CENTRAL BANK OF CYPRUS
EUROSYSTEM

# FOREIGN DIRECT INVESTMENT
# 2014

## INTRODUCTION

This report provides an overview of the main developments in foreign direct investment (FDI) statistics[1] for 2014, 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, Sixth Edition (BPM6) and the European System of Accounts, 2010 (ESA 2010), which were implemented in 2014. All publications and data releases prior to 2008 are, therefore, not comparable as they are based on the BPM5[2] methodology. The most important change concerns the incorporation and publication of data on "special purpose entities" (SPEs) registered in Cyprus.

FDI plays an important and growing role in the global economy. According to the Organisation for Economic Co-operation and Development (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 well-being of societies. The importance of FDI in the economy of Cyprus is significant and rising over the years.

The key points of this analysis are summarised as follows:

- Net FDI stock improved in 2014 although it remained negative (i.e. inward FDI stock exceeded outward FDI stock).
- The FDI stock of Cyprus expressed as a percentage of GDP ranked among the top five countries in the world.
- The profitability of FDI, both outward and inward, improved in 2014 compared with the previous year, although in net terms it remained at similar levels as in the previous year.
- The FDI stock invested in/from Cyprus was mainly associated with Europe and America.
- Most of the FDI invested in/from Cyprus related to the tertiary sector, specifically "financial and insurance activities".

## FOREIGN DIRECT INVESTMENT 2014

### Stocks

The **net FDI stock** of Cyprus has been typically negative, i.e., inward FDI surpasses outward FDI. In 2014, net FDI stock was recorded at - €8.369,8 million, its highest level during the period 2008 – 2014 and up from - €9.516,6 million in 2013 (**Chart 1**, p. 2). The improvement in FDI in 2014 was due to the fact that inward FDI recorded higher decreases compared with outward FDI. During the 2008 – 2014 period, net FDI stock recorded its lowest level in 2010, registering - €11.331,8 million.

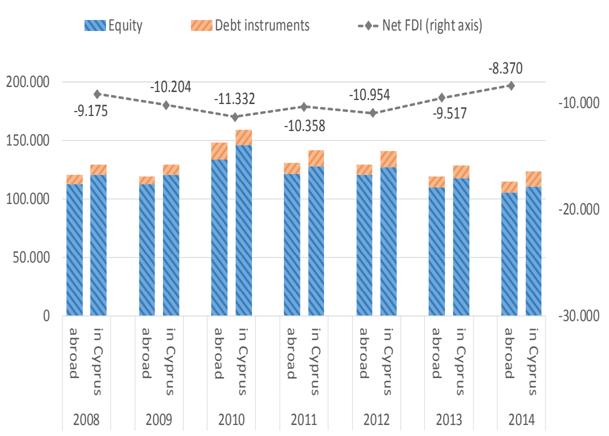
As regards **outward FDI stock**, this registered at €114.716,3 million in 2014, compared with €119.162,4 million in 2013 (**Chart 1**, p. 2). The majority of outward FDI stock in 2014 comprises

[1] For more information on the definition and scope of FDI statistics please refer to the appendix.

[2] Balance of Payments Manual of the International Monetary Fund, Fifth Edition.

of equity with a share of 92% (same share as the average share for the period 2008 – 2014) and, to a lesser extent, debt instruments with a share of 8%. The drop in outward FDI stock in 2014 marked the fourth consecutive year in which outward FDI recorded a decrease. Moreover, 2014 recorded the lowest level of outward FDI over the period 2008 - 2014. The drop in outward FDI was almost exclusively due to the fall in equity stock while debt instruments recorded only a marginal decline of €95,0 million.

CHART 1 FDI stocks
(€ million)




Source: Central Bank of Cyprus.

**Inward FDI** amounted to €123.086,2 million in 2014 compared with €128.679,0 million in 2013 (**Chart 1**). As with outward FDI, this was the fourth consecutive year that inward FDI recorded a decrease and it was the lowest level reached over the 2008 – 2014 period. The decrease recorded in 2014 was due to the fall in equity by €6.842,2 million, while debt instruments recorded an increase of €1.249,3 million.

As regards the composition of inward FDI, this is very similar to outward FDI, as the ratio of equity to total inward FDI averaged 91% over the 2008 – 2014 period.

The similarities between inward and outward FDI as regards their changes and composition can be attributed to the large share of special purpose entities (SPEs)[3] on inward and outward FDI stock. In particular, since these entities have very little or no involvement in the domestic economy, their assets vis-à-vis non-residents are very similar to their liabilities vis-à-vis non-residents and, therefore, any movements in their assets is 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 due to: (i) prices; (ii) exchange rates; and (iii) other changes (e.g. reclassifications, write-offs).

Although over the long run, it is generally expected that changes in FDI stocks are primarily determined by FDI transactions, in the short run they can also be determined by the aforementioned changes, which in some cases dominate the FDI transactions.

In Cyprus, the stock changes in 2014 were mainly caused by "other changes" for both inward and outward FDI. In contrast, in 2013 it was FDI transactions that primarily caused the change in stocks for inward and outward FDI (**Chart 2**, p. 3).

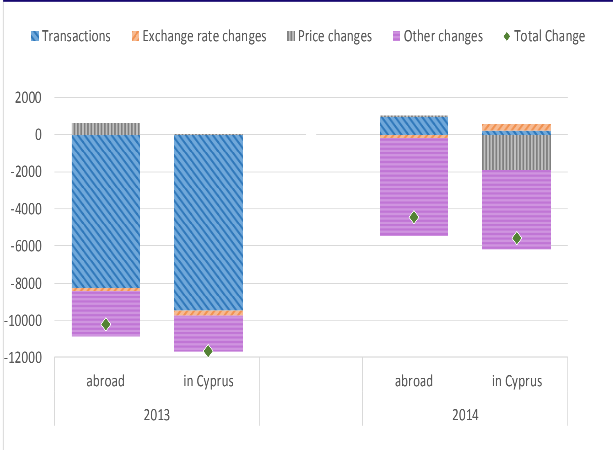
More specifically, in 2014 outward FDI stock recorded a decline of €4.446,1 million, despite the fact that FDI transactions recorded an increase of €953,6 million. The latter was surpassed by the significant decrease recorded in "other changes" of the order of €5.295,5 million, while the changes arising from price valuations and exchange rates were much smaller.

A similar picture appears in inward FDI stock in 2014, which recorded a drop of €5.592,9 million while FDI transactions recorded an increase of €232,3 million. The change in inward FDI stock

[3] SPEs are legal entities which are created in order to serve specific purposes. They are used as vehicle entities and are typically subsidiaries. Please refer to the appendix for more information on SPEs.

was primarily determined by "other changes" and, to a lesser extent, by price changes, as they both recorded decreases of €4.285,1 million and €1.880 million, respectively. Exchange rate changes on the other hand recorded a small increase.

**CHART 2 Changes in FDI stocks**
(€ million)




Source: Central Bank of Cyprus.

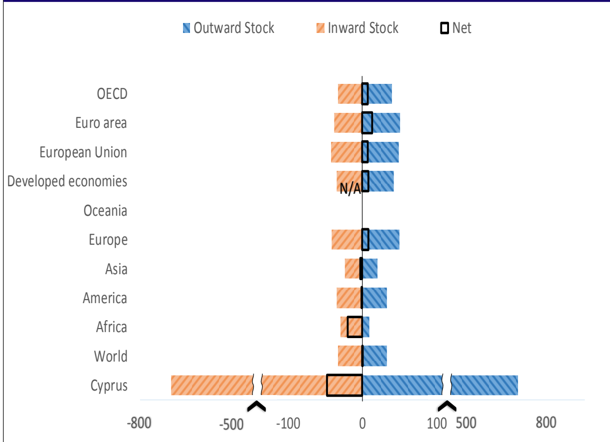
Although in absolute terms the magnitude of inward and outward FDI stock is not notable when compared with other countries, the relative size of FDI for Cyprus is considerable. In particular, Cyprus ranks among the top five countries as regards inward and outward FDI stock expressed as a percentage of GDP.

More specifically, in 2014 Cyprus's outward FDI was recorded at 660% of GDP and inward FDI at 708%. This compares with 33% for world FDI[4] (**Chart 3**).

Moreover, according to the latest data available in the WIR, in 2014 Cyprus ranked fourth in the list of countries with the highest outward FDI stock expressed as a percentage of GDP. At the top of the list was British Virgin Islands followed by Cayman Islands and Cook Islands.

As regards inward FDI, Cyprus also ranked fourth behind British Virgin Islands, Cayman Islands and Malta.

**CHART 3 FDI stocks as a % of GDP, 2014**
(%)




Sources: UNCTAD, Central Bank of Cyprus.
Note: X axis is truncated in the middle

It should be noted that the aforementioned ranking of Cyprus can, to a large extent, be attributed, to SPEs. The above rankings of Cyprus would deteriorate if SPE data were to be excluded.

## Transactions

Net FDI transactions in Cyprus are, on average, positive over the period 2008 - 2014. This development coincides with the fact that net FDI stock has been improving over this period.

Net FDI transactions in 2014 were recorded at €721,2 million, as the increase in outward FDI transactions surpassed the increase in inward FDI transactions (**Chart 4**, p. 4).

The trend of positive net FDI transactions continued for the fourth consecutive year, although in 2011 and 2013 this was due to the higher drop in inward FDI compared with the drop in outward FDI transactions, as opposed with 2012 and 2014, when the increase in outward FDI transactions surpassed the increase in inward FDI transactions.

Regarding transactions of outward FDI, these were recorded at €953,6 million in 2014 (**Chart 4**, p. 4),

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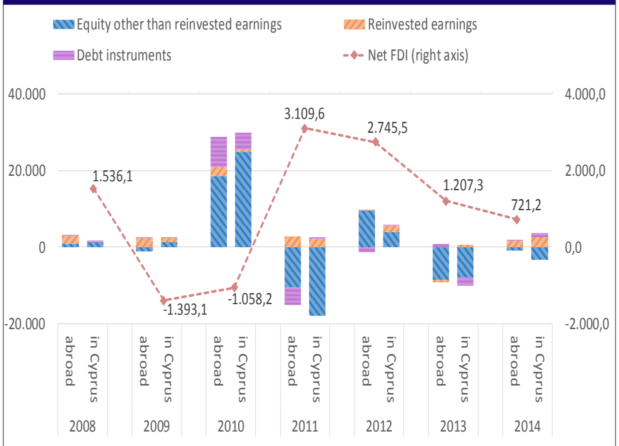
[4] The world FDI is reported in the 2015 edition of the World Investment Report (WIR), which is compiled by the United Nations Conference on Trade and Development (UNCTAD). The data used for Cyprus are the latest available figures as published by the CBC.

consisting of reinvested earnings of the order of €1.714,3 million, debt instruments of €148,9 million and equity other than reinvested earnings of -€909,7 million.

**CHART 4 FDI transactions**
(€ million)




Source: Central Bank of Cyprus.

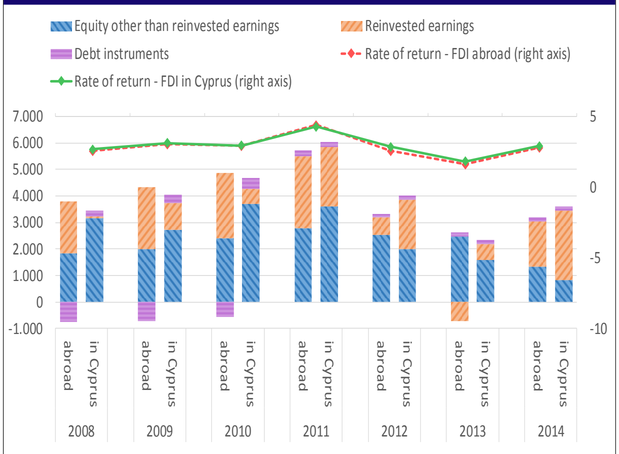
The distribution of outward FDI transactions into their three main components over the period 2008 – 2014, consisted of 49% reinvested earnings, 37% equity other than reinvested earnings and 14% debt instruments, although these have exhibited fluctuations over the years.

Inward FDI transactions were recorded at €232,3 million in 2014. This can be broken down into reinvested earnings of €2.607,8 million, debt instruments of €1.027,9 million and equity other than reinvested earnings of -€3.403,4 million (**Chart 4**). Even though considerable fluctuations exist, over the period 2008–2014, reinvested earnings as a percentage of inward FDI transactions represented 57%, debt instruments 28% and equity other than reinvested earnings, 15%.

## Income

Net income from FDI has been negative for Cyprus over the period 2008 - 2014 (i.e. inward FDI income exceeded outward FDI income). This trend is correlated with the fact that inward FDI stock consistently exceeded outward FDI stock over this period. In 2014 net FDI income was recorded at -€407,9 million compared with -€429,7 million in 2013 (**Chart 5**). Net FDI income averaged -€435 million per year over the 2008 – 2014 period.

**CHART 5 FDI income**
(left axis: € million, right axis: %)




Source: Central Bank of Cyprus.

Income from outward FDI was recorded at €3.193,5 million in 2014 compared with €1.903,2 million in 2013 (**Chart 5**). The increase recorded in 2014 was due to the improvement registered in reinvested earnings by €2.429,3 million, thus reaching €1.714,4 million for the year. The improvement in reinvested earnings was mitigated by the lower income from equity other than reinvested earnings in 2014 (€1.318,6 million) compared with 2013 (€2.472,7 million).

It is evident from the aforementioned analysis that profitability improved in 2014 compared with 2013, in which a number of entities recorded losses. It is also noteworthy that in 2014 resident entities received less dividends compared to 2013.

Income from inward FDI amounted to €3.601,3 million in 2014 compared with €2.332,9 million in 2013 (**Chart 5**). The increase in inward FDI income in 2014 is attributed to the improvement recorded in reinvested earnings in 2014 (€2.607,8 million) compared with 2013 (€591,9 million). This was mitigated by the deterioration in income from equity other than reinvested earnings, which was recorded at €836,5 million in 2014, down by €741,8 million compared with 2013. Similarly with income from outward FDI, profitability improved for inward FDI and entities distributed less dividends in 2014.

The rate of return of outward and inward FDI is very similar, both in levels and movements (**Chart 5**, p. 4). More specifically, the rate of return was recorded at 2,8% for outward FDI while the respective percentage for inward FDI was 2,9% in 2014, an improvement compared with 2013. The rates recorded in 2014 for both inward and outward FDI are the same as the average rates of return for the period 2008–2014. There is almost perfect correlation between the two rates of return over the 2008–2014 period with the annual differential ranging between 0,1% and -0,3%. The explanation behind this probably lies in the large share of SPEs in Cypriot FDI, which have similar inward and outward income as a result of the structure of their financial assets and liabilities.

## Regional analysis

The Cyprus FDI stock, both inward and outward, is dispersed in all continents with the most important partners being those of Europe and America. In particular, the main destination of outward FDI stock was America with €38.462 million in 2014, up from €37.072 million in 2013 (**Table 1**). Europe was the second most important destination with €27.190 million in 2014 after recording a big drop in 2013 of €7.466 million. The remaining continents had much smaller amounts.

It should be noted that there was a considerable unallocated amount of €48.200 million in 2014 compared with €44.939 million in 2013 which exceeded the amount allocated to each of the continents for both years.

As a percentage of total outward FDI stock, the share of America's stock was 33,5% while that of Europe's was 23,7%. The unallocated share amounted to 42% of the total.

The picture for inward FDI stock is different compared with outward stock. Inward FDI stock is mostly channelled from Europe and, to a much lesser extent, from America. More specifically, inward FDI stock from Europe reached €82.259 million in 2014, after recording a drop of €3.246, compared with the previous year (**Table 1**). Inward FDI stock from America, the second most important continent as regards inward FDI, was recorded at €5.533 million in 2014, down from €6,390 million in 2013. Inward FDI stock from the remaining continents was much smaller in size.

**Table 1: FDI stock by region**
€ million

| | Abroad | | In Cyprus | |
|---|---|---|---|---|
| | 2013 | 2014 | 2013 | 2014 |
| **By continent** | | | | |
| Europe | 34.656 | 27.190 | 85.505 | 82.259 |
| America | 37.072 | 38.462 | 6.390 | 5.533 |
| Africa | 558 | 548 | 467 | 587 |
| Australia, Oceania and polar regions | -38 | -50 | 110 | 1 |
| Asia | 1.975 | 366 | 356 | 419 |
| **Selected groups** | | | | |
| EU28 | -1.036 | -989 | 48.489 | 50.796 |
| EA | -4.510 | -4.386 | 45.205 | 47.475 |
| OECD | 410 | 534 | 53.635 | 54.381 |
| **Selected countries** | | | | |
| United Kingdom | 2.494 | 2.518 | 3.174 | 3.211 |
| Germany | 21 | 12 | 6.944 | 7.732 |
| Greece | -6.124 | -5.905 | 1.061 | 920 |
| Switzerland | 1.970 | 2.038 | 1.765 | 73 |
| Russian Federation | 31.923 | 25.416 | 33.520 | 29.741 |
| United States | 192 | 187 | 3.421 | 3.552 |
| **Unallocated** | 44.939 | 48.200 | 35.851 | 34.287 |

Source: Central Bank of Cyprus.

As in the case of outward FDI stock, the unallocated amount of inward stock was considerable, reaching €34.287 million in 2014, compared with €35.851 million in 2013.

The share of inward FDI stock from Europe as a percentage of total inward FDI stock was recorded at 66,8% in 2014 while the corresponding stock from America was 4,5%. Another 27,9% was recorded as unallocated in 2014.

The outward FDI stock of Cyprus in 2014 was dispersed to at least 126 countries while inward FDI stock was channelled to Cyprus from at least

161 countries[5], of which 112 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 countries. More specifically, the top 10 countries of inward and outward FDI stock constitute more than 90% 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 2014 amounted to €113.184 million, up from €112.853 million in 2013 (**Table 2**). The primary and secondary sectors together totalled €1.532 in 2014, compared with €6.309 million in 2013. The vast majority of tertiary FDI in Cyprus was channelled to "financial and insurance activities", which amounted to €106.134 million in 2014. An amount of €3.115 million was channelled to "transportation and storage activities" while real estate abroad owned by Cypriot residents totalled €1.168 million for the year.

The picture for inward FDI stock is similar to the one described above. The majority of FDI in Cyprus is directed to the tertiary sector which reached €122.042 million in 2014, down from €127.775 in 2013 (**Table 2**). The primary and secondary sectors recorded an increase of €140 million in 2014, reaching a total of €1.044 million. As in the case of outward FDI, most of the inward FDI in the tertiary sector was channelled towards "financial and insurance activities", which amounted to €106.134 million in 2014. "Transportation and storage activities" reached €7.313 million for the year and real estate owned by non-residents in Cyprus reached €3.096 million, up from €2.905 million in 2013. The fact that most inward FDI is channelled into "financial and insurance activities", indirectly implies the specialisation of Cyprus in the provision of financial services.

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

| | Abroad | | In Cyprus | |
|---|---|---|---|---|
| | 2013 | 2014 | 2013 | 2014 |
| **Primary and secondary sectors** | 6.309 | 1.532 | 904 | 1.044 |
| **Tertiary sector** | 112.853 | 113.184 | 127.775 | 122.042 |
| *of which* | | | | |
| Financial and insurance activities | 98.622 | 96.872 | 108.074 | 106.134 |
| Transportation and storage activities | 2.947 | 3.115 | 6.532 | 7.313 |
| Real estate activities | 1.167 | 1.168 | 2.905 | 3.096 |

Source: Central Bank of Cyprus.

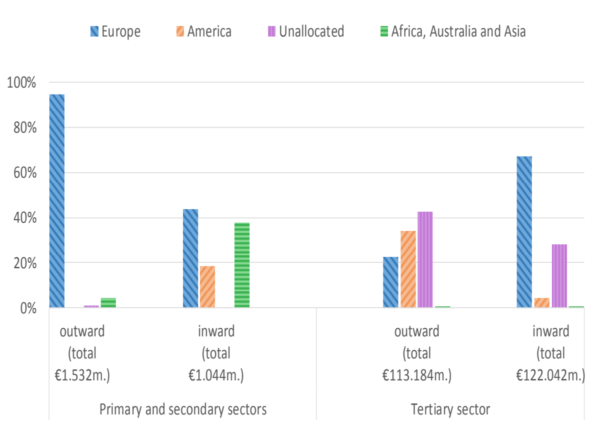
The share of the tertiary sector FDI in Cyprus, for both outward and inward, clearly exceeds the respective global share, which amounted to 63% of total stock, according to the latest figures for 2012 as reported in WIR.

A further decomposition of the economic activity in order to allow for regional analysis, reveals that in 2014 FDI abroad in the primary and secondary sectors mainly ended up in Europe, with a share of 94,6% (**Chart 6**, p. 7). FDI abroad directed to the tertiary sector was mainly destined to America and Europe with shares of 34% and 22,7%, respectively, while a share of 42,6% remained unallocated.

As regards inward FDI stocks for the primary and secondary sectors in 2014, the biggest share of 43,7% emanated from Europe (**Chart 6**, p. 7). In the tertiary sector, FDI from Europe dominated with a share of 67% while the unallocated share amounted to 28,1%.

[5] The reference to "at least…countries" is made due to the fact that a considerable amount in FDI stock is not allocated to a specific country and therefore a country which is not indicated as a recipient/originator of FDI stock could actually be represented in the unallocated amount.

**CHART 6 Share of FDI stocks by continent and economic activity**
(%)




Source: Central Bank of Cyprus.

## 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, Sixth 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.

**Residence**

The residence of an economic entity (or an institutional unit) is determined on the basis of the economic territory with which it has the strongest connection determined by its predominant centre of economic interest. More specifically, an economic entity has a centre of economic interest in the economy in which it is legally constituted and registered.

**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).