



## FOREIGN DIRECT INVESTMENT 2016

### INTRODUCTION

This report provides an overview of the main developments in foreign direct investment (FDI) statistics<sup>1</sup> for 2016<sup>2</sup>, as published by the Statistics Department of the Central Bank of Cyprus (CBC).

The CBC compiles FDI statistics in accordance with the Balance of Payments and International Investment Position Manual of the International Monetary Fund, 6th Edition (BPM6) and the European System of Accounts, 2010 (ESA 2010), which were implemented in 2014. Data based on the BPM6 methodology covers the period from 2008 onwards. All publications and data releases prior to 2008 are, therefore, not comparable as they are based on the BPM5<sup>3</sup> methodology. The most important change which emanated from the implementation of the BPM6 concerns the enhanced coverage and publication of data on resident<sup>4</sup> “special purpose entities” (SPEs)<sup>5</sup>.

FDI plays an important and growing role in the global economy. According to the OECD, FDI is a

key driver of international economic integration and, with the right policy framework, it can provide financial stability, promote economic development and enhance the economic well-being of societies. Likewise, the importance of FDI in the economy of Cyprus is significant and has been increasing over the years.

The key points of this analysis are summarised as follows:

- Net FDI stock remained negative in 2016 as it recorded a decrease compared with 2015<sup>6</sup> (i.e. inward FDI stock exceeded outward FDI stock).
- FDI returns, both outward and inward, decreased considerably in 2016 compared with the previous year, although in net terms they are still positive.
- The FDI stock invested in Cyprus was mainly from Europe.
- Most of the FDI invested in/from Cyprus was related to the tertiary sector, specifically “financial and insurance activities”.

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<sup>1</sup> For more information on the definition and scope of FDI statistics please refer to the Appendix.

<sup>2</sup> Comprehensive annual FDI statistics are transmitted to Eurostat nine months after the end of the reference year and released two months later.

<sup>3</sup> Balance of Payments manual of the IMF, 5<sup>th</sup> edition.

<sup>4</sup> The meaning of “resident” is based on the Definition of the Term “resident of Cyprus” for Statistical Purposes Directive, 2008. More information on the definition of resident is provided in the Appendix.

### FOREIGN DIRECT INVESTMENT

#### Stocks

The **net FDI stock** of Cyprus decreased in 2016, thus remaining in negative balance, i.e. inward FDI exceeded outward FDI. More specifically, in 2016,

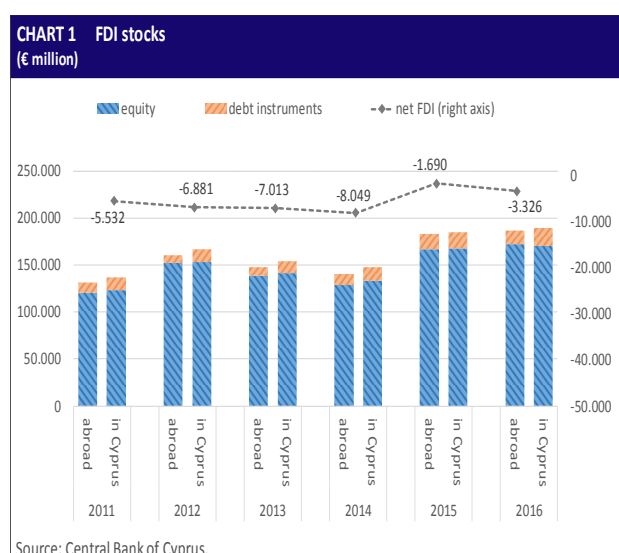
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<sup>5</sup> Please refer to the Appendix for the criteria under which an entity is considered an SPE.

<sup>6</sup> More information on the meaning of sign convention is given in the Appendix.

net FDI stock reached -€3.326,4 million, compared with -€1.689,6 million in 2015 (**Chart 1**, p.2). The above development was due to the fact that inward FDI recorded higher increases compared with outward FDI. It should be noted that, due to a recent revision which covered the years 2015 and 2016, there is a break in the FDI series between 2014 and 2015.

As regards outward FDI stock, this reached €186.554,9 million in 2016, compared with €183.151,2 million in 2015 (**Chart 1**). The majority of outward FDI stock in 2016 comprised of equity (92%) and, to a lesser extent, debt instruments (8%). The increase in outward FDI stock in 2016 was due to the increase in equity stock by €4.846,3 million, while debt instruments recorded a decrease of €1.442,6 million.



Inward FDI amounted to €189.881,3 million in 2016, compared with €184.840,8 million in 2015 (**Chart 1**). The increase was mainly due to the increase in equity by €3.551,4 million and, to a lesser extent, the increase in debt instruments by €1.489,1 million. As regards the composition of inward FDI, it comprised of 90% equity and the remaining 10% debt instruments, as was the case for outward FDI.

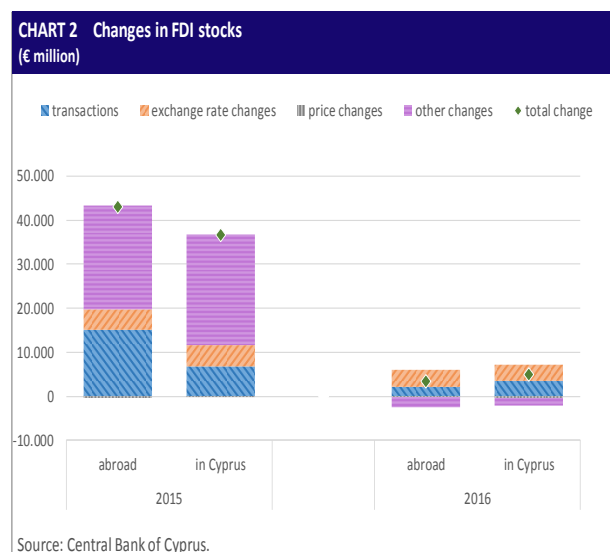
The similarities between inward and outward FDI with regard to their changes and composition can

be attributed to the large share of SPEs in inward and outward FDI stock. In particular, since these entities have little or no involvement in the domestic economy, their assets vis-à-vis non-residents are very similar to their respective liabilities. Consequently, any movements in SPEs assets are reflected in their liabilities and vice versa.

The changes recorded in FDI stocks over consecutive years can be attributed not only to transactions but also to changes arising from: (i) price fluctuations; (ii) exchange rate fluctuations; and (iii) other changes (e.g. reclassifications, write-offs).

Although over the long run one would expect changes in FDI stocks to be primarily determined by FDI transactions, in the short run they can also be determined by the aforementioned changes, which in some cases dominate FDI transactions.

In 2016 the increase in outward FDI stocks was mainly driven by changes in the exchange rate due to the weakening of the euro and, to a lesser extent, transactions. The increase in inward FDI was driven by similar increases recorded in both exchange rate changes and transactions. In contrast, the stock changes in 2015 were primarily caused by “other changes” followed by transactions (**Chart 2**).



“Other changes” was an important factor in the change in stocks in 2015 due to the break in the series as a result of revisions between 2014 and 2015. Excluding this, transactions would have been the most important factor behind stock changes.

More specifically, in 2016 the increase of €3.403,7 million in outward FDI stock was attributed to exchange rate changes (€3.756,2 million) and transactions (€2.195,4 million). Changes arising from price fluctuations and “other changes”, however, were negative and mitigated the increases recorded by transactions and exchange rate changes.

A similar picture was recorded for inward FDI stock, which registered an increase of €5.040,6 million due to transactions (€3.608,5 million) and exchange rate changes (€3.526,2 million). Price changes and “other changes” were negative at €269,2 million and €1.824,9 million, respectively, and mitigated the increases recorded in transactions and exchange rate changes.

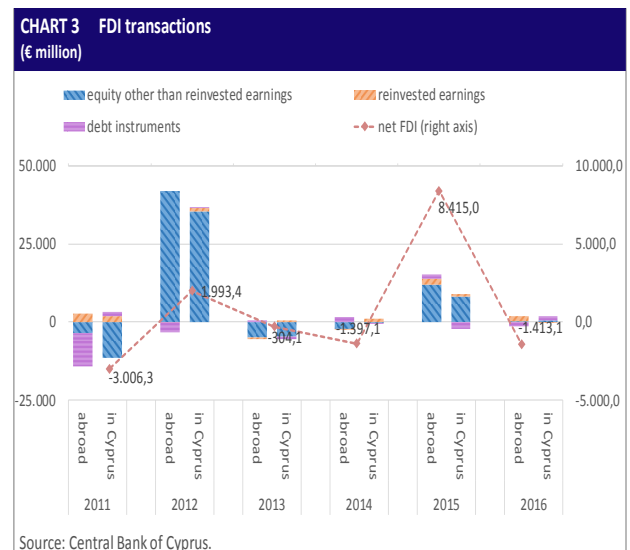
**Transactions**

Net FDI transactions in Cyprus were, on average, positive over the period 2011-2016. This development coincides with the fact that net FDI stock improved over this period. Net FDI transactions in 2016 were recorded at -€1.413,1 million, as the increase in inward FDI transactions surpassed the increase in outward FDI transactions (Chart 3).

As regards outward FDI transactions in 2016, these were recorded at €501,8 million (Chart 3), and consisted of equity other than reinvested earnings of €158,1 million, reinvested earnings of €1.799,9 million and debt instruments of -€1.456,1 million.

Inward FDI transactions were recorded at €1.914,9 million in 2016 and comprised of equity other than reinvested earnings of €498,2 million,

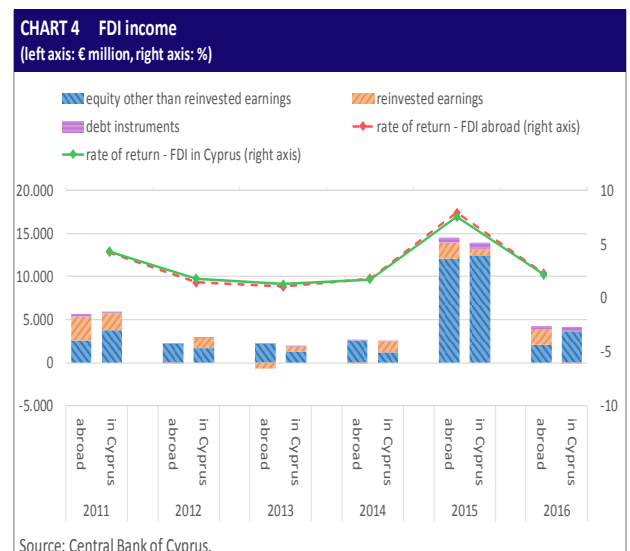
reinvested earnings of -€84,2 million and debt instruments of €1.501,0 million (Chart 3).



**Income**

Net income from FDI has been, on average, negative for Cyprus (i.e. inward FDI income exceeded outward FDI income), and this is associated with the fact that inward FDI stock has generally exceeded outward stock.

In 2015 and 2016 though, net FDI income was positive resulting from the fact that the rate of return of outward FDI exceeded the respective return for inward FDI (Chart 4). This overcompensated the fact that net FDI stock was negative.



Specifically, income from outward FDI was recorded at €4.281,1 million in 2016, compared with €14.491,0 million in 2015 (**Chart 4**). The large decrease was due to the deterioration recorded in equity other than reinvested earnings (dividends) which fell from €12.062,6 million in 2015 to €2.062,1 million in 2016. Income from debt instruments and reinvested earnings recorded much smaller decreases.

It is evident from the aforementioned analysis that when compared with 2015, profitability in 2016 worsened and resident entities received less income.

Income from inward FDI amounted to €4.115,8 million in 2016 compared with €13.911,1 million in 2015 (**Chart 4**, p. 3). The decrease recorded in inward FDI income in 2016, as with income from outward FDI, is attributed to the worsening of income from equity other than reinvested earnings by €8.821,9 million. Much smaller decreases were recorded in the other two income categories, i.e. income from debt instruments and reinvested earnings. As with income from outward FDI, profitability worsened for inward FDI in 2016.

The rates of return of outward and inward FDI are very similar over time as, not only they move together but they are almost identical in levels as well (**Chart 4**, p.3). More specifically, the rate of return was recorded at 2,3% for outward FDI in 2016, while the respective return for inward FDI was 2,2%. Both percentages worsened when compared with the previous year when they reached record levels.

During the period 2014-2016, the rate of return for outward investment exceeded the rate for inward investment. However, during the period 2011-2013, the rate of return for inward investment was higher. There is almost perfect correlation between the two rates of return over the period 2011–2016, with the annual differential ranging between 0,4% and -0,4%.

A possible explanation lies in the large contribution of SPEs in Cypriot FDI, and the fact that these entities have similar inward and outward income due to the structure of their financial assets and liabilities.

### Regional analysis

The Cyprus FDI stock, both inward and outward, is dispersed in all continents with Europe being one of the major partners. In particular, inward FDI stock from Europe was by far the most important for Cyprus while it was the second most important in outward FDI, behind America (**Table 1**).

Outward FDI stock destined for America amounted to €103.780,4 in 2016 up from €99.919,4 million in 2015 (**Table 1**). Outward FDI destined for Europe, the second most important continent as regards outward FDI, was recorded at €58.038,7 million in 2016. It should be noted that there is a considerable amount of stock which refers to unallocated/confidential data<sup>7</sup> and amounted to €23.727,4 million in 2016.

	Abroad		In Cyprus	
	2015	2016	2015	2016
<b>By continent</b>				
Europe	61.035	58.039	157.506	165.042
America	99.919	103.780	17.846	16.873
Africa	C*	C*	240	259
Australia, Oceania and polar regions	C*	C*	C*	C*
Asia	969	1.008	715	900
Unallocated (incl. confidential)	21.228	23.727	8.534	6.808
<b>Selected groups</b>				
EU28	19.122	19.524	119.325	126.300
EA	11.533	11.073	113.355	118.388
OECD	20.772	21.179	126.857	133.586
<b>Selected countries</b>				
United Kingdom	3.069	4.076	3.973	5.493
Germany	19	20	8.246	9.107
Luxemburg	6.047	5.971	C*	C*
Greece	C*	C*	2.446	2.408
Netherlands	8.079	8.228	12.527	12.640
Russian Federation	29.604	28.900	30.324	31.133
United States	237	C*	C*	3.505
* C denotes confidential information				
Source: Central Bank of Cyprus.				

<sup>7</sup> Unallocated data refers to FDI that could not be allocated to a specific country and confidential data refers to the data that cannot be disclosed due to confidentiality reasons.

As a percentage of total outward FDI stock, the share of America’s stock in 2016 was 55,6%, up from 54,5% in 2015. Europe’s share of outward FDI amounted to 31,1% in 2016 compared with 33,3% in 2015. The share of the euro area and the European Union in 2016 was much lower, at 5,9% and 10,5%, respectively. The unallocated/confidential amount was recorded at 12,7% for the same year.

As regards inward FDI, this is mostly channelled from Europe and, to a much lesser extent, from America. More specifically, inward FDI stock from Europe reached €165.041,6 million in 2016, after recording an increase of €7.536,0 million, compared with the previous year (Table 1, p.4). Inward FDI stock from America (the second most important continent as regards inward FDI) was recorded at €16.873,2 million in 2016, decreasing from €17.846,4 million in 2015. The unallocated/confidential amount was much lower, at €6.807,7 million in 2016.

The share of inward FDI stock from Europe as a percentage of total inward FDI stock was recorded at 86,9% in 2016, while the corresponding stock from America was 8,9%. The unallocated/confidential amount was recorded at 3,6% in 2016. As regards the shares of the euro area and the European Union, these were recorded at 62,3% and 66,5%, respectively.

The outward FDI stock of Cyprus in 2016 was dispersed to at least 126 countries while inward FDI stock was channelled to Cyprus from at least 162 countries<sup>8</sup>. Of these, 114 are common to both outward and inward FDI stock.

Although the number of partner countries for both inward and outward FDI stock is large, there is a large concentration in a small number of

<sup>8</sup> It should be noted that the actual number of countries might be higher because some FDI stock is not allocated to a specific country.

countries. More specifically, the top 10 countries of inward and outward FDI stock constitute more than 95% of the total allocated stock, with Russia being one of the most important partners.

### Analysis by economic activity

Most of Cyprus’s FDI stock, both inward and outward, was channelled to/from the tertiary sector (i.e. services). In particular, outward FDI stock channelled to the tertiary sector abroad in 2016 amounted to €120.722,6 million, up from €117.418,9 million in 2015 (Table 2). The primary and secondary sectors totalled €53.631,1 million in 2016, compared with €52.398,3 million in 2015.

**Table 2: FDI stock by economic activity**  
€ million

	Abroad		In Cyprus	
	2015	2016	2015	2016
Primary and secondary sectors	52.398	53.631	453	439
Tertiary sector	117.419	120.723	184.388	189.442
of which				
Financial and insurance activities	97.253	99.380	169.718	171.551
Transportation and storage activities	9.139	9.350	7.594	8.614
Real estate activities	1.922	1.716	3.330	3.782
Unallocated by sector	13.334	12.201	0	0

Source: Central Bank of Cyprus.

The vast majority of tertiary outward FDI was channelled to “financial and insurance activities”, which amounted to €99.380,5 million in 2016. An amount of €9.349,6 million was channelled to “transportation and storage activities” while real estate abroad owned by Cypriot residents totalled €1.716,4 million for the year under review.

The picture for inward FDI stock is even more concentrated compared to the one described above. Specifically, almost all of the inward FDI is directed to the tertiary sector, which reached €189.441,7 million in 2016, up from €184.388,2 million in 2015 (Table 2).

The primary and secondary sectors were recorded at €439,6 million in 2015, down from €452,6 million compared with the previous year. Similarly with outward FDI, most of the inward FDI in the tertiary sector was mainly channelled towards

“financial and insurance activities”, amounting to €171.551,4 million in 2016.

“Transportation and storage activities” reached €8.614,4 million for the year under review and real estate owned by non-residents in Cyprus reached €3.782,3 million, increasing from €3.330,3 million in 2015. The fact that the majority of inward FDI is channelled into “financial and insurance activities”, reflects Cyprus’s specialisation in the provision of financial services.

The share of the tertiary sector in outward FDI in Cyprus is similar to the respective global share. This amounted to approximately 67% in 2015, according to the 2017 edition of the *World Investment Report* as compiled by the United Nations Conference on Trade and Development. On the other hand, the share of the tertiary sector in inward FDI in Cyprus clearly exceeds the respective global share.

### APPENDIX: SOURCES AND DEFINITIONS/ GLOSSARY

#### Sources

Cypriot FDI data are compiled using various sources as follows:

- Survey on External Financial Statistics conducted by the CBC on a quarterly basis, which collects information on stocks, transactions and income from investments. The aforementioned survey collects data for all types of investments and not only for the FDI category, giving the opportunity to gather comprehensive data for each specific company.
- Survey on balance sheet and profit & loss statistics compiled by the CBC on an annual basis. The survey collects certain balance sheet and profit and loss items which, *inter alia*, are used for the compilation of FDI data.
- Annual financial statements of resident entities.

- Data collected from the banking system (international transactions reporting system-ITRS), which are used for the compilation of the real estate assets and liabilities.
- Data from the ship owning survey conducted by the CBC on an annual basis, complemented by other industry sources for the compilation of statistics on ship owning entities.

#### Definitions/ glossary

The definitions used for the FDI data for Cyprus are in line with the definitions used in the Balance of Payments and International Investment Position Manual, 6th Edition (BPM6) and the OECD Benchmark Definition of Foreign Direct Investment, fourth edition (BD4).

#### Foreign direct investment (FDI)

FDI is a category of investment that reflects the objective of establishing a lasting interest by a resident enterprise in one economy (direct investor) in an enterprise (direct investment enterprise) that is resident in an economy other than that of the direct investor. The lasting interest implies the existence of a long-term relationship between the direct investor and the direct investment enterprise and a significant degree of influence on the management of the enterprise. The direct or indirect ownership of 10% or more of the voting power of an enterprise resident in one economy by an investor resident in another economy is evidence of such a relationship. An exception to the above rule are the issues and holdings of investment funds which are considered portfolio investment, irrespective of the percentage holdings.

#### Foreign direct investor

A foreign direct investor is an entity (an institutional unit) resident in one economy that has acquired, either directly or indirectly, at least 10% of the voting power of a corporation (enterprise), or equivalent for an unincorporated enterprise, resident in another economy.

### Foreign direct investment enterprise

A foreign direct investment enterprise is an enterprise resident in one economy and in which an investor resident in another economy owns, either directly or indirectly, 10% or more of its voting power if it is incorporated or the equivalent for an unincorporated enterprise.

### Equity capital

Equity consists of all instruments and records that acknowledge claims on the residual value of a corporation or quasi-corporation, after the claims of all creditors have been met. Equity is treated as a liability of the issuing institutional unit (a corporation or other unit). It comprises: i) equity/participation in branches; ii) all shares in subsidiaries and associates (except non-participating, preferred shares that are treated as debt securities and included under direct investment, debt instruments); and iii) other contributions of an equity nature.

### Debt instruments

Debt instruments are those instruments that require the payment of principal and/or interest at some point(s) in the future. For FDI purposes, debt instruments consist of deposits, debt securities, loans, trade credits and other accounts receivable/payable which are transacted between companies with an FDI relationship. There are some exceptions in case of transactions in debt instruments between certain financial companies in which case they fall in a category different than FDI.

### Reinvested earnings

Reinvested earnings refer to earnings on equity accruing to direct investors less distributed earnings, proportionate to the percentage ownership of the equity owned by the direct investor(s).

### Inward direct investment

Inward direct investment is investment by a non-resident direct investor in a direct investment

enterprise resident in the host economy; the direction of the influence by the direct investor is “inward” for the reporting economy. Also referred to as direct investment in the reporting economy.

### Outward direct investment

Outward direct investment is investment by a resident direct investor in a non-resident direct investment enterprise; the direction of the influence by the direct investor is “outward” for the reporting economy. Also referred to as direct investment abroad.

### Special purpose entity (SPE)

An enterprise is usually considered as an SPE if it meets the following criteria:

- i) The enterprise is a legal entity, formally registered with a national authority; and subject to fiscal and other legal obligations of the economy in which it is resident.
- ii) The enterprise is ultimately controlled by a non-resident parent, directly or indirectly.
- iii) The enterprise has no or few employees, little or no production in the host economy and little or no physical presence.
- iv) Almost all the assets and liabilities of the enterprise represent investments in or from other countries.
- v) The core business of the enterprise consists of group financing or holding activities, that is – viewed from the perspective of the compiler in a given country – the channelling of funds from non-residents to other non-residents. However, in its daily activities, managing and directing plays only a minor role.

### Signs

- Transactions: a positive sign denotes an increase in inward/outward FDI while a negative sign denotes a decrease in inward/outward FDI transactions.
- Income: income is usually shown with a positive sign which indicates an increase in inward/outward income. There are some exceptions with the most common being the

realisation of net losses for an entity in a given period.

- Changes in stocks other than transactions (exchange rate, price and other changes): a positive sign represents an increase in the said changes while a negative sign represents a decrease.
- Stocks: stocks are usually depicted with a positive sign although there are some exceptions. The most common exception is negative stocks which arise due to accumulated losses of an entity (i.e. reserves of the entity turn negative and exceed the value of equity).

**Definition of the Term “resident of Cyprus” for Statistical Purposes:**

"Resident" has the meaning assigned to it in the Definition of the Term "resident of Cyprus" for Statistical Purposes Directive, 2008;

In this directive:

- (1) A **legal entity** is resident in the economic territory under whose laws the entity is incorporated or registered. This applies also to legal entities with little or no physical presence, e.g. investment funds (as distinct from their managers), securitisation vehicles, and some special purpose entities (SPEs). If the entity is not incorporated, it is considered to be resident in the country whose legal system governs the creation and continued existence of the entity.
- (2) A **natural person** is a resident in the country that has a centre of economic interest. A centre of economic interest exists when a unit engages and intends to continue engaging, either indefinitely or over a finite but long period of time, in economic activities and transactions on a significant scale in or from a location, dwelling, place of production or other premises within a territory.

For practical reasons, actual or intended location for one year or more is used as an operational threshold. However, the following are examples of **borderline cases** in the determination of residency:

- Students who go abroad to study full-time generally continue to be resident in the territory in which they were resident prior to studying abroad. This treatment is adopted even though their course of study may exceed a year.
- Patients who go abroad for medical treatment maintain their predominant centre of interest in the territory in which they were resident before they received the treatment, even if the treatment lasts one year or more.
- Crews of ships, aircraft, oil rigs, space stations or other similar equipment which operate outside a territory or across several territories are treated as being resident in their home country.
- National diplomats, peacekeeping and other military personnel, and other civil servants employed abroad in government enclaves, as well as members of their households are considered to be residents of the economic territory of the employing government.
- Staff of international organisations, including those with diplomatic status and military personnel are resident in the territory of their principal dwelling.
- Border workers, seasonal workers and other short-term workers who cross borders for a short period to undertake a job are considered residents in the economic territory in which they maintain a dwelling used by members of the household as their principal dwelling.