs House Price Expectations for the next three months**



Sources: CBC, European Commision

The continued increase in demand for real estate, which is still supported by the demand from domestic buyers, is strengthened to some extent by the signs of stabilisation in the demand from foreign investors. According to data of sales contracts from the Department of Lands and Surveys (DLS), real estate sales in Cyprus reported an annual increase of 37,6% in the first half of 2021, albeit from a low base due to Covid-19 measures. This increase corresponds to an annual increase of 62,8% and 3,5% in sales to domestic and foreign buyers, respectively. During the first ten months of 2021, the transactions of real estate on a Pancyprian basis showed an annual increase of 21,6%, which corresponds to an annual increase of 29,4% and 9% in sales to domestic and foreign buyers, respectively (**Table A.5**). It is worth mentioning that transactions increased in Nicosia by 37,6% in the first ten months of 2021, compared with the same period of 2019, which is mainly attributed to domestic buyers (increase of 44,2%).

The increased demand from domestic buyers is favoured by the continued environment of low interest rates, while the fact that lending criteria remained at relatively strict levels is an indication that the new mortgage lending will continue to be sustainable to a large extent (**Chart A.11**).

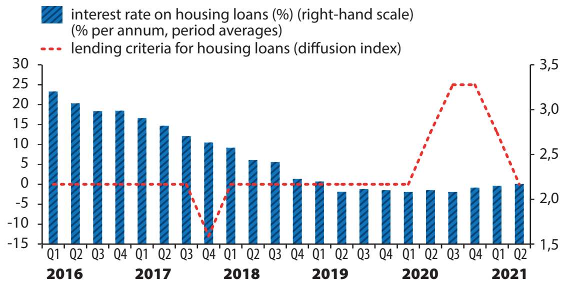
The increase in the cost of construction materials seems to play an important role in maintaining prices, regardless of demand, especially in 2021Q3. It is thus imperative to closely observe the real estate market developments, so as to monitor if the hitherto

TABLE A.5 **Real estate sector**
(annual change, %, unless otherwise stated)

	Jan.-Oct. 2020	Jan.-Oct. 2021	Oct. 2020	Sep. 2021	Oct. 2021
Sales contracts (total)	-23,9	21,6	30,9	16,3	-14,4
Sales contracts (locals)	-16,1	29,4	43,3	9,3	-22,3
Sales contracts (foreigners)	-33,8	9,0	12,3	30,4	0,8
Building sentiment indicator (average of index)	-11,0	-19,8	-11,3	-19,6	-16,4
Property price expectations for the next 3 months (average of index)	2,4	28,7	1,6	54,0	67,0
Price index of construction materials(1)	-0,6	8,9	-0,5	-0,8	n/a

Sources: Cystat, DLS, European Commission.
(1) Data up to October 2021.

CHART A.11 **Lending criteria and interest rate on housing loans**
(annual change, %)



Source: CBC.
Note: The higher the posotive number in the lending criteria series the tighter the criteria.

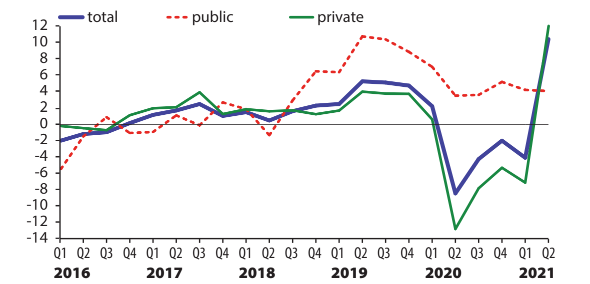
positive trend in the sector will be maintained, despite the problems observed in the market as a result of epidemiological developments, as well as the existing effort to sell real estate properties from the portfolios of banks and credit acquiring companies.

Labour costs

The pandemic had a significant impact on labour costs (compensation per employee) over 2020, partly mitigated by compensatory measures to support jobs and incomes. The schemes were in place until end-October 2021 and mainly aimed at supporting the tourism sector. Over 2021, and following the decline recorded until the first quarter of the year, there was a significant correction in labour costs in the second quarter, due to a base effect and the rise in hours worked per employee (see Labour Market). At the same time, compensation per hour recorded a much smaller increase.

More specifically, nominal compensation per employee recorded an increase of 2,9% in 2021H1, following a decrease of 3,3% in the corresponding half of the previous year (**Chart A.12**). Compensation per employee in the public sector rose by 4,1%, while a smaller increase of 2,3% was recorded in the private sector. In addition to the effect stemming from the General Health System (GHS), developments in public sector compensation per employee were also mainly the result of the ongoing gradual restitution of cuts in wages and pensions that had been adopted during the crisis. In the private sector, the aforementioned increase mainly emanated

CHART A.12 **Nominal compensation per employee by sector**
(annual change, %)



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

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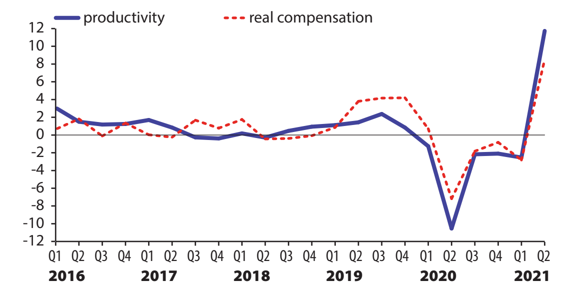
from the construction, manufacturing and professional services sectors.

Real compensation per employee[8] recorded an increase of 2,6% compared with a decline of 3,3% in 2020H1, influenced to a small extent by price developments that slightly reduced the purchasing power of households (**Chart A.13**).

Regarding productivity, which is calculated as the change in real GDP per employed person, the relevant index recorded a significant increase of 4,3% in the period under consideration compared with a drop of 6,6% in 2020H1. This indicator is significantly affected by the impact of the pandemic and the associated restrictive measures on GDP, as well as the implementation of policy measures to support employment (**Chart A.13**, p. 29).

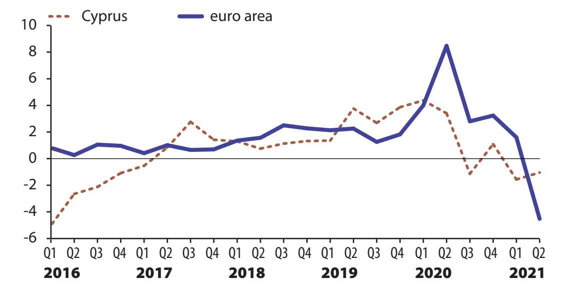
The smaller increase in compensation per employee over 2021H1 compared with the rise in productivity translates to a decrease in unit labour costs by 1,3% (**Chart A.14a**), a significant indicator of competitiveness vis-à-vis competitor economies. Despite the significant increase that has been recently observed, the significant cumulative reductions in wages from 2012 and following the crisis help to maintain the competitiveness of the Cyprus economy in the long term. In particular, the index recorded a cumulative decrease of 13,2% in the period 2013-16 and, despite the annual increases recorded since then, continues to stand lower than the euro area since 2013 (by about 19 percentage points in 2020) (**Chart A.14b**).

CHART A.13 **Productivity and real compensation per employee**
(annual change, %)



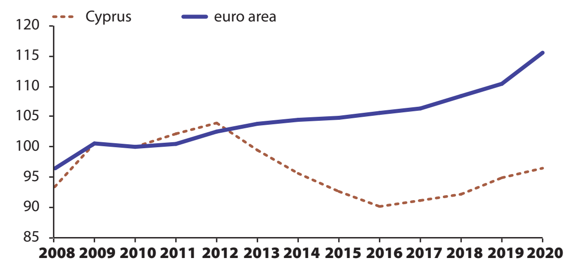
Sources: SDW (ECB), CBC.

CHART A.14a **Unit labour costs: Cyprus and the euro area**
(annual change, %)



Source: SDW (ECB).

CHART A.14b **Unit labour costs: Cyprus and the euro area**
(index 2010=100)



Source: SDW (ECB).

8. It should be noted that for the calculation of real compensation per employee the private consumption deflator is used rather than the CPI.

3. Labour market

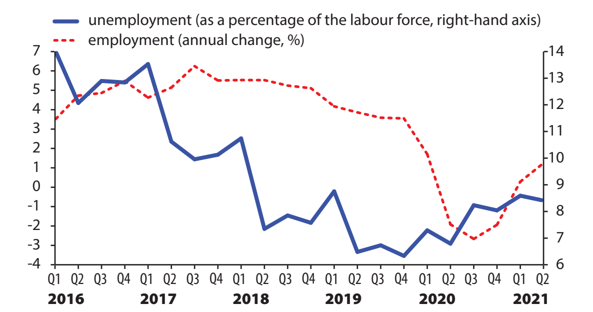
Overall, the policy support measures helped to contain both the deterioration in unemployment and the contraction in employment over 2020 compared with the previous crisis of 2013. It should be noted that the measures were extended until end-October 2021 and have then been lifted due to the significant improvement in the economic environment and, as a result, in the labour market.

In 2021, there was a gradual recovery in employment, reaching 0,8% over the first half of the year under consideration, following an increase of 0,6% in the corresponding half of the previous year (**Chart A.15**). The small increase in employment came mainly from the sectors of information and communication, construction, professional services as well as trade, transportation, hotels and restaurants. The aforementioned increases were partially moderated by a marginal decline in employment in the financial services sector.

Hours worked per employee registered an annual increase of 2,5% in 2021H1 compared with a significant decline of 7,6% in the corresponding period of the previous year owing to the full or partial suspension of company operations. It should be noted that a significant increase was recorded in 2021Q2 (9,5%), in conjunction with the robust recovery in GDP, thus pointing to the limited likelihood of hysteresis effects[9].

The negative effects of the pandemic, albeit subdued, are captured in the unemployment data relating to the first half

CHART A.15 **Unemployment and employment**



Source: Cystat (LFS).

9. Such effects include delayed impacts on unemployment, whereby the unemployment rate continues to rise even after the economy has recovered, e.g. due to loss of professional skills.

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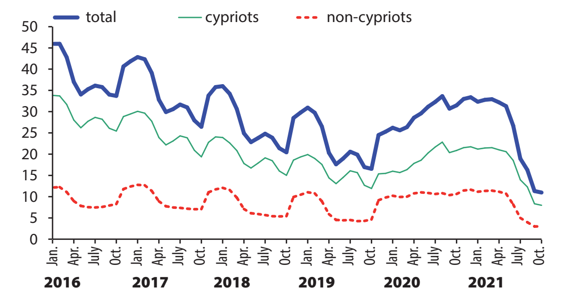
of the year. According to the Labour Force Survey (LFS), unemployment rose to 8,5% over 2021H1 (**Chart A.15**, p. 30). However, with the publication of the third quarter figures for the current year following the cut-off date for the statistical data update of this *Economic Bulletin*, unemployment recorded a significant improvement reaching 6,6%. According to the registered unemployment data, the downward trend is evident as from June 2021 (**Chart A.16**), with the latest data for October pointing to a significant annual drop of 65,1% (from 31.487 to 10.974 individuals). In addition to the significant impact emanating from the GDP recovery, the significant reductions recorded in the registered unemployment data from June 2021 onwards were expected owing to the termination of the automatic renewals of registered unemployed and new registrations of unemployed individuals without their physical presence. It should be noted that the previous system was introduced in March 2020, aiming at limiting the spread of the coronavirus.

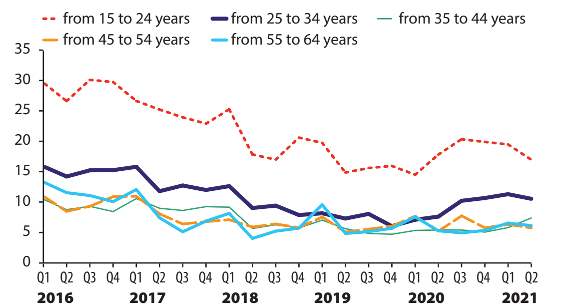
Regarding developments in unemployment by age group (**Chart A.17a**), the observed increase in unemployment over the first half of the current year is mainly driven by the age group of 25-34 years of age, with a contribution of 3 percentage points to the overall unemployment rate of 8,4% for 2021Q2. A smaller contribution to the overall unemployment rate emanated from young individuals aged 15-24. This percentage fell marginally to 17% in 2021Q2 compared with 17,8% in the corresponding quarter of the previous year, and constitutes only about 1,4

CHART A.16 **Registered unemployment**
(number of unemployed, thousands)



Source: Cystat.

CHART A.17a **Unemployment rate by age group**
(as a percentage of the labour force)



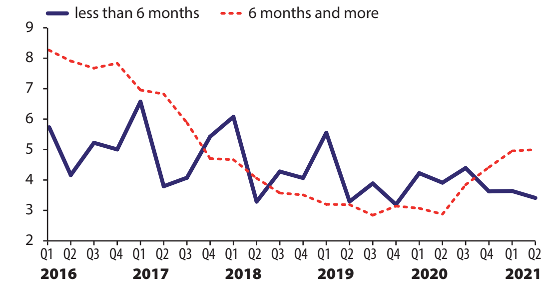
Source: Cystat (LFS).

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

An important parameter in the analysis of labour market developments is the path of long-term unemployment as, in periods of persistently high unemployment, the long-term unemployed find it more difficult to re-enter employment. According to the latest available Cystat data relating to the number of long-term registered unemployed, a significant drop of 15.601 individuals was recorded in October 2021 compared with the corresponding month of the previous year. At the same time, and according to the LFS data that is considered to reflect more accurately the labour market situation, the unemployment rate with a duration of six months and over, rose in 2021Q2 to 5% compared with 2,9% in the corresponding quarter of the previous year (**Chart A.17b**).

In relation to the view of possible tightness in the labour market, the following elements should be noted. First, and according to LFS data, the inflow of foreign labour continues, which may meet job requirements by businesses. Second, with the ongoing economic recovery, the long-term unemployed may be gradually absorbed into the labour force, given the enhanced capacity of the Public Employment Services to match unemployed individuals to job vacancies. Third, owing to the gradual recovery foreseen in some services sectors, especially tourism, working hours are expected to return to pre-crisis levels slowly and towards the end of the forecast horizon, thus reflecting the underutilisation of the labour force (labour market slack). At the same time, and according to a

CHART A.17b **Unemployment by duration**
(as a percentage of the labour force)



Source: Cystat (LFS).

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recent survey by the Cyprus Employers and Industrialists Federation (November 2021), the relative tightness in the labour market is associated with specific sectors and occupations (hospitality, cleaning staff and generally unskilled workers).

Overall, the latest available economic data demonstrate the improvement in labour market conditions and the small probability of hysteresis effects, owing to the GDP rebound and the implementation of policy measures to support affected workers in the private sector. At the same time, the available quantitative data and surveys do not capture broad-based labour market tightness across the economy, but for specific sectors, which is expected to decrease with the normalisation of epidemiological situation.

4. Balance of payments[10]

The current account deficit reached €1.453,5 million (-13,1% of GDP) in 2021H1, compared with a deficit of €812,1 million (-7,8% of GDP) in the corresponding period of 2020 (**Table A.6** and **Chart A.18**). The deterioration of the deficit was mainly driven by the primary income account and the goods balance, which was partly offset by the increase of the surplus in the services balance. The current account deficit, adjusted for the impact of SPEs, deteriorated and reached €1.269,9 million (-11,4% of GDP), compared with -€945,8 million (-9% of GDP) in the corresponding period of 2020 (**Table A.6** and **Chart A.18**). The above, mentioned path of the current account deficit was determined by the outbreak of the pandemic, as well as the various restrictive measures adopted.

In particular, the trade deficit of goods increased substantially to €2.362,5 million in 2021H1, compared with a deficit of €1.735,4 million in the corresponding period of the previous year, due to the decrease in exports of goods and the simultaneous increase in imports of goods. The decrease in exports of goods refers primarily to SPEs transactions, while the increase in imports is mainly due to the imports of goods for home consumption and investments. More specifically, intermediate inputs, consumer and capital goods, increased, in line with the recovery in domestic demand. Oil imports registered a small increase, due to large increases in oil prices, despite the decrease in the volume of oil imports.

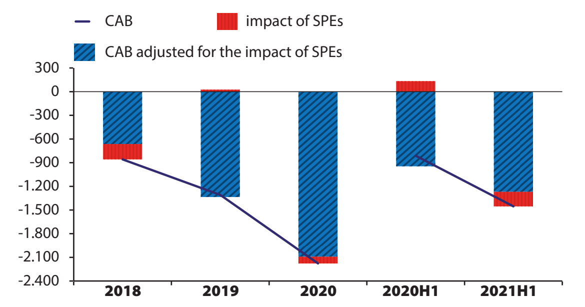
10. The external statistics data are significantly affected by the classification of SPEs as residents of Cyprus and, in particular, by those which are considered as economic owners of mobile transport equipment (mainly ships). The transactions of SPEs do not affect nor are affected substantially by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

TABLE A.6 **Balance of payments (main categories)**

	2020H1 (€ million)	2021H1 (€ million)	Change (€ million)
Current account balance	**-812,1**	**-1.453,5**	**-641,4**
Current account balance adjusted for the impact of SPEs	**-945,8**	**-1.269,9**	**-324,1**
Goods and services balance	**-309,4**	**-542,9**	**-233,4**
Trade balace	**-1.735,4**	**-2.362,5**	**-627,1**
Exports of goods	1.675,7	1.341,7	-334,0
of which:			
Exports of goods - SPEs	588,3	259,3	-329,0
Imports of goods	3.411,1	3.704,2	293,2
of which:			
Imports of goods - SPEs	650,8	645,2	-5,6
Services balance	**1.425,9**	**1.819,6**	**393,7**
Exports of services	6.341,3	6.871,3	529,9
Imports of services	4.915,4	5.051,7	136,2
Primary income (net)	**-292,3**	**-718,1**	**-425,8**
Secondary income (net)	**-210,4**	**-192,5**	**17,9**
Current account balance (% of GDP)	**-7,8**	**-13,1**	
Current account balance adjusted for the impact of SPEs(% of GDP)	**-9,0**	**-11,4**	

Sources: Cystat, CBC.

CHART A.18 **Current account balance (CAB)**
(€ million)



Sources: Cystat, CBC.

The surplus of the services balance reached €1.819,2 million in 2021H1, increasing by €393,7 million, compared with the corresponding period of the previous year, mainly due to the larger increase in exports over imports of services (**Table A.7**). For analysis purposes, exports of services and specifically tourism related services are considered to be important, as Cyprus is a tourist destination and a business centre thus relying heavily on the supply of services. In 2020, tourism was significantly affected by the spread of the pandemic. However, in 2021, vaccinations against the pandemic intensified, both in Cyprus and in other countries, leading to the gradual lifting of the restrictive measures in travel, as from the early months of the summer, achieving a significant recovery of the tourism sector.

In 2021H1 exports of services (**Table A.7**) recorded an annual increase of 8,4% (€529,9 million), mainly driven by the most major categories, with the exception of other business services (-€25,3 million). In particular, telecommunications, computer and information services increased by €235,2 million. Financial services increased by €174,4 million, reflecting the pickup in the turnover of investment companies as a result of the pandemic. At the same time, travel category which includes revenues from tourism increased by €119,3 million (current developments and more recent, available data on tourism are analysed in the Tourism sub-section).

Imports of services increased by 2,8% (€136,2 million) in 2021H1 (**Table A.7**) as a result of the increases recorded in the cate-

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

	2020H1 (€ million)	2021H1 (€ million)	Change (€ million)
Services balance	**1.425,9**	**1.819,6**	**393,7**
Exports of services	**6.341,3**	**6.871,3**	**529,9**
of which:			
Transport	1.478,5	1.513,7	35,3
Travel	210,2	329,5	119,3
Finanacial services	2.560,8	2.735,2	174,4
Telecommunications, computer and information services	1.307,3	1.542,5	235,2
Other business services	362,5	337,1	-25,3
Imports of services	**4.915,4**	**5.051,7**	**136,2**
of which:			
Transport	861,6	881,1	19,5
Travel	332,4	273,1	-59,3
Finanacial services	1.662,7	1.734,4	71,7
Telecommunications, computer and information services	1.181,7	1.196,7	15,0
Other business services	533,6	609,0	75,4

Source: CBC.

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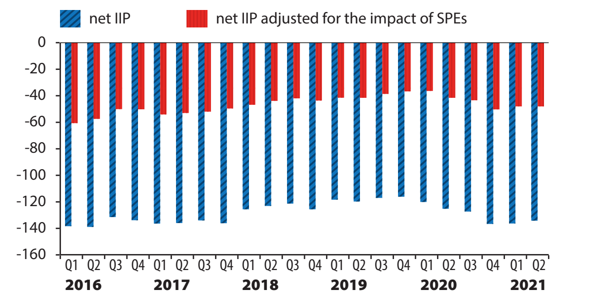
gories of other business services (€75,4 million) and financial services (€71,7 million). It is noted that in 2021 many Cypriots did not travel abroad, therefore the import side of the travel category decreased by (-€59,3 million), supporting the domestic tourism sector.

In 2021H1, the deficit in the primary income account (which mainly includes income from employment and investment) widened by €425,8 million, compared with the corresponding period of 2020, and reached -€718,1 million. This development is mainly associated with the income from direct investments and more specifically, to the larger decrease in the inflows of income from abroad, compared to the income outflows abroad. The deficit in the secondary income account (which mainly includes current transfers) did not record any material change (**Table A.6**, p. 34).

Regarding the financial account, in 2021H1, significant inflows were recorded from the private sector and to a lesser extent from the issuance of government bonds.

The net international investment position (IIP) at the end of 2021H1 was negative, standing at -€29,8 billion (-134,2% of GDP) (**Chart A.19**). 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

CHART A.19 **Net International Investment Position (IIP)**
(as a percentage of GDP)



Sources: Cystat, CBC.

almost entirely by non-domestic banks, they do not constitute a risk to the Cypriot financial system.

Adjusted for the impact of SPEs, the net IIP improved by 86,2 percentage points, standing at -€10,7 billion or -48% of GDP, compared with -€10,8 billion or -50,3% of GDP at the end of 2020 (**Chart A.19**, p. 36). It is noted, that the marginal improvement in the net IIP as a percentage of GDP in 2021H1, was mainly due to the strong GDP recovery.

Tourism

Tourism constitutes one of the most important pillars of the Cyprus economy, which has been significantly affected by the pandemic crisis, recording a record of negative arrivals and revenues in 2020 and the first quarter of 2021. Nevertheless, the tourism sector is on a recovery path being in line with the improvement of the epidemiological picture, the progress in the rate of vaccination coverage of the population and the gradual lifting of the restrictive measures.

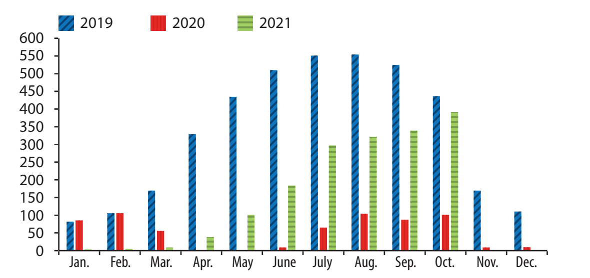
On the basis of available data, arrivals for the first ten months of 2021, increased by 175,9% (1,1 million) on an annual basis reaching 1,7 million tourist (**Table A.8** and **Chart A.20a**). More specifically in the first quarter of 2021, significant reductions were recorded due to the outbreak of the pandemic and restrictive measures taken in order to limit the spread of the pandemic. From April, with the improvement of the epidemiological picture, tourist arrivals increased. During the summer months, which have a higher weight in the total arrivals for

TABLE A.8 **Tourism**

	Tourist arrivals (thous.)	Tourist receipts (€ million)	Expenditure per person (€)
2019	3.976,8	2.683,0	674,7
2020	631,6	392,0	620,6
annual % change	-84,1	-85,4	-8,0
2020 Jan. - Aug.	424,9	235,6	554,5
2021 Jan. - Aug.	960,2	777,0	809,2
annual % change	126,0	229,8	45,9
2020 Jan. - Oct.	613,0	n/a	n/a
2021 Jan. -Oct.	1.691,0	n/a	n/a
annual % change	175,9	n/a	n/a

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

CHART A.20a **Tourist arrivals**
(number of persons, thousands)



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

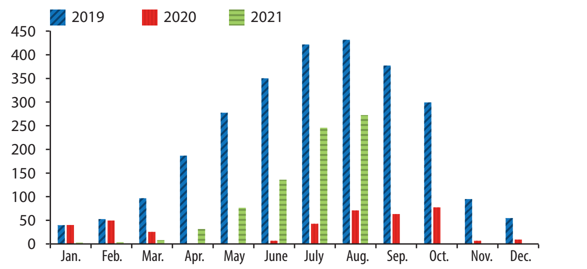
the year, significant increases have been recorded close to one million tourists, compared with the same period of 2020. This improved picture continued during the autumn months, due to the good weather conditions in Cyprus. As a result, tourist arrivals for the first ten months of 2021 reached 46% of the 2019 level. The main tourism export markets have been Russia and the UK with arrivals reaching 495 thousand tourists and 333 thousand tourists respectively in the first ten months of 2021.

Revenues from tourism increased to €777 million in the first eight months of 2021, compared with €235,6 million in the corresponding period of the previous year. This development is mainly driven by the increased number of tourist arrivals, as well as, the rise in the per capita expenditure by 45,9% (**Table A.8**, p. 37 and **Chart A.20b**).

It is noted, that the government measures to boost the performance of the tourism sector in 2020, including incentives for domestic tourism, were extended until March 2022. This was considered as another determining factor for a large number of Cypriots to choose not to travel abroad for their summer holidays, contributing, to some extent, to the easing of the losses in the tourism industry.

Based on the tourist performance so far, 2021 has recorded a better performance than originally projected, and much better than last year. For the coming years, and especially for 2022, challenges are excessive amid the uncertainty surrounding the course of the pandemic. (i.e. mutations in the virus). A gradual recovery of tourism is expected, while

CHART A.20b **Receipts from tourism**
(€ million)



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

it is estimated to reach the 2019 level in 2024, at the end of the forecast horizon (see Macroeconomic Forecasts).

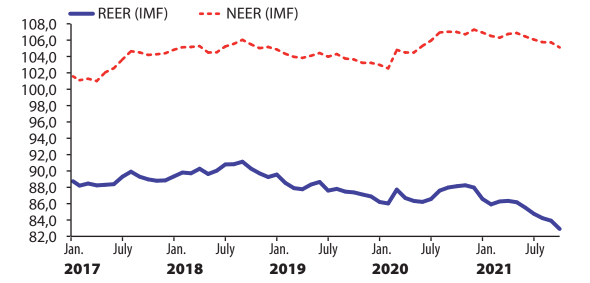
According to the Strategy of the Deputy Ministry of Tourism, there are ongoing efforts to further support and upgrade the tourist product. It includes hotel renovations and new infrastructure, such as the construction of luxury hotels, marinas and the casino-resort, which is expected to operate by the third quarter of 2022, and to attract a large number of tourist. All these efforts started a few years ago, aiming to attract more tourists during the winter months and to extent the tourism season.

Effective exchange rate

Chart A.21 shows the effective exchange rate (EER) index of the euro in Cyprus, in nominal (NEER) and real (REER)[11] terms, as calculated by the IMF. The NEER index strengthened in the first six months of 2021 compared with the corresponding period of 2020, while registering a weakening trend thereafter. On the contrary, the REER index recorded weakening path since the beginning of 2021, being more pronounced in the period July to October 2021. 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, 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

CHART A.21 **Real and nominal effective exchange rates (IMF weights)**
(base year 2010=100)



Source: IMF.

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

analysed in the previous section, are important measures of the competitiveness of an economy. Lower unit labour costs (see Labour Costsand a lower REER in Cyprus compared with competing countries, suggest that domestic exports tend to be more price competitive. In general, inflation is related to, among other factors, the variables mentioned above, also reflects the degree of competitiveness of the Cyprus economy.

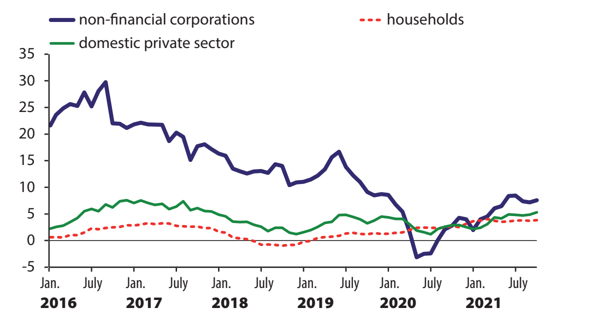
5. Deposits, credit growth, and interest rates[12,13]

The wide range and timely usage of fiscal and monetary policy measures for the support of the economy have greatly alleviated the negative impact of the pandemic, reflected among other things in deposits as well. Despite the historically low deposit interest rate environment, domestic private sector[14] deposits recorded an annual increase of 5,3% in October 2021, compared with 2,5% in December 2020 and 2,9% in October 2020.

The ongoing uncertainty associated with the evolution of the pandemic has led to a marked increase in precautionary savings. Furthermore, the restrictive measures on services and retail trade inevitably limited private consumption, despite the fiscal support measures adopted to protect disposable income. Specifically, the domestic households' deposits annual growth reached 3,8% in October 2021 from 3,2% in December 2020 and 2,7% in October 2020.

In addition, domestic non-financial corporations' deposits annual growth increased significantly by 7,6% in October 2021, from 4,0% in December 2020 and 2,8% in October 2020 (**Chart A.22**). This is mainly attributed to the government's measures to support the economy, the suspension of loan instalments until the end of June 2021 and the postponement of investment projects due to uncertainty concerning future

CHART A.22 **Deposits of the domestic private sector**
(annual change, %)



Source: CBC.

12. For a detailed explanation of the methodology and technical analysis of monetary aggregates (deposits and credit growth), see Technical Notes on p. 62.
13. The analysis on deposits and credit growth in this section of the *Economic Bulletin* focuses on domestic residents excluding SPEs. SPEs are included in the non-residents category.
14. Domestic private sector refers to non-MFIs domestic residents, excluding SPEs and central government.

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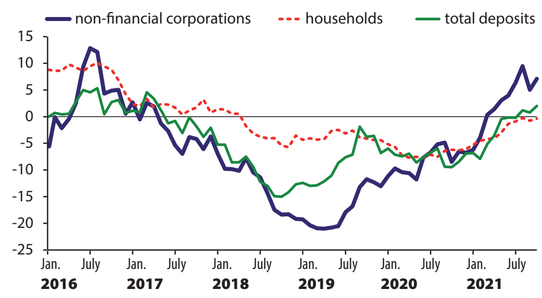
prospects. In addition, the resumption of economic activity following the significant lifting of restrictions since mid-May 2021, the improvement of the epidemiological situation and the reopening of important sectors of the economy such as tourism, contributed to the recovery of revenues and the reinforcement of business deposits.

At the same time, non-residents deposits[15], which traditionally exhibit high volatility, turned positive since August 2021 and reversed the negative trend of previous years. Specifically, the annual growth of non-residents deposits stood at 2,0% in October 2021 compared with -6,9% in December 2020 and -9,5% in October 2020 (**Chart A.23**).

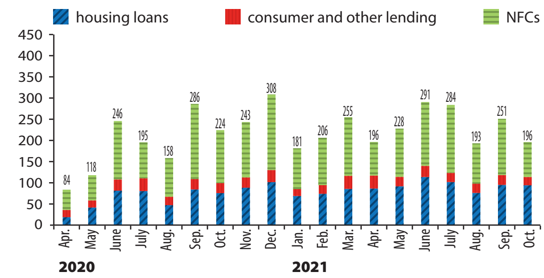
In terms of credit growth, new lending to the non-financial private sector[16] recovered as from mid-2020. The recovery continued in the first ten months of 2021. This development is mainly due to the government interest rate subsidisation scheme for new housing and business loans, which was extended until the end of 2021, as well as to the largest than expected economic activity recovery from 2021Q2. Specifically, new lending to the non-financial private sector reached €2,3 billion in the first ten months of 2021 (**Chart A.24**) compared with €1,9 billion and €2,7 billion in the same period of 2020 and 2019, respectively. The increase in new lending in the first ten months of 2021 concerns both new loans to non-financial corporations and households, mainly housing loans. Specifically, new housing loans, which have exceeded their pre-pandemic levels, reached €887 million in the first ten months of 2021 compared with

CHART A.23 **Deposits of non-residents: Cyprus**
(annual change, %)



Source: CBC.

CHART A.24 **Volumes of pure new loans (euro-denominated) to euro area non-fianancial corporations and households(1)**
(€ million)



Source: CBC.
(1) Pure new loans include all new loan contracts within the reference month.

15. Including SPEs.
16. New loan contracts (euro-denominated) to euro area non-financial corporations and households.

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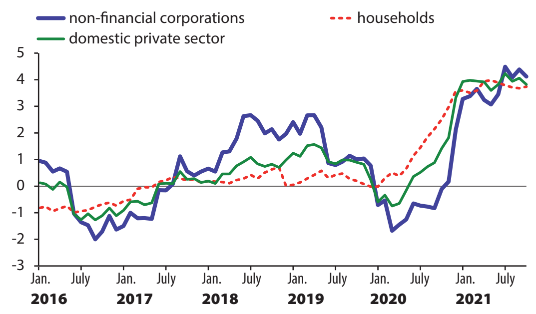
€594 million in the same period of 2020 and €734 million in the corresponding, pre-pandemic, period of 2019. New lending to non-financial corporations reached €1,2 billion compared with €1 billion and €1,7 billion in the same period of 2020 and 2019, respectively. It is noted that in the first ten months of 2021 new loans up to €1 million to non-financial corporations have exceeded their pre-pandemic levels. As derived from the Bank Lending Survey since March 2020, this may reflect the firms' increased financing needs for working capital.

The increase in new lending resulted in an acceleration of the annual growth rate of net loans[17] to the domestic private sector[18] during the first ten months of 2021. This occurred despite the expiry of the initial loan instalment suspension scheme in December 2020 and, consequently, the end of its positive impact on net loans' annual growth rates due to reduced repayments. Although there was a second loan instalment suspension scheme, which expired in June 2021, strict eligibility criteria significantly limited borrowers' interest. Specifically, the annual growth rate of net loans to the domestic private sector reached 3,8% in October 2021 compared with 3,3% in December 2020 and 1,4% in October 2020. More analytically, the annual growth rate of net loans to domestic non-financial corporations reached 4,1% in October 2021 compared with 2,1% in December 2020 and -0,1% in October 2020. Loans to domestic households recorded an annual increase of 3,7% in October 2021 compared with 3,6% in December 2020 and 2,5% in October 2020 (**Chart A.25**). Most of the twelve-month

CHART A.25 **Loans to the domestic private sector**
(annual change, %)



Source: CBC.

17. New lending plus capitalisation of interest minus repayments.
18. Domestic private sector refers to non-MFIs domestic residents, excluding SPEs and general government.

increase in household loans until October 2021 came from housing loans. Specifically, at the end of October 2021, an annual increase of 5,3% and 2,1% was recorded in housing loans and consumer credit, respectively, while the annual growth rate in other lending to households was negative at -1,4% (**Table A.9**).

According to the October 2021 Bank Lending Survey[19] (**Table A.10**), credit standards for loans to enterprises in 2021Q3 remained unchanged, for a third consecutive quarter. This development followed the net tightening observed in 2020 for business loans, mainly driven by the heightened banks' risk perceptions, as a result of the pandemic. This is the second quarter since the start of the pandemic in Cyprus that no increase in risk perception was reported by the surveyed banks, possibly reflecting the improved pandemic situation and the general perception of stabilised credit risk.

On the other hand, credit standards for loans to households have tightened in 2021Q3, for all loan categories. The factor contributing to the tightening of credit standards for housing loans as well as consumer credit and other lending to households was, according to the survey, the "European Banking Authority guidelines on loan origination and monitoring". In addition, according to the surveyed banks' expectations for 2021Q4, credit standards for loans to enterprises and households for all loan categories will remain unchanged compared with the previous quarter.

At the same time, enterprises' net demand for loans in Cyprus recorded an increase during 2021Q3 due to increased financing

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

TABLE A.9 **Loans to domestic households[(1),(2)]**

	Outstanding balance as % of total[(3)]	Annual percentage change 2020 June	2020 Sep.	2020 Dec.	2021 Mar.	2021 June	2021 Oct.
Domestic households	100,0	1,1	2,2	3,6	3,6	3,9	3,7
1. Consumer credit	11,6	-0,9	-0,4	1,3	1,1	2,5	2,1
2. Lending for house purchase	72,2	1,7	3,0	4,5	4,9	5,3	5,3
3. Other lending	16,2	0,9	1,0	1,9	0,6	-0,3	-1,4

Source: CBC.
(1) Sectoral classification is based on ESA 2010.
(2) Including non-profit institutions serving households.
(3) As at the end of the last month available. Figures may not add up due to rounding.

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

Summary of BLS results October 2021	**Cyprus 2021Q3**	**2021Q4 (expectations)**
Credit standards for loans		
Enterprises	Unchanged	Unchanged
Households		
- *Housing loans*	Tightening	Unchanged
- *Consumer credit and other lending*	Tightening	Unchanged
Demand for loans		
Enterprises	Increase	Increase
Households		
- *Housing loans*	Unchanged	Increase
- *Consumer credit and other lending*	Unchanged	Increase

Source: CBC.

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needs for inventories and working capital, debt restructuring and for the first time since the onset of the pandemic for financing fixed investment. This development partly reflects the improved macroeconomic environment and positive outlook.

In contrast, net demand for loans from households for all loan categories remained unchanged during 2021Q3 compared with the previous quarter. In 2021Q4 banks expect a net increase in demand for loans, compared with the previous quarter, both from enterprises and households for all loan categories.

Regarding NPFs[20], during the first eight months of 2021 the level of NPFs remained broadly stable after the decline recorded in 2020, mainly due to loan sales and write-offs. Specifically, in August 2021 (latest available data) the balance of NPFs in the banking sector amounted to €4,97 billion (17,4% of total loans), remaining at approximately the same levels of 2020, compared with €9 billion (27,9% of total loans) at the end of 2019.

It is noted that a significant proportion of businesses and households, which serviced their loans, participated in the initial nine-month loan instalments suspension scheme, which expired at the end of December 2020. A very limited number joined the second scheme which had an expiration date of June 2021. With the expiration of both schemes, the attention of banks and supervisory authorities is focused on the evolution of the quality of loan portfolios. To date, the repayment of the loans that were included in the loan instalment suspension schemes is overall positive, given the limited percentage that has turned non-performing. However,

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

given the prevailing uncertainty over the evolution of the pandemic, the challenges of addressing potential new restructuring applications and a new wave of NPFs remain.

Despite the decline in NPFs in both the banking system and the economy as a whole, the non-financial private debt to GDP ratio remains high despite its notable decrease in the last five years 2015-2019. The downward trajectory of the non-financial private debt to GDP ratio was reversed in 2020, due to the decline in economic activity from the pandemic. However, this was temporary and in the first half of 2021 private debt returned to its downward trend. Specifically, the ratio at the end of 2021Q2 stood at 260,7% compared with 269,4% at the end of 2020 and 258% at the end of 2019.

Amidst the continuous challenges associated with the negative impact of the pandemic, interest rates in Cyprus remained at very low levels during the first nine months of 2021 compared with the last five-year period, supported by the ECB's expansionary monetary policy and its revised strategy, as well as the government interest subsidisation scheme for new housing and business loans. However, the continued uncertainty about the duration of the pandemic, its negative effects on the real economy and the increased credit risk perception by banks, have caused slight upward pressures on certain categories of lending rates during the period under review.

Indicatively, the average interest rate on new loans to households for house purchase[21] increased to 2,20% in September 2021 compared with 2,16% in December 2020 and

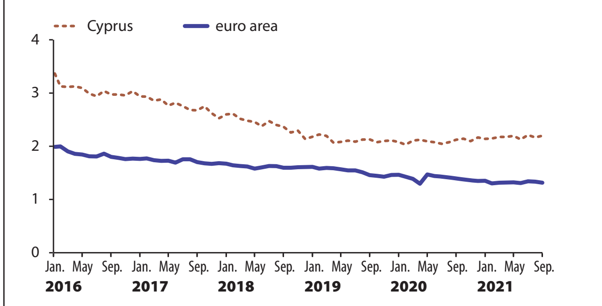
21. Euro-denominated loans from Cyprus MFIs with an initial rate fixation of up to one year.

2,12% in September 2020 (**Chart A.26**). The cost of new lending from domestic MFIs to euro area non-financial corporations for amounts of up to € 1 million increased to 3,27% in September 2021 from 3,13% in December 2020. The specific category might concern loans to small and medium-sized enterprises, associated with a higher credit risk rather than large enterprises. At the same time, the cost of new lending for amounts over € 1 million decreased to 3,05% in September 2021 from 3,26% at the end of 2020 (**Chart A.27**).

The spread between domestic and euro area housing lending rates increased by 6 basis points in September 2021 compared with December 2020, reaching 88 basis points. For non-financial corporations[22], the corresponding spread increased by 24 basis points, reaching 156 basis points, partly related to the contained financing costs for euro area NFCs which benefited from the government-guaranteed loan schemes. It is recalled that, in Cyprus the corresponding tool was only recently adopted in November 2021, and is not expected to have a significant impact due to its short-term duration.

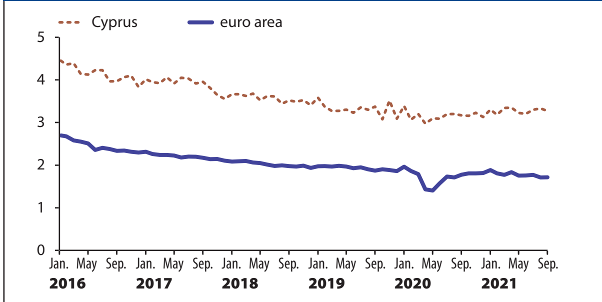
Domestic deposit interest rates remained at extremely low levels, supported by the ECB's continuous expansionary conventional and non-conventional monetary policy measures, as well as banks' increased liquidity. In summary, the domestic average interest rate[23] on new household deposits decreased to 0.06% in September 2021 from 0.08% in December 2020 (**Chart A.28**), while the average interest rate on deposits for non-financial corporations increased to 0,11% in

CHART A.26 **MFI interest rates on euro-denominated housing loans (new business) to euro area households(1)**
(% per annum, period averages)



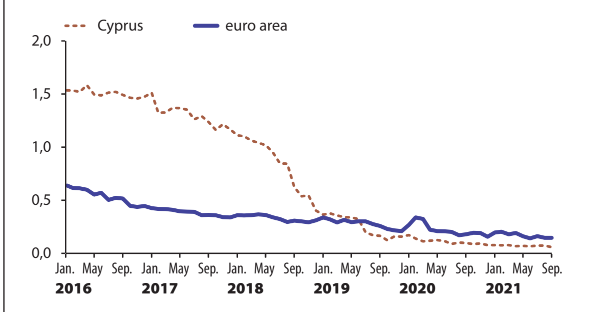
Sources: SDW (ECB), CBC.
(1) With floating rate and up to 1 year initial rate fixation.

CHART A.27 **MFI interest rates on euro-denominated loans (new business) up to €1 million to euro area non-financial corporations(1)**
(% per annum, period averages)



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

CHART A.28 **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.

22. Loans up to €1 million to non-financial corporations.
23. Average interest rate with an agreed maturity of up to one year.

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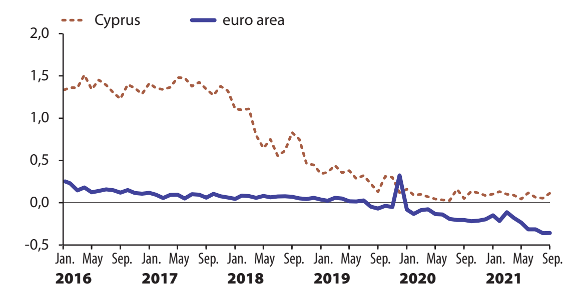
September 2021 from 0,09% in December 2020 (**Chart A.29**).

Withdrawal of the pandemic emergency support measures for households and businesses could lead to further upward pressures on lending rates if credit risk deteriorates. These pressures could be mitigated by the positive effects associated with the resumption of economic activity, the government-guarantee scheme in Cyprus and ECB's expansionary monetary policy.

CHART A.29 **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.

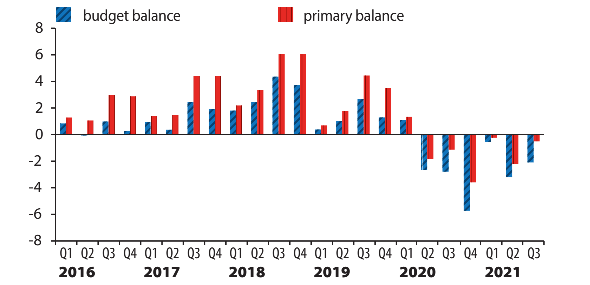
6. Fiscal developments

The significant economic recovery has a positive impact on public finances, as reflected by the strong increase in tax revenue and social contributions. The government pandemic-related support measures, despite their gradual withdrawal, are expected to sum to around €800 million in 2021 or 3,5% of GDP. The largest part of these fiscal measures aimed to business support, either through direct subsidies or by subsidising employees' wages (about 65% of the total support package in 2021), and support of the health system (about 20% of the total support package in 2021).

According to Cystat data, the budget deficit in the first nine months of 2021 reached 2,1% of GDP compared with a deficit of 2,8% of GDP in the corresponding period of 2020 (**Chart A.30** and **Table A.11**). The budget deficit is expected to be somewhat larger at the end of the year, despite the expected economic recovery, due to the deficits traditionally observed in December of each year (due to payments of 13th salaries and pensions and sizeable payments for investment projects).

In more detail, the budget balance for the first nine months of 2021 was affected by increased revenue from social contributions, taxes on production and current taxes on income (+16,9%, +9,8% and +13,4%, respectively, compared with the first nine months of 2020; **Table A.11**). The increase in social contributions is due to the increased contribution rates to the GHS that applied to all 12 months of 2021 (as opposed to 7 months

CHART A.30 **Budget and primary balances of the general government**
(cumulative for the year as from Q1 as a percentage of GDP)



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

TABLE A.11 **Accounts of general government**

	Jan.-Sep. 2020 (€ million)	Jan.-Sep. 2021 (€ million)	Change %
EXPENDITURE			
Intermediate consumption	586,7	659,6	12,4
Compensation of employees	1.973,7	2075,1	5,1
Social transfers	2.395,4	2738	14,3
Interest	358,0	367,1	2,5
Subsidies	481,7	543,3	12,8
Other current expenditure	376,9	444,4	17,9
Gross fixed capital formation	309,4	326,9	5,7
Other capital expenditure	96,5	77,5	-19,7
Total expenditure	**6.578,3**	**7.231,9**	**9,9**
Total expenditure as a % of GDP	**30,5**	**31,2**	
REVENUE			
Taxes on production and imports	2.192,7	2.408,5	9,8
Current taxes on income, wealth, etc	1.434,0	1.626,5	13,4
Social contributions	1.666,6	1.947,8	16,9
Other current revenue	123,0	159,1	29,3
Sales	414,2	427,9	3,3
Capital transfers received	63,1	78,4	24,2
Property income	84,6	100,3	18,6
Total revenue	**5.978,2**	**6.748,5**	**12,9**
Total revenue as a % of GDP	**27,7**	**29,1**	
Primary balance	**-242,1**	**-116,3**	
Primary Balance as a % of GDP	**-1,1**	**-0,5**	
Budget Surplus (+) / Deficit (-)	**-600,1**	**-483,4**	
Surplus (+) / Deficit (-) % of GDP	**-2,8**	**-2,1**	

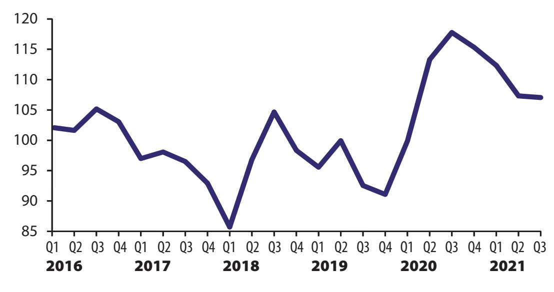
Sources: Cystat, CBC.

in 2020) and the base effect of the impact of wage subsidisation schemes – which were not subject to social contributions – that were larger in size in 2020 compared with 2021. The increase in taxes on production reflects the increase in economic activity, and the increase in current taxes on income reflects the improvement in the labour market and the increase in operating profits.

Public expenditure also increased significantly compared with the same period of the previous year (+9,9%), although at a lower rate than the increase in revenue. This was mainly due to increased social payments and, to a lesser extent, due to increases in compensation of employees and intermediate consumption. The increase in social payments (14,3% compared with the same period of the previous year) mainly reflects the increase in GHS-related expenses. The increase in compensation of employees (5.1% compared with the same period of the previous year) mainly reflects the gradual restitution of public wages, and to a lesser extent, the increase in the number of government employees, the granting of increments, the increased payments to medical staff due to the needs created by the pandemic and the higher contributions of the State as an employer due to increased GHS contributions. The increase in intermediate consumption (12,4% compared with the same period of the previous year) is mainly due to purchases of vaccines, drugs and services relating to the pandemic.

Regarding government debt (**Chart A.31**), it stood at 107,1% of GDP in September 2021, recording a decrease of about 10 percentage

CHART A.31 **General government consolidated gross debt**
(as a percentage of GDP)



Sources: Cystat, CBC.

points compared to September 2020, despite the primary deficit recorded in the first nine months of the year (0,5% of GDP). This is mainly due to the use of cash reserves to repay maturing debt (decline in cash reserves) and the strong economic recovery.

Public debt-to-GDP ratio is expected to decline significantly in the coming years, reflecting the estimates for the recovery in economic activity. It is noted that rating agencies expect a significant reduction in government debt; thus, any derailment not associated with the needs created by the pandemic, will have a serious impact on the credibility of fiscal policy.

Finally, the crisis, despite causing several problems, has also created the opportunity for a faster transition to a sustainable economy. Our economy's recovery plans, and in particular the effective absorption of the funds of the European Recovery and Resilience Facility, offers the opportunity to carry out and support development projects that centre on the dual goal of digital development and green growth. If this endeavour is successful, it can be an important pillar for supporting sustainable economic growth in the coming years.

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(C) Macroeconomic Forecasts for the Cyprus Economy[24]

24. Forecasts and assumptions have been prepared taking into account economic developments and available data until the 26th of November 2021.

- *Positive GDP growth rates for the period 2021-24 owing to the recovery in domestic demand and net exports.*
- *Drop in unemployment over 2021H1, with an ongoing decline in the coming years. Hysteresis effects owing to the impact of the pandemic are not expected.*
- *Significant rise in inflation in 2021 and 2022, mainly due to significant increases in energy prices, as well as supply chain bottlenecks. More modest rates expected over 2023-24, owing to the reductions in oil prices.*
- *Balanced risks in relation to the baseline scenario for GDP and slightly to the upside for inflation for the period 2021-24.*

The macroeconomic forecasts presented in this *Economic Bulletin* have been prepared in the context of the Eurosystem exercises using common assumptions. Compared with the June 2021 forecasts, the assumptions in the updated set of projections are partially differentiated as follows:

First, the recent deterioration in the epidemiological situation and the introduction of incentives to expand the vaccination coverage of the population are taken into account, while the working hypothesis is that no new lockdowns or strict measures having significant impact on economic activity would be introduced, with a resolution of the health crisis expected during the course of 2022.

Second, supply chain bottlenecks are assumed to persist longer than previously envisaged. Specifically, they are foreseen to intensify over 2022H1, to gradually ameliorate over the second half of the year, and to fully normalise by the beginning of 2023.

Third, the downward revision of the external environment prospects is taken into account, owing to the ongoing supply chain problems and the deterioration in the general epidemiological situation.

Fourth, both direct and indirect economic impacts emanating from the absorption of financing from the EU's Recovery and Resilience Fund (RFF) have been incorporated in the projections.

The CBC's updated GDP forecasts have been revised significantly upwards for all years of the forecast horizon. This is motivated by the significant adaptation effects demonstrated by households and businesses since the beginning of the pandemic, the higher vaccination coverage of the population compared with the situation prior to the summer, as well as the significant support to economic activity that is expected from the aforementioned absorption of EU funds.

Regarding inflation, the CBC's updated projections for the HICP point to a significant upward revision, especially in 2021 and 2022. This is attributable to the common assumptions incorporating larger increases in energy prices as well as upward pressure on the HICP's main components, owing to persistent supply chain bottlenecks in conjunction with growing demand, in a context of a continuing recovery in economic activity. The projected reduction in oil prices contributes to the slowdown in the HICP in 2023 and 2024.

Economic Activity

Further to a rise of 5,1% registered over the first half of this year, GDP for 2021 is projected to record a recovery of 5,6% (**Table A.12**). This is driven from all GDP sub-categories, partly owing to the ongoing implementation of fiscal support measures totalling approximately to 3,5% of GDP as well as the measures adopted by the European Central Bank and the Central Bank of Cyprus. Specifically, the increase in private consumption by 1,3% is driven by a base effect owing to the lockdowns over 2020 and the restoration of the level of disposable income in 2021 (**Table A.12**). At the same time, the fact that the savings rate - which increased significantly in 2020, partly due to the prolonged lockdown - remains high, is a factor that constrains growth in private consumption. Gross fixed capital formation is expected to recover by 9% in 2021, following the stagnation observed in the previous year owing to the postponement and / or cancellation of some investment plans over 2020 (**Table A.12**). The relative slowdown in public consumption growth to 10,6% is due to a base effect relating to increased spending for health services purchases by the GHS in 2020. At the same time, it reflects the ongoing gradual restitution of wage cuts adopted during the crisis years (see Economic Activity, p. 19 and **Table A.12**).

The increase in net exports is also expected to contribute to the foreseen GDP recovery in 2021. Exports of goods and services are foreseen to increase by 8,1% in 2021 (**Table A.12**), mainly due to the gradual recovery in tourism revenues, with a better than previously envisaged path for the current year (see Balance of Payments). The increase in imports of goods and services by 6,7% (**Table**

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

	2020	2021f	2022f	2023f	2024f
GDP	-5,2	5,6	3,6	3,7	3,8
Private consumption	-5,0	1,3	1,5	1,8	2,3
Public consumption	15,0	10,6	-1,5	1,3	2,1
Gross fixed capital formation	0,0	9,0	2,1	2,8	4,8
Exports of goods and services	-5,1	8,1	5,9	5,5	4,0
Imports of goods and services	-2,5	6,7	2,6	3,2	2,9

Sources: Cystat, CBC.

A.12, p. 55) is due, in part, to the recovery in imports of goods for private consumption and investment.

GDP growth of about 3,7% per annum is forecasted for the period 2022-24 (**Table A.12**, p. 55), driven by the recovery in domestic demand and net exports. The gradual rise in private consumption, expected to reach 2,3% in 2024, is also affected by the increase in disposable income from labour sources (**Table A.12**, p. 55). At the same time, the savings rate is expected to remain high compared with the period prior to the crisis owing to "pre-cautionary savings", reflecting the prevailing uncertainty, the need to repay loans and possible introduction of measures to improve public finances (Ricardian effects). Gross fixed capital formation is expected to exhibit a dynamic path, reaching 4,8% in 2024, owing to new projects to be financed by the RRF as well as the gradual completion of large and multi-year projects that have already begun (**Table A.12**, p. 55). These projects span the areas of energy, tourism, transport and the casino-resort. Public consumption is projected to contract by 1,5% in 2022 due to a base effect relating to health services expenditures by the GHS, including spending on vaccines and testing, followed by small rises in the following years (**Table A.12**, p. 55). It is noted that the gradual restitution of public wages is completed in 2023.

Net exports are expected to continue to positively contribute to economic growth in the period 2022-24. Exports are projected to grow slowly, reaching 4% in 2024 (**Table A.12**, p. 55), with a significant contribution coming from tourism and, to a lesser extent, from the sectors of telecommunications, computer and information services, financial services (investment funds) and transport. A complete normalisation in tourism is expected in 2024 owing to uncertainty associated with possible virus mutations, as currently observed ("Omicron" variant). The recovery projected in tourism is also linked to the expected operation of the casino-resort[25]. Total imports are expected to recover further over the period 2022-24, in conjunction with the ongoing improvement in domestic demand (**Table A.12**, p. 55).

Compensation, productivity and the labour market

The GDP recovery is reflected in the employment path, which is projected to increase by around 1,6% per annum in the period 2021-24 (**Table A.13**). Policy support measures were extended to end-October 2021, supporting private sector employment, with the impact of the pandemic clearly visible in the path of working hours per employed person.

The unemployment rate is expected to decline significantly from the second half of the current year, reaching 7,5% in 2021 due to the extensive recovery of economic activity and the absence of hysteresis effects from the pandemic. The downward trend in unemployment is projected to continue in the coming years, reaching 5,6% of the labour force in 2024.

The relatively small rises projected in nominal compensation per employee for the period 2021-24 (annual average of 2,7%) compared with the GDP rebound (**Table A.13**)

TABLE A.13 **Labour market projections**
(annual change, %, unless otherwise indicated)

	2020	2021f	2022f	2023f	2024f
Compensation per employee	-2,2	2,8	2,7	2,7	2,6
Unit labour costs	1,9	-1,2	0,8	0,5	0,4
Productivity	-4,0	4,0	1,9	2,2	2,2
Total employement	-1,2	1,6	1,6	1,5	1,5
Unemployment rate(% of labour force)	7,6	7,5	6,8	6,2	5,6

Sources: Cystat, CBC.

25. Owing to the pandemic, the operation of the casino-resort is expected as from 2022Q3 in the December 2021 forecast, with only a partial impact from its operation included, as in previous sets of projections.

reflect the modest increases expected in the private sector, given the level of unemployment, which should converge to full-time employment conditions only in 2024. At the same time, larger increases are recorded in the public sector, mainly due to the continued gradual restitution of wages and pensions, with its completion in 2023 (see Labour Costs). The 2024 growth rate of nominal compensation per employee includes the increase in social contribution rates towards the Social Insurance Fund that will be valid for the next five years.

Productivity is expected to recover in the coming years, following the significant 4% drop recorded in 2020 due to the effects of the pandemic, registering a positive rate of change of 4% in 2021 and around 2,1% per annum over the period 2022–24 (**Table A.13**, p. 57).

Unit labour costs are expected to fluctuate slightly over the forecast horizon (**Table A.13**, p. 57). In 2021, the modest increase in wages relative to the significant rise in productivity is expected to lead to a drop in unit labour costs by 1,2%. On the contrary, for the period 2022-24 small and decelerating increases are foreseen, reaching 0,4% in 2024. The unit labour costs index in Cyprus maintains a comparative advantage compared with the rest of the euro area due to the wage reductions observed in the past and, as a consequence, the improvement in competitiveness recorded in previous years (see Labour Costs).

Inflation

HICP inflation is expected to reach 2,2% in 2021 and 2,5% in 2022 compared with -1,1%

in 2020 (**Table A.14**), mainly as a result of the GDP recovery and significant increases in energy and services prices. To a lesser extent, it is attributable to the prices of non-energy industrial goods due to ongoing problems in supply chains. In line with the GDP recovery path, core inflation is projected to reach 1,3% in 2021 and 1,6% in 2022 compared with -0,8% in 2020.

In 2023 and 2024, HICP inflation is expected to slow to 1,2% and 1,5%, respectively, affected by the significant drop in energy prices, in line with the common oil price assumptions. Core inflation is projected to reach 1,7% and 1,9% in the years 2023-24, respectively, in line with the expected positive developments in the prices of non-energy industrial goods as well as services, owing to the projected strong economic activity.

Risk assessment of macroeconomic forecasts[26]

The expected GDP path (**Table A.12**, p. 55), as well as the HICP and the core inflation projections (**Table A.14**) represent the baseline scenario. The probabilities of deviating from the baseline scenario for GDP and HICP are outlined in **Charts A.32** and **A.33** (p. 60) respectively. Possible deviations in the forecast of core inflation are presented in **Chart A.34** (p. 60). A summary of the risk assessment relating to possible deviations from the baseline scenario is presented in **Table A.15** (p. 61).

The risks of deviating from the baseline GDP forecasts over 2021-24 are assessed to be balanced overall. Upside risks are

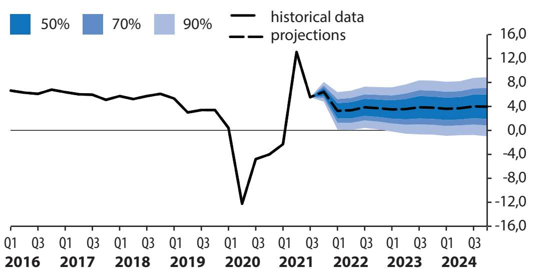
26. For further information regarding the methodology of the risk assessment of macroeconomic projections, see *Economic Bulletin*, June 2015, p. 6.

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

	2020	2021f	2022f	2023f	2024f
HICP	-1,1	2,2	2,5	1,2	1,5
HICP excluding energy and food	-0,8	1,3	1,6	1,7	1,9

Sources: Cystat, CBC.

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



Source: CBC.

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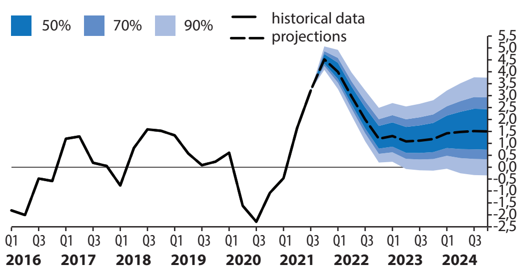
associated with a higher than expected impact from absorption of available financing for investments under the RRF, as well as possible greater than expected impact on private consumption from pandemic-delayed spending ("pent-up demand"), associated with a lower than foreseen savings rate. In addition, they are associated with higher than envisaged performance in the tourism sector, at least in the medium-term, in line with the Eurosystem common assumption of a resolution to the health crisis in 2022. Finally, robust economic growth and the abundance of the relevant upside risks to GDP suggest a continuation of the significant drop in the public debt ratio, thus reducing the risk of adopting restrictive fiscal measures to reduce the high level of public debt. Downside risks are associated with worse than foreseen prospects regarding the external environment as well as ongoing disruptions and / or greater than expected impacts relating to supply chain problems. Domestically, they include worse than expected epidemiological developments that partially affect economic activity, whilst assuming that no new lockdowns are introduced.

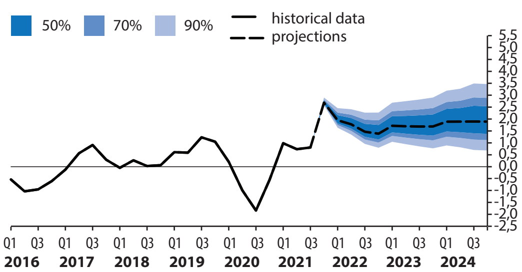
Risks in relation to HICP inflation for the years 2021-24 are assessed to be tilted slightly upwards. Upside risks stem mainly from potentially larger than expected impacts on prices owing to supply chain bottlenecks. They are also associated with a more positive than expected path in private consumption, due to pent-up demand. In addition, a better than foreseen implementation of various

CHART A.33 **HICP fan chart**
(annual change, %)



Source: CBC.

CHART A.34 **HICP excluding energy and food fan chart (core inflation)**
(annual change, %)



Source: CBC.

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investment plans as well as performance in services, in particular tourism, is expected to have a positive effect on inflation. In relation to oil prices, relevant risks are assessed to be balanced for the period 2021-24. The risk of adopting restrictive fiscal measures, as mentioned above, are also balanced for the entire period 2021-24, as is the case for GDP. Downside risks to inflation are associated with a worse than expected outlook relating to the external environment. Finally, the risks of deviating from the baseline scenario for core inflation are also assessed to be slightly upwards, as is the case for HICP.

TABLE A.15 **Summary of risk assessment**

Risk	**GDP (2021-2024)**	**Inflation (2021-2024)**
Epidemiological developments and vaccination rollout against the virus	-	-
Greater than expected impact from absorption of funds from EU support package	+	+
Higher than foreseen oil prices	=	=
Continued and/or higher than foreseen impacts on supply chains	-	+
Impact on domestic economic outlook as a result of external environment developments	-	-
Adoption of contractionary fiscal measures aimed at lowering the public debt-to-GDP ratio	=	=
Better than foreseen developments in the tourism sector	+	+
Higher than expected impact owing to accumulated savings and pent-up demand	+	+
Overall assessment	**=**	**+**

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

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Technical Notes

(A) Domestic monetary aggregates (deposits and credit grouwth)

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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