



CENTRAL BANK OF CYPRUS

ECONOMIC BULLETIN

JUNE 2021

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Macroeconomic
Forecasts for the
Cyprus Economy

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Note: The cut-off date for data in this *Bulletin* is 19th of May 2021.

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ABBREVIATIONS

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

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Introduction

The domestic economy is expected to record a recovery from the second quarter of the year due to the acceleration of vaccinations, the extension of targeted measures to support the economy and the gradual improvement in the external environment resulting in a strengthening of external demand. The recovery was negatively affected by the imposition of new stricter measures to contain the pandemic at the beginning of the year and this situation led to a downward revision of GDP growth forecasts compared to the December 2020 forecasts of the Central Bank of Cyprus (CBC). However, the available macroeconomic and other financial indicators suggest that the above-mentioned new stricter measures have had a significantly lower impact on economic activity than in the previous year. As a result, the downward GDP growth revision for 2021 has been limited and, overall, GDP growth is expected to increase by 3,8% compared to the projected 4,1% of the December 2020 forecast. Unemployment is expected to increase this year compared to 2020, due to the hysteresis effect usually associated with the impact of changes in GDP on the labour market, but also due to the gradual withdrawal of employment support measures.

Despite the significant recovery expected this year, it should be noted that GDP will continue to be below the pre-pandemic level of 2019. Measures taken to support the economy, both domestically by the State and the CBC, as well as at European level, by the European Central Bank (ECB) and the

European Banking Authority (EBA), continue to constitute an important driver of growth and employment support. Therefore, they should be withdrawn gradually, carefully and in line with developments in each sector of economic activity. With regard to fiscal measures, account should of course be taken of the sustainability of the country's public finances, as well as of future budgetary needs.

The above baseline forecast scenario for GDP in 2021 is characterized by a great degree of uncertainty, mainly due to the volatile epidemiological situation. For example, assumptions adopted in relation to the course of main variables that cannot be predicted on the basis of historical precedent, such as the reviving of tourism or the reduction of savings after the end of the pandemic, are characterised by a high risk of non-verification.

The Harmonised Index of Consumer Prices (HICP) is expected to reach 1,1% in 2021 compared with -1,1% in 2020, mainly driven by the significant upward impact of several factors that are expected to be temporary on overall inflation (increases and upward base effect in energy prices, possible price increases in various products due to disruptions/shortages in the supply chain) and the expected economic recovery during the 2021H2. In 2022, HICP is envisaged to decelerate compared with 2021, reaching 0,7% mainly stemming from the projected fading out of the positive impact of several temporary factors on inflation during 2021. Concerning inflation excluding energy and food prices (core inflation), this is expected to stand at 0,5% in 2021 and 0,7% in 2022.

In relation to developments in the banking sector, the broad monetary and fiscal policy

package taken to enhance liquidity in the economy has greatly alleviated the impact of the pandemic on both deposits and domestic private sector borrowing.

With regard to monetary policy, the ECB through the decisions of its Governing Council, in which the Governor of the CBC also participates, continues to provide support to euro area economies through, inter alia, the Public Sector Purchase Programme (PSPP) and the Pandemic Emergency Purchase Programme (PEPP). At the same time, the ECB's policy of keeping interest rates at historically low levels as well as the Targeted Longer-Term Refining Operations (TLTROs) make a significant contribution to maintaining low borrowing costs in Cyprus. It should also be noted that through the explicit assurance to maintain supportive monetary policy for as long as needed (Forward Guidance), the ECB is decisively strengthening the efforts to boost economic activity.

Apart from the above monetary measures, the CBC acted immediately in cooperation with the European authorities in order to provide the necessary flexibility with regard to prudential regulations. As a consequence of the above, concrete measures and decisions were taken to support the economy. In particular, the amendment of the relevant CBC Directive on the granting of new short-term credit facilities, the preparation of the payment moratorium and the cooperation with the Ministry of Finance on the adoption of the Decree implementing the payment moratorium, the release of capital to provide breathing space to banks to absorb losses and to facilitate them to provide new lending or

proceed with restructurings and the circular of the CBC to all banks to accelerate the restructurings of existing loans so as to facilitate the smooth operation of businesses, were key elements that supported and enhanced thousands of households and businesses and at the same time assisted the banking sector.

In the NPL front and despite the deterioration of the macroeconomic environment in 2020, their contraction continued, supported mainly by non-organic reductions and write-offs of loans by banks. The historically low interest rate environment continues to support the lending dynamics, although upward pressures in lending rates have been observed since the second half of 2020, which continued into the first quarter of 2021.

The so far developments regarding the credit facilities that were in a moratorium and whose repayment resumed in January 2021 support an encouraging view for the banking sector as a whole. However, since we continue to go through a period of challenges and high uncertainty, we should expect a longer period for more secure and robust conclusions. In addition, the results between credit institutions differ and attention should be paid to those institutions that have been mostly affected.

Furthermore, the management of existing non-performing loans is expected to continue with a view to clean – up banking institutions' balance sheets as quickly as possible. This is anticipated to take place mainly through sales and/or securitisations of NPL portfolios and loan restructuring. Low profitability due to low interest rates and relatively high opera-

ting costs increases the need to adjust our banks' business model and invest in technological upgrading to provide cheaper and faster services.

Despite the above, the capital base of our banking sector is stable in the first months of 2021, which facilitates the more efficient management of non-performing loans and, combined with high liquidity, the new financing to the economy.

The pandemic has also intensified the need to shift towards environmentally friendly investments that are resilient to climate and environmental change. The emphasis placed

at European and wider level on the development of the 'green' economy and the management of risks from climate change should raise awareness among banking institutions and the Cypriot economy in general. The policies and practices of banks should incorporate the framework for measuring and managing the risks emanated from climate changes and potential changes in policies targeting the reduction of carbon emissions and additionally, the new funding should also be assessed by taking into account the above mentioned risks and the transition to the era of 'green' economy.

Summary of the Economic Bulletin

The pandemic and the subsequent mitigation restrictive measures taken at global level, continued to have a negative impact on the global economy in the first five months of 2021. However, the impact was relatively smaller than in 2020 due to the large government support measures and the considerable progress in vaccination rates. The world economic growth projections for the developed economies have been revised upwards, according to the latest forecasts by international organisations. More specifically, in 2021, economic growth is expected to be around 4,4% and 6,3% for the euro area and the USA, respectively, and around 4,1% and 3,7%, respectively, in 2022.

The global inflation rate increased in the first months of 2021, mainly due to rising energy prices and various factors that are considered temporary. As regards inflation in the euro area, according to international organisations, it is expected to fluctuate around 1,6% in 2021 compared with 0,3% in 2020. Nevertheless, the long-term outlook for euro area inflation remains unchanged at 1,7%, which is below the ECB's inflation target over the medium term.

The ECB continued its expansionary monetary policy, particularly through the Pandemic Emergency Purchase Programme (PEPP). A sharp decline in the 10-year government bond yields for euro area countries has been observed, particularly those countries that were most affected by the pandemic. Furthermore, there has been a decline in the bond spreads in relation to the corresponding German bond.

As regards the Cyprus economy, economic activity recorded a relatively small contraction of 1,6% in the first quarter of 2021 due to the pandemic-related stringent restrictive measures. The GDP contraction of 5,1% in 2020 was due to all categories of expenditure, with the exception of public consumption, which recorded an increase.

From the sectoral point of view, most production sectors recorded a drop, with the tourism sector and food service activities being significantly affected by the implementation of restrictive measures.

The real estate sector has been proven resilient during the current health crisis. The construction sector has been supported significantly by local demand. The sector's resilience is also displayed by the developments in house prices, which recorded an increase of 0,9% year-over-year in the first quarter of 2021.

The pandemic had a negative impact on the labour market, although this was smaller compared to the impact on GDP due to the fiscal measures that supported private sector workers and businesses. The unemployment rate is expected to record an increase to 8% in 2021 compared with 7,6% in 2020, due to hysteresis effects. Furthermore, nominal compensation per employee recorded a drop of 3,2% in 2020, while employment recorded an annual decline of 1,2%. The decline in employment levels occurred for the first time since 2014Q4.

The wide range of monetary and fiscal policy measures taken to help boost liquidity in the economy has largely mitigated the impact of the pandemic on deposits as well as domestic private sector lending. Domestic

private sector deposits recorded an acceleration and increased by 3,6% in March 2021, compared with 2,5% at the end of 2020. This acceleration reflects the increased savings following the decline in consumption, which resulted from the pandemic-related restrictive measures. The growth in net loans to the private sector increased compared to 2020H2, reaching 3,9% in March 2021 compared with 0,4% in June 2020. This is mainly due to the reduction in loan repayments following the adoption of the loan payment moratorium and the increase in new borrowing related to the state interest rate subsidy scheme for new housing and new business loans.

The level of non-performing facilities (NPFs) continued to decline in 2020, despite the deterioration in the macroeconomic environment, supported mainly by non-organic deleveraging activities and loan write-offs. In 2021, a temporary increase in NPFs is expected due to the impact of the pandemic. In 2022-2023, NPFs' levels are expected to return to a downward trend, reflecting the anticipated improvement in the macroeconomic outlook and the ongoing efforts of banks to further streamline their balance sheets.

The historically low interest rate environment continues to support lending dynamics, although slight upward pressures on lending rates have been observed since the second half of 2020. These upward pressures, which were observed in the first quarter of 2021 as well, are expected to continue for the remaining of the year mainly due to increased default risk faced by banks. In short, the

average interest rate on new housing loans to households reached 2,17% in March 2021 compared with 2,10% in March 2020. The average interest rate for loans up to €1 million to non-financial corporations reached 3,34%. In summary, the average interest rate on new home loans to households reached 2.17% in March 2021 from 2.10% in March 2020, while for non-financial corporations on loans up to € 1 million it reached 3.34% in March 2021 compared with 3,20% in March 2020.

As regards the CBC macroeconomic forecasts, GDP recovery is projected at 3,8% in 2021, due to growth expected in all categories of expenditure, following a contraction of 5,1% in 2020. Further GDP growth of 3,1% and 2,5% is expected in 2022-23. These growth rates are marginally lower than those expected in the previous forecasts of December 2020 due to the outbreak of the new wave of the pandemic. Inflation is expected to rise to 1,1% in 2021 compared with -1,1% in 2020, as a result of increases in oil prices and to a lesser extent in services prices.

For 2022-23, further price increases are expected, which, however, will remain subdued. More specifically, inflation is expected to decelerate to 0,7% in 2022 and rise to 1% in 2023, mainly due to the projected GDP growth and wage growth, as well as rising service prices, given a gradual recovery of the tourism sector.

It should be noted that the aforementioned projections are characterized by significant uncertainty due to the volatility of the epidemiological situation.

(A) International Environment: main developments

- Continuation of the negative effects of the pandemic on the global economy, albeit to a lesser extent, on account of the large policy support package and the significant progress in the vaccinations rollout.
- Increase in global inflation mainly due to rising energy prices and temporary factors, but longer-term inflation expectations in the euro area remain below the ECB's medium-term price stability target.
- Preservation of favourable financing conditions in the euro area, mainly due to the effectiveness of the immediate and substantial monetary policy and the flexibility of the Pandemic Emergency Purchase Programme (PEPP).

The COVID-19 pandemic developments continued to have adverse implications on the global economic activity in the first months of 2021 as well, albeit to a much lesser extent compared with 2020, given the improvement observed. More specifically, the sizeable vaccination progress, albeit with differences in vaccination rates between countries, the ongoing monetary expansionary measures adopted by the major central banks as well as the notable fiscal support measures by governments (Biden's fiscal stimulus package in the US, the European Union's Next Generation mechanism "NGEU") have contributed decisively to the containment of the negative effects of the pandemic on the global economy. As a result, according to the projections of international organisations¹, the outlook for the global economic activity has been revised upwards with a

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

substantial recovery to be expected for the years 2021-2022 in the main advanced economies (**Chart A.1**). In particular, GDP growth in 2021 is expected to reach around 4,4% and 6,3% for the euro area and the US, respectively, and 4,1% and 3,7%, in 2022 respectively.

Global inflation² continued to register increases during the first months of 2021 mainly driven by the upward impact of temporary factors as well as the positive base effect in energy prices. According to the projections of international organisations, which continued to be characterised by a high degree of uncertainty, inflation in selected major advanced economies such as the US, UK, Japan and the euro area, is expected to fluctuate at higher levels in 2021 and 2022 compared with 2020 (**Chart A.2**). With regards to the euro area, according to the latest available data, euro area HICP inflation stood at 1,6% in April 2021 compared with 1,3% in March 2021 mainly on account of the notable increases in energy prices. With regard to 2021, euro area HICP inflation, according to the projections of international organisations, is expected to fluctuate around 1,6% compared with 0,3% in 2020 due to the positive impact of the temporary factors.

The indicator for the euro area inflation expectations that reflects the market longer-term inflation expectations (five-year rate five years ahead “5Y5Y”) stood at 1,62% on 19 May 2021 compared with 1,26% on 31 December 2020. Despite the latter increase in the 5Y5Y market-based longer-term inflation expectations indicator mainly driven by the improvement in risk sentiment concerning

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

CHART A.1 GDP in selected countries

(annual change %, seasonally adjusted %)

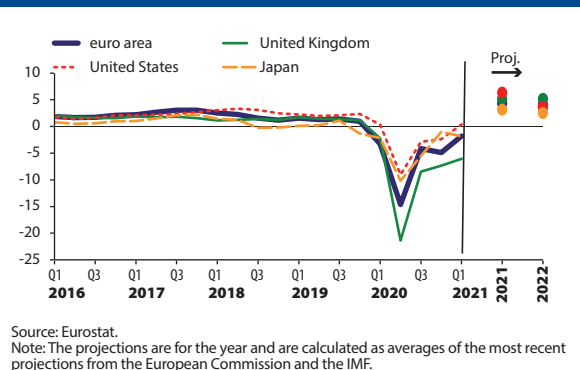
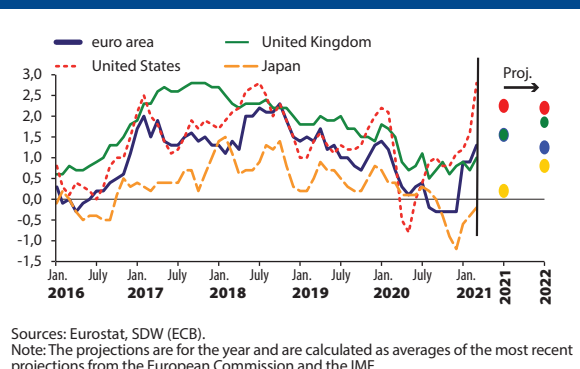


CHART A.2 Inflation in selected countries

(annual change, %)



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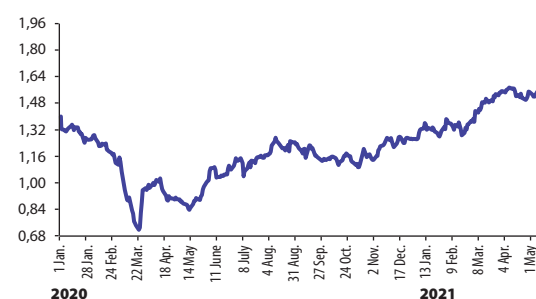
the dynamic of the pandemic and the size of the fiscal stimulus in the United States, the latest ECB Survey of Professional Forecasters for 2021Q2 showed that the survey-based indicator of longer-term inflation expectations for 2025 remained unchanged at 1,7% (**Chart A.3**). The persistence of the longer-term inflation expectations below the ECB's price stability target continues to be a challenge for its monetary policy.

Further to the existing €1.850 bn Pandemic Emergency Purchase Programme "PEPP", the ECB Governing Council decided to further adjust the terms of the third series of targeted longer-term refinancing operations (TLTRO III), and more specifically, to extend the period over which significantly more favourable conditions will apply until June 2022³.

The effectiveness of the immediate and substantial monetary policy intervention as well as the macro-prudential policy measures of the European Banking Authority, is reflected in the normalisation of the financing conditions in the euro area. In particular, sovereign bond purchases under the PEPP have led to a sharp decline in the ten-year (10YR) sovereign bond yields of the euro area countries (including Cyprus sovereign bonds yields) compared with the levels reached around the end of March 2020. Especially for countries that were the hardest hit by the pandemic, their 10YR sovereign bond yields now stand at lower levels than in the pre-pandemic period (**Chart A.4**). In addition, the spread between the yields on selected 10YR government bond and the yield on 10YR

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

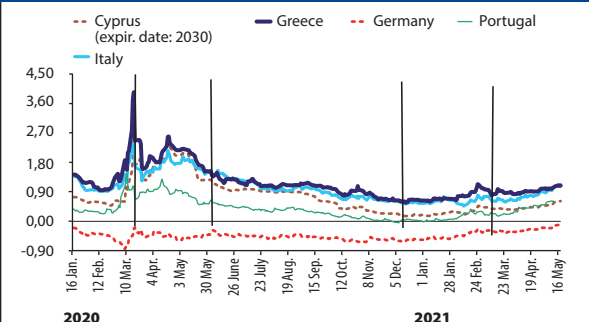
(five-year rate five years ahead "5Y5Y", annual change in %)



Sources: Bloomberg.

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 600bn. to 1.350 bln.

10/12/2020: The GC of the ECB decided, among others, to further increase the PEPP envelope by 500bn. 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.

3. For more and precise details on the particular decisions of the Governing Council of the ECB (22 April 2021), see the ECB website link below:
<https://www.ecb.europa.eu/press/pr/date/2021/html/ecb-mp210422~f075ebe1f0.en.html>

German government bond has decreased significantly since the onset of the pandemic. More specifically, the average yield spread of the 10YR government bonds of Cyprus, France, Ireland, Portugal, Greece and Italy over Germany decreased by 66 basis points during March 2020 - December 2020 compared with an increase of 36 basis points since the end of 2019 and until the end of March 2020. It is noted that, since mid-February 2021 onwards, there was an increase in government bond yields of the euro area mainly due to a positive "spill-over effect" of US economic developments on the euro area economy. However, as of 19 May 2021 the said average yield spread has not changed significantly.

Preserving favourable financing conditions during the ongoing pandemic remains essential to reduce uncertainty and increase confidence, and thereby underpin economic activity and safeguard medium-term price stability. For these reasons, both monetary and fiscal policy need to remain supportive and complementary to each other, in order to support citizens' incomes, production, consumption and the real economy in general throughout the euro area.

(B) Domestic Environment

- Despite strict lockdowns owing to the pandemic, there was a relatively small annual contraction in GDP in 2021Q1, owing to the adaptation of consumers, employees and businesses to the new “normal”.
- Subdued activity in the real estate sector, with a decrease in construction activity and house prices in certain districts. The effects of the pandemic and the reduction in demand from abroad are outweighed by the continuing significant demand from locals.
- Small negative impact due to the pandemic on the labour market compared with the impact on GDP owing to measures to support workers.
- The protracted pandemic crisis has negatively affected the tourism industry in 2021 as well, while a gradual recovery is expected in the coming years.
- The broad monetary and fiscal policy package taken to enhance liquidity in the economy has greatly alleviated the impact of the pandemic on both deposits and lending to the domestic private sector.
- Significant deterioration in public finances and increase in the government debt-to-GDP ratio in March 2021 compared with its pre-pandemic level, reflecting the impact of the pandemic.

1. Economic Activity⁴

According to preliminary data by Cystat, the GDP contraction in 2021Q1 was contained

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

to -1,6%, despite the introduction of new lockdown measures from the beginning of the year owing to the pandemic. The measures in 2021 were not as strict as those adopted in the spring of 2020 and affected a smaller share of economic activity (e.g. the construction sector was not affected). Nevertheless, the milder than expected recession appears to be mainly related to the adaptation effects of consumers, employees and businesses to the new “normal”.

On a quarterly basis, GDP grew by 2% in 2021Q1, following a q-o-q growth of 1,1% in 2020Q4. Although detailed data for the first quarter were not available by the *Economic Bulletin* cut-off date, available qualitative (soft data) and quantitative indicators (hard data), suggest that the improvement compared with 2020Q4 was partly attributable to the strengthening of economic confidence among consumers. Specifically, the relevant data from the Economic Sentiment Indicators (ESI) (Table A.1) for 2021Q1 point to an improvement by 2,5 percentage points compared with 2020Q4. In relation to quantitative data, following the significant annual decline by 10,8% recorded in January 2021 owing to the implementation of the new strict lockdown, the turnover index of retail trade (Chart A.5) rose by 1% on a y-o-y basis in February and, according to seasonally adjusted data, registered a significant m-o-m increase by 15,9%. The level of the relevant index in February 2021 was marginally higher than the levels observed prior to the crisis.

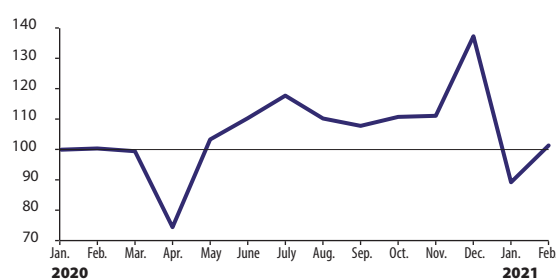
TABLE A.1 Business and consumer surveys: confidence indicators

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

	2020 Q1	2020 Q2	2020 Q3	2020 Q4	2021 Q1	2021 Apr.-May
ESI	109,0	79,9	83,9	84,0	81,8	96,9
Industry	7,5	-35,8	-26,7	-28,8	-35,2	-19,6
Services	22,4	-58,4	-45,8	-45,9	-48,5	4,6
Consumer	-10,8	-28,3	-27,0	-32,3	-29,8	-18,1
Retail trade	-3,7	-29,9	-27,0	-26,9	-27,8	-15,5
Construction	-4,3	-11,9	-16,5	-18,8	-23,8	-19,2

Source: European Commission.
Note: Seasonally adjusted data.

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



Sources: Cystat, CBC.

Based on detailed data available for the entire 2020 (**Table A.2**) and in line with the *Economic Bulletin* cut-off date, the contraction in activity emanated from all GDP sub-categories, except public consumption, which recorded an increase of 13,1%. This increase primarily reflects the rise in expenditures related to the purchase of health services by the GHS and, secondly, the ongoing gradual restitution of crisis-era wage cuts (see Domestic Fiscal Developments, p. 45). The drop in private consumption reached 3,9%, as a result of the restrictive measures adopted and the decline in private sector wages, while investment recorded a decrease of 2%. The aforementioned reductions were partly mitigated by the implementation of fiscal measures amounting to around 4% of GDP aimed at supporting workers and businesses. In addition, the loan moratorium until end-2020 supported the liquidity position of households and businesses, thus curbing the decline in domestic demand. The decrease in total exports by 12,4% was driven by the sharp drop in tourism revenues owing to the pandemic and the restrictions in air transport (see Balance of Payments, p. 32). At the same time, the 4,2% fall in total imports mainly reflected the decrease in imports of goods related to investment and private consumption (see Balance of Payments, p. 32).

From a sectoral point of view (**Table A.3**), the GDP contraction in 2020 emanated from reduced activity in most services sectors, with the main ones being those of trade, transportation, hotels and restaurants (contribution by -3,8 percentage points), as well as construction (-0,4 percentage points) and

TABLE A.2 GDP by expenditure category
(real terms, annual change, %)

	2018	2019	2020
GDP	5,2	3,1	-5,1
Private consumption	4,7	1,8	-3,9
Public consumption	3,5	15,1	13,1
Gross fixed capital formation	-5,2	2,0	-2,0
Exports of goods and services	8,0	-0,4	-12,4
Imports of goods and services	4,5	2,0	-4,2

Source: Cystat.

TABLE A.3 GDP by economic activity
(weighted contribution to the overall annual change, percentage points)

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

Source: Cystat.

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

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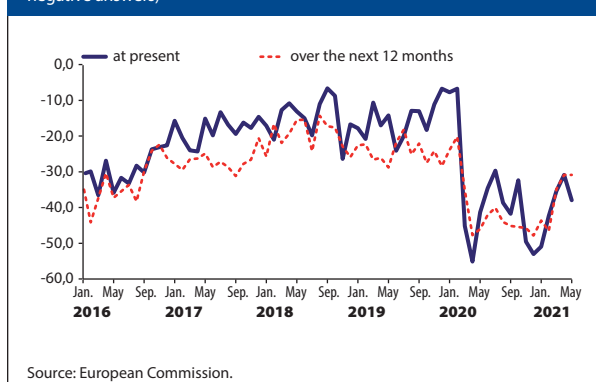
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professional, scientific and administrative activities (-0,3 percentage points).

Regarding latest available indicators relating to 2021Q2, albeit limited, these reflect an improvement in the economic outlook. Specifically, the GDP path closely follows developments in the ESI, pointing to early signs of a corrective path for the Cyprus economy. Specifically, the ESI rose to 100,6 in May 2021, recording a continuous increase compared with 80 in May 2020 and 85,7 in December 2020. In May 2021, the significant increase in the index compared with the previous month originated from the strengthening of the business climate across all sectors. More specifically, it was mainly driven by the increase in the index for services by 21,2 percentage points relative to the previous month. Smaller monthly increases were recorded in the sectors of industry, trade and construction (by 9,2, 8,6 and 7,8 percentage points, respectively).

Despite the fact that until the publication of this *Economic Bulletin* hard data for 2021Q2 were not yet available, the recovery in private consumption is already reflected in various leading qualitative indicators (soft data). Regarding consumers' expectations about major purchases, both at present and for the next 12 months (**Chart A.6**), there is an overall improvement observed for January-April 2021. However, whilst a stabilisation is recorded in May 2021 regarding expectations of major purchases for the next 12 months, a drop by 7,1 percentage points was recorded in expectations for major purchases for the month under considera-

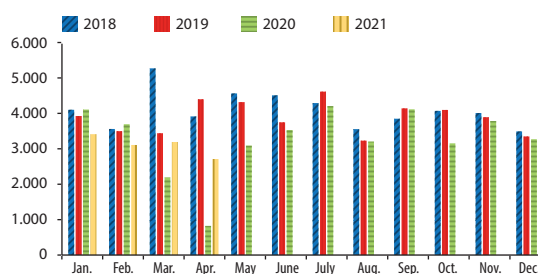
CHART A.6 Consumers' assessment of major purchases
(difference between percentage of positive answers and percentage of negative answers)



tion. Despite the volatility in the relevant time series, an overall improvement is observed, thus pointing to favourable prospects regarding the path of private consumption. At the same time, the level of the aforementioned indicators remains clearly lower than the pre-crisis levels. Regarding motor vehicle registrations (**Chart A.7**), significant annual increases were recorded as of March 2021 owing to the significant impact of the pandemic on relevant purchases.

Indicators for the construction sector and tourism (see Real Estate Market, p. 25 and Tourism, p. 35, respectively), show signs of recovery. Regarding the real estate sector, activity is expected to continue to recover owing to the large and multi-year projects that had already begun prior to the outbreak of the pandemic, some of which are of foreign interests (see Macroeconomic forecasts, p. 56). As regards tourism, the improvement in the epidemiological picture, both in Cyprus and in the main tourism markets owing to the vaccination programme, is expected to restart the economic activity in the sector. However, full normalisation in tourist flows is expected beyond the forecast horizon (see Macroeconomic forecasts, p. 56).

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



Source: Cystat.

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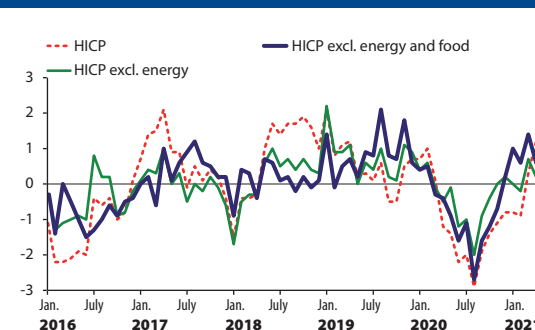
2. Domestic Environment: main developments

Prices

The Harmonised Index of Consumer Prices (HICP) increased by 1,2% in April 2021 compared with -1,2% in the corresponding month of 2020. This development was mainly attributed to the significant increases in energy prices. With regard to the first four months of 2021, HICP inflation decreased, on average, to -0,1% compared with 0,1% in the corresponding period of 2020 (**Chart A.8** and **Table A.4**) amid mixed developments in the main sub-inflation categories during the period under review. In general, the aforementioned developments in domestic HICP reflected, on one hand, the ongoing negative effects of the pandemic on the domestic economic activity, while on the other hand, the upward impact of several temporary factors on particular categories of the HICP.

More analytically, during the first four months of 2021, food and energy prices fluctuated, on average, at negative levels. On the other hand, services and non-energy industrial goods prices recorded increases. The main contributors were the base effect from the impact of the March-April 2020 measures against the pandemic on demand and prices as well as other temporary factors. The above developments seem to be in line with the previous acknowledgement that the effects of the restrictive measures in 2021 are smaller than those of 2020. In particular,

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



Source: Eurostat.

TABLE A.4 Inflation in Cyprus, main categories
(annual growth rate, %)

	Weights ⁽¹⁾	Annual change (%)				
		Jan.-Apr. 2020	Jan.-Apr. 2021	Apr. 2020	Mar. 2021	Apr. 2021
HICP	1000,00	0,1	-0,1	-1,2	0,3	1,2
Unprocessed food	54,34	1,3	-6,5	-4,4	-3,3	1,2
Processed food	186,87	0,2	-0,8	0,4	-1,0	-1,4
Energy	93,48	0,5	-4,5	-10,5	-5,8	10,6
Services	411,52	0,9	1,1	0,1	2,1	0,2
Non-energy industrial goods	253,79	-1,6	0,8	-1,3	0,1	1,5
HICP excluding energy	906,52	0,1	0,2	-0,5	0,7	0,2
HICP excluding energy and food	665,31	0,1	0,9	-0,4	1,4	0,6

Source: Eurostat.

(1) Based on the weight for 2021.

one of the key sub-categories of services inflation, namely “passenger by air prices”, which is very volatile, recorded sizeable increases mainly stemming from the limited supply of airline travel from/to Cyprus. Moreover, during the period under review, non-energy industrial goods prices had a positive contribution to HICP on account of the upward impact from the shift in sales amid the pandemic.

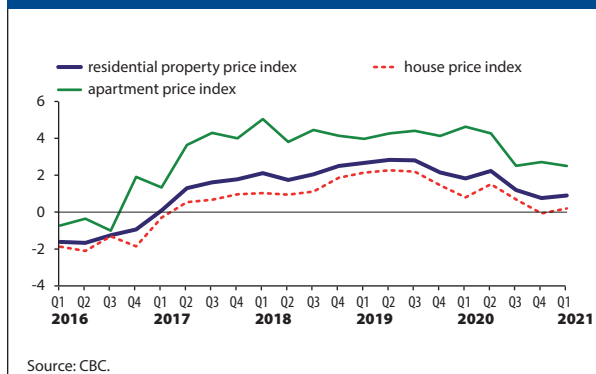
In light of the said developments in services and non-energy industrial goods prices, inflation excluding energy and food prices (core inflation) stood at 0,9% during the first four months of 2021 compared with 0,1% in the corresponding period of 2020 (Chart A.8 and Table A.4, p. 24).

Construction sector and real estate prices

The real estate sector in Cyprus exhibited a small decline in the second half of 2020, with residential property prices recording quarterly reductions. Specifically, according to available data from the Residential Property Price Index (RPPI) of the CBC, residential property prices recorded quarterly decreases of 0,4% and 0,2% in 2020Q3 and 2020Q4, respectively (Chart A.9). CBC data for 2021Q1 (see Residential Property Price Indices report for 2021Q1⁵) show a stabilisation in residential property prices as a result of, inter alia, government measures to support unemployment and boost demand for mortgage loans. This development is generally in line with the broader macroeconomic developments, such as the more positive GDP growth rate in 2021Q1

5. <https://www.centralbank.cy/en/publications/residential-property-price-indices>

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

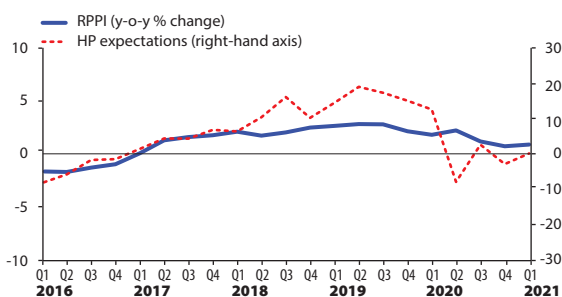


compared to expectations. More recent indicators, such as the property price expectations index for the next three months published in the European Commission's Business and Consumer Surveys, confirm the resilience of the sector by recording a positive sign in the first four months of 2021 (**Chart A.10**).

The continuing increase in domestic demand for real estate supports the market, and outweighs the lower demand from foreign buyers. According to data of sales contracts from the Department of Lands and Surveys (DLS), property transactions at a Pancyprian level recorded an annual increase of 27,6% in the period January - April 2021, although the figure is affected by a low base due to anti-pandemic measures in 2020. The annual increase from domestic buyers amounted to 64,1% and exceeded the decrease of 16,5% recorded from foreign buyers (**Table A.5**). Increased demand from locals is supported by the environment of continuing low interest rates, while the fact that lending criteria remain at very strict levels ensures to a large extent the credit quality of the new mortgage lending (**Chart A.11**).

On the basis of the above, the construction activity records a recovery, after the large decrease (27%) recorded in 2020Q2. Specifically, the index of production in construction for buildings, published by Cystat, recorded an annual increase of 1,3% in 2020Q3, while a small decrease of 1,1% was recorded in 2020Q4.

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



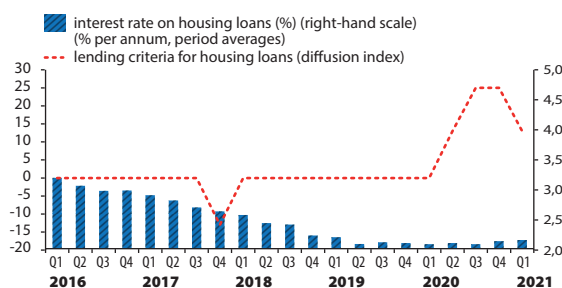
Sources: CBC, European Commission.

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

	Jan.-Apr. 2020	Jan.-Apr. 2021	Apr. 2020	Mar. 2021	Apr. 2021
Sales contracts (total)	-35,5	27,6	-79,6	62,0	285,2
Sales contracts (locals)	-35,8	64,1	-85,4	101,3	535,9
Sales contracts (foreigners)	-35,2	-16,5	-71,1	6,6	99,2
Building sentiment indicator (average of index)	-5,6	-23,7	-9,3	-22,2	-23,1
Property price expectations for the next 3 months (average of index)	7,2	2,8	-9,0	0,0	10,6
Price index of construction materials	-0,5	4,1	-0,6	4,4	5,3

Sources: Cystat, DLS, European Commission.

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



Source: CBC.

Note: A positive number in the lending criteria means stricter criteria.

Labour costs

Labour costs in 2020 were also affected by the pandemic, with significant wage cuts recorded. Compensatory fiscal measures to support employment and incomes were thus adopted, such as the wage subsidisation schemes for affected private sector workers. The schemes have been selectively extended until June 2021 and were mainly targeted towards the tourism sector.

Nominal compensation per employee decreased by 3,2% in 2020 following an increase of 1,9% in 2019 (**Chart A.12**). Specifically, private sector compensation per employee dropped by 6,5%, which was partly mitigated by a rise of 4,6% in the public sector. Compensation per employee in the public sector, in addition to the impact owing to the GHS, was mainly attributable to the ongoing gradual restitution of crisis-era cuts in wages and pensions, in effect as of July 1, 2018. The significant decline in nominal compensation per employee in the private sector mainly reflects the developments in the sectors of trade, transportation, hotels and restaurants.

Real compensation per employee⁶ decreased by 2,3%, following a rise of 0,7% in 2019. The reduction was to some extent contained by price developments, which led to a smaller deterioration in households' purchasing power (**Chart A.13**).

Regarding productivity, which is calculated as the change in real GDP per employed person, the relevant index recorded a significant annual decline of 4,6% in 2020. This development was attributable to the relatively

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

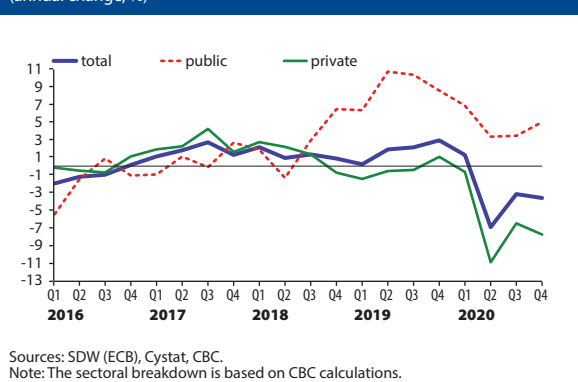
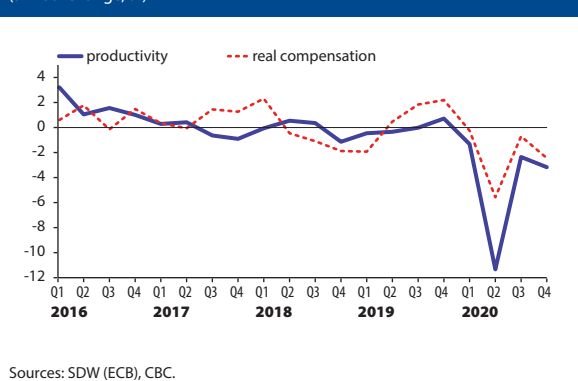


CHART A.13 Productivity and real compensation per employee
(annual change, %)

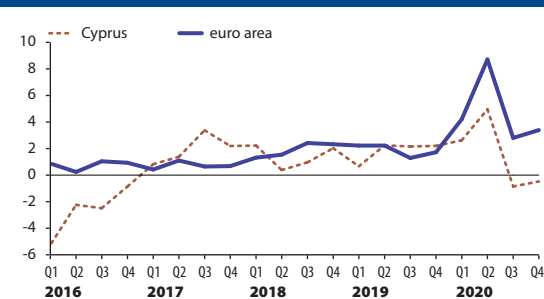


6. It should be noted that the private consumption deflator was used rather than CPI.

modest decline in employment, as a result of measures to support workers, in contrast with the significant reduction in GDP owing to the impact of the pandemic and the restrictive measures adopted (**Chart A.13**, p. 27).

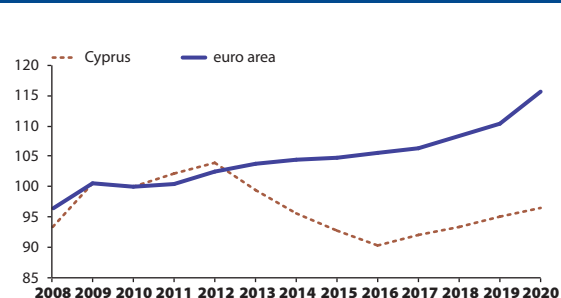
The smaller reduction in compensation per employee in 2020 relative to the decline in productivity implied a rise in unit labour costs, an important competitiveness indicator for an economy, vis-à-vis competitor economies. This index recorded an annual increase of 1,5% in the year under consideration, following a rise of 1,9% in 2019 (**Chart A.14a**). However, despite the significant increase recently observed, the significant cumulative wage reductions as from 2012 and beyond the crisis, helped to maintain the competitiveness of the Cyprus economy over the longer term. In particular, the index recorded a cumulative decrease of 13% over the period 2013-2016 and, despite the rises recorded since then, remains at lower levels compared with the euro area since 2013 (by about 19 percentage points in 2020) (**Chart A.14b**). Overall, the rise in 2020 is attributable to the external influence of the pandemic and is not expected to affect competitiveness in the longer term, especially since in relative terms the increase in unit labour costs in Cyprus is lower than that in the euro area.

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).

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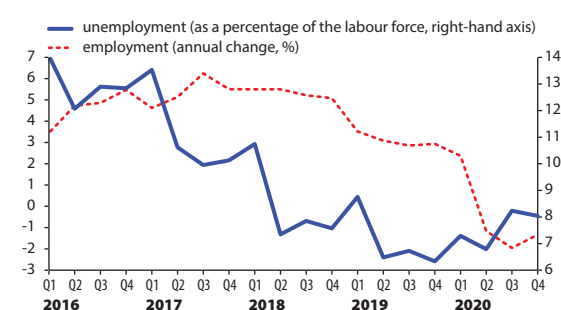
3. Labour market

The fiscal support measures helped to curb both the deterioration in unemployment and the contraction in employment in contrast with the crisis of 2013. The measures have been extended until June 2021 and are mainly targeted at supporting the tourism sector.

The impact of the pandemic was evident in the labour market data as of 2020Q2, albeit this was contained due to the effect of the fiscal support measures, with employment recording an annual decline of 1,2% for the first time since 2014Q4. Employment recorded a decrease of 0,6% in 2020, following a rise of 3,1% in 2019 (Chart A.15). A significant contraction in employment was recorded in the sectors of trade, transportation, hotels and restaurants owing to the effects of the pandemic and the restrictive measures adopted, including the closure of airports until early June 2020. The aforementioned declines were partly offset by reductions in other services sectors as well as in the construction and manufacturing sectors.

According to Labour Force Survey (LFS) data, the pandemic mainly affected part-time workers, while greater resilience was observed in the employment of full-time workers. This development contrasts with the 2013 crisis, during which there was an increase in part-timers and a drop in full-time employment. Total hours worked registered a significant annual decline of 6,4% in 2020. Hours worked per employed person dropped by 5,9% in the year under consideration following a slight decrease of 0,2% in 2019, owing to the full or partial suspension of company operations

CHART A.15 Unemployment and employment



Source: Cystat (LFS).

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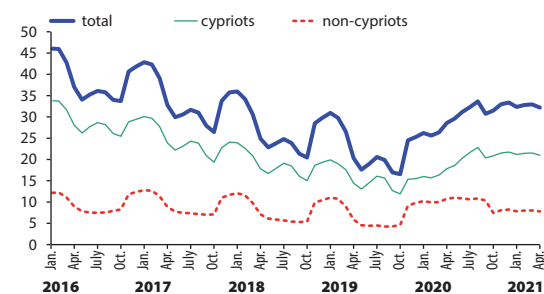
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during the lockdown period. Reflecting the gradual recovery foreseen in some services sectors, including tourism, hours worked per employed person are expected to return to pre-crisis levels gradually and beyond the forecast horizon.

The impact of the pandemic is also reflected in the unemployment data, which exhibits a reversal of its previously observed declining path. Specifically, the number of registered unemployed (**Chart A.16**), recorded a significant annual increase of 12,6% in April 2021 (from 28.591 to 32.186 individuals). However, comparing the data from March 2020 onwards with the data of previous months is not considered reliable, given the automatic renewals of registered unemployed and new registrations of unemployed individuals without physical presence in order to prevent the spread of the virus. According to Eurostat data, the harmonised unemployment rate (seasonally adjusted data) reached 7,1% in March 2021 compared with 6,3% in the corresponding month of the previous year and relative to 7,3% in December 2020.

On the other hand, the LFS data are considered to reflect relatively more accurately developments in unemployment. According to the latest data, unemployment reached 8% of the labour force in 2020Q4, compared with 8,2% in the previous quarter. However, it recorded a significant increase compared with 2019Q4 (6,3%) (**Chart A.15**, p. 29). As previously mentioned, the small rise in unemployment compared with the comparatively larger fall in GDP in 2020 is mainly due to the adoption of measures in the private sector aiming to

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



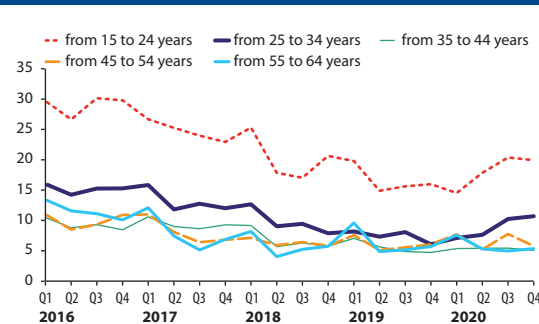
Source: Cystat.

maintain employment (labour hoarding) so that economic activity can resume immediately with the lifting of restrictions. In addition, it should be noted that the unemployment rate in Cyprus in 2020Q4 was at about the same level compared with the euro area average, according to non-seasonally adjusted data.

In relation to developments in unemployment by age group, for the year 2020 as a whole, the observed rise is mainly attributed to the age group of 25-34 years of age, with a contribution of about 2,6 percentage points to the overall unemployment rate of 7,6% in 2020 (Chart A.17a). The lowest contribution to the overall unemployment rate comes from young people aged 15-24. This percentage rose to 19,9% in 2020Q4, compared with 16% in the corresponding quarter of the previous year, and constitutes only about 1,7 percentage points of the total unemployment rate for the quarter in question.

An important parameter associated with the analysis of labour market developments relates to the path of long-term unemployment given that, in periods of persistently high unemployment, the long-term unemployed find it harder to re-enter employment. According to LFS data, the unemployment rate with a duration of six months and over rose in 2020Q4 to 4,4%, compared with 3,1% in the corresponding quarter of the previous year (Chart A.17b). Overall, the available data capture the negative impact of the pandemic on the labour market, however the relatively small deterioration compared to GDP decline is mainly due to economic measures to support private sector workers that have been affected.

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



Source: Cystat (LFS).

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



Source: Cystat (LFS).

4. Balance of payments⁷

In 2020, the current account deficit deteriorated, reaching €2.476,4 million (-11,9% of GDP), compared with a deficit of €1,406 million (-6,3% of GDP) in the previous year (Table A.6 and Chart A.18). Key factors for the deterioration were the outbreak and the course of the pandemic, as well as the restrictive measures that were adopted in transport. This had a direct and negative impact on tourism revenues leading to a large reduction in the surplus of the services balance. This development was partly offset by the decrease in the trade deficit of goods, due to the reduction in imports. The current account deficit, adjusted⁸ for the impact of SPEs, also deteriorated and reached €2.384,5 million (-11,4% of GDP), compared with -€1.510 million (-6,8% of GDP) in 2019 (Table A.6 and Chart A.18).

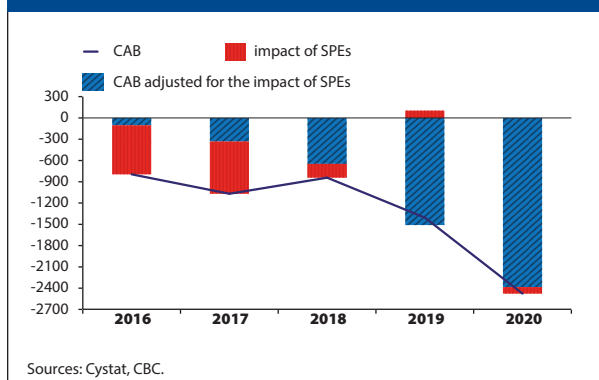
More specifically, the trade deficit of goods fell to €4.177,1 million in 2020, compared with a deficit of €4.634,4 million in 2019, mainly due to the substantial drop in imports for home consumption. In particular, oil imports decreased due to the decline in oil prices. At the same time, imports of consumer goods and intermediate inputs, as well as transport equipment, decreased due to the fall in domestic demand owing to the pandemic. It is noted that exports of

TABLE A.6 Balance of payments (main categories)

	2019 (€ million)	2020 (€ million)	Change (€ million)
Current account balance	-1.406,0	-2.476,4	-1.070,4
Current account balance adjusted for the impact of SPEs	-1.510,0	-2.384,5	-874,5
Goods and services balance	-237,8	-1.295,9	-1.058,1
Trade balance	-4.634,4	-4.177,1	457,3
Exports of goods	3.106,2	2.964,0	-142,3
of which:			
Exports of goods - SPEs	998,2	870,6	-127,6
Imports of goods	7.740,7	7.141,1	-599,6
of which:			
Imports of goods - SPEs	1.275,2	1.295,2	20,0
Services balance	4.396,6	2.881,2	-1.515,4
Exports of services	12.912,4	11.135,2	-1.777,1
Imports of services	8.515,8	8.254,0	-261,7
Primary income (net)	-898,7	-877,5	21,2
Secondary income (net)	-269,6	-303,0	-33,4
Current account balance (% of GDP)	-6,3	-11,9	
Current account balance adjusted for the impact of SPEs (% of GDP)	-6,8	-11,4	

Sources: Cystat, CBC.

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



Sources: Cystat, CBC.

7. 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.
8. It is noted that the current account deficit in 2019 and 2020 does not deviate much from the adjusted one, since the net effect of non-financial SPEs on the balance of goods in 2019, was offset by the adjustment (in terms of depreciation and tonnage tax) in reinvested earnings.

goods decreased slightly mainly due to transactions of SPEs.

The surplus of the services balance shrank to €2.881,2 million in 2020, compared with €4.396,6 million in the previous year, mainly due to the very large decrease in exports of services (Table A.6, p. 32). In 2020, the spread of the pandemic and the restrictive measures adopted by the Republic of Cyprus and other states had a negative impact on exports of services and especially on the tourism sector and the transport industry. Exports of services, and specifically tourism related services, is an important indicator for the analysis of domestic economic developments, given the high dependency of the Cyprus economy on the exports of services.

In 2020 exports of services recorded an annual decrease of 13,8% (–€1.777,1 million), mainly driven by the drop in the travel category (–2.330,4 million) which includes revenues from tourism and the decrease in the transport category (–€455,2 million) (Table A.7). Current developments and more recent available data on tourism are analysed in the subsequent sub-section (see Tourism). On the other hand, exports of financial services increased (€670,3 million), reflecting the pickup in the turnover of investment companies as a result of the pandemic. Similarly, telecommunications, computer and information services, as well as other business services increased by €233,2 million and €113 million, respectively, in the period under review.

At the same time, imports of services decreased by 3,1% (–€261,7 million) in 2020. This development is mainly attributed to decreases recorded in the categories of travel

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

	2019 (€ million)	2020 (€ million)	Change (€ million)
Services balance	4.396,6	2.881,2	-1.515,4
Exports of services	12.912,4	11.135,2	-1.777,1
<i>of which:</i>			
Transport	3.249,2	2.794,0	-455,2
Travel	2.906,7	576,4	-2.330,4
Financial services	3.260,2	3.930,5	670,3
Telecommunications, computer and information services	2.365,4	2.598,6	233,2
Other business services	378,3	491,3	113,0
Imports of services	8.515,8	8.254,0	-261,7
<i>of which:</i>			
Transport	2.099,9	1.548,2	-551,7
Travel	1.426,4	769,5	-656,9
Financial services	1.857,4	2.312,3	454,9
Telecommunications, computer and information services	1.748,2	2.062,9	314,7
Other business services	747,8	920,4	172,5

Source: CBC.

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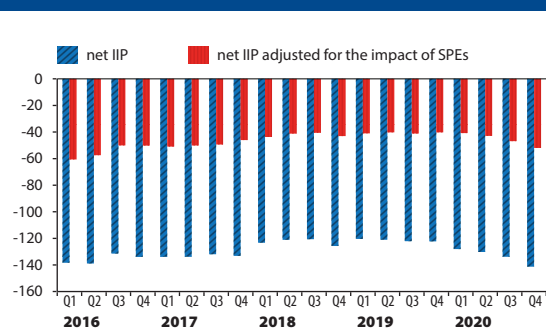
(-€656,9 million) and transport (-€551,7 million), that were partly offset by increases in financial services (€454,9 million) and the category of telecommunications, computer and information services (€314,7 million), (Table A.7, p. 33). It is noted that in 2020, due to the pandemic, many Cypriots did not travel abroad, a factor that mitigated to some extent the losses from external tourism.

In 2020, the deficit in the primary income account (which mainly includes income from employment and investment) contracted slightly compared with the previous year, to €877,5 million, almost exclusively associated with developments in direct investments. More specifically, Cypriots' income from abroad recorded a larger increase than the income of foreigners in Cyprus. The deficit in the secondary income account (which mainly includes current transfers) widened, as a result of the decrease in government inflows from European funds (Table A.6, p. 32).

Regarding the financial account, large inflows were recorded in 2020, owing to the issuance of government bonds.

The net international investment position (IIP) at the end of 2020 was negative, standing at -€29,4 billion (-141,3% 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

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



Sources: Cystat, CBC.

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

Adjusted for the impact of SPEs, the net IIP improved by 89,3 percentage points, standing at -€10,8 billion or -52% of GDP, compared with -€9 billion or -40,3% of GDP in 2019 (**Chart A.19**, p. 34). It is noted that part of the deterioration that was recorded in the net IIP as a percentage of GDP in 2020, was due to the GDP contraction.

Tourism

Tourism constitutes one of the most important pillars of the Cyprus economy, which has been significantly affected by the protracted pandemic crisis and the restrictive measures taken by the Cypriot government and by other countries, in order to limit the spread of the pandemic. The tourism sector is undergoing the biggest crisis of the last decade, with arrivals and revenues dropping to record lows in 2020. It is already obvious that the pandemic will have a bigger impact on the tourism sector both in terms of magnitude and duration than originally estimated.

More specifically, in 2020 tourist arrivals decreased by 84,1% on an annual basis reaching 0,6 million tourists, with all markets recording declines (**Table A.8** and **Chart A.20**). The key factor was the temporary prohibition of entry in the Cyprus territory of various categories of travellers, including tourists, with the restrictive measures being gradually lifted. Main markets, such as United Kingdom and Russia, have not been included in the list of countries from which tourists were allowed

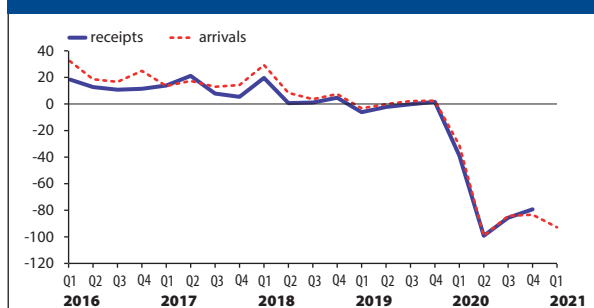
TABLE A.8 Tourism

	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. - Feb.	191,2	89,7	469,1
2021 Jan. - Feb.	8,9	6,6	738,6
annual % change	-95,3	-92,6	57,4
2020 Jan. - Apr.	246,6	n/a	n/a
2021 Jan. - Apr.	56,0	n/a	n/a
annual % change	-77,3	n/a	n/a

Source: Cystat.

Note: Due to COVID-19 pandemic entrance to the Republic was prohibited for the period 15/3-08/06/2020 and since then there was a gradual lifting of the restrictive measures.

CHART A.20 Tourist arrivals and receipts
(annual change, %)



Source: Cystat.

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

to travel to Cyprus without any restrictions. As a result, in April and May zero arrivals have been recorded, while in the summer months, which contribute the most, arrivals decreased sharply. More specifically, arrivals from the United Kingdom decreased by 83% reaching 226 thousand tourists and from Russia arrivals decreased by 96,8% reaching 25 thousand tourists.

Similarly, revenues from tourism in 2020, declined by 85,4%, affected by the reduced number of arrivals, as well as, the reduction in the daily per capita expenditure by 8% (**Table A.8**, p. 35).

On the basis of available data, arrivals for the first four months of 2021, also decreased dramatically, by 77,3% on an annual basis. Similarly, revenues for the first two months of 2021 recorded an even larger decrease, of the order of 92,6%. Data is affected by the repeated and prolonged lockdowns. From May 10th onwards, tourists who have completed their vaccination programme can visit Cyprus without any restrictions, without tests and without a need to quarantine. Also, for travel purposes, in addition to European vaccines, the Republic of Cyprus accepts those of other third countries, such as the Russian and Chinese vaccines. With the recent improved epidemiological picture and the progress in vaccinations in Cyprus, tourist arrivals from the United Kingdom are expected to commence, while tourists from Russia have already started arriving.

Tourism in 2021 is expected to exhibit a better performance than last year. For the coming years, 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 it is not estimated to reach 2019 levels until 2023, at the end of the forecast horizon (see Macroeconomic Forecasts, p. 56).

Nonetheless, there are ongoing efforts to support and upgrade the tourist product further, including hotel renovations and new infrastructure, such as the construction of marinas and luxury hotels. Furthermore, with the construction of the casino-resort, the first multi-themed resort in Cyprus and the largest in Europe, and from its operation by the third quarter of 2022, tourist arrivals are expected to increase.

Effective exchange rate

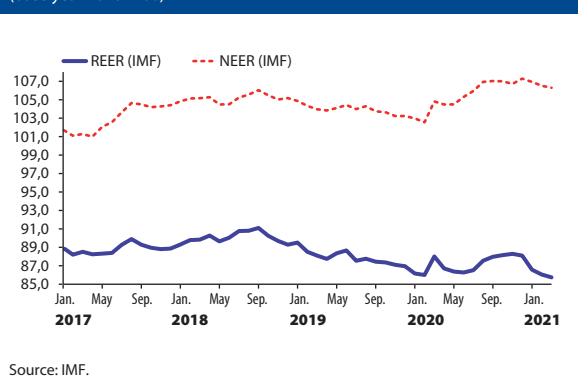
Chart A.21 shows the effective exchange rate (EER) index of the euro in Cyprus, in nominal (NEER) and real (REER)⁹ terms, as calculated by the IMF. The NEER index strengthened in the first quarter of 2021 compared with the corresponding period of 2020 (pre pandemic period). On the contrary, the REER index recorded marginal weakening. 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 analysed in the previous section, are important measures of the competitiveness of an economy. Lower unit labour costs and a lower REER in Cyprus compared with competing

9. 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).

CHART A.21 Real and nominal effective exchange rates (IMF weights)

(base year 2010=100)



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

5. Deposits, credit growth, and interest rates

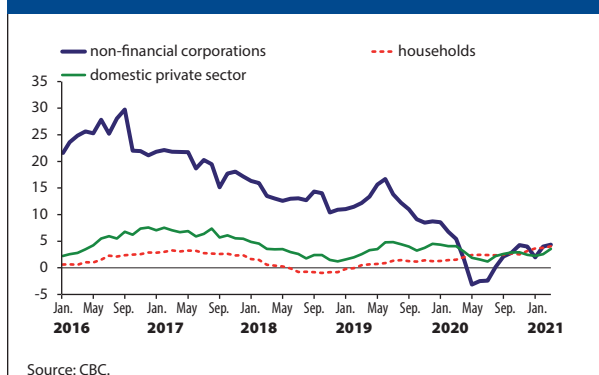
Domestic private sector deposits¹⁰ growth slowed down in 2020, mainly due to the effects of the pandemic and the imposition of negative interest rates on large corporate deposits by the two largest domestic banks. It should be noted that the ECB's expansionary monetary policy (see International Environment, p. 13), on the basis of which the deposit facility rate is at -0.50%, contributed to this end. However, after the end of the first wave of the pandemic, and specifically after July 2020, a partial acceleration in the deposit growth rate was recorded, which was generally maintained until the end of March 2021 (last available data). This development reflects underlying different trends in the deposits of the main institutional sectors, namely households and non-financial corporations, particularly during the periods with stricter restrictive measures that were imposed to contain the spread of the

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

pandemic. Specifically, since the beginning of the health crisis and despite the decline in economic activity, household deposits have increased during the lockdown periods. This was mainly due to the forced reduction in consumption and at the same time the conscious increase of savings for precautionary reasons, given the increased uncertainty as to their future income and employment condition. As regards non-financial corporations' deposits, the opposite trend was observed. During the periods with stricter restrictive measures, these deposits decreased, due to the elevated financing needs of affected corporations to cover-up working capital expenses. Conversely, during the periods when restrictive measures were eased, there was an increase in their cash and cash equivalents, due to increased revenue and the simultaneous reduction in long-term investment projects. This stemmed from the great uncertainty associated with the future economic activity outlook. Apart from the state aid, the suspension of loan instalment payments measure also contributed to the increase in the non-financial private sector's deposits in 2020 and to a lesser extent in 2021.

More specifically, domestic private sector deposits recorded an annual increase of 3,6% in March 2021 compared with 2,5% in December 2020 and 4,1% in March 2020. The annual change in domestic households deposits reached 4,0% in March 2021 compared with 3,2% in December 2020 and 1,6% in March 2020, while for non-financial corporations it reached 4,3% from 4,0% in December 2020 and 5,4% in March 2020 (Chart A.22). The domestic private sector

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

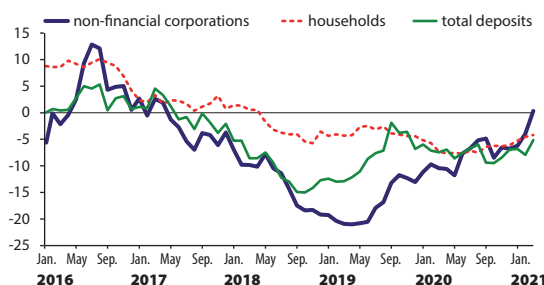


deposit inflows were offset by the continuing, albeit to a lesser extent, outflows of non-resident deposits, which typically exhibit higher volatility. In particular, the annual growth rate of non-residents deposits stood at -5,1% in March 2021 compared with -6,9% in December 2020 and -7,5% in March 2020 (Chart A.23).

Turning to credit growth, new lending to the non-financial private sector¹¹ decreased by €0,8 billion in 2020 compared with 2019, reaching a historically low level in April 2020 amid the first wave of the pandemic. Since mid-2020, it has picked up mainly due to the interest rate subsidisation scheme for new housing and business loans. In particular, since September 2020 new housing loans have exceeded their pre-pandemic levels. The recovery continued in 2021Q1 (Chart A.24).

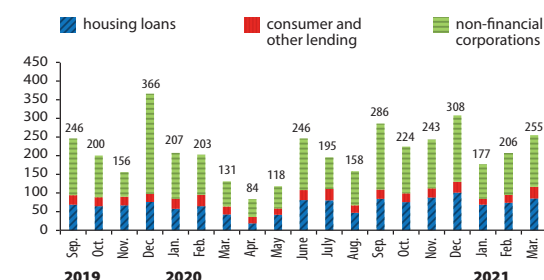
Despite the overall decline in new lending, net loans¹² to the domestic private sector¹³ recorded an annual increase of 3,9% in March 2021 compared with 3,3% in December 2020 and an annual decrease of 0,8% in March 2020. This is mainly attributed to the initial measure for the suspension of loan instalment payments that expired in December 2020. Although this scheme was extended until June 2021 for targeted borrowers, the strict eligibility criteria announced significantly reduced borrowers' interest. Specifically, the annual growth rate in net loans of both domestic non-financial corporations and households stood at 3,6% in March 2021, respectively

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-financial corporations and households
(€ million)



Source: CBC.

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

12. New lending plus capitalisation of interest minus repayments.

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

(Chart A.25). As regards loans to households, the largest growth rate was recorded by housing loans, of the order of 5% as at end-March 2021, while consumer credit and other lending to households recorded growth rates of 1% and 0,5%, respectively (Table A.9).

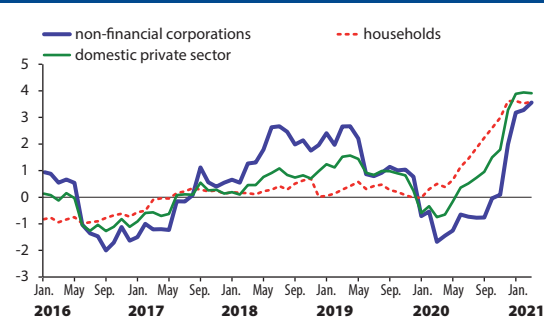
Reflecting the effects of the pandemic and the high economic uncertainty, the cumulative results of the Bank Lending Survey¹⁴ for 2020 indicate a tightening of the credit standards applied by banks, particularly in the second half of 2020. In addition, there was a significant decrease in loan demand in 2020Q2, partially reversed in the remaining period up to the end of 2020. According to participating banks, the increase in demand was mainly driven by the recovering consumer confidence, the low interest rate environment, the partial subsidisation scheme of lending rates for new housing and business loans and, consequently, the improved housing market prospects as well as the increased need for stocks and working capital by enterprises.

According to the results of the April 2021 survey (Table A.10), credit standards for loans in Cyprus were basically unchanged in 2021Q1, that is, they remained at the tightened levels reached at the end of 2020. On the other hand, credit standards for loans to households tightened further for both housing loans and consumer credit and other lending, mostly reflecting the perception of increased risk in relation to the general economic outlook and borrowers' creditworthiness.

In terms of demand, net loan demand in 2021Q1 decreased compared to the previous quarter by both enterprises and households,

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

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



Source: CBC.

TABLE A.9 Loans to domestic households^{(1),(2)}

	Outstanding balance as % of total ⁽³⁾	Annual percentage change					
		2019 Dec.	2020 Mar.	2020 June	2020 Sep.	2020 Dec.	2021 Mar.
Domestic households	100,0	0,0	0,5	1,1	2,2	3,6	3,6
1. Consumer credit	12,1	0,0	-0,4	-0,9	0,1	1,3	1,0
2. Lending for house purchase	70,1	0,3	0,9	1,7	3,0	4,6	5,0
3. Other lending	17,8	-1,1	-0,2	0,9	1,1	1,8	0,5

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 Bank Lending Survey (BLS)
(diffusion index, %)

Summary of BLS results April 2021	Cyprus	
	2021Q1	2021Q2 (expectations)
Credit standards for loans		
Enterprises	Unchanged	Unchanged
Households		
- Housing loans	Tightening	Tightening
- Consumer credit and other lending	Tightening	Tightening
Demand for loans		
Enterprises	Decrease	Increase
Households		
- Housing loans	Decrease	Increase
- Consumer credit and other lending	Decrease	Increase

Source: CBC.

as a result of the second wave of the pandemic in Cyprus.

According to the participating banks' expectations for 2021Q2, credit standards for loans to enterprises in Cyprus are expected to remain unchanged, while for loans to households are expected to tighten further for all loan categories. In contrast, net loan demand from both enterprises and households in 2021Q2 is expected to increase.

Despite the deteriorating macroeconomic environment, the contraction in the level of NPFs¹⁵ continued in 2020, supported by the suspension of loan instalments, loan write-offs and non-organic reductions related to sales and transfers of loan portfolios outside the banking system. Although NPFs are expected to increase in 2021 due to the possible inability of some borrowers to service their loans, this is expected to be temporary. Preliminary data for the first months of 2021 indicate that the percentage of borrowers who were in a moratorium and have difficulty repaying their loans is low. The prudent management of loan portfolios by banks so far and the tightening of credit standards for loan approval, in response to the expected increase in impaired exposures due to the pandemic, is expected to contain NPFs. In fact, the level of NPFs is expected to return to a downward trajectory in the years 2022-2023, in line with the expected improvement in macroeconomic developments and the banks' ongoing efforts to further consolidate their balance sheets.

The downward trajectory of the non-financial private debt to GDP ratio until the end of 2019 has been reversed, as a result of

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

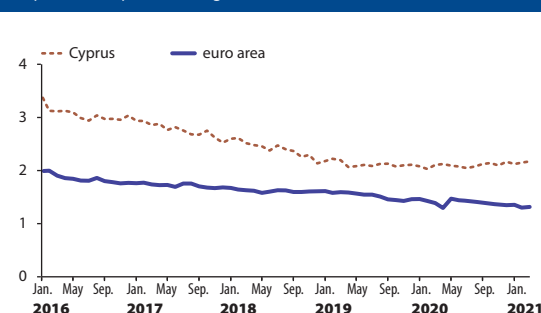
the contraction in nominal GDP (denominator effect). At the end of 2020, it increased by 10 percentage points, to 269% from 259% at the end of 2019. The upward trend is expected to continue until around mid-2021 and reverse thereafter in line with the recovery of the domestic economy as well as the increased repayments following the end of the second moratorium and subsequently the decrease in net loan transactions.

The ECB's further expansionary monetary policy measures have maintained favourable financing conditions in both the euro area and Cyprus. As a result, the historically low interest rate environment continues to support loan dynamics. However, from the second half of 2020 slight upward pressures on lending rates were observed, which continued in 2021Q1. This is related to the uncertainty about the effects of the pandemic on the real economy, the subsequent adoption of tighter credit standards by banks and the continuing decline in banks' profitability.

Indicatively, the average interest rate on new loans to households for house purchase¹⁶ reached 2,17% in March 2021 from 2,16% in December 2020 and 2,10% in March 2020 (**Chart A.26**). Conversely, there was a decrease in the interest rate on consumer credit, specifically to 2,92% in March 2021 from 2,99% and 2,98% in December 2020 and March 2020, respectively. The cost of new lending from domestic MFIs to euro area non-financial corporations for amounts of up to €1 million increased to 3,34% in March 2021 compared with 3,13% in December 2020 and 3,20% in March 2020 (**Chart A.27**).

The spread between domestic and euro

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.

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

area housing lending rates increased by 4 basis points in March 2021 compared with December 2020, reaching 86 basis points. For non-financial corporations¹⁷, the corresponding spread increased by 25 basis points, reaching 156 basis points. The increase in the spread possibly reflects the increased insolvency risk of domestic non-financial corporations compared to those in the euro area. It is recalled that, unlike Cyprus, the rest of the euro area member countries benefited from the introduction of government-guaranteed loan schemes in 2020, resulting in a lower default risk for banks and thus to a reduction in the euro area corporate lending rates.

On the other hand, domestic average interest rates¹⁸ on new deposits for households and non-financial corporations decreased further in 2020 compared with 2019. In December 2020 they stood at the historically low levels of 0,08% and 0,09%, respectively. In March 2021, they did not record a material change, remaining at approximately the same levels of December 2020 and specifically at 0,08% for both institutional sectors (**Chart A.28** and **A.29**). Regarding the spread between domestic and euro area deposit rates for households and non-financial corporations in the period between December 2020 and March 2021, it decreased by 2 and 8 basis points, respectively, reaching -10 and 20 basis points, respectively.

In 2021, the potential increase in default risk, given the expiration of the initial suspension of loan instalments measure as well as the resulting increase in NPFs, is expected to exert some further upward pressure on lending rates.

17. Loans up to €1 million to non-financial corporations.

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

CHART A.28 MFI interest rates on euro-denominated deposits (new business) by euro area households⁽¹⁾
(% per annum, period averages)

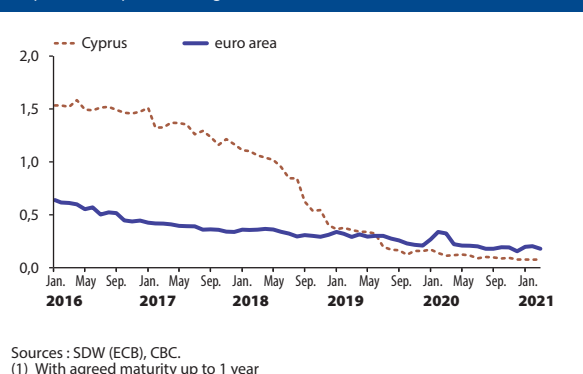


CHART A.29 MFI interest rates on euro-denominated deposits (new business) by euro area non-financial corporations⁽¹⁾
(% per annum, period averages)



6. Fiscal Developments

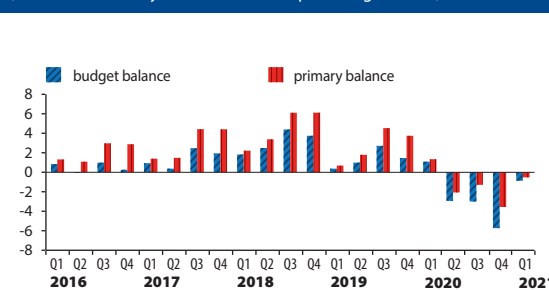
Targeted fiscal policy measures continue to support employees, businesses and households. Yet, they continue to have a significant negative impact on public finances. The total size of government measures supporting the economy to mitigate the negative effects of the pandemic amounted to almost €800 million in 2020, while the fiscal support is expected to remain strong in 2021, albeit at slightly lower levels. Employment support schemes constitute the largest component of these fiscal measures, about 50% of the total support package in 2020. However, their size and share are expected to be smaller in 2021, reflecting the easing of restrictive measures and the larger direct support to businesses through subsidies (approximately 35% of the total support package in 2021 compared to 15% of the 2020 package). Health system and social benefit support measures are also important.

According to Cystat data, the budget deficit in the first quarter of 2021 reached 0,9% of GDP compared with a budget surplus of 1,1% of GDP in the corresponding quarter of 2020 (Chart A.30 and Table A.11). The budget deficit is expected to be even higher at the end of the year, despite the expected economic recovery, mainly reflecting the rollover of the fiscal support measures in the second quarter of the year.

More specifically, the budget balance for the first quarter of 2021 was affected by the reduced revenue from current taxes on income and social contributions (-6,1% and -4,5%, respectively, compared with the first quarter

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 (€1,5 billion) do not include the fiscal impacts associated with the Cyprus Cooperative Bank (CCB).

TABLE A.11 Accounts of general government

	Jan.-Mar. 2020 (€ million)	Jan.-Mar. 2021 (€ million)	Change %
EXPENDITURE			
Intermediate consumption	171,1	159,2	-7,0
Compensation of employees	649,7	679,8	4,6
Social transfers	749,5	828,1	10,5
Interest	52,8	75,2	42,4
Subsidies	10,4	274,8	2.542,3
Other current expenditure	148,6	159,6	7,4
Gross fixed capital formation	111,3	63,3	-43,1
Other capital expenditure	24,2	18,6	-23,1
Total expenditure	1.917,6	2.258,6	17,8
Total expenditure as a % of GDP	9,2	10,4	
REVENUE			
Taxes on production and imports	751,8	738,8	-1,7
Current taxes on income, wealth, etc	511,8	480,4	-6,1
Social contributions	616,5	588,5	-4,5
Other current revenue	46,0	42,8	-7,0
Sales	143,4	125,3	-12,6
Capital transfers received	47,6	63,2	32,8
Property income	27,3	31,7	16,1
Total revenue	2.144,4	2.070,7	-3,4
Total revenue as a % of GDP	10,3	9,5	
Primary balance	279,6	-112,7	
Primary Balance as a % of GDP	1,3	-0,5	-6,1 pp
Budget Surplus (+) / Deficit (-)	226,8	-187,9	
Surplus (+) / Deficit (-) % of GDP	1,1	-0,9	-6,0 pp

Sources: Cystat, CBC.

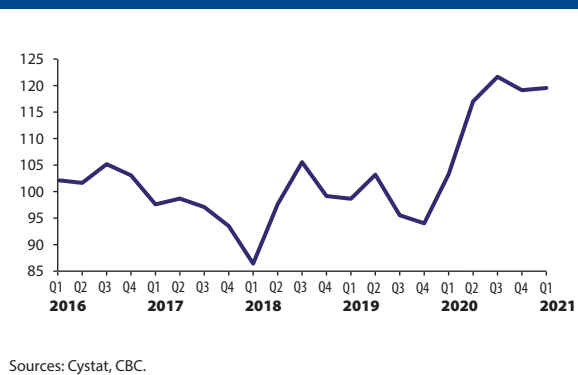
of 2020; **Table A.11**, p. 45). The decline in social contributions was due to the impact of the necessary employment support measures – which are not subject to social contributions – that more than offset the rise owing to the increased contribution rates to GHS. There was also a significant drop in sales and, to a lesser extent, in taxes on production.

Public expenditure increased compared with the same period of the previous year, mainly due to higher subsidies and social transfers. Higher subsidies relate to the income support schemes for employees and the direct support to businesses to cover operating expenses as compensation for the impact of the pandemic-related restrictive measures. The increase in social benefits (10,5% compared with the corresponding period of the previous year) mainly reflects the increase in GHS-related expenditure. The increase in compensation of employees (4,6% 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, and the higher contributions of the State as an employer due to higher GHS contributions.

Public debt (**Chart A.31**) stood at 119,6% of GDP in March 2021, recording an increase of about 16 percentage points compared with its pre-pandemic level (March 2020). This is mainly due to the increase in the financing needs created by the pandemic and the accumulation of significant cash reserves reflecting the uncertainty related to the evolution of the health and economic crisis¹⁹.

19. Also, in line with the Public Debt Management Law of 2012.

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



Public debt is expected to decline significantly in the coming years, reflecting the decline in cash reserves (mainly in 2021) and the expected economic recovery. 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 preparation of the National Recovery and Resilience Plan and its submission to the European Commission is an important development in 2021. The Plan is associated with the implementation of reforms and productive investments centred on the green and digital transition, with completion up to 2026, and therefore constitutes an important pillar for supporting economic growth in the coming years. The successful absorption of funds and their utilisation in the aforementioned areas can contribute to creating a sustainable and more resilient economy.

First results from the third wave of the Eurosystem Household Finance and Consumption Survey in Cyprus (2017)¹

Introduction

Since 2010, the Central Bank of Cyprus is participating in the Eurosystem Household Finance and Consumption Survey (HFCS). The Survey is conducted every three years under the auspices of the European Central Bank, in which all euro area countries are participating.

The objective of the survey is the collection of micro data at household level on savings, investments, lending, net wealth and consumption. Other data collected include demographics, labour status, inheritances-intergenerational transfers, etc.

The HFCS data for Cyprus and all participating countries are already being used on a worldwide basis by researchers and organisations for relevant analyses and academics aimed at drawing useful conclusions for policy purposes². This dataset constitute also valuable source of information for analysis and research that supports a more effective monetary policy transmission and concurrently ensures financial stability. In addition, it allows the exploration and comparison of the different behaviours of households between euro area Member States.

This survey is the only one of this sort conducted at European level and offers a comprehensive picture of the financial situation of households, examining both sides of their portfolio, i.e. both assets and liabilities.

As mentioned, the data collected by the Survey can help to draw useful conclusions for policy implementation, for example, in assessing the impact that an economic shock or a particular policy or perhaps an institutional change may have on the decisions of different household sub-groups. The data are also considered particularly useful for the estimation of various correlations such as, inter alia, the calculation of the structural relationships between consumption and household wealth, the effect of interest rate changes on the various income cohorts etc.

In Cyprus, the first wave of the Survey took place in 2009/2010 (with the year 2009 being the reference year for income), the second wave took place in 2014 (income reference year in 2013) and the third wave in 2017 (income reference year 2016)³.

The households that participated in the third wave amounted to 1303 in relation to 1289 in the second wave and 1237 in the first. It is noted that, Cyprus maintains one of the highest percentages of household panel data⁴ from all participating countries, amounting to approximately 70%.

1. Household Finance and Consumption Survey (HFCS)
2. For example, in the case of Cyprus there is a relevant box in the Economic Bulletin December 2018 with an analysis of the financial behaviour of Cypriot households for 2010 and 2014.
3. Regarding the collection method of research data, in the first wave, the PAPI methodology was used (paper assisted personal interviews), while in the last two waves the CAPI method (computer assisted personal interviews) was used, which is also the method proposed by the ECB
4. In addition, the method of over-representation of wealthy households was used in all three waves so that the most effective assessment of the statistical results is ensured, in particular for those results that are positively correlated with wealth.

The time period frames during which each of the three waves took place are particularly important for Cyprus. The first coincides with the period before the 2013 crisis, the second during the 2013 crisis and the third with the period three years after the crisis. These time period frames allow the assessment of the effects of the crisis on the financial situation of households and their consumption habits, as well as the changes observed after the successful exit of the Republic of Cyprus from the Memorandum of Understanding with the Troika and the recovery in the real economy that was observed in the period 2015-2016.

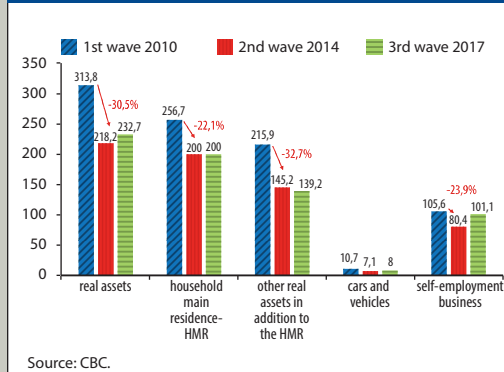
The fourth wave of the survey is ongoing and the field survey is expected to be completed by 2021. More specifically, the fourth wave of the HFCS survey was scheduled to take place in 2020 with the reference year for income and consumption to be 2019. However, due to the outbreak of the coronavirus pandemic, most countries, including Cyprus, were forced to postpone the survey to 2021. The Cypriot fieldwork started in March 2021 and the questionnaire includes income questions with reference years 2019 and 2020, in order to have comparable results with all participating countries. In addition, the questionnaire includes general questions about the pandemic, its impact on household budgets and consumption habits, as well as some financial literacy questions.

Initial results

Below are some results from the 2017

CHART 1 Median value of total households' assets

(€0000, thousands)



survey in Cyprus with emphasis on household assets and credit liabilities. It is understood that these results constitute only a small part of the information contained in the research and which is expected to be further utilised by both the CBC and other researchers. The presentation also includes a comparison with the results of the first two waves of the research.

A. Households' assets

The value of total household assets consists of real and financial assets. The median prices⁵ of assets and of their main categories for households in Cyprus (e.g. main household residence (HMR), other real estate, self-employed enterprises) are presented in **Chart 1**.

As shown in **Chart 1**, the median value of total assets increased slightly by 6,6% in the third wave compared with the second wave, mainly due to the 25,7% increase in the value of real assets of self-employed

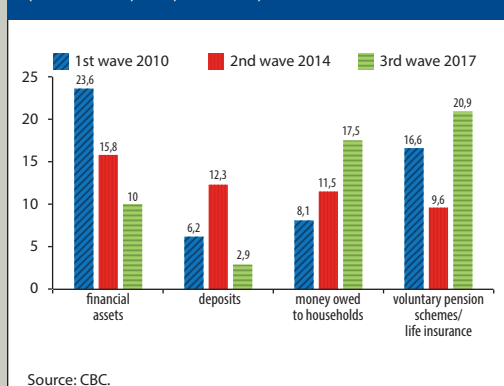
5. The median value (p50) is the average number in a group of numbers in ascending order. That is, half the numbers have a value greater than the median and the other half numbers have values less than the median.

enterprises. It is noted that, the median value of assets shrank by 30,5% in the second wave compared with the first wave, mainly due to the 22,1% decrease in the value of the household main residence, but also the 32,7%⁶ decrease in the value of other assets.

During the last two waves, however, the median value of the household main residence remained at about the same levels. Other assets continued to record a marginal decline. The contraction in the value of real estate is generally in line with the Residential Property Price Index of the CBC, which decreased from 99,6 in 2010 to 77,8 in 2014 and 74,3 in 2017.

In terms of financial assets, a reduction was recorded during the third wave, despite the improvement in the overall economic situation and the increase in total assets, mainly due to the recorded decrease in deposits (**Chart 2**). In addition, the reduction is observed for both the periods starting from the first to the second wave, and from the second to the third wave (**Chart 2**). The decline during the second wave is mainly due to the deterioration of the economic activity, which partly led to the liquidation of voluntary pension plans and life insurance schemes. It is noted that after comparing household deposits from the HFCS survey with the macroeconomic balance sheet statistics, it appears that households, especially in the third wave, did not disclose the true value of their deposits (underreporting of deposits), thus

CHART 2 Selected households' financial assets
(median value, €000, thousands)



distorting the true picture of financial assets for these waves. In fact, it is a general international observation that the value of deposits is being under-reported in such surveys.

B. Household credit liabilities

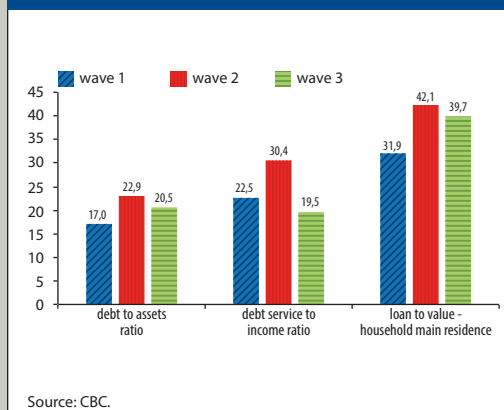
Regarding the total liabilities of households, it is observed that the percentage of households with loans has decreased between the three waves, from 65,4% in the first wave to 59,1% in the second wave and 56,8% in the third wave. This is mainly due to the decision of many households to repay part of their loans, while the decrease observed in the second wave is also attributed to the offsetting of Laiki bank's deposits and loans undertaken in 2013. In addition, the increasing trend in the debt for asset swaps procedure⁷ could also justify the reduction in the percentage of households with loans.

6. It should also be noted that the Residential Property Price Index (RPPI) of the Central Bank of Cyprus indicates that the value of land has also decreased in the period 2014-2017.
7. The Debt for Asset Swap (DFAS) procedure is a tool being used by domestic banks and aims to reduce the portfolio of non-performing loans.

In the third wave of the survey, it appears that households repaid higher-valued loans, as the median value of their credit liabilities decreased to € 64,6 thousand. The type of loans that recorded a greater decrease are the collateralised loans related for the purchase of real estate other than the main residence. This is in line with the general macroeconomic picture of a drop in the purchase of secondary residences / other real estate as a consequence of the crisis. Indicatively, it is reported that, although the percentage of households with loans decreased in the second wave compared with the first, the median value of their loans increased from € 60,2 thousand to € 75,7 thousand, indicating that the loans repaid were small- or medium-valued.

For a better evaluation of the households' credit liabilities, a comparison of household debt ratios is made between the three waves (**Chart 3**). In particular, a slight improvement was observed during the third wave compared with the second. However, only the debt-to-income ratio appears to be declining to levels below the ones in the first wave, suggesting that nowadays households may be able to service their credit liabilities more effectively than in 2009-2010. Examining the macroeconomic data, this picture seems to be consistent with the reduction observed in non-performing facilities that was registered between the last two waves. As expected, the debt burden ratios, namely the debt-to-assets ratio, the debt-to-income ratio and the loan-to-value

CHART 3 Debt burden indicators and credit constraints



ratio of the household main residence increased from the first to the second wave, mainly due to a change in the denominator values.

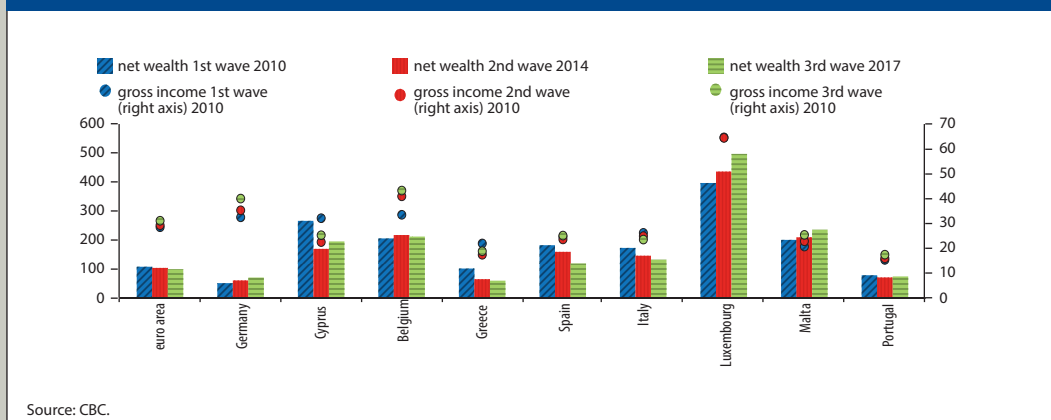
C. Net wealth⁸ and gross income

Chart 4 (p. 52) shows the net wealth data (left axis) and the gross annual income of households (right axis) for all three waves for different euro area countries. There is a significant decrease from the first to the second wave, both in net wealth and gross household income, while from the second to the third wave there is a small increase in both. This phenomenon is justified as the 2013 crisis took place between the first and second wave, whereas in 2017 the economy began to slowly but steadily recover.

Regarding net wealth, it is noted that Cyprus is in a rather advantageous position compared with other countries and this is mainly due to the fact that in Cyprus the

8. Net wealth is defined as the difference between the household's total assets (real and financial) and its total credit liabilities (mortgages or not).

CHART 4 Households' net wealth Gross income
(euro, thousands)



Source: CBC.

number of working adults per household is higher, and as such a higher percentage of wealth per household is being accumulated. This finding is also consistent with the Cyprus financial literacy survey⁹ conducted in 2018, that showed that, 54% of working adults in the age group 18-29 continue to live with their parents.

Between the second and third wave, there was a 15% increase in the net wealth of households, mainly due to the decrease in the value of their loan liabilities and the increase in the real assets of self-employed companies. The decrease in net wealth from the first to the second wave is mainly due to the decrease in property prices and the bail-in of uninsured deposits in 2013.

Regarding the gross annual income of households, its average price rose to €25,400 in the third wave, marking an increase of 11,9% compared with the second wave, in line with the later economic recovery picture. In contrast, a decrease of 29,7% was

observed between the first and the second wave. Specifically, the median price of annual household income in the second wave decreased to €22,700, from €32,300 in the first wave, clearly showing the large downward adjustment in the financial situation of households during the crisis.

D. Analysis on the servicing of Household Debt

Table 1 presents summary data on the general financial situation of households in Cyprus (credit liabilities, assets, financial (e.g. deposits) and real) based on the responses of households that participated in the three waves of the sample survey¹⁰. For analysis purposes, in **Table 1** (p. 53) households are categorised into those without loans (category A) and those with loans (category B). The number of households in the first category increased to 43,3% of the total households in Cyprus

9. Results of the financial literacy sample survey in Cyprus (centralbank.cy) (<https://www.centralbank.cy/images/media/redirection/Financial%20Literacy/Financial-Literacy-Presentation-15-04-2021.pdf>).
10. For further details regarding Table 1 see Central Bank of Cyprus (2018) "Box 1: Analysis of the financial position of households in Cyprus, 2010 and 2014 »Economic Bulletin, December, pp. 30-38 (https://www.centralbank.cy/images/media/pdf_el/CBC-Dec-%202018-Economic%20Bulletin%20GR.pdf).

TABLE 1 Summary data on the general financial situation of households in Cyprus for the three waves: 2021, 2014, 2017

	Wave 1 (2010)	Wave 2 (2014)	Wave 3 (2017)
A. Hhs with no Loans %	33,3	40,9	43,3
Gross HH income - EUR, average	27.384	23.495	26.569
Deposits - EUR, average	32.741	28.207	19.436
Total Liabilities - EUR, average	0	0	0
Total Real Assets - EUR, average	412.849	223.330	252.140
of which			
value of Household Main Residence - EUR, average	181.002	108.531	119.625
total Real Assets excl. HMR Value - EUR, average	231.847	114.799	132.515
B. Hhs with Loans %	66,7	59,1	56,7
Gross HH income - EUR, average	51.530	35.040	38.164
Deposits - EUR, average	32.548	16.553	13.493
Total Liabilities - EUR, average	116.058	129.216	122.423
Total Real Assets - EUR, average	676.035	430.504	556.984
of which			
value of Household Main Residence - EUR, average	309.194	213.568	240.707
total Real Assets excl. HMR Value - EUR, average	366.841	216.936	316.277
B1. Hhs with 90DPD (% of Hhs with loans)	10,8	27	22
Gross HH income - EUR, average	37.082	23.561	28.575
Deposits - EUR, average	13.634	6.643	5.853
Total Liabilities - EUR, average	160.732	193.947	222.834
Total Real Assets - EUR, average	530.600	399.997	511.491
of which			
value of Household Main Residence - EUR, average	249.325	196.905	226.007
total Real Assets excl. HMR Value - EUR, average	281.275	203.092	285.484
B2. Hhs with Performing Loans (% of Hhs with loans)	89,2	73	78
Gross HH income - EUR, average	53.282	39.286	40.873
Deposits - EUR, average	34.842	20.219	15.652
Total Liabilities - EUR, average	110.641	105.268	94.052
Total Real Assets - EUR, average	693.671	441.790	569.837
of which			
value of Household Main Residence - EUR, average	316.453	219.732	244.860
total Real Assets excl. HMR Value - EUR, average	377.218	222.058	324.977

Source: Eurosystem Household Finance and Consumption Survey. Results of the third wave rely on imputed and weighted microdata (CBC calculations).

in 2017 compared with 40,9% in 2014, while the category of households with loans recorded a decrease with their percentage amounting to 56,7% in 2017 compared with 59,1% in 2014, due to the ongoing deleveraging effort of the non-financial private sector. In addition, sub-category B.1 presents data on households with loans, whose repayments were more than 90 days in arrears (90 + MKD), while sub-category B.2 presents data on households with performing loans.

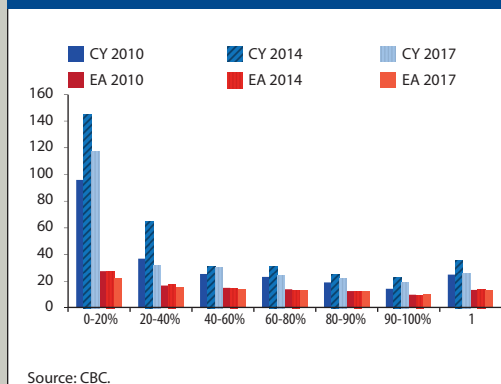
As shown in the Table, after the end of the financial crisis in Cyprus, the number of households with loans that had arrears in their repayments of more than 90 days (90 + MK) decreased as a percentage of total households with loans, from 27% in 2014 to 22% in 2017. At the same time, the number of households with performing loans increased (from 73% in 2014 to 78% in 2017). Despite this, the average value of the total credit liabilities of households who had loans with 90 + MK increased in

the third wave, reaching € 222,834 from € 193,947 in the second wave, as opposed to households with performing loans. This may be attributed to the intensification of loan restructurings in mid-2016, with banks initially targeting small valued loans rather than higher-valued mortgage loans, as it was easier and simpler to reach an agreement for the former.

In addition to the above, the gradual recovery of the real economy had a positive impact on residential property prices, with a slight increase in the CBC RPPI during the period 2014-2017. This is reflected in the increase recorded by the real assets of all households' groups, including those with loans 90 + MK. This confirms the effectiveness of the Debt for Asset Swaps tool applied by banks to reduce their non-performing loan portfolio.

Regarding the debt service to income ratio broken down by income category (in terms of percentiles) presented in **Chart 5**, it seems that Cypriot households continue to face difficulties in repaying their loans, despite the small improvement recorded in the third wave compared with the second. More specifically, the biggest improvement seems to be recorded by the lowest income households, and in particular, by households with income levels between the 20th and 40th decile. A significant decrease between the second and third wave was also recorded by households with income at the 0-20 decile, although these households continue to record the greatest difficulty in repaying their credit obligations, with their debt to income ratio far exceeding 100%.

CHART 5 Debt service to income ratio by income category
(median)



This means that their monthly instalments more than outweigh their monthly income. On the other hand, households with income levels between 40% and 100% of the distribution, which have comparatively lower levels of debt service to income ratio, recorded a much smaller decrease. In all income categories, the debt service to income ratio in the third wave remains much higher compared with the rest of the euro area countries. This indicates the need to continue the effort to reduce NPLs and consolidate the balance sheets of both banks and the private sector.

Concluding remarks

The presentation of the initial survey results on the financial situation and consumption habits of Cypriot households' as at 2017 has focused on assets and credit liabilities, as well as other related issues, such as households' debt servicing ability.

In general, the data reflect the negative

impact of the financial crisis on net wealth and gross household income. In addition, the data reveal the difficulties that households had to withstand, since the observed wage cuts, rising unemployment and falling property prices had significantly affected their financial situation, as well as their ability to service their loans.

At the same time, however, they also reflect the gradual recovery of the real economy after the exit of the Republic of Cyprus from the Memorandum of Understanding with the Troika in 2016. In fact, based on the data from the third wave, households seem to have slowly begun recovering in all economic sectors, in line with macroeconomic trends. More specifically, there has been a decrease in the number of households with loans in arrears of more than 90 days, reflecting households' effort to reduce their over-indebtedness as well as banks' ongoing efforts to consolidate their balance sheets. However, it is noted that the decrease mainly concerns small-valued loans. This could be an indication of the difficulty in dealing with households' non-performing loans related with their main residence, a problem that continues to be a key challenge for the authorities.

The initial results, in conjunction with many other elements of the third wave of the sample survey, are crucial for updating and providing useful information that facilitate the conduct of in-depth economic analyses and the implementation of specialised studies. Based on the wealth of information available in the research area,

these analyses and studies are particularly useful, both for academic purposes as well as for formulating appropriate policy decisions. For example, the information available in relation to the pre- and post-crisis periods is very useful, as described in this *Bulletin*. In addition, as regards the next sampling wave, which is expected to be completed by 2021, issues of inequality and wealth distribution among households are likely to become even more important due to the pandemic outbreak.

In general, economic growth and development, especially in the periods following economic crises and the subsequent changes observed in daily life, seem to affect households in different ways. Taking these into account, the relevant analysis is deemed to be particularly useful.

Sources:

European Central Bank, The Household Finance and Consumption Survey, Statistical Tables, Wave 1, April 2017

European Central Bank, The Household Finance and Consumption Survey, Statistical Tables, Wave 2, April 2017

European Central Bank, The Household Finance and Consumption Survey, Statistical Tables, Wave 3, June 2020

Central Bank of Cyprus, Box: Analysis of the financial position of households in Cyprus, 2010 and 2014, Economic Bulletin, December 2018

Link to website:

<https://www.ecb.europa.eu/home/search/html/index.en.html?search=hfcs>

(C) Macroeconomic Forecasts for the Cyprus Economy²⁰

20. Forecasts and assumptions take into account economic developments and available data with a cut-off date the 18th of May 2021.

- *Positive GDP growth rates in the period 2021-23, owing to the recovery of domestic demand and net exports.*
- *Rise in unemployment in 2021 despite the expected positive GDP growth rates due to hysteresis effects, with a gradual drop expected in the coming years.*
- *Sluggish inflation developments in the period 2021-23, with expected increases in services and energy prices in 2021.*
- *Significant uncertainty in forecasts owing to volatility of the epidemiological situation.*

The macroeconomic forecasts presented in this *Economic Bulletin* were prepared in the context of the Eurosystem exercises using common assumptions. In this context, it was decided that the Eurosystem central banks would prepare only a baseline scenario for the June 2021 forecast round, as opposed to three scenarios (mild, baseline and severe) as per previous forecasts rounds.

In relation to the December 2020 projections, the assumptions underpinning the updated forecasts are updated as follows:

First, the phasing out of restrictive measures is now assumed to commence as of mid-2021Q2 owing to the new wave of pandemic compared with the assumed commencement as of 2021Q1 in the December 2020 forecast exercise.

Second, the assumptions take into account the positive indirect effects on the economy owing to the better than expected external environment, as a result of the finalisation of the UK-EU trade agreement and the expansionary US fiscal policy.

Third, the economic implications associa-

ted with the absorption of financing from the Recovery and Resilience Fund are taken into account.

The updated CBC forecasts for GDP have been revised downwards compared with those of December 2020, owing to the smaller than expected recovery in domestic demand. This reflects the strict containment measures due to the pandemic in 2021H1 and the associated carryover effect in the following years. Despite the strict containment measures, the impact on economic activity was smaller than that recorded in 2020Q2. Therefore only a small downward revision was adopted in the projections, in line with the latest available indicators.

Regarding HICP inflation, the CBC's updated forecasts point to an upward revision for 2021 and a downward revision for the coming years. The 2021 revision for both headline and core inflation is attributable to the projected rise in services prices. Regarding headline inflation, this is also driven by increases in oil prices, on the basis of the relevant assumptions incorporated in the projections. The downward revision in inflation in the period 2022-23 is mainly driven by the expected dissipation of the upward effects of temporary factors in 2021, as well as the expected slowdown in oil prices and despite the upward revision in services prices.

Economic activity²¹

GDP is projected to rebound by 3,8% in 2021

21. Due to the volatility in imports and exports of mobile transport equipment (ships and aircraft), it is extremely difficult to forecast the aforementioned series. Therefore, it is assumed that the level of transactions associated with these series for the projection horizon 2020-23 remains broadly fixed at the 2019 levels. Consequently, the rate of change in imports and exports as well as in gross fixed capital formation adjusted for the impact of these transactions does not differ relative to the unadjusted series.

(Table A.12), driven by all GDP sub-categories, owing to the continued implementation of fiscal measures amounting to around 4% of GDP, as well as the measures of the European Central Bank and the Central Bank of Cyprus. More specifically, the modest increase of 0,9% in private consumption is driven by the subdued rise in disposable income, owing to the gradual withdrawal of fiscal support measures, as well as the resumption of loan repayments following the expiration of the relevant moratorium. At the same time, the savings ratio, which increased significantly in 2020 partly as a result of the restrictive measures adopted, is expected to remain high in 2021, thus constraining private consumption. Gross fixed capital formation is expected to recover by 1,7% in 2021, following the decline observed in 2020. The increase in public consumption by 4,2% (Table A.12) reflects the rise in expenditures associated with healthcare services from the GHS, spending for vaccines and testing (intermediate consumption), as well as the ongoing gradual restitution of crisis-era wage cuts (see Economic Activity, p. 19).

The rise in net exports is also expected to contribute to the projected GDP recovery in 2021. Exports of goods and services are expected to increase by 7,4% in 2021, mainly driven by the gradual recovery in tourism revenues (see Balance of Payments, p. xx). The projected 4% rise in imports of goods and services (Table A.12) is due, in part, to the recovery in imports of goods for private consumption and investment.

A further recovery in GDP by 3,1% and 2,5% is projected for the years 2022-23,

TABLE A.12 National accounts projections in real terms

(annual change, %)

	2020	2021f	2022f	2023f
GDP	-5,1	3,8	3,1	2,5
Private consumption	-3,9	0,9	1,1	1,3
Public consumption	13,1	4,2	0,4	1,4
Gross fixed capital formation	-2,0	1,7	1,5	1,5
Exports of goods and services	-12,4	7,4	8,2	5,5
Imports of goods and services	-4,2	4,0	5,0	3,9

Sources: Cystat, CBC.

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respectively (**Table A.12**, p. 59). These growth rates are expected to be driven by the recovery in domestic demand and net exports. The increase in private consumption in the years 2022-23 (around 1,2% per annum) is attributable to the expected rise in disposable income from labour compensation. At the same time, a gradual drop in the savings ratio is expected. However, the relevant ratio is not expected to return to pre-crisis levels in 2023 owing to "precautionary savings", which are mainly associated with the repayment of loans and the possible introduction of measures to improve public finances (Ricardian effects). Gross fixed capital formation is expected to recover further in the years under consideration by around 1,5% per annum, due to new projects to be financed via the Recovery and Resilience Fund, as well as the gradual completion of large and multi-year projects that are underway. The projects relate to the sectors of energy, tourism, transportation as well as the casino-resort. Public consumption is expected to decelerate by 0,4% and 1,4% in 2022 and 2023, respectively, reflecting the ongoing gradual restitution of wages as well as the base effect in 2021 owing to spending for intermediate consumption, as previously mentioned.

Net exports are expected to continue to contribute positively to growth in 2022-23. Exports are projected to increase by 8,2% in 2022 and 5,5% in 2023 (**Table A.12**, p. 59), with a significant contribution coming from tourism and, to a lesser extent, from transport as well as telecommunications, computer and information services. Due to uncertainty regarding virus variants of the virus and the

desire of potential tourists to reduce the risks to their health, complete normalisation in the activity of the tourism sector is expected to take place beyond the forecast horizon. The foreseen recovery in tourism is also associated with the expected operation of the casino-resort²². Total imports are expected to recover further in 2022-23, in line with the continued improvement in domestic demand.

Compensation, productivity and the labour market

The recovery in economic activity is also reflected in employment, which is projected to recover by around 1,3% per annum over 2021-23 (Table A.13). Government measures have been extended until June 2021 and continue to support employment in the private sector, with the impact of the pandemic being more pronounced in the path of working hours per employed person.

The unemployment rate is expected to rise further to 8% in 2021 owing to hysteresis effects in the labour market. A downward trend in unemployment is projected as of 2022, gradually reaching 6,6% of the labour force in 2023.

The relatively small increases, compared with the GDP rebound, projected in nominal compensation per employee by around 1,8% per annum over 2021-23 (Table A.13) reflect the modest rises expected in the private sector, given that the unemployment rate remains at higher levels than prior to the health crisis. At the same time, larger increases are foreseen in the public sector, owing to the ongoing gradual restitution in wages and

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

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

	2020	2021f	2022f	2023f
Compensation per employee	-3,2	1,7	1,9	1,7
Unit labour costs	1,5	-0,9	0,4	0,5
Productivity	-4,6	2,7	1,6	1,2
Total employment	-0,6	1,1	1,5	1,3
Unemployment rate (% of labour force)	7,6	8,0	7,1	6,6

Sources: Cystat, CBC.

pensions (see Labour Costs, p. 27). In 2021, the increase in nominal compensation per employee includes the full year impact of the rise in social security contributions due to the introduction of the GHS, which was suspended for three months in 2020, as part of legislative package adopted to support employers.

Productivity, following a significant 4,6% decline in 2020 owing to the effects of the pandemic, is expected to recover in the coming years, recording positive rates of change by 2,7% in 2021, 1,6% in 2022 and 1,2% in 2023 (Table A.13, p. 61).

Unit labour costs are expected to fluctuate over the forecast horizon (Table A.13, p. 61). In 2021, the modest increase in compensation per employee in relation to the rise in productivity is expected to lead to a decrease in unit labour costs by 0,9%. For the years 2022-23, rises by around 0,4% per annum are forecasted. A broadly similar path is expected to be recorded in the respective euro area index. As a result, Cyprus' unit labour costs index maintains its comparative advantage relative to 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, p. 27).

Inflation

Domestic prices are expected to increase in the period 2021-23. HICP inflation is expected to reach 1,1% in 2021 compared with -1,1% in 2020 (Table A.14), mainly as a result of the rise in energy prices, the

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

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

Sources: Cystat, CBC.

upward effect of various temporary factors, as well as due to the envisaged recovery path of the economy as of 2021H2. Core inflation is projected to reach 0,5% in 2021 compared with -0,8% in 2020.

Further increases in prices are expected for the years 2022-23, even though they will remain subdued. Inflation is expected to reach 0,7% in 2022 and 1% in 2023, mainly affected by the projected recovery of GDP and wages, as well as the rise in services prices, in a context of a gradual recovery in tourism. In line with the oil price assumptions, energy prices are expected to decelerate significantly in 2022 and to fall in 2023. In addition, HICP inflation is expected to be positively affected by the expected rises in food prices. Core inflation, excluding energy and food, is projected to reach 0,7% and 1,3% in 2022-23, respectively.

Risk assessment of macroeconomic forecasts^{23, 24}

The expected GDP path (Table A.12, p. 59), as well as the HICP and the core inflation projections (Table A.14, p. 62) represent the baseline scenario. The confidence intervals associated with the baseline forecasts for GDP and HICP capture the probabilities of deviating from the corresponding baseline

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

24. The assumptions were made on the basis of the epidemiological situation and the conditions that prevailed in the run-up to these forecasts (i.e. before May 26, 2021) and therefore before the recent apparent deterioration in the epidemiological situation. As such, references to slight upside risks are not valid based on latest developments (i.e. until end-June 2021).

scenario and are outlined in **Charts A.32** and **A.33**, respectively. Possible deviations with respect to the baseline forecast for core inflation are shown in **Chart A.34**. A risk assessment summary is presented in **Table A.15** (p. 65).

According to the cut-off date of the projections (May 26, 2021), the risks of deviating from the baseline GDP forecasts for the years 2021-23 are assessed to be slightly upwards and are associated with a higher than expected absorption of available financing from the European Recovery and Resilience Fund, as well as a larger than expected impact on private consumption from pandemic-delayed spending ("pent-up demand"), in the context of a larger than expected reduction in the savings ratio. In addition, upside risks are associated with a possibly higher than expected performance in the tourism sector. Downside risks include a possible weakening of the quality of banks' assets, which could be associated with an increase in NPLs and greater than expected losses in the banking sector. In addition, a slower than expected economic recovery path could lead to a worsening in credit conditions, thus constraining new lending, consumption and investment. Finally, a premature withdrawal of fiscal support measures, with the objective of enhancing the sustainability of public debt may slow down the outlook for economic growth in the medium term, even though it might have a positive impact on the sovereign rating.

Risks to inflation for the years 2021-23 are also assessed to be slightly upwards, based on the cut-off date of the June 2021 forecasts

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

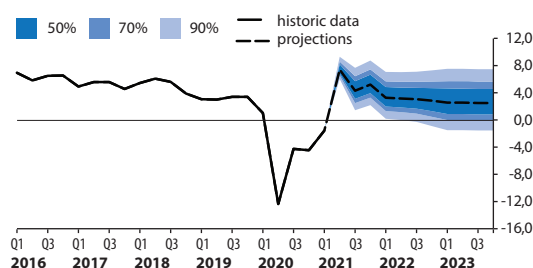


CHART A.33 HICP fan chart
(annual change, %)

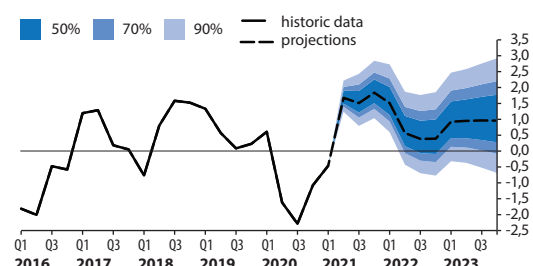
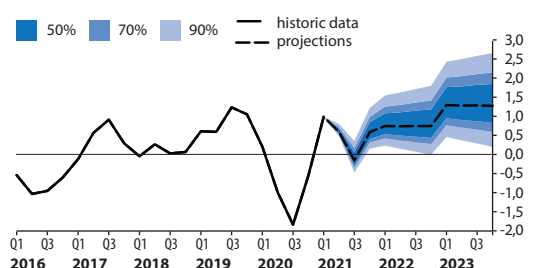


CHART A.34 HICP excluding energy and food fan chart (core inflation)
(annual change, %)

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(May 26, 2021). Upside risks relate to a more favourable than expected trend in private consumption, associated with a larger than expected reduction in the savings ratio, owing to the materialisation of pent-up demand, as previously mentioned. In addition, better than expected implementation of various investment projects and better performance of services, in particular tourism, are expected to have a positive impact on inflation. Higher oil prices than originally expected also pose an upside risk to the inflation outlook. Downward risks are associated with a weakening in the quality of banks' assets, as already mentioned for the GDP path. Risks are also linked to a possible deterioration in domestic credit conditions, with a consequent negative impact on domestic demand and inflation. A premature withdrawal of fiscal support measures, especially on the expenditure side, so as to enhance public debt sustainability, could have a negative impact on inflation over the medium term through a negative impact on economic activity. Finally, risks to core inflation are also slightly on the upside, as is the case for headline HICP inflation.

It should be emphasised that the overall assessment for slight upside risks associated with the baseline scenario was made during the forecast period and in the run-up to the 26 May 2021 cut-off date, a period which preceded the recent deterioration in the epidemiological situation in Cyprus, Europe and worldwide owing mainly to the "Delta" variant of the virus. The latest developments in the epidemiological situation observed until end-June 2021 seem to no longer

TABLE A.15 Summary of risk assessment

Risk	GDP (2021-2023)	Inflation (2021-2023)
Epidemiological developments and vaccination rollout against the virus	=	=
Greater than expected absorption of funds from EU support package	++	+
Deterioration in credit quality impacting NPFs	-	-
Greater than expected deterioration in credit conditions	-	-
Higher than foreseen oil prices	-	+
Impact on domestic economic outlook as a result of external environment developments	=	=
Faster than foreseen withdrawal of supportive fiscal measures aimed at strengthening public debt sustainability	-	-
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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support the presence of these upside risks to the baseline scenario. Overall, the baseline scenario remains the same, whilst risks of deviating from the baseline are assessed to be balanced.



Technical Notes

(A) Domestic monetary aggregates

All monetary aggregates' data exclude the CBC.

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

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

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

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

(B) Balance of Payments

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

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

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

(C) National Accounts

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

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

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