



CENTRAL BANK OF CYPRUS

ECONOMIC
BULLETIN
DECEMBER 2023

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Macroeconomic
Forecasts for the
Cyprus Economy

NICOSIA - CYPRUS

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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		

Governor's introduction

During 2023, the Cyprus economy continued to demonstrate remarkable resilience despite international geopolitical challenges. Specifically, according to the latest Central Bank of Cyprus (CBC) forecasts as of December 2023, the GDP growth rate for 2023 is projected to reach 2.2%, compared to 5.1% growth in 2022. For the years 2024-2026, GDP is projected to increase by 2.6%, 3.1%, and 3.2%, respectively. Compared to 2022, the lower projected GDP growth rate during the period 2023-2026 is attributed to the impact of the war in Ukraine and the conflict in the Middle East. The economic consequences of the conflict in the Middle East remain uncertain, as the impact will depend on the duration and possible expansion of the conflict. Already, the turmoil has spread to the Red Sea, once again creating significant disruptions in the global supply chain.

In 2023, inflation in Cyprus recorded a significant decline, reaching 3.9% from 8.1% in 2022. This development mainly reflects the significant impact of the single monetary policy in the euro area combined with the decline in energy prices. According to the latest CBC forecasts as of December 2023, further easing of inflationary pressures in Cyprus is projected for the years 2024, 2025, and 2026, at 2.4%, 2%, and 1.9%, respectively, as the monetary policy continues to exert a dampening effect on demand with a lagged and medium-term horizon, indirectly causing downward pressure on the main categories of inflation.

One of the most significant milestones of the year was the further upgrade of Cyprus's

credit rating by Credit Rating Agencies, which now places it in the investment-grade level category by all major agencies. This development reflects both the improved fiscal situation and the continuation of reforms in the Cypriot banking system.

Furthermore, the continuation of the implementation of reforms outlined in the EU's Recovery and Resilience Plan will contribute to the medium and long-term trajectory of the Cypriot economy, as these reforms aim to enhance Cyprus's competitiveness. The reforms include upgrading digital infrastructure, improving education and workforce training, as well as bolstering innovative sectors of the economy, with positive implications for the banking sector. The reforms also encompass promoting a more sustainable and environmentally responsible economy through the development of green technologies and the adoption of more sustainable production methods.

With these reforms, Cyprus can also strengthen its fiscal position by increasing transparency and efficiency in public administration. Moreover, they will contribute to improving the investment climate in Cyprus by attracting foreign investment and facilitating business activity. Additionally, the reforms can have a positive impact on addressing demographic challenges, such as population aging and migration, by improving social welfare and healthcare systems.

With regards to the country's banking sector, it retained its soundness and resilience during 2023, as evident by the key supervisory indicators, despite the significant challenges. The above mentioned upgrade of the Cyprus economy to investment grade rating from all

reputable credit rating agencies, reflects, among other things, the strict prudential supervision and effective risk management.

In particular, the Common Equity Tier 1 ratio (CET1) stood at 19,4% at 30 September 2023, compared to the 15,9% European ratio at June 2023. With regards to the Non-Performing Loans (NPL), they have decreased further, to 8,3% of the total loan portfolio as at September 2023, as compared to 9,5% at December 2022.

It is also important to mention that in light of the increase in interest rates, banks recorded increased profitability during 2023 as compared to 2022, significant part of which results from the excess liquidity of banks which is deposited with the ECB. In particular, during the nine month period to 30 September 2023, the Cyprus banking sector, recorder profits of €880mln, compared to €38mln losses at the respective period in 2022. It is noted though, that for banks to distribute as dividends this increased profitability, the approval by the supervisory authorities is required, whose primary target though is to ensure that banks maintain adequate capital to encounter adverse events. Consequently, this unexpected high profitability should soundly and prudently be used by banks, in the context of their strategic planning that will ensure a sustainable profitable course in the long term, fortifying their main indicators, while enabling them to absorb future unexpected losses due to unforeseen shocks. In parallel, considering the adverse financial conditions for households and businesses, banks should apply a prudent pricing policy when granting new loans or when restructuring existing loans. While

maintaining prudent practices in the management of their loan portfolios, banks are expected to address their customers' needs and provide viable restructurings, without undue delays and additional costs.

Additional challenges faced by the banking sector are the risk of climate change, as well as Information, Communication and Technology risks, with special reference to cyber-threats. In this direction, supervised institutions are expected to intensify their efforts to enhance their digital development and green awareness.

In a nutshell, the Cyprus economy and the banking system should adapt and evolve in a constantly changing international environment, while simultaneously safeguarding their stability and reliability. The implementation of reforms and the emphasis on viable growth, constitute key factors towards further prosperity and progress in our country. With optimism and determination we can move towards a dynamic and sustainable future.

In conclusion, within an ever-changing international environment, the Cypriot economy and its banking system must adapt and evolve, while maintaining stability and reliability. Implementing reforms and emphasising sustainable development are crucial factors for further prosperity and progress in our country. With optimism and determination, we can move towards a dynamic and sustainable economic future.

Constantinos Herodotou
Governor
Central Bank of Cyprus

(A) International Environment

- *Interest rate hikes continued in 2023 with the aim of containing prices.*
- *Inflation decreased significantly in 2023 compared to 2022, especially in recent months.*
- *International economic activity was more subdued in 2023 than in 2022.*
- *In 2024, global economic growth is expected to decline slightly.*

Similar to 2022, global economic developments in 2023 focused mainly on efforts to reduce inflation. The world's major Central Banks continued to raise their key interest rates in a bid to reduce inflation, succeeding to a large extent.

In particular, the key interest rate of the US Federal Reserve Bank stands at 5.25-5.50% as of 27 July 2023, compared with 4.25-4.50% in December 2022, while the interest rate of the Bank of England (BoE) stood at 5.25% on the last data update date (24 November 2024) compared with 3.5% at the end of 2022. At the same time, the ECB's Deposit Facility Rate is at 4% since 20 September 2023, compared with 2% at the beginning of the year.

As a result of the interest rate hikes, inflationary pressures across the world's major economies have eased significantly. In particular, inflation in the US decreased from 8% in 2022 to 4.3% in the first 10 months of 2023, while inflation in the United Kingdom dropped from 9.2% in 2022 to 4.7% in the January-October 2023 period. Similarly, inflation in the euro area decreased from 8.3% in 2022 to 5.7% over the January-November 2023 period.

More broadly, global economic growth

appears to have moderated in the second half of 2023, due to the impact of monetary policy. However, the impact appears to be smaller than expected, with the US GDP growth rate expected to be higher than in previous forecasts. At the same time, the UK is expected to avoid recession in 2023, although its GDP growth rate forecast has been revised downwards for the next two years. Similar revisions, reflecting lower GDP growth expectations in 2024 and 2025 have also been made for the euro area.

Overall, according to the latest ECB forecasts (December 2023), global economic growth is expected to decline slightly over the next year, from 3.3% in 2023 to 3.1% in 2024, mainly reflecting the impact of tight monetary policy on developed economies, which account for the vast majority of imports. Therefore, while the recovery in global trade continues, its growth trajectory is likely to be weaker in the coming quarters as it will be negatively affected by the slowdown in global economic activity.

(B) Domestic Environment

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- *The Cyprus economy exhibits significant resilience and flexibility to negative external factors related to the Russian-Ukrainian war and the Middle East conflict, recording a positive but decelerated GDP growth rate of 2,6% over 2023Q1-Q3.*
- *During the first ten months of 2023, domestic inflation (HICP) registered a sizeable drop mainly driven by the developments in energy prices along with the impact of the single monetary policy of the ECB for the euro area countries as well as due to the domestic government mitigating measures, remaining, however, still at levels above the 2% medium-term target.*
- *In October 2023, HICP inflation decelerated to 3,6%, while core inflation (inflation excluding energy and food prices) to 2,8%.*
- *Residential property prices recorded a 7,4% increase in 2023Q2, driven by increased demand, stemming from both local and foreign buyers.*
- *The labour market continues to demonstrate resilience despite geopolitical tensions.*
- *The current account deficit widened to 15.3% of GDP in the first half of 2023, driven by the imports of goods (mainly ships) of the Special Purpose Entities (SPEs) and the increased demand for domestic consumption.*
- *Tourist arrivals during the period of January to October 2023 reached nearly the levels of the corresponding period in 2019. The conflict in the Middle East is expected to impact tourist arrivals from Israel. The effects on the tourism sector will depend on the intensity and possible escalation of hostilities.*

- Domestic private sector deposits exhibited an upward trend in the first half of 2023, with slight moderation in the third quarter of the year, yet remaining resilient.
- Net loans to the domestic private sector have recorded negative annual growth rates since April 2023, amid tighter financial conditions.
- The upward trend in domestic lending rates observed since the second half of 2022, became more pronounced in 2023, mainly reflecting the faster pace of ECB policy rate hikes. Deposit rates recorded small increases in the first months of 2023, followed by relatively larger increases, remained however at low levels.
- The government budget balance recorded a surplus of 3,3% of GDP in the first nine months of 2023, compared with a surplus of 2,6% of GDP in the respective period of 2022.
- The government debt-to-GDP ratio declined in September 2023 compared to its level a year before, mainly due to a strong primary surplus and the continued economic growth.

1. Economic Activity

According to the most recent preliminary data published by Cystat that was available at the relevant cut-off date of this *Economic Bulletin*, GDP recorded a positive, albeit decelerated growth rate of 2,5% on a year-on-year basis in 2023Q3.

The available analytical data for 2023H1 (Table 1) point to a slowing GDP recovery, reaching 2,6%, following an increase of 7,1% in the corresponding half of the previous year,

TABLE 1 GDP by expenditure category
(real terms, annual change, %)

	2019	2020	2021	2022	2022 H1	2023H1
GDP	5,5	-3,4	9,9	5,1	7,1	2,6
Private consumption	3,9	-6,8	5,6	8,5	9,7	5,9
Public consumption	12,4	10,6	7,9	2,7	2,2	3,9
Gross fixed capital formation	6,9	4,7	-0,1	7,8	10,3	8,7
Exports of goods and services	8,7	2,2	21,6	13,6	19,0	-1,3
Imports of goods and services	9,5	3,1	15,4	18,3	23,4	3,4

Source: Cystat.

primarily due to the rise in private consumption by 5,9%. This is attributed to the gradual restoration of the level of disposable income and the adjustment of consumption behaviour. The increase in investments by 8,7% stems from the rise in public and residential investments. Public consumption recorded an increase of 3,9%, driven by the rise in compensation of employees (see Fiscal Developments, p. 49). Total exports fell by 1,3%, mainly due to the decline in financial services exports owing to the sanctions against Russia (see Balance of Payments, p. xx). At the same time, the increase in total imports by 3,4% mainly reflected the rise in imports of goods for home consumption (see Balance of Payments, p. 27).

From a sectoral perspective, the GDP recovery over 2023H1 (**Table 2**) emanates from increased activity across all economic sectors except professional services due to the sanctions (-0,2 percentage points). The sectors with the largest contribution to GDP growth were trade, transportation, hotels and restaurants with a contribution of 1,5 percentage points. A smaller contribution came from the information and communication sectors (0,6 percentage points), supported by the influx of foreign companies within the framework of the "Strategy for Attracting Businesses for Activities or/and Expansion of their Activities in Cyprus" (headquartering policy) in technology sector. The manufacturing and construction sectors also contributed positively (by 0,2 and 0,1 percentage points, respectively).

The latest available soft data for 2023Q4 point to a further slowdown in GDP. The GDP

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

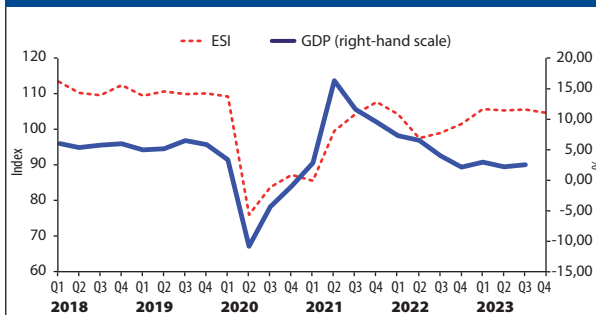
	2019	2020	2021	2022	2022 H1	2023H1
GDP (%)	5,5	-3,4	9,9	5,1	7,1	2,6
Construction	0,8	-0,3	0,1	-0,2	-0,4	0,1
Trade, transportation, hotels and restaurants	0,9	-6,5	5,2	2,4	3,6	1,5
Information and communication						
Financial and insurance activities	-0,2	2,4	1,4	0,2	0,3	0,1
Professional, scientific and administrative activities	0,8	-0,2	0,8	0,4	0,3	-0,2
Other sectors ⁽¹⁾	2,0	-0,1	1,1	0,7	0,9	0,5

Source: Cystat.

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

path closely follows developments in the Economic Sentiment Index (ESI) (Chart 1) as well as its sub-indicators (Table 3). So far, the Cyprus economy appears to be resilient, while any economic effects associated with the Middle East conflict are expected to become more pronounced in the coming quarters. Specifically, the ESI in October 2023 reached 104,6, lower than 105,6 in 2023Q3 (Table 3). According to the underlying sub-indicators (Table 3), the decrease in the index is mainly due to the deterioration in consumer confidence. Therefore, the CBC adopted a conservative GDP growth projection for 2023 in the December 2023 forecasts, taking into account possible negative economic effects that may arise from the Middle East conflict (see Macroeconomic Forecasts, p. 51).

CHART 1 Annual GDP growth and Economic Sentiment Indicator index



Sources: Cystat, European Commission.
Note: The figures for the 4th quarter refer to October 2023.

TABLE 3 Business and consumer surveys: confidence indicators

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

	2022 Q3	2022 Q4	2023 Q1	2023 Q2	2023 Q3	2023 Oct.
ESI	98,9	101,5	105,7	105,3	105,6	104,6
Industry	-6,7	-7,4	-2,7	1,1	1,6	0,4
Services	9,6	16,5	25,0	20,4	25,9	26,2
Consumer	-32,9	-30,3	-19,2	-23,7	-24,6	-27,6
Retail trade	-11,6	-6,2	-1,0	0,9	2,3	0,0
Construction	-17,6	-16,0	-15,6	-12,4	-9,6	-6,1

Source: European Commission.
Note: Seasonally adjusted data.

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2. Prices

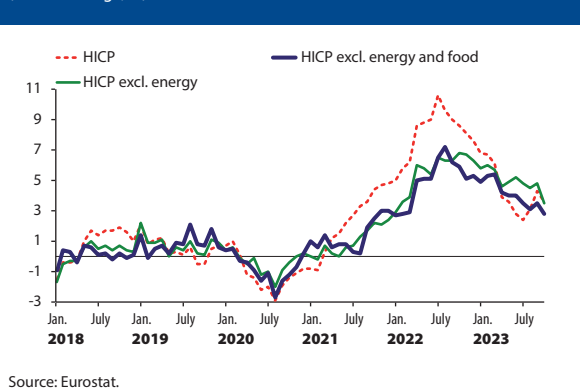
Inflation

The domestic Harmonised Index of Consumer Prices (HICP) slowed-down to 3,6% in October 2023 compared with 4,3% in September 2023 and 8,6% in October 2022. Regarding the first ten months of 2023, HICP inflation registered, on average, a yearly increase of 4,3% compared with 8,2% in the corresponding period of 2022 (Chart 2a and Table 4). In general, the domestic HICP inflation experienced significant annual slowdown during the first ten months of 2023, albeit still remaining at levels above the 2% medium-term target. The major factors for the substantial downward course of overall HICP inflation during the described period were the developments in energy prices compared with the high level in 2022 along with the sizeable impact of tightening of the single monetary policy of the ECB for the euro area countries. At the same time, the various domestic government mitigating measures related mainly to energy and food prices also contributed to the significant slow-down of domestic inflation during 2023.

More analytically, energy prices contributed substantially to the downward trend of HICP during the first ten months of the year (Chart 2b), registering, on average, an annual decrease of 1,1% during January-October 2023 compared with an annual increase of 34,7% during the period January-October 2022 (Table 4) on account of the significant fall in the international price of Brent oil compared with the corresponding

CHART 2a Inflation in Cyprus (HICP)

(annual change, %)



Source: Eurostat.

TABLE 4 Inflation in Cyprus

(annual change, %)

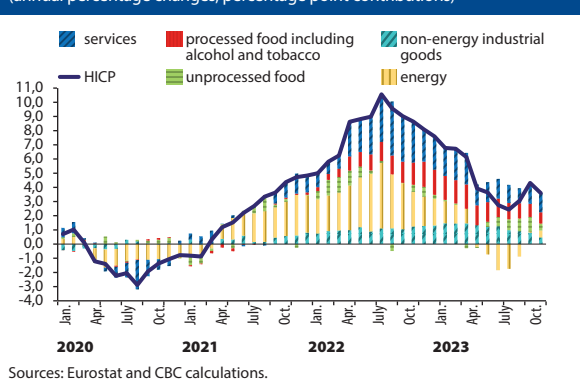
	Weights ⁽¹⁾	Jan.-Oct. 2022	Jan.-Oct. 2023	Oct. 2022	Sep. 2023	Oct. 2023
HICP	1000,00	8,2	4,3	8,6	4,3	3,6
Total Food prices,						
of which:	232,53	7,1	7,5	9,9	8,5	5,3
(i) Unprocessed food prices	51,59	10,1	6,9	10,3	18,9	7,8
(ii) Processed food prices	180,94	6,1	7,7	9,7	5,3	4,5
Energy prices	112,38	34,7	-1,1	25,6	0,4	4,3
Services prices	421,77	5,3	3,7	6,3	3,5	3,3
Non-energy industrial goods prices	233,32	4,1	4,8	5,1	3,5	2,0
HICP excluding energy	887,62	5,4	5,0	6,8	4,8	3,5
HICP excluding energy and food	655,09	5,0	4,1	5,9	3,5	2,8

Source: Eurostat.

(1) Based on the weight for 2023.

CHART 2b Contributions of HICP components to overall domestic HICP inflation

(annual percentage changes; percentage point contributions)



Sources: Eurostat and CBC calculations.

period of 2022. The government mitigating measures related to energy prices (on main fuels & electricity prices) for domestic consumers until June 2023 contributed additionally to the downward path of energy prices during the first ten months of 2023.

In contrast with the said main developments that contributed significantly to the decelerating course of domestic HICP inflation during the period under review, food prices (processed and unprocessed food prices) had considerable upward pressures in the HICP, registering further yearly increase of 7,5% during the period January-October 2023 compared with a yearly increase of 7,1% during the period January-October 2022 (Table 4, p. 18). This development seems to continue to be mainly related to the increased input and production cost of food in the aftermath of the long-lasting adverse consequences of the ongoing Russian invasion of Ukraine and the consequent rises in the prices of fertilisers, wheat, oil products and energy (including “time-lag effect”) as well as due to higher profits for firms. It is noted that, domestic government mitigating measures (as announced on 02 May 2023) related to, among others, several main necessity food products and came into force for the period May 2023 – October 2023 contained, to some extent, the increases in food prices.

Non-energy industrial goods “NEIG” prices recorded an annual rise of 4,8% during the first ten months of the year compared with a rise of 4,1% in the corresponding period of 2022, hence, also contributed upwards to the HICP. The particular development is still

related at a great extent to the increased production/input cost of goods in the aftermath of the war, the solid demand for goods as well as the profit margins for firms. In turn, the said factors continued to pose sizeable upward price pressures to the key sub-categories of NEIG inflation such as motor cars, furniture and fittings and major household electrical appliances.

During the period January-October 2023, Services prices, albeit registered a deceleration compared with the corresponding period of 2022, also recorded an annual increase of 3,7% compared with an annual increase of 5,3% during January-October 2022 (**Table 4**, p. 18). The continuing growth of domestic economy, the robust demand for various services which are related to domestic consumption and tourism (restaurants and cafes, accommodation services and travelling), the increases in wages and profit margins for firms are factors that had an upward impact on services prices during the period under review. It should be mentioned that food prices as well as energy prices (lagged effect) had also posed sizeable indirect upward pressures to the said key sub-categories of Services inflation during the described period.

Regarding domestic inflation excluding energy and food prices (core inflation), this continued to fluctuate at levels above 2%, while remaining, in general, more persistent than the overall domestic HICP path (as also holds in the euro area). Particularly, core inflation registered, on average, a yearly increase of 4,1% during the period January-October 2023 compared with, on average,

5,0% in the corresponding period of 2022 (Chart 2a and Table 4, p. 18) in light of the developments in both NEIG and services prices (core inflation components). Having said that, it should be noted that as from April 2023, core inflation has, in general, registered signs of a sharper slow-down, reaching 2,8% in October 2023 compared with 3,5% in September 2023 and 5,9% in October 2022.

Finally, it is worth mentioning that part of the domestic government relief measures announced on 13 September 2023 and 19 October 2023 which relate to specific subcategories of main components of the HICP, are expected to continue to contain the domestic inflation and its course in the short-term horizon, amid the fragile and uncertain international economic environment and ongoing geopolitical tensions.

Construction sector and real estate prices

Despite the limited construction activity in 2022, shown in the negative growth rates of the index in construction, the demand for real estate is at high levels, as reflected in the number of sales contracts. According to sales contracts data, published by the Department of Lands and Surveys (DLS), real estate transactions recorded a 19% increase over the first ten months of 2023 across Cyprus. This increase reflects a 13,8% and 25,8% annual increase in the sales to local and foreign buyers, respectively (Table 5), with local buyers still accounting for the market’s largest share (Chart 3). The building sentiment indicator remains at negative levels over the first ten months of 2023 (Table 5).

TABLE 5 Real estate sector

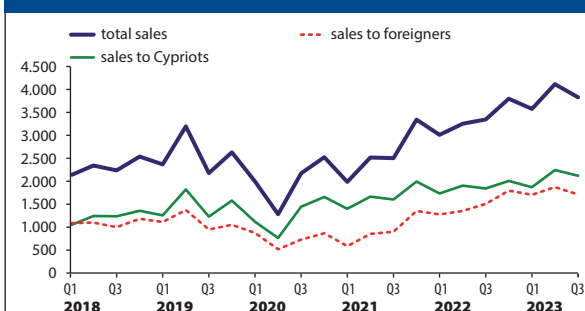
(annual change, %, unless otherwise stated)

	Jan.-Oct. 2022	Jan.-Oct. 2023	Oct. 2022	Sep. 2023	Oct. 2023
Sales contracts (total)	36,2	19,0	28,5	15,5	11,5
Sales contracts (locals) ⁽¹⁾	18,0	13,8	22,7	21,8	13,7
Sales contracts (foreigners)	71,3	25,8	37,1	8,6	8,7
Building sentiment indicator (average of index)	-18,6	-11,9	-22,1	-10,1	-6,1
Property price expectations for the next 3 months (average of index)	84,9	73,3	86,5	75,4	71,5
Price index of construction materials	18,3	3,5	14,3	-0,1	-0,3

Sources: Cystat, DLS, European Commission.

(1) The number of sales contracts to Cypriots results from CBC calculations.

CHART 3 Number of sales contracts



Source: Department of Lands and Surveys.

Note: The definition of foreigner has changed since 2018Q1, thus the figures are not comparable with previous periods.

The demand for real estate seems to remain unaffected, despite the fact that the increase in ECB's base rates has led to a drop in new housing loans. Specifically, according to CBC's Monetary and Financial Statistics publication, new housing loans decreased by 19,9% over the first nine months of 2023 compared with the corresponding months in 2022, while, over the same period in 2023, the mortgage-loan rate increased to 4,14% from 2,38% over the corresponding months of 2022.

In 2023Q2, residential property prices in Cyprus continued their upwards path (**Chart 4**). Specifically, according to the latest data on CBC's Residential Property Price Index (RPPI), in 2023Q2 residential property prices recorded an annual growth of 7,4%, reflecting a 10,1% and 5,6% increase in the prices of flats and houses, respectively. These price increases are driven mainly by increased demand in combination with restrained supply. As far as the construction cost in concerned, the price index of construction materials, published by CYPSTAT, recorded a decrease of 0,3% on an annual basis in October 2023 (**Chart 5 and Table 5**, p. 21), following the international trend of price decreases in the main construction materials, albeit with a relative time lag.

Property price expectations for the next three months, published by the Business and Consumer Surveys of the European Commission, continued fluctuating at relatively high levels over the first ten months of 2023 (**Chart 5 and Table 5**, p. 21) indicating that the majority of market participants still expect real estate price increases in the near future.

CHART 4 House and Apartment price indices
(annual change, %)

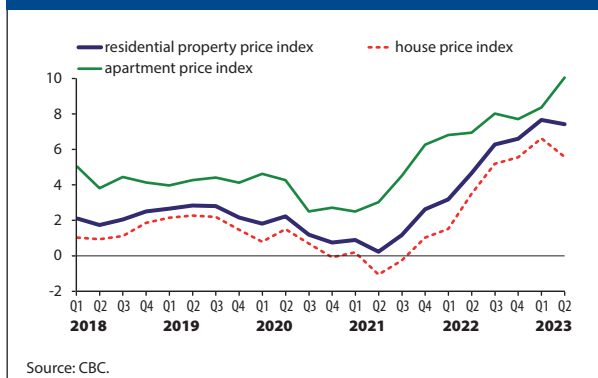
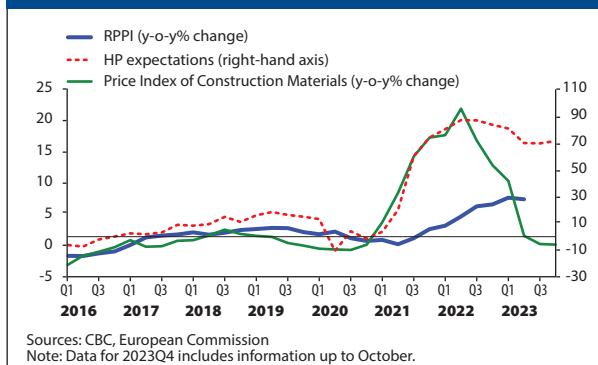


CHART 5 Residential property price index (RPPI), Price Index of Construction Materials and House Price (HP) Expectations for the next three months



Labour Costs

The labour cost (nominal expense per employee) in 2023 continues to recover, primarily due to a 3.9% increase in hourly labour cost during the first half of 2023. Nominal expenditure per employee increased by 4.1% in the first half of 2023, following a 2.4% increase in the previous year (**Chart 6**). Private sector expenditure increased by 1.9%, while the public sector showed a higher increase of 10.5%, mainly due to the payment of the Cost-of-Living Allowance (COLA) to salaries and the elimination of reductions in allowances and pensions that were applied in previous years. In the private sector, this increase is mainly attributed to wage increases in trade, transportation, hotels, and restaurants, and to a lesser extent in the professional and financial sectors.

Real expenditure per employee¹ showed a marginal decrease of 0.1% in the first half, following a 2.8% decline in the corresponding period of 2022. The decrease is smaller compared to the same period in 2022 due to lower inflationary pressures (**Chart 7**).

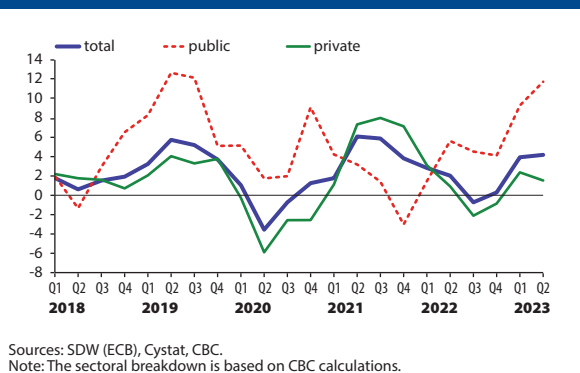
Regarding productivity, calculated as the change in real GDP per employee, the relative index increased by 0.8% in the reported period compared to a 4.3% increase in the first half of 2022 (**Chart 7**).

The recovery in expenditure per employee and productivity leads to a slight increase in unit labour cost of 0.5% (**Chart 8a**), a significant competitiveness indicator. Despite the recent increase, significant wage reductions in 2013 continue to contribute to maintaining the competitiveness of the

1. It is noted that the private consumption deflator is used, rather than the CPI deflator.

CHART 6 Nominal compensation per employee by sector

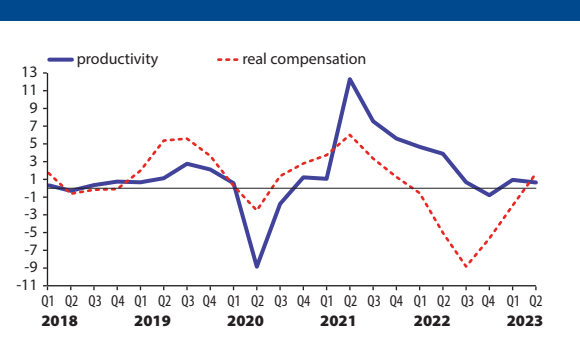
(annual change, %)



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

CHART 7 Productivity and real compensation per employee

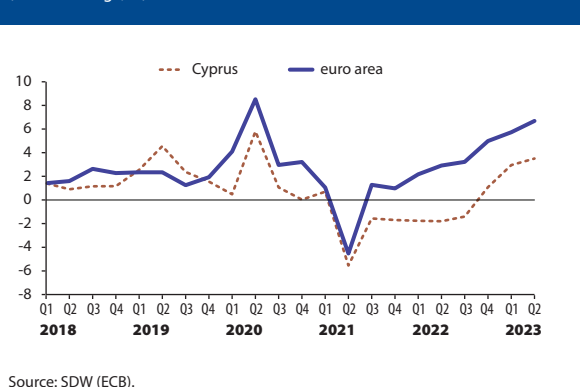
(annual change, %)



Sources: SDW (ECB), CBC.

CHART 8a Unit labour costs: Cyprus and the euro area

(annual change, %)



Source: SDW (ECB).

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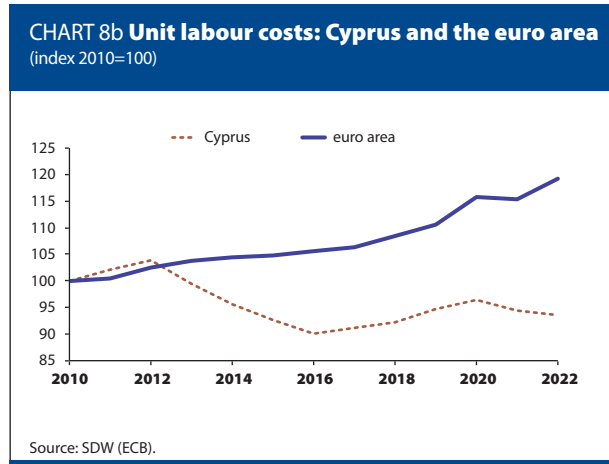
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Cypriot economy. Specifically, the index recorded a cumulative decrease of 13.8% from 2013 to 2016, despite annual increases, consistently remaining lower than the eurozone from 2013 until today (approximately 29 units in the first half of 2023) (Chart 8b).



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3. Labour market

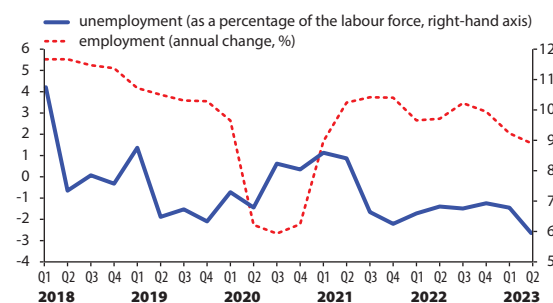
Recent developments following the start of the Russian-Ukrainian and Israeli-Palestinian wars do not seem to have had a significant impact on the labour market in Cyprus. According to the most recent labour market statistics, there is an increase, albeit at a slower pace, in employment during the first half of 2023, with an annual growth rate of 1.8%, compared to 2.7% in the corresponding period of 2022 (Chart 9). Concurrently, according to data from the Labour Force Survey (LFS), unemployment decreased to 6.4% in 2023, compared to 6.7% in 2022 (Chart 9). The increase in employment mainly originated from the sectors of trade, transportation, hotels, and restaurants, with a smaller contribution from professional services, manufacturing, and information and communication sectors.

Working hours per employed person recorded an increase of 1.9% in the first half of 2023, compared to 4.3% in 2022, with the slowdown attributed to the greater increase in employment compared to working hours.

The data from the Statistical Service of Cyprus (CYSTAT) on registered unemployment indicate a continuous decrease since June 2021 (Chart 10), with the most recent data for October 2023 showing an annual decrease of 17.4% (from 11,183 to 9,232 individuals). The resilience of the labour market is attributed to the increase in economic activity despite the impact of the wars in Ukraine and the Middle East.

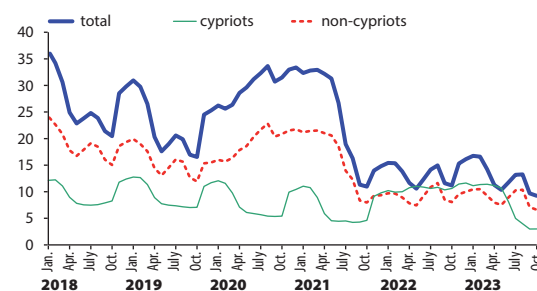
Regarding unemployment by age group (Chart 11a), individuals aged 25-34 contribute

CHART 9 Unemployment and employment



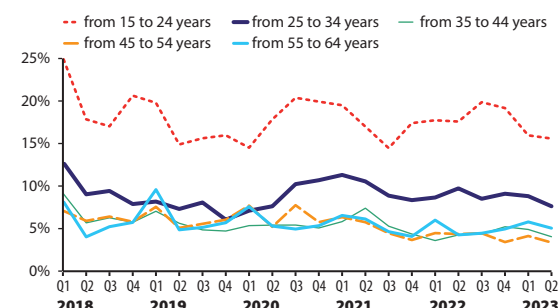
Source: Cystat (LFS).

CHART 10 Registered unemployment
(number of unemployed, thousands)



Source: Cystat.

CHART 11a Unemployment rate by age group
(as a percentage of the labour force)



Source: Cystat (LFS).

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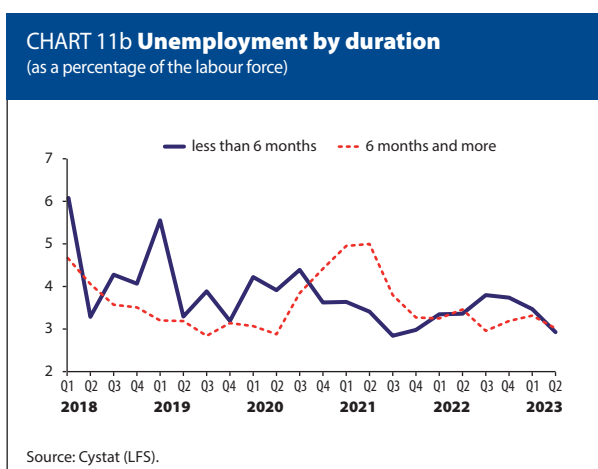
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the most to the overall percentage with 2.2 percentage points for the first half of 2023. The unemployment rate for the age group 15-24 years decreased by 1.9 percentage points in 2023, representing only 1.3 percentage points of the overall unemployment rate for the examined period.

A significant parameter in labour market analysis is the stabilization of long-term unemployment at low levels, remaining at 3.0% in the second quarter of 2023 (**Chart 11b**), reflecting stability in the labour market. The data indicates that the influx of foreign labour continues, allowing to some extent the fulfillment of the personnel needs of businesses. Additionally, the research reveals a significant increase in job vacancies in the first half of 2023, especially in the tourism industry, a sector that significantly contributes to economic activity.



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4. Balance of payments²

The current account deficit widened to €2,171.3 million (-15.3% of GDP) in the first half of 2023 (2023H1), compared with a deficit of €1,725.2 million (-13.0% of GDP) in 2022H1 (Table 6 and Chart 12). The deterioration in the deficit mainly arises from the balance of goods and, to a lesser extent, from the primary income account. The surplus in the balance of services partially offset the overall result. Adjusted for the impact of SPEs, the current account deficit recorded a deterioration also, standing at €1.670,0 million (-11,8% of GDP) in 2023H1, compared with €1.410,4 million (-10,6% of GDP) in 2022H1 (Table 6 and Chart 12).

In more detail, the trade deficit of goods worsened by €639,7 million and reached €3.931,5 million in 2023H1. Specifically, net imports of goods by SPEs (mainly ships), that do not impact the domestic economy, increased by €196,6 million. Additionally, the increased demand observed during the economic reopening following the pandemic continued, leading to an increase in imports for home consumption. The largest increase was recorded in the transport equipment and consumer goods categories, while the fuel and intermediate goods categories recorded a decrease compared to 2022H1 due to the normalization of supply chain conditions. An improvement in the balance of goods is envisaged for the rest of 2023, due to the expected slowdown in consumer spending.

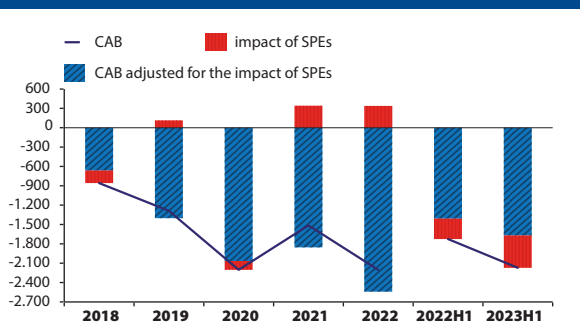
2. The external statistics data are significantly affected by the classification of SPEs as residents of Cyprus and, in particular, by those which are considered as economic owners of mobile transport equipment (mainly ships). The transactions of SPEs do not affect nor are affected substantially by the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

TABLE 6 Balance of payments (main categories)

	2022H1 (€ million)	2023H1 (€ million)	Change (€ million)
Current account balance	-1.725,2	-2.171,3	-446,1
Current account balance adjusted for the impact of SPEs	-1.410,4	-1.670,0	-259,6
Goods and services balance	-470,8	-862,4	-391,6
Trade balance	-3.291,8	-3.931,5	-639,7
Exports of goods	1.964,0	2.039,7	75,8
<i>of which:</i>			
Exports of goods - SPEs	407,7	603,9	196,2
Imports of goods	5.255,7	5.971,2	715,5
<i>of which:</i>			
Imports of goods - SPEs	912,4	1.305,2	392,8
Services balance	2.820,9	3.069,1	248,1
Exports of services	10.366,5	10.408,6	42,1
Imports of services	7.545,6	7.339,6	-206,0
Primary income (net)	-1.105,6	-1.160,1	-54,5
Secondary income (net)	-148,8	-148,8	-0,1
Current account balance(% of GDP)	-13,0	-15,3	
Current account balance adjusted for the impact of SPEs(% of GDP)	-10,6	-11,8	

Sources: Cystat, CBC.

CHART 12 Current account balance (CAB)
(€ million)



Sources: Cystat, CBC.

The surplus of the services balance increased by €248,1 million and reached €3.069,1 million in 2023H1 (Table 7). Net exports in the Telecommunications, Computer and Information services (ICT) sector recorded an increase of €418,4 million, as a result of the continuous attraction of foreign businesses to set up and/or expand their operations in Cyprus (headquartering), the increase in exports and the simultaneous decrease in imports of the sector³. Sanctions against Russia significantly affected financial services, with the sector's net exports falling by €259,5 million. This stemmed from a significant decrease in exports by €507,6 million, compared to 2022H1, which was partially offset by a decrease in imports by €248,1 million. A significant decrease of €192,3 million was also observed in the imports of the other business services sector, due to the general uncertainty and slowdown in the external environment.

In the primary income account, which mainly includes income from dependent work and investments, the deficit widened by €54.5 million in 2023H1 compared to 2022H1, reaching €1,160.1 million, while the secondary income deficit, which mainly includes current transfers, remained steady at €148.8 million (Table 6, p. 27).

The net International Investment Position (IIP) stood at -€28,7 billion (-99,7% of GDP) at the end of 2023Q2 (Chart 13). Adjusted for the impact of SPEs, net IIP stood at -€10,7 billion, or -37,3% of GDP.

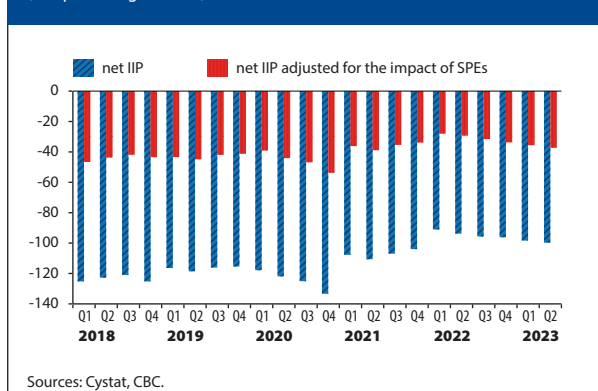
3. Further analysis of the role of companies of foreign interests in Cyprus, particularly in connection to the current account balance, is included in Box A, page 30.

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

	2022H1 (€ million)	2023H1 (€ million)	Change (€ million)
Services balance	2.820,9	3.069,1	248,1
Exports of services	10.366,5	10.408,6	42,1
<i>of which:</i>			
Transport	1.919,6	1.973,2	53,6
Travel	948,0	1.210,1	262,1
Financial services	2.681,2	2.173,6	-507,6
Telecommunications, computer and information services	3.445,9	3.683,0	237,1
Other business services	746,9	768,4	21,5
Imports of services	7.545,6	7.339,6	-206,0
<i>of which:</i>			
Transport	1.243,1	1.387,6	144,5
Travel	510,7	674,5	163,8
Financial services	1.652,5	1.404,4	-248,1
Telecommunications, computer and information services	2.240,0	2.058,7	-181,3
Other business services	1.492,4	1.300,1	-192,3

Source: CBC.

CHART 13 Net International Investment Position (IIP)
(as a percentage of GDP)



Tourism

The tourism sector recovered significantly in 2023, despite the loss of the Russian market following the outbreak of war in Ukraine. Based on available data for the first ten months of 2023, tourist arrivals reached 3.6 million, marking an annual increase of 21.1%. This amounts to 96% of the level of arrivals in the corresponding period of 2019. (Table 8 and Chart 14). Most arrivals came from the United Kingdom with 1,2 million tourists, followed by Israel with 393 thousand and Germany with 189 thousand tourists. The increase in tourist flows from Poland, France and the Scandinavian countries was also significant.

Tourism revenues in the first eight months of 2023 recorded an annual increase of 25.4% and reached €2.027,7 million (Table 8 and Chart 15). The increased number of tourist arrivals and the increase in per capita expenditure by 0.7% contributed positively to this development. It is noted that the average duration of tourist stay amounted to 8,3 days during the first eight months of 2023, versus 10,2 days in the corresponding period of 2022.

Due to uncertainty regarding the duration and outcome of the Russo-Ukrainian war and the war in Israel, it is expected that the tourism sector in 2024 will hover around the levels of 2023. Key factors for the further development of the sector will include the expansion of air connectivity and new routes, extending the tourist season and duration of visitor stays, and promoting outdoor, mountainous, and remote areas as alternative tourist destination choices.

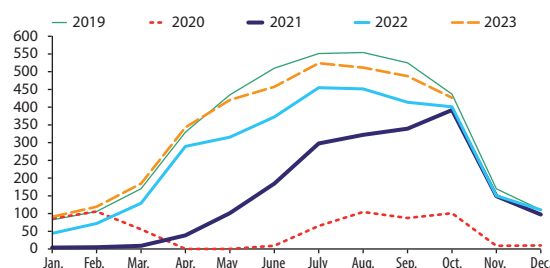
TABLE 8 Tourism

	Tourist arrivals (thous.)	Tourist receipts (€ million)	Expenditure per person (€)
2021	1.936,9	1.513,6	781,5
2022	3.201,1	2.439,2	762,0
annual % change	65,3	61,2	-2,5
2022 Jan. - Aug.	2.127,2	1.617,1	760,2
2023 Jan. - Aug.	2.648,8	2.027,7	765,5
annual % change	24,5	25,4	0,7
2022 Jan. - Oct.	2.941,2	n/a	n/a
2023 Jan. - Oct.	3.562,4	n/a	n/a
annual % change	21,1	n/a	n/a

Source: Cystat.

CHART 14 Tourist arrivals

(number of persons, thousands)

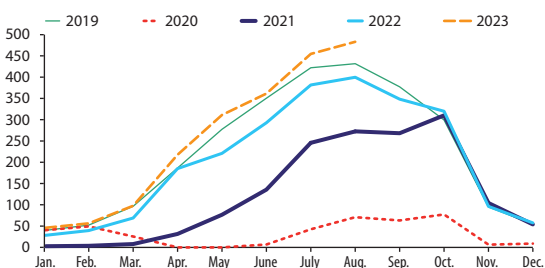


Source: Cystat.

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

CHART 15 Receipts from tourism

(€ million)



Source: Cystat.

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

Box A: The Current Account Balance (CAB) in Cyprus and the Role of Foreign-Owned Companies¹

Introduction

The Current Account Balance (CAB)² is an important macroeconomic measure that reflects a country's trade transactions, compensation of employees, investment income and current transfers with the rest of the world, for both the public and private sectors. It is significantly important for a small and open economy, such as Cyprus. The CAB consists of four components: the balance of goods, the balance of services, the primary income account and the secondary income account.

The box features a brief summary of the CAB in Cyprus and its components. It also

discusses how foreign-owned companies affect the CAB, how CAB is financed, and whether the CAB deficit is sustainable. The period of focus is from 2008 onwards³, given the availability of comparable detailed data.

The four main accounts of the CAB in Cyprus are presented below, for the period 2008-2023Q2 (Table 1 and Chart 1, p. 31).

1. Components of the Current Account

1.1 Goods Balance

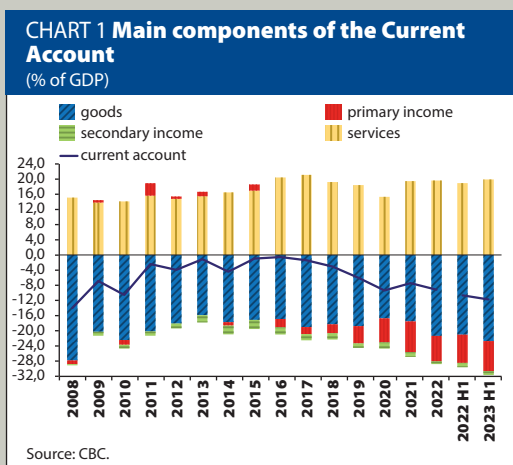
Historically, Cyprus' CAB has been in deficit, driven primarily by the deficit in the balance of goods. For the period 2008-2023Q2, the average deficit in the balance of goods fluctuated around 19% of GDP. This is due to the limited factors of

TABLE 1 Main components of the Current account
(% of GDP)

	2008								2023
	-2015	2016	2017	2018	2019	2020	2021	2022	Q1-Q2
1. Goods	-19,9	-16,9	-19,0	-18,3	-18,8	-16,7	-17,5	-21,3	-22,7
Exports of goods	9,1	8,5	9,6	10,3	9,0	9,5	10,0	11,5	10,1
Imports of goods	29,0	25,4	28,6	28,6	27,7	26,3	27,6	32,9	32,8
2. Services	15,3	20,4	21,1	19,2	18,4	15,3	19,5	19,6	19,9
Exports of goods	36,9	48,4	52,1	49,3	52,9	55,9	67,1	71,5	66,5
Imports of goods	21,6	28,0	31,0	30,1	34,5	40,6	47,6	51,8	46,6
3. Primary income	0,5	-2,2	-1,9	-2,3	-4,5	-6,3	-8,1	-6,7	-7,9
Receivable	15,3	9,0	9,0	9,4	9,0	11,5	6,5	8,8	11,1
Payable	14,8	11,2	10,9	11,7	13,6	17,8	14,6	15,5	19,0
4. Secondary income	-1,4	-1,9	-1,6	-1,7	-1,2	-1,6	-1,3	-0,7	-1,0
Receivable	2,3	2,0	2,0	2,2	2,5	2,5	2,7	2,7	2,8
Payable	3,8	3,9	3,7	3,9	3,7	4,2	4,0	3,4	3,8
Balance of goods and services (1+2)	-4,6	3,6	2,1	1,0	-0,4	-1,4	1,9	-1,7	-2,8
Current account balance (1+2+3+4)	-5,5	-0,5	-1,5	-3,5	-6,0	-9,4	-7,4	-9,1	-11,8

Sources: CBC, Cystat.

1. This Box is an excerpt from a related study of the CBC.
2. This Box presents/analyses data that are adjusted for the impact of Special Purpose Entities (SPEs), given that the domestic economic cycle is better represented using data adjusted for SPEs. For more information on SPEs, refer to the relevant CBC publication Review of External Statistics 2016.
3. The Balance of Payments data based on the 6th edition of the International Monetary Fund's manual (BPM6) is available from 2008 onwards. Selected series of external statistics based on the BPM6 methodology are available for the period 2004-2007.



production and the small size of Cyprus, which limit the domestic production of goods and services for the purposes of consumption and investment. As a result, Cyprus imports a lot more goods than it exports. The imports of goods comprise mostly of consumer goods (e.g. home appliances and furniture), intermediate inputs (e.g. raw materials such as construction materials and fuel), capital goods (e.g. machinery) and transport equipment (e.g. passenger vehicles). The exports of goods comprise mostly of pharmaceutical and agricultural products. During the recent period of 2021-2023Q3, the goods deficit exhibits substantial volatility, largely due to the volatility of international oil prices (given Cyprus' high dependence on oil imports) and the price fluctuations of other imported commodities.

1.2 Services Balance

The Cypriot economy relies heavily on the provision of services. That is to say, the country exports far more services than it

imports. Key sectors of exported services include transport, tourism, financial, and other business services (legal, accounting, and advertising), as well as information technology. The balance of services has historically been in surplus, largely offsetting the deficit in the balance of goods, but even more so in recent years, following a significant change in the structure of exported services. More specifically, during the period 2008-2015, the average surplus in the balance of services fluctuated around 15% of GDP, while from 2016 onwards, it hovers around 19% of GDP. This increase is mainly due to the impact from the influx of foreign-owned companies in Cyprus that engage in export-oriented activities, particularly in the fields of information and communication technology (ICT) services, as well as shipping. This development was, among other factors, a result of the "Strategy for Attracting Businesses for Activities or/and Expansion of their Activities in Cyprus" (headquartering policy).

1.3 Primary Income Account⁴

The deficit in the primary income account in Cyprus arises mostly from the profits of Cypriot foreign-owned companies, which belong to their foreign shareholders/owners. These profits are recorded as payable income, either in the form of dividends or reinvested profits. The net primary income surplus averaged about 0.5% of GDP, during the period 2008-2015. In 2016, however, the primary income account

4. Primary income includes mostly the compensation of employees and investment income.

netted a deficit of around 2% of GDP. It has since been on a deteriorating trend, reaching a net deficit of 8% of GDP in the first half of 2023. The structural change in the primary income deficit from 2016 onwards is, among other factors, a result of the aforementioned attraction of foreign companies to Cyprus. On one hand, the influx of a large number of foreign-owned companies improves the services balance due to increased exports, which in turn positively affects the CAB. On the other hand, the profits generated by these companies are recorded as payable income, which widens the primary income deficit and thus negatively affects the CAB.

1.4 Secondary Income Account

The secondary income balance historically shows a deficit of around 1% of GDP. This primarily reflects the higher remittances sent from foreign workers to their home countries, compared to the remittances sent from Cypriots working abroad to Cyprus. Additionally, it reflects Cyprus' net contributions to the various funds of the European Union.

2. The role of foreign-owned companies

The impact of foreign-owned companies operating in Cyprus on the CAB depends mainly on the nature of their activities, i.e., whether they transact with residents of Cyprus or export/import goods and services to/from non-residents of Cyprus.

Regarding foreign-owned companies in Cyprus that are export-oriented, particularly in the fields of ICT⁵, shipping, and non-bank financial services, their operations have a positive impact on the CAB. This is because their net exports of services (surplus in services balance) generally outweigh the net profits attributed to foreign shareholders (deficit in the primary income). Thus, from 2016 onwards, these companies contribute positively to the CAB.

On the other hand, foreign-owned companies that engage a lot with the domestic market and have very limited or no transactions with non-residents (i.e., they do not export goods or services), such as those operating in retail trade or the credit acquiring companies, have a negative impact on the CAB. Firstly, they have no exports that could positively affect the balance of goods and services and, secondly, their profitability from domestic economic activities with residents negatively affects the primary income account. In the case of retail trade companies that rely on imports for resale in the domestic market, the negative impact on the CAB is even more pronounced. Additionally, the profitability of banks, which are predominantly foreign-owned, as well as the imports of natural gas extraction companies, which currently have no exports, also contribute to the widening deficit of the CAB. Indicatively, it is noted that during the period 2019-2022, on average, 0.8% of the CAB deficit originated from credit acquiring and natural gas extraction companies.

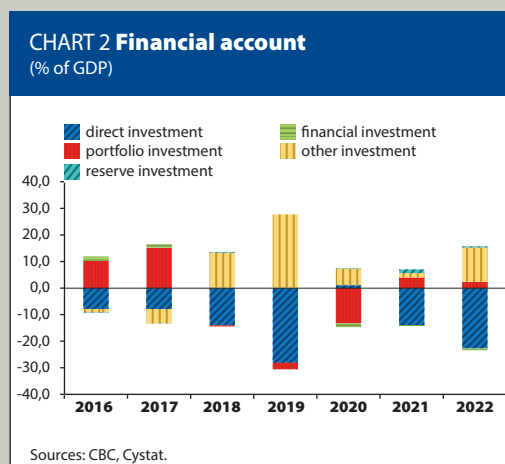
5. It is noted that in real terms, the share of the ICT sector has increased from an average of 4% of GDP during the period 2008-2015 to 11.2% of GDP in 2022. At the same time, the share of the non-bank financial services sector reached 3.8% of GDP in 2021 (the latest year with available data), up from 0.9% of GDP during the period 2008-2015.

In addition to their impact on the CAB, foreign companies operating in Cyprus influence the Cypriot economy in various other ways. For example, they bring in technological know-how, create job opportunities, enhance competition, and contribute to the development of the broader region where they are located. As a result, human capital develops and the economy's production possibilities frontier and international competitiveness increase.

On the other hand, the arrival of these foreign-owned companies can also lead to distortions, the mitigation of which does not fall in the scope of the present study. For example, the demand for real estate from foreign companies and their highly paid executives has driven property prices and rents in the affected areas to very high levels for the average household to afford. According to CBC's Residential Property Price Indices (RPPI)⁶, for the period 2015-2023Q2, apartment prices in Nicosia recorded an average annual increase of 1,2%, while in Limassol, which attracts a large percentage of ICT companies, the increase was 5,2%.

3. Sustainability and financing of the current account balance (CAB)

The impact of foreign-owned companies on the CAB has increased in recent years, which, as mentioned earlier, partly contributes to the widening of the current account deficit (Table 1 and Chart 1, p. 31). Questions arise as to how worrisome the deterioration of the current account deficit should be and how



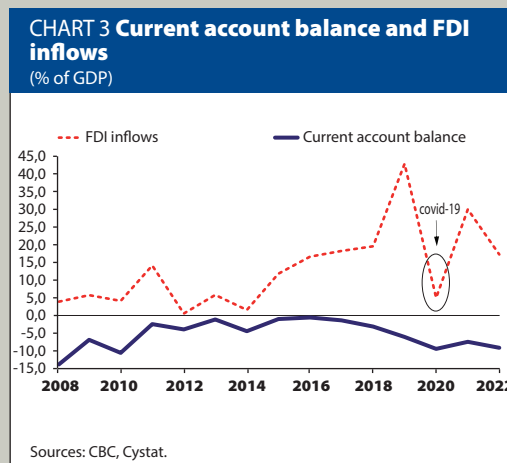
it can be financed. Regarding the first question, it is noted that the deterioration of the deficit is partly due to factors that can be considered transitory or will not persist in the medium term. For example, in recent years, the CAB has been affected by the covid-19 pandemic (2020-2021) and very high energy prices (2022) due to Russia's invasion of Ukraine. In addition, the aforementioned impact of credit acquiring companies and natural gas extraction companies are expected to reverse in the medium term. It is well understood that the sustainability of the CAB requires that the Cypriot economy remains competitive. This involves, among other things, maintaining low unit labour costs, relatively low inflation compared to the European average, and the continued improvement of public finances, within a friendly economic environment towards investments in Cyprus. As regards the second question, financing the current account deficit seems to be sustainable. The sources of financing the current account deficit are presented in the financial account (Chart 2⁷). The main components of the

6. The quarterly CBC publication regarding Residential Property Price Indices is relevant to this context: Central Bank of Cyprus - Δείκτης Τιμών Κατοικιών

7. The negative flow of financial transactions contributes positively to the financing of the current account deficit and vice versa.

financial account are direct investments, portfolio investments (equities and bonds), financial derivatives, other investments and reserve assets.

Inward FDI (liabilities) are considered the preferred method of financing, as they reflect the long-term focus of foreign investors and their confidence in the country's future development. They constitute an important source of financing for the current account deficit in Cyprus. Factors contributing to the uninterrupted flow of FDI in Cyprus include, among others, the absence of exchange rate risk due to the adoption of the euro, low unit labour costs, relatively low inflation and high GDP growth rate compared to the corresponding European averages, improvement in public finances, and the recent upgrade of Cyprus' credit rating even further (now at the investment grade level by all major rating agencies), despite the persistent deficits in the current account. Another contributing factor is that net external debt, adjusted for the impact of Special Purpose Entities (SPEs), has been negative in recent years, indicating Cyprus' position as a net lender⁸. The recurring FDI inflows reflect the resilience and high growth trajectory of the Cypriot economy in recent years, driven by significant investments. According to a report by "FDI Intelligence"⁹, investments in the information technology sector in Cyprus have increased, with the sector



registering a 600% increase in the first half of 2022 compared to the same period in 2019. Cyprus has achieved the greatest improvement in innovation since 2016 at the European level, ranking 10th in the European Commission's 2023 European Innovation Scoreboard¹⁰. Furthermore, the relative credit risk for Cyprus is limited, as capital for major FDI projects is not financed by the domestic banking system. It is noted that the average FDI rate of return in Cyprus has ranged between 5%-6% since 2017¹¹. More specifically, for the period 2016-2021, inward FDI averaged at 22% of GDP, while in 2022, despite the sanctions imposed against Russia, it reached 17.3% of GDP, (Chart 3). In addition, in the first half of 2023, FDI inflows to Cyprus stood at 20.6% of GDP. Moreover, there is no indication that FDI inflows from Israel will stop following the outbreak of hostilities in the Middle East.

8. Assets held in debt instruments exceed the corresponding instruments under Liabilities.
 9. Cyprus builds tech momentum | fDi Intelligence – Your source for foreign direct investment information - fDiIntelligence.com
 10. ec_rtd_eis-country-profile-cy.pdf (europa.eu)
 11. For an extensive overview of FDI in Cyprus, you can read the relevant publication of CBC's Statistics department: Central Bank of Cyprus - Foreign Direct Investment

Concluding remarks

The recent increase in the current account deficit is partly due to transitory factors, which are expected to reverse or significantly decay in the medium term. It is also due to structural changes in the composition of the current account that elevates the deficit but are accompanied by inward FDI flows; the most favourable form of financing that supports the sustainability of the current account.

In particular, the growth prospects of the ICT, tourism, financial services, and transport sectors will continue to improve the services balance in the medium term. Long-term, the exploitation of hydrocarbons and renewable energy sources is expected to improve considerably the goods balance. Furthermore, attracting high-value-added investments via inward FDI safeguards the financing of the current account deficit and lays the foundation for sustainable economic development.

The importance of the CAB in a small open economy cannot be understated, especially once considering the major

recent international and geopolitical developments. The best economic buffer from such shocks is to preserve the country's competitiveness and safeguard the soundness of its economic fundamentals. Only this way, both the government, via its fiscal soundness, and the private sector, via its business flexibility and adaptability, will be able to overcome significant economic challenges. Such resilience is a necessary condition for sustainable development and quality of life enhancement in Cyprus.

Sources

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- CBC (2023), *“Foreign Direct Investment 2021”*, February 2023.
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Box 2: Results from the fourth wave of the Eurosystem Household Finance and Consumption Survey in Cyprus (2021)¹

Introduction

Since 2010, the Central Bank of Cyprus (CBC) has been conducting the Household Finance and Consumption Survey (henceforth 'Survey'). The Survey is coordinated by the Household Finance and Consumption Network (HFCN) under the auspices of the European Central Bank (ECB), which includes all euro area countries and several additional countries within the European Union.

The Survey in Cyprus is conducted through personal interviews² and aims to record and analyse household decision-making and developments in areas such as saving, investing, borrowing, consumption, and retirement. Data collection occurs at both the individual and household levels, ensuring a significant source of information regarding their behaviour.

The Survey and the analysis of the data are utilized for policy purposes within the Eurosystem, aiding in the assessment of the impact of various economic policies or unexpected shocks on household finances. Additionally, the data has been used for specific analyses in the past, such as the marginal propensity to consume out of income, and the effect of interest rate changes on wealth and household income

distribution. Furthermore, analysing the collected data, which includes assets, income, loans, and consumption, can enhance our understanding in areas such as income inequality, financial stability, and payment habits.

The Survey is conducted every three years. The latest, fourth wave, with a reference year for income of 2019, was completed in 2021 as it was delayed due to the COVID-19 pandemic. The timing of the completion of each wave is particularly important for Cyprus. Specifically, the first wave coincides with the period before the 2013 crisis. The second wave was conducted during the 2013 crisis, and the third was completed three years after the crisis, marking the beginning of the economic recovery period. As already mentioned, the fourth wave took place in the period following the outbreak of the COVID-19 pandemic.³ As a result, each wave provides important information about the situation of Cypriot households during these important periods when major developments occurred in the Cypriot economy.

It is also important to note that Cyprus maintains one of the highest rates of panel⁴ data among all participating countries, exceeding 70%. The households participating in the fourth wave amounted to 1332 compared to 1303, 1289, and 1237 in the third, second, and first waves, respectively. It is worth mentioning that the fifth wave of the

1. Household Finance and Consumption Survey (HFCS)
 2. In the fourth wave, a combination of methodologies was used, namely, CAPI (Computer Assisted Personal Interviews), CATI (Computer Assisted Telephone Interviews), and CAWI (Computer Assisted Web Interview).
 3. More specifically, the first wave was conducted in 2010 (with an income reference year of 2009), the second wave in 2014 (with an income reference year of 2013), and the third wave in 2017 (with an income reference year of 2016).
 4. The term "panel" refers to households that have also participated in one or more of the previous waves of the Survey.

Survey is ongoing, and fieldwork was completed at the end of 2023.

The below analysis presents some key findings from the 2021 Survey in Cyprus, focusing on assets, liabilities, income, and consumption of participating households. The presentation also includes a comparison of the results of the fourth wave with the results of the first three waves of the Survey.

A. Households' assets

According to the Survey, in 2021, 96% of Cypriot households held some form of real asset, while 77% held some form of financial asset. The corresponding figures for the euro area were at 92% and 99%, respectively.

Real assets include the value of the primary residence of the household (for owners), the value of other properties, the value of vehicles and any other valuables, as well as the value of business ownership.⁵ The median⁶ values of the main categories of real assets for households in Cyprus are presented in **Chart 1**.

As shown in Chart 1, the median value of total real assets increased by 6% in the fourth wave compared to the third, mainly due to a 44% increase in business assets owned by households. However, the median value of the total real assets remained lower than the respective median value prior to the financial crisis of 2013.

The median value of household primary residence increased by

CHART 1 Median value of household real assets

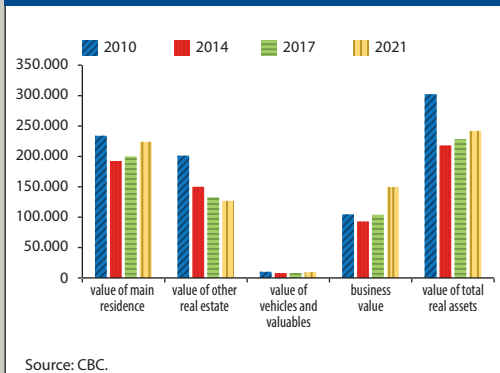
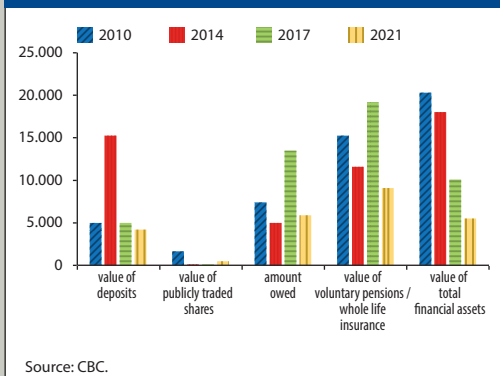


CHART 2 Median value of selected household financial assets



approximately 12% compared to the previous wave, while the value of other real assets remained at approximately the same levels. The increase in property values generally aligns with the CBC's House Price Index, which increased from 74.3 in 2017 to 80.0 in 2021.

The median values of the main categories of financial assets are presented in **Chart 2**. Financial assets include all financial instruments potentially held by households: deposits

5. In the text, the term "business" is defined as the active participation of the household in either a sole proprietorship (independent professional), a cooperative society, or a limited liability company.
 6. The median is defined as the value that separates the upper 50% of a data sample from the lower 50% and is calculated using households that possess the specific asset under consideration. The median is preferred over the mean as it is not susceptible to outliers.

in current and savings accounts, mutual funds, bonds, stocks, amounts owed to households, voluntary pension schemes, life insurance policies, etc. **Chart 2** (p. 37) shows a significant decrease in financial assets in the fourth wave, despite the increase in total assets. The decrease is evident in all categories of financial assets, except for stocks.

Although 75% of households hold deposits in banks and represent the largest share (73% of the total value) of financial assets, deposits do not appear to be reported at their true value. In contrast, the reported real assets of the Survey seem to correspond to the macroeconomic data. The phenomenon of the “under-reporting of deposits” is observed in similar surveys internationally.

B. Households’ liabilities

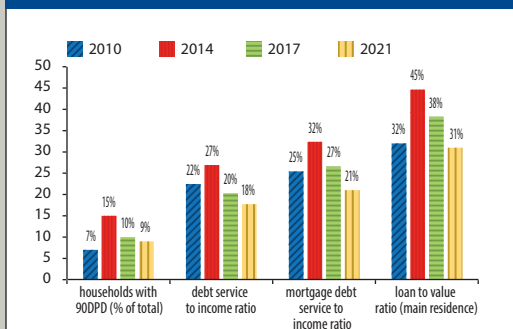
The results of the Survey indicate that, in 2021, 46% of households had some form of credit obligation. This share is lower than the one observed in the three previous waves, which stood at 65%, 59%, and 54%, respectively. This appears to be mainly due to the decision of a significant number of households to reduce their borrowing, as well as the increasing trend towards using debt-to-asset swaps, especially in the case of non-performing loans. Additionally, the Survey showed that many households in Cyprus tend to hold loans while maintaining their deposits as a safety net. In 2021, for example, about 42% of

households had sufficient deposits to cover three months’ worth of loan instalments, and about 37% had enough deposits to cover six months’ worth of instalments, providing a safety net in the case of financial difficulties.

Related to the above, the Survey indicates a significant reduction in loans which are more than 90 days past due (90DPD). In 2014, about one in six households held a 90DPD loan, while this number significantly decreased to one in eleven households in 2021. Furthermore, the number of households holding loans with late or missed payments as a percentage of households holding any loan decreased from 35% to 25%. The reduction in 90DPD loans also reflects the implementation of legal frameworks regarding the resolution of non-performing loans and guidelines on the procedures for granting new loans and reviewing existing credit facilities, as well as the monitoring and internal governance of banks to streamline the banking system and the economy as a whole. Finally, it is noted that the median value of real assets excluding the value of the main residence recorded for households with 90DPD loans exceeds the median value of the total debt of these households, indicating that there may be some financial flexibility for households to further reduce non-performing loans without significantly affecting their consumption.

For a more comprehensive assessment of household obligations arising from

CHART 3 Debt burden indicators



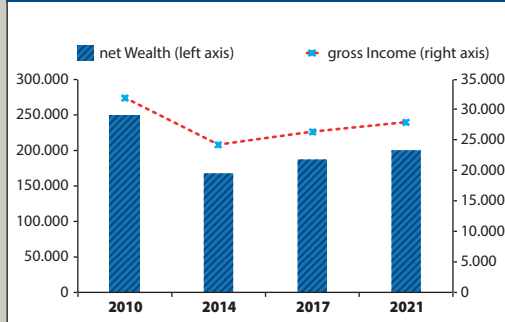
Source: CBC.

borrowing, **Chart 3** presents a comparison of household debt indicators. The debt service to income ratio provides information on the impact of debt payments on disposable income and thus reflects the burden of short-term commitments.⁷ According to the ratio, there was an improvement in household ability to service their credit obligations during the fourth wave compared to the third. The financial burden of households can also be measured by comparing the levels of outstanding debt to gross wealth (debt-to-asset ratio). As expected, the debt burden ratio increased from the first to the second wave, but exhibited a gradual decrease in the last two waves. This appears to align with the reduction observed in non-performing loans, as observed in the macroeconomic data.

C. Net wealth and gross income

Chart 4 shows the data for household net wealth (left axis) and gross annual income

CHART 4 Household net wealth and gross income



Source: CBC.

(right axis) for the four waves of the Survey. The median net wealth increased by 7% between the last two waves of the Survey, reaching €200,400 in 2021, marking a significant recovery from the low levels observed in 2014. This increase is mainly attributed to the decrease in debt obligations and the increase in real assets. However, the value remains lower than the median value of net wealth of Cypriot households before the 2013 crisis. Additionally, the percentage of households with negative net wealth, meaning the percentage of households whose liabilities exceeded their assets, decreased to 3.4% in 2021 from 5.1% in 2014.

Household gross annual income increased by 6% since 2017, reaching €27,990, reflecting both the increase in income from employment and self-employment, as well as income from real estate assets. However, the median value of gross household income remained lower than the median value of 2010 (see **Chart 4**).

7. The debt-to-income ratio is calculated for households that have any form of credit obligations, while the mortgage debt-to-income ratio is calculated for households with mortgage debt. Thus, the second ratio is usually higher than the first.

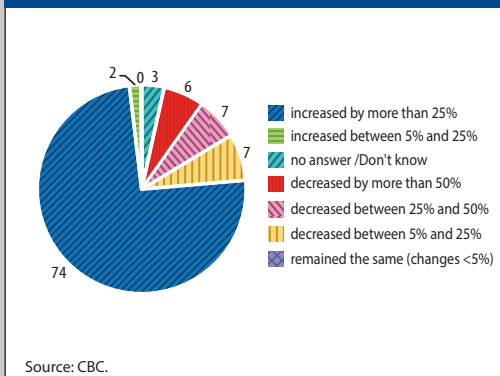
With regards to inequality, the Gini⁸ coefficient, shows that in 2021, net wealth inequality decreased to 0.63 from 0.70 in 2017. The coefficient was 0.68 in 2014 and 0.70 in 2010. Regarding income, the Gini coefficient was 0.41 in 2021, slightly down from 0.42 in 2017. In comparison, the Gini coefficient in the euro area remained unchanged.

D. Impact of Covid-19

Due to the Covid-19 pandemic, restrictions and/or bans were imposed on public events, strict lockdown measures were implemented, and limitations were imposed on numerous economic activities during the spring of 2020, which had significant adverse effects on the economy.

The impact of the pandemic on labour markets and household income varied across countries in the euro area. In Cyprus, when comparing their income in 2020 to that of 2019, the majority of households (74.5%) reported that their income generally remained the same and was not affected by the pandemic (see **Chart 5**). This was partly due to state support programs, such as partial wage subsidies aimed at safeguarding household income to some extent for those whose jobs were more affected by mobility restrictions or pandemic-related measures. Approximately 20% of households reported a decrease in income, with most households in this group stating that the reduction was between 5%

CHART 5 Covid-19 Impact: Change in Income (2020 vs 2019): Percentage of households



and 25%. Additionally, 1.9% of households reported higher income in 2020 compared to a year earlier.

About 72% of respondents who reported a decrease in income stated that they reduced their expenses on food, clothing, travel, and other consumer goods and services to cope with the decrease (see **Chart 6**).⁹ Other ways of compensating for the income reduction included using savings and selling financial assets (41%), as well as postponing loan and rent payments (24%). Some households (17%) delayed purchasing houses, cars, or other durable goods, while a lower percentage (9%) were able to renegotiate the terms of their loan or mortgage.

Concluding remarks

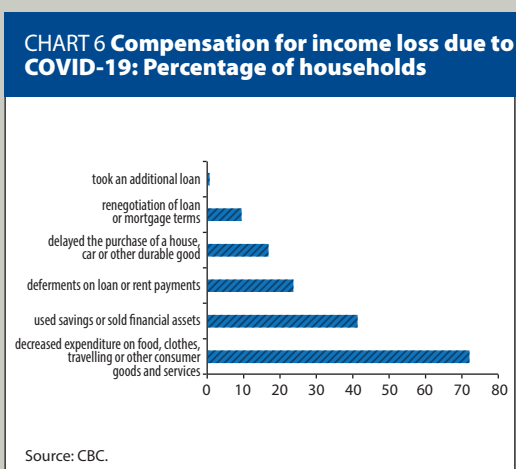
This presentation of some of the key findings from the Household Finance and Consumption Survey, which took place in 2021, focused on assets, credit

8. A Gini coefficient of 0 reflects perfect equality, where all income or wealth values are identical, while a Gini coefficient of 1 reflects maximum inequality among values. Negative values of net wealth are replaced by zero in the calculation of the Gini coefficient.
 9. It is important to note that respondents had the option to choose more than one measure to compensate for the loss of their income, as most respondents adopted a combination of measures.

obligations, and related issues such as debt servicing ability.

Overall, the data reflect the continuation of the recovery in the real economy following the financial crisis in 2013 and Cyprus's exit from the Memorandum of Understanding with international creditors in 2016. Since then, both household net wealth and income have shown steady growth. Summarizing the results, in 2021, changes on both sides of households' balance sheets resulted in an improvement in net wealth and a decrease in inequality. On the asset side, total assets increased due to the rise in the value of households' real assets, despite the significant decrease in financial assets compared to the previous Survey wave. The majority of households in Cyprus reported that their income generally remained the same and was not affected by the pandemic.

On the liability side, there was a decrease in both the number of households with debt and those with loans in arrears (90DPD), reflecting household deleveraging efforts and the ongoing efforts by banks to strengthen their balance sheets. As mentioned earlier, while in 2014 about one in six households held a 90DPD loan, this number decreased to one in eleven households in 2021. However, despite the progress made, the need to continue the efforts to reduce



non-performing loans and stabilize the balance sheets of both banks and of private sector persists.

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 European Central Bank, The Household Finance and Consumption Survey, Statistical Tables, Wave 2, March 2020
 European Central Bank, The Household Finance and Consumption Survey, Statistical Tables, Wave 3, July 2023
 European Central Bank, The Household Finance and Consumption Survey, Statistical Tables, Wave 4, July 2023
 Central Bank of Cyprus, Box: First results from the third wave of the Eurosystem Household Finance and Consumption Survey in Cyprus (2017), Economic Bulletin, June 2021

5. Financing conditions and credit developments^{4,5}

The domestic financial sector has been on a positive path in recent years, despite the uncertainty created by the successive challenges. The continuous progress of the sector has played a decisive role in the recent upgrades of the Cypriot economy to investment grade by all credit rating agencies.

In general, domestic private sector deposits remained robust, recording an annual increase of 3,6% in September 2023 compared with 2,7% in September 2022. Deposits growth was stronger in the first half of 2023, with a slight moderation in the third quarter of the year, yet continues to remain resilient.

Regarding the sectoral breakdown, household deposits recorded an upward trend especially in the first six months of the year, bolstered by the strong economic activity of the Cyprus economy and the improvement in employment, but weakened slightly thereafter in the third quarter of 2023. The moderation observed in deposit growth possibly reflects households' consumption smoothing to finance summer holidays, in combination with high prices which erode household's disposable income. Specifically, the domestic households' deposits annual growth stood at 3,6% in September 2023 compared with 5,3% in June 2023 and 3,8% in September 2022. Domestic non-financial corporations' deposits annual growth increased significantly by 6,0 % in September

4. For a detailed explanation of the methodology and technical analysis of monetary aggregates (deposits and credit growth), see Technical Notes on p. 60.
5. The analysis on deposits and credit growth in this section of the Economic Bulletin focuses on domestic residents excluding SPEs. SPEs are included in the non-residents category unless otherwise stated.

2023, compared with 4,6% in in September 2022. The resilience of business deposits reflects the good performance of important sectors of the Cyprus economy, the recovery in turnover and tourism receipts (**Chart A.16**).

On the other hand, non-resident deposits⁶ continued their downward trend. Specifically, their annual negative growth stood at -5,6% in September 2023, compared with -6,3% in September 2022 (**Chart A.17**).

Regarding credit developments there is a slight increase in new lending to the non-financial private sector⁷ during the first nine months of 2023, amidst higher interest rates, reduced loan demand and tighter credit standards. However, developments in individual categories show mixed trends (**Chart 18**). The increase is mainly attributed to new lending to non-financial corporations, which reached €1,5 billion in the first nine months of 2023, compared with €1,3 billion in the same period of 2022, partly due to lending to a small number of clients for large projects. Additionally, the increase may also reflect businesses' need for additional financing to address economic challenges. The Bank Lending Survey⁸ records increased demand for financing working capital and inventories, while indicating reduced demand for financing fixed investments. In an environment of economic uncertainty, businesses seem to prefer maintaining high levels of working capital and inventories to address increased operational and unforeseen costs. At the same time, reluctance towards long-term investments seems to reflect concerns

6. Including SPEs
 7. New loan contracts (euro-denominated) to euro area non-financial corporations and households.
 8. Detailed analysis of the survey results for Cyprus is available on the CBC website (Central Bank of Cyprus - Bank Lending Survey).

CHART 16 Deposits of the domestic private sector
(annual change, %)

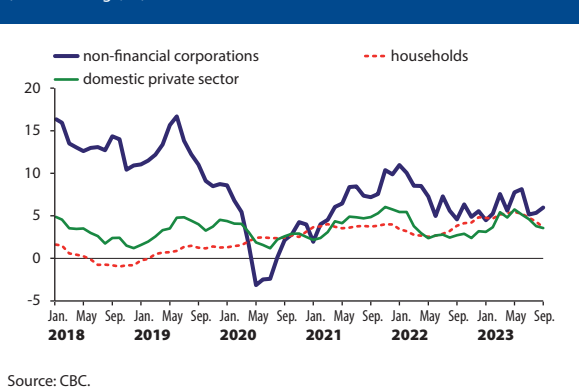


CHART 17 Deposits of non-residents: Cyprus
(annual change, %)

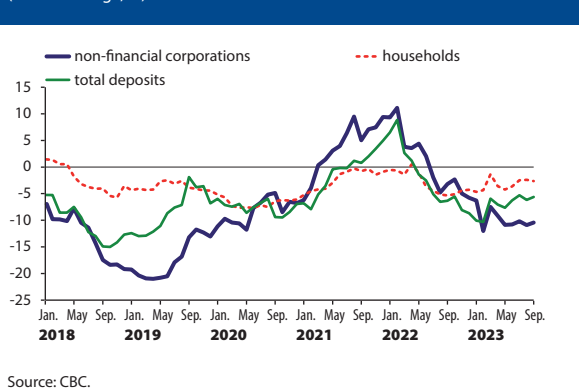
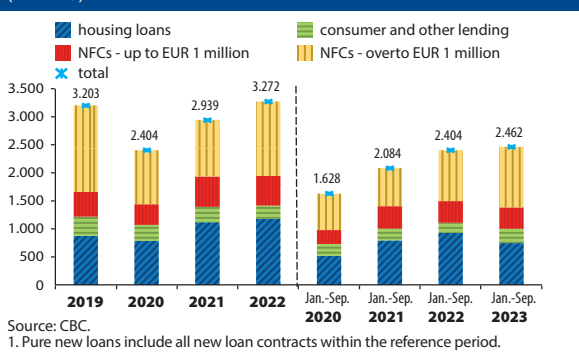


CHART 18 Volumes of pure new loans (euro-denominated) to euro area non-financial corporations and households⁽¹⁾
(million €)



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about the economic outlook. New housing loans to households, on the other hand, recorded a significant decrease, reflecting the decline in demand for housing loans, partly due to higher borrowing costs, the high cost of construction materials, and the tightening of bank lending policies. Specifically, new housing loans in the first nine months of 2023 decreased to €0,7 billion from €0,9 billion in the corresponding period of 2022. Conversely, consumer credit and other lending to households increased, possibly reflecting the need to maintain purchasing power in an environment of inflationary pressures.

Despite the increase in new lending, the annual growth rate of net loans⁹ to the domestic private sector¹⁰ has decelerated sharply since mid-2022 and turned negative since April 2023, indicating that loan repayments exceeded new lending. The negative growth rates are mainly attributed to the non-financial corporations sector, which has been recording negative growth rates since December 2022, reaching -2,2% in September 2023 (Chart 19). Some well-liquid non-financial corporations may have chosen to repay their loan obligations due to the rise in interest rates. Regarding housing loans, there has been a continuous deceleration in the annual growth rate, in line with the decrease in new lending in this category. In contrast, the annual growth rate of consumer credit has accelerated since mid-2023, consistent with the increase in the corresponding new lending, possibly due to consumption smoothing. As for other lending, the growth rate remained negative (Table 9), indicating that repayments exceed new lending.

9. New lending plus capitalisation of interest minus repayments.

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

CHART 19 Loans to the domestic private sector
(annual change, %)

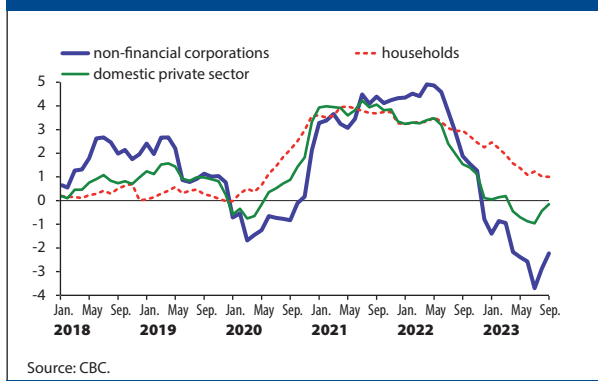


TABLE 9 Loans to domestic households⁽¹⁾⁽²⁾

	Outstanding balance as % of total ⁽³⁾	Annual percentage change					
		2022 June	2022 Sep.	2022 Dec.	2023 Mar.	2023 June	2023 Sep.
Domestic households	100,0	3,3	3,0	2,3	1,9	1,1	1,0
1. Consumer credit	11,4	0,5	-0,4	-2,1	0,2	0,2	2,9
2. Lending for house purchase	77,7	5,7	5,6	5,0	4,0	2,9	2,2
3. Other lending	10,9	-5,3	-7,1	-8,0	-7,9	-8,5	-8,0

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.

According to the Bank Lending Survey¹¹ results, banks continue to be particularly cautious with their lending policies, possibly to avoid new inflows of non-performing facilities (NPFs). In 2023Q4, banks expect a further tightening of credit standards and a further decrease in loan demand (Table 10).

Additionally, in their ongoing efforts to safeguard the quality of their loan portfolios, banks seem to be also focusing on sustainable loan renegotiations¹². With higher lending rates and prices limiting the disposable income of households and businesses, banks assess requests for restructurings or renegotiations for sustainable solutions, in the context of prudent management of their loan portfolios. So far, the quality of their loan portfolios does not appear to have been particularly affected given the decrease in the volume of NPFs¹³ and in the loans classified at Stage 2¹⁴ according to the International Financial Reporting Standard 9 (IFRS 9), the anteroom of NPFs, within 2023.

The significant improvement in the quality of banks' loan portfolios in recent years has primarily resulted from the transfer/sale of systemic banks' NPFs to credit-acquiring companies (CACs). Further progress will depend on the ability of smaller banks to reduce NPFs on their balance sheets. However, it is noted that NPFs transferred to CACs continue to burden the real economy, as they remain part of private debt.

11. Detailed analysis of the survey results for Cyprus is available on the CBC website (Central Bank of Cyprus - Bank Lending Survey).
12. See the October 2023 edition of the Monetary and Financial Statistics of the Statistics Department of the CBC, which is available on the CBC's website (Table 11 and Table 12).
13. See summary tables with aggregate non-performing loans data of the Supervision Division with reference date 31 August 2023 (latest available data), on the CBC's website.
14. Stage 2 includes assets that have had a significant increase in credit risk since initial recognition.

TABLE 10 Banking Lending Survey (BLS)

Summary of BLS results - October 2023	Cyprus	
	2023Q3	2023Q4 (expectations)
Credit standards for loans		
Enterprises	Unchanged	Tightening
Households		
- Housing loans	Tightening	Tightening
- Consumer credit and other lending	Tightening	Tightening
Demand for loans		
Enterprises	Decrease	Decrease
Households		
- Housing loans	Decrease	Decrease
- Consumer credit and other lending	Decrease	Decrease

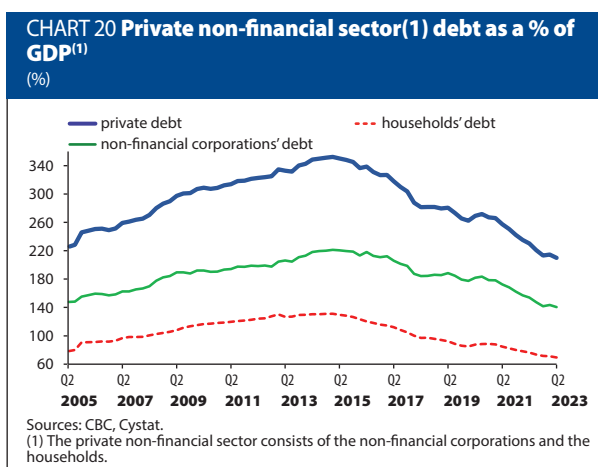
Source: CBC.

Despite the declining trend, private debt remains high compared to other countries in the euro area, partly due to the inclusion of debt belonging to CACs and the debt of SPEs¹⁵. Specifically, the debt of the domestic non-financial private sector¹⁶ has decreased significantly from its peak of 352% of GDP in 2015Q1 to 210% in 2023Q2, mainly due to the increase in nominal GDP and loan write-offs (Chart 20). Excluding SPEs, private debt falls to 157% of GDP. The ratio is expected to continue decreasing, based on the projected GDP trajectory, tighter credit standards, and moderate credit flows, while a significant reduction is anticipated with the resolution of the debt held by CACs.

The fast pace of ECB's policy rate hikes in the context of its monetary policy tightening, has changed significantly the interest rate environment in Cyprus over a short period of time. Domestic lending rates have increased markedly since the second half of 2022, with the upward trend becoming more pronounced in the first nine months of 2023.

Interest rates on new loans to Non-financial corporations (NFCs) increased at a faster pace compared to the respective rates on new loans to households for house purchase. Specifically lending rates for Non-financial corporations responded swiftly to the change in monetary policy, as they recorded a higher interest rate pass-through. Indicatively, the average interest rate on new loans to NFCs¹⁷ of up to €1 million and over €1

15. Special Purpose Entities (SPEs) are enterprises which, although registered / incorporated in Cyprus, have little or no relation to the domestic real economy.
16. The domestic non-financial private sector consists of domestic non-financial corporations (including Special Purpose Entities (SPEs)) and domestic households.
17. New business with initial interest rate fixation up to one year.



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million reached 5,72% and 5,59% respectively in September 2023, compared with 4,13% and 3,69% in September 2022 (**Chart A.21**).

The pass-through of policy rates to interest rates on new housing loans was relatively weaker and with a time lag. The slower response observed in housing loans is largely due to the fact that a significant proportion of these loans are not linked to the Euribor but to the banks' base rate¹⁸, which has recorded small increases so far. As a result, the increase in housing lending rates has been more cautious and contained, with the domestic interest rates remaining at lower levels in relation to the corresponding euro area housing lending rates, especially during the most recent months of May-September 2023. Indicatively, the average interest rate on new loans to households for house purchase¹⁹ increased to 4,42% in September 2023 from 3,06% in September 2022, i.e. 30 basis points lower than the corresponding average euro area lending rate (**Chart 22**).

Domestic deposit rates recorded small increases in the first months of 2023, followed by relatively larger increases, but remained below the respective euro area rates. The limited adjustment in deposit rates is related to the domestic banks' excess liquidity and their subsequent reduced financing needs. Briefly, the average interest rate²⁰ on new household and non-financial corporations deposits increased to 1,59% and 1,67% respectively in September 2023, compared with 0,11% and -0,09% in September 2022 (**Chart 23**, p. 47 and 24, p. 48).

- 18. The bank's base interest rates are partly based on the aggregate Cyprus Household deposit rates, as published by the CBC.
- 19. Euro-denominated loans from Cyprus MFIs with an initial rate fixation of up to one year.
- 20. Average interest rate with an agreed maturity of up to one year.

CHART 21 MFI interest rates on euro-denominated loans (new business) up to €1 million to euro area non-financial corporations⁽¹⁾
(% per annum, period averages)

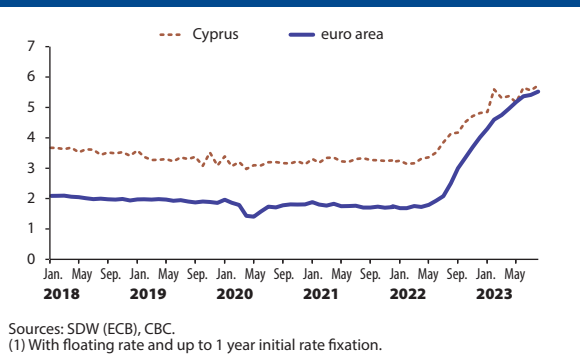


CHART 22 MFI interest rates on euro-denominated housing loans (new business) to euro area households⁽¹⁾
(% per annum, period averages)

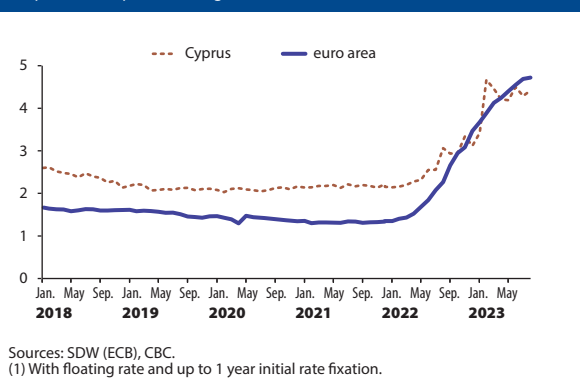
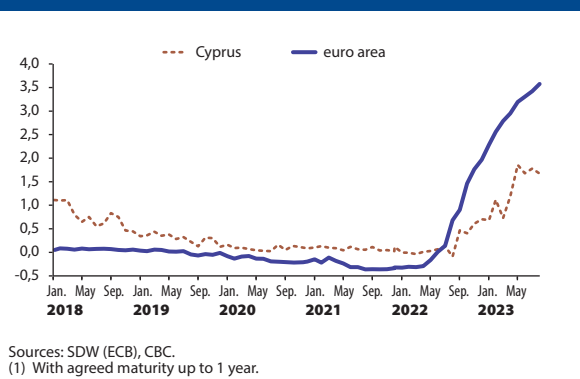


CHART 23 MFI interest rates on euro-denominated deposits (new business) by euro area households⁽¹⁾
(% per annum, period averages)

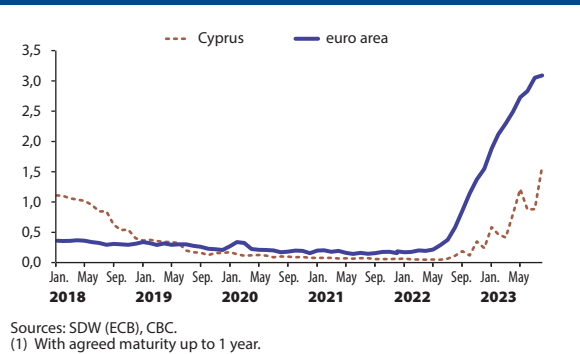


It should be noted, however, that, as of May 2023, banks have been offering relatively higher interest rates on time deposits, resulting in a shift of savings from current account deposits to fixed-term deposit accounts with higher remuneration and to banks that have raised deposit rates at a faster pace.

Concluding, despite the significant progress achieved so far, the ongoing challenges emerging in the domestic and international environment leave no room for complacency for the financial sector. This requires the continued vigilance and commitment of banks and authorities, to further safeguard the banking system from unpredictable future shocks.

CHART 24 MFI interest rates on euro-denominated deposits (new business) by euro area non-financial corporations⁽¹⁾

(% per annum, period averages)



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6. Fiscal Developments

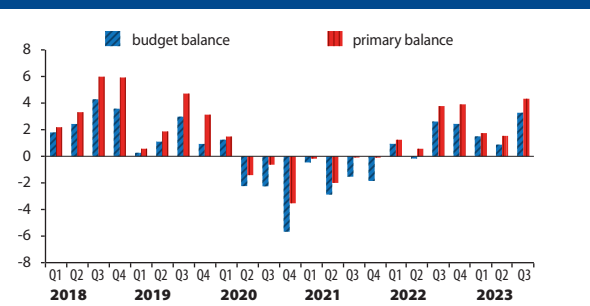
According to Cystat data, the government budget balance recorded a surplus of 3,3% of GDP in the first nine months of 2023, compared with a surplus of 2,6% of GDP in the respective period of 2022. For the same period, primary surplus reached 4,3% of GDP compared with 3,8% of GDP in the respective period of 2022 (Chart 25).

The increase in the budget surplus compared with the respective period of 2022 is due to the substantial growth in the main revenue categories, namely revenue from social contributions (154,45%), taxes on production and imports (11,3%) and current taxes (14,5%). The revenue growth was partly offset by the increase in some expenditure categories, more importantly, compensation of employees (12%) and social transfers (8,8%) (Table 11).

On the expenditure side, the most significant development of 2023 relates to the percentage growth in compensation of employees, which is expected to be the largest one since 2003 and stand to reach to around 12% according to data for the first nine months. This significant increase is mainly due to the payment of COLA and the final stage of the reversal in the wage cuts in the public sector (that were implemented in December 2012), and to a lesser extent to agreements for salary upgrades in specific government sectors (e.g. police force). It is noted that compensation of employees as a percent of GDP is expected to stand at around 12% for 2023, which is higher than the level of 2019 when it stood at 11,8% (i.e. the year before the

CHART 25 Budget and primary balances of the general government

(cumulative for the year as from Q1 as a percentage of GDP)



Sources : Cystat, CBC.

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

TABLE 11 Accounts of general government

	Jan.-Sep. 2022 (€ million)	Jan.-Sep. 2023 (€ million)	Change %
EXPENDITURE			
Intermediate consumption	836,8	810,6	-3,1
Compensation of employees	2.199,0	2.462,1	12,0
Social transfers	3.008,9	3.272,8	8,8
Interest	322,6	312,5	-3,1
Subsidies	60,8	123,6	103,3
Other current expenditure	404,1	490,3	21,3
Gross fixed capital formation	444,4	556,8	25,3
Other capital expenditure	147,0	100,0	-32,0
Total expenditure	7.423,6	8.128,7	9,5
Total expenditure as a % of GDP	26,7	27,4	
REVENUE			
Taxes on production and imports	2.976,0	3.312,9	11,3
Current taxes on income, wealth, etc	2.005,3	2.295,9	14,5
Social contributions	2.235,7	2.580,5	15,4
Other current revenue	150,4	204,8	36,2
Sales	533,9	548,4	2,7
Capital transfers received	151,3	83,1	-45,1
Property income	97,7	75,6	-22,6
Total revenue	8.150,3	9.101,2	11,7
Total revenue as a % of GDP	29,3	30,7	
Primary balance	1.049,3	1.285,0	
Primary Balance as a % of GDP	3,8	4,3	
Budget Surplus (+) / Deficit (-)	726,7	972,5	
Surplus (+) / Deficit (-) % of GDP	2,6	3,3	

Sources: Cystat, CBC.

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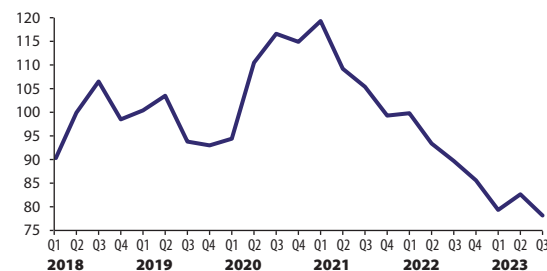
COVID crisis and the high inflation period that followed), but remains at lower levels than those of the 2009-2013 period, which ranged between 14,2%-14,6%.

The public debt-to-GDP ratio stood at 78,2% in September 2023, recording a decrease of more than 9 percentage points compared to September 2022. This was due to the relative strong primary surplus and the continued economic growth. The impact from the increase in Cyprus government bond yields and the increased interest payments in the coming years is expected to be manageable, due to the reduction in public debt, the issuance of longer-term bonds during the period of low-interest rates, and the current high level of cash reserves that allows greater flexibility in debt management.

Public debt-to-GDP ratio is expected to decline significantly in the coming years, reflecting the estimates for primary surpluses and continued economic growth. It is noted that rating agencies expect a significant reduction in government debt; thus, any derailment will have a serious impact on the credibility of fiscal policy.

CHART 26 General government consolidated gross debt

(as a percentage of GDP)



Sources: Cystat, CBC.

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(C) Macroeconomic Forecasts for the Cyprus Economy²¹

21. Forecasts and assumptions take into account economic developments and available data with a cut-off date of 30th November 2023.

- *The GDP path over 2023-26 is mainly supported by the projected continuation of the recovery in domestic demand, albeit to a lesser extent compared with 2022.*
- *A small impact is expected from geopolitical tensions on the labour market, with the unemployment rate continuing to gradually decline to 5,3% in 2026.*
- *Compared with the baseline scenario, downside risks to GDP and balanced risks to inflation over 2024-26.*
- *In 2023 the domestic HICP is projected to drop significantly to 4,0% from 8,1% in 2022, while further fall of inflation is expected for the years 2024, 2025 and 2026 to 2,4%, 2,0% and 1,9%, respectively.*
- *Core inflation is also expected to decelerate to 3,9% in 2023 from 5% in 2022, while further deceleration is forecasted for 2024, 2025 and 2026 to 2,6%, 2,4% and 2,2%, respectively.*

The macroeconomic forecasts presented in this Economic Bulletin were prepared in the context of the Eurosystem exercises using common assumptions. The updated forecasts took into account potential economic effects stemming from the conflict in the Middle East. Specifically, a negative impact was incorporated through the expected direct effects mainly on the tourism and investment paths, as well as indirect effects on the private consumption path, due to economic uncertainty, and exports of non-tourism services, as a result of the geopolitical tensions.

Compared with the September 2023 projections, there is a slight downward revision in GDP growth in 2023 and in 2024 by

0.2 and 0.1 percentage points, respectively, while growth in 2025 has not been revised. This is due to the downward revision of net services exports (less favourable outlook for tourism and lower exports of professional and financial services owing to the fragile external environment), which outweighs the upward revision in domestic demand, especially for 2023 (better than expected performance in private consumption). Significant support to economic activity over the period 2024-26 comes from the absorption of EU Recovery and Resilience Fund (RRF) financing for investments.

When comparing the current inflation projections with the September 2023 projections, the downward revision in HICP inflation by 0,3 percentage points in 2024 is mainly due to the projected lower energy prices. Concerning core inflation, the upward revision by 0,2 and 0,1 percentage points compared with the September 2023 forecasts for 2023 and 2024, respectively, is mainly due to the latest available data but also to expectations of increased demand for services.

Economic Activity

GDP is expected to rise by 2,2% in 2023 (Table 12), compared with a significant increase by 5,1% in 2022. This expected slowdown is driven, in part, by the fragile external environment, the impact of the restrictive monetary policy on domestic demand, inflationary pressures affecting disposable income as well as the impact of the sanctions against Russia on the turnover of professional services firms.

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

	2022	2023f	2024f	2025f	2026f
GDP	5,1	2,2	2,6	3,1	3,2
Private consumption	8,5	5,0	1,9	1,8	1,7
Public consumption	2,7	3,2	2,7	2,5	2,5
Gross fixed capital formation	7,8	6,0	5,4	6,7	5,4
Exports of goods and services	13,6	-1,9	0,5	1,7	2,2
Imports of goods and services	18,3	-0,2	0,8	1,5	1,6

Sources: Cystat, CBC.

Over the period 2024-26, GDP growth is expected to reach 2,6%, 3,1% and 3,2%, respectively (**Table 12**, p. 53). This is mainly driven by the recovery of domestic demand and, to a lesser extent, net exports for the years 2025-26, in the context of the expansion of the turnover of foreign companies in the technology sector that have already established operations in Cyprus especially during the previous years. It is also based on the expected correction of tourism receipts, following the negative impact expected in 2024 owing to the Middle East conflict, in the context of a diversification of tourism markets.

Specifically, a significant contribution to growth in the coming years is expected mainly from large private sector investments that are underway, as well as from projects to support the digital and green transition and other reform projects in the context of the implementation of the Recovery and Resilience Plan. A contribution is also expected from residential investments due to the government's interest rate subsidisation scheme for new housing loans that were finalised by end-2021 and for which the disbursement period is 3 years. A negative impact from an expected decrease in demand and a delay in the implementation of private sector investment projects of Israeli interests, owing to the Middle East conflict, was adopted in the projections. Overall, investments are expected to increase by 6% in 2023, 5,4% in 2024, 6,7% in 2025 and 5,4% in 2026 (**Table 12**, p. 53). Private consumption, although projected to slow to around 1,8% per annum over 2024-26, down from 5% in 2023 (**Table 12**, p. 53), is expected to remain

an important growth driver in the coming years. This slowdown is mainly the result of the aforementioned base effect owing to the re-opening of the economy in 2022 following the 2021 lockdowns, the prevailing economic uncertainty attributed to the Middle East conflict and the projected gradual rise in the saving ratio for loan repayments.

Compensation, Productivity and the Labour Market

Regarding the labour market, the available data reflect the continued tightness observed, which however is showing signs of easing. At the same time, the impact from the geopolitical tensions is expected to be manageable, as demonstrated by the European Commission's monthly surveys of employment expectations over the next three months, which even picked-up following the outbreak of the Middle East conflict. For 2023, employment is projected to increase by 1,6% and, in line with the favourable GDP path, an increase by 0,9% in 2024 and by 1,2% per annum over 2025-26 is expected (Table 13).

Unemployment is foreseen to record a continued downward trajectory, reaching 6,4% of the labour force in 2023, down from 6,8% in 2022 (Table 13). In the coming years, and in line with the ongoing GDP expansion, unemployment is projected to converge closer to full employment conditions, reaching 5,3% in 2026 (Table 13). The small upward revision in the unemployment rate over 2023-24 by 0,1 percentage points per annum compared with the September

TABLE 13 Labour market projections
(annual change, %)

	2022	2023f	2024f	2025f	2026f
Compensation per employee	1,1	4,6	4,1	3,1	3,0
Unit labour costs	-0,9	3,9	2,4	1,1	1,0
Productivity	2,0	0,6	1,6	1,9	2,0
Total employment	3,0	1,6	0,9	1,2	1,2
Unemployment rate(% of labour force)	6,8	6,4	6,0	5,6	5,3

Sources: Cystat, CBC.

projections, reflects the small downward revision in GDP growth.

Nominal compensation per employee is forecasted to rise by 4,6% in 2023, with further increases by 4,1%, 3,1% and 3% over 2024-26, respectively (**Table 13**, p. 55). The wage outlook reflects the granting of higher COLA, also in line with the new transition agreement that is based on the previous year's prices, as well as the relatively larger increases expected in collective agreements in some parts of the private sector due to the price pressures, which however are not expected to lead to a damaging wage-price spiral. In 2024, growth in nominal compensation per employee also captures the rise in social security contribution rates towards the Social Insurance Fund (SIF) that will apply for the next five years. Overall, the ongoing correction in the labour market, which is approaching full employment conditions in 2026, is also associated with the incorporation of higher wage increases due to the transition agreement concerning COLA.

Productivity, following a rise of 2% in 2022, is forecasted to slow to 0,6% in 2023 owing to the job-rich economic recovery. Over the period 2024-26, it is expected to continue to recover by 1,6%, 1,9% and 2%, respectively (**Table 13**, p. 55). In general, the increase in productivity reflects the positive economic effects stemming from the influx of foreign companies in the technology sector as well as the implementation of investments associated with the absorption of financing from the EU's RRF.

Unit labour costs are projected to rise further over 2023-26 by around 8½ percentage points cumulatively (**Table 13**, p. 55), mainly due to



expected rises in nominal compensation per employee. The relative index in the euro area is projected to record a higher cumulative rise, also owing to the higher wage increases that are expected. Overall, the unit labour cost index in Cyprus maintains a comparative advantage in relation to the rest of the euro area due to past reductions in wages and, by extension, due to the improvement in competitiveness (see Labour Costs, p. 23).

Inflation

HICP inflation is forecasted to decelerate significantly to 4% in 2023 from 8,1% in 2022, as a result of the sizeable impact of the ECB's single monetary policy in the euro area in conjunction with the oil price path in 2023 compared with the high level recorded in 2022. The various domestic government mitigating measures related at a large extent to energy and food prices also contributed to the slow-down of domestic inflation during 2023. Further deceleration of overall inflation is expected in 2024, 2025 and 2026, to 2,4%, 2% and 1,9%, respectively, mainly owing to the anticipated path of energy and food prices as well as due to the magnitude of the ECB's single monetary policy which continues to exert a lagged dampening effect on demand also in the medium term horizon, causing indirect downward pressures on the main subcategories of inflation.

Concerning core inflation, this is also projected to drop to 3,9% in 2023 compared with 5% in 2022. In 2024, 2025 and 2026, it is forecasted to decline further to 2,6%, 2,4% and 2,2%, respectively, mainly driven by the

expected impact of the ECB's single monetary policy in the euro area which exerts a lagged effect on the demand for goods and services in the medium-term horizon. The anticipated normalisation of profit margins of firms is an additional factor that is expected to have a dampening impact on the path of domestic core inflation in the medium term.

The deviation risks of the HICP inflation forecasts from the baseline scenario for the years 2024-2026 are overall assessed as balanced. Upside risks are mainly emanated from possible higher than expected energy prices as well as from consequences linked with climate change (adoption of relevant government tax policies, extreme weather-related events). Upside risks are also associated with the materialisation of possible second-round effects, such as wage-price spiral and higher than foreseen profit margins for firms. On the other hand, there is a possibility that the HICP will be lower than the projection of the baseline scenario due to tighter than expected financing conditions through decrease in domestic demand as well as due to possible consequences which could arise from the worsening than foreseen impact of geopolitical tensions on domestic economic outlook.

Risk assessment of macroeconomic forecasts²²

The expected GDP path (Table 12, p. 53), as well as the HICP and the core inflation projections (Table 14) represent the baseline scenario. The probabilities of deviating from the baseline scenario for GDP and HICP are outlined in Charts 27 and 28 respectively.

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

TABLE 14 HICP projections
(annual change, %)

	2022	2023f	2024f	2025f	2026f
HICP	8,1	4,0	2,4	2,0	1,9
HICP excluding energy and food	5,0	3,9	2,6	2,4	2,2

Sources: Cystat, CBC.

CHART 27 Real GDP fan chart
(annual change, %)

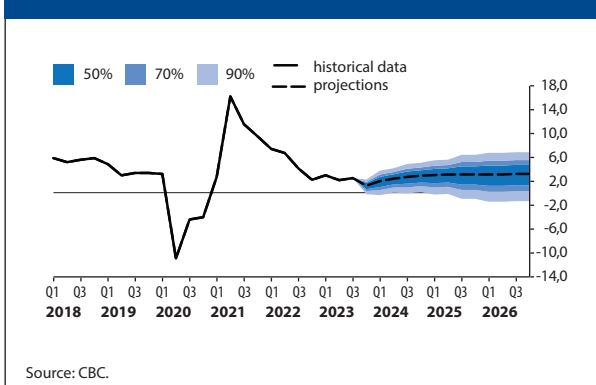
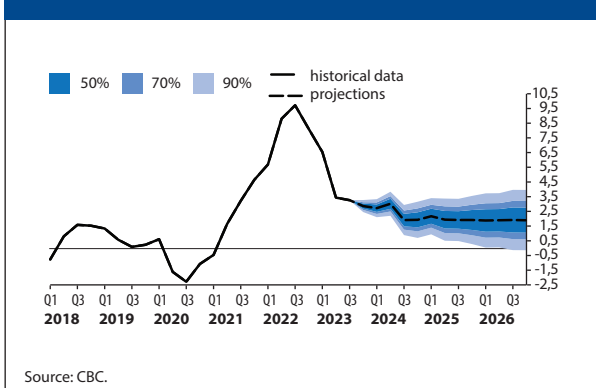


CHART 28 HICP fan chart
(annual change, %)



Possible deviations in the forecast of core inflation are presented in **Chart 29**. A summary of the risk assessment relating to possible deviations from the baseline scenario is presented in **Table 15**.

The risks of deviation of the GDP forecasts from the baseline scenario for the years 2024-26 are on the downside. These are mainly related to the negative impact from the Middle East conflict on the investment and tourism paths, as well as from the ongoing Russian-Ukrainian war, particularly in relation to the path of non-tourism services due to the sanctions. Also, they are linked to the formation of higher energy prices due to the Middle East conflict and decisions of oil-producing economies in relation to limiting supply. Downside risks include tighter than anticipated financing conditions, which may affect domestic demand and possible materialisation of second round effects, e.g. wage-price spiral and higher than expected corporate profit margins. Finally, they are associated with a lower than expected impact from absorption of financing available for investments from the RRF. Upside risks are associated with a higher than forecasted path in private consumption, stemming from a potentially lower household savings ratio than in the baseline scenario.

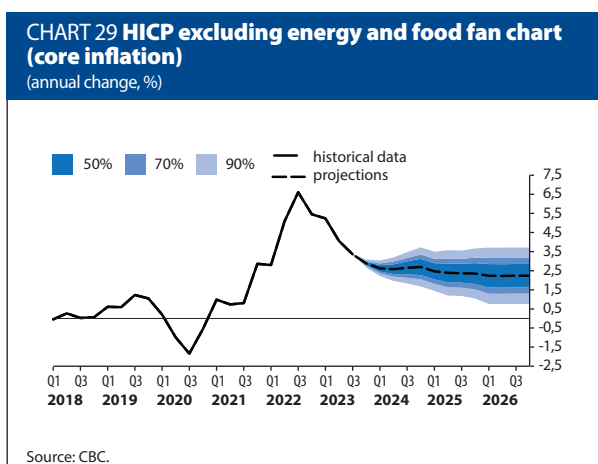


TABLE 15 Summary of risk assessment

Risk	GDP (2024-2026)	Inflation (2024-2026)
Lower than expected impact from absorption of funds from EU support package	-	=
Formation of higher than foreseen energy prices	-	+
Worse than foreseen impact on domestic economic outlook as a result of geopolitical tensions	-	-
Worse than foreseen developments in the tourism sector	-	=
Impacts linked with climate change (adoption of relevant tax policies, extreme weather-related events)	-	+
Materialisation of possible second-round effects, e.g. wage-price spiral, higher than foreseen profit margins, etc.	-	+
Higher than foreseen path in private consumption	+	+
Tighter than foreseen financing conditions	-	-
Overall assessment	-	=

Source: CBC.
Note: the following symbols cover the spectrum of risks: ++ (upside), + (slightly to the upside), = (balanced), - (slightly to the downside), -- (downside).

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Technical Notes



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

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.