THE CYPRUS ECONOMY
AFTER THE MEMORANDUM

2nd Wealth Management Forum
12 January 2017

Yiannis Tirkides,
Bank of Cyprus Economic Research
We will look at …

• The Recession

• The Recovery

• The Adjustment, and,

• The Outlook going forward
THE RECESSION ...

... Deep but less severe than initially anticipated

... in line with recessions in IE, PT and SP

Sources: Cyprus Statistical Service; Eurostat; Bank of Cyprus Economic Research
THE RECESSION …

… Employment loses in line with GDP

Sources: Cyprus Statistical Service; Eurostat; Bank of Cyprus Economic Research

Real GDP, Employment indices and the unemployment rate

Employment volumes 4Q moving averages: cumulative decline and shares 2011Q2-2015Q4

Sources: Cyprus Statistical Service; Eurostat; Bank of Cyprus Economic Research
THE RECESSION ...

... Driven by secondary sectors and some services sectors on the supply side

... and by domestic demand, mainly a collapse of fixed investment on the expenditure side

Sources: Cyprus Statistical Service; Bank of Cyprus Economic Research
THE RECESSION … LEGACY AND PRIORITIES

• The Legacy:
  • Low fixed investment
  • High unemployment particularly for the long term unemployed
  • High public debt
  • High non-performing loans in the banking sector

• The Priorities
  • To maintain the current growth momentum and raise potential output, through,
    • … further productivity gains,
    • … higher investment ratios,
    • … further gains in fiscal stabilisation
    • … and continuation with the reform process
THE RECOVERY ...

... Started in 2015 and accelerated in 2016...

... and was broadly based driven by tourism, professional, but also industry and construction.

Recovery 2014Q4-2016Q3: cumulative increase of Gross Value Added by sector

Sources: Cyprus Statistical Service; Bank of Cyprus Economic Research
THE RECOVERY …

…On the expenditure side growth was driven by both domestic demand and net exports

Recovery 2014Q4-2016Q7: Cumulative increases of real GDP by category of expenditure

Contribution to growth by category of investment in percent points

Fixed investment in 2015 and 2016 was driven by transport equipment

Sources: Cyprus Statistical Service; Bank of Cyprus Economic Research
In the labour market unemployment is dropping and employment started to rise

For the first time in 2016, the unemployment rate dropped without the Labour Force shrinking

Sources: Cyprus Statistical Service; Eurostat; Bank of Cyprus Economic Research
On labour productivity Cyprus remains a laggard, before the memorandum ...

... and after it!

Sources: Eurostat; Bank of Cyprus Economic Research
THE RECOVERY … CONCLUSIONS

• The recovery gained momentum in 2016
• … it is broadly based with all sectors contributing positively with only few exceptions
• The main drivers remain tourism and professional services
• …however, most services sectors remain resilient,
• … and industry and construction have shown string growth in 2016
• Tourism reached capacity constraints in the peak months and continued expansion will require changes in three areas: building capacity and related infrastructure; extending the tourist season; and upgrading the tourist product to attract higher spending
• In the labour market the unemployment rate continues to decline and employment is rising amidst a rising employment rate and increases in the labour force, which bodes well for private consumption
• Wage moderation in recent years has been important in restoring competitiveness but Cyprus remains a chronic laggard in the Eurozone regarding productivity growth
Residential property prices declined by a cumulative 30.2% from peak and started to stabilise from the second half of 2015...

they appear correlated with GDP growth with a lag, and might thus turn higher in the next few quarters.
As a result total Gross Debt may have peaked at the end of 2015 at 19 billion euro or at about 109% of GDP.

Sources: Cyprus Statistical Service; Bank of Cyprus Economic Research
Expenditures dropped by 17% and revenues only by 3.7% between 2011Q4 and 2016Q3 on a 4Q moving sums basis.

This follows significant adjustments in public finances especially on the expenditure side.

Sources: Cyprus Statistical Service; Bank of Cyprus Economic Research
Deposits increased in 2016 with loans deleveraging - the loans to deposits ratio dropped to 112.9% in September.

Total deposits are edging higher whilst loans continued to drop sharply down by 11.9% in September y-o-y.

Sources: Central Bank of Cyprus; Bank of Cyprus Economic Research
ECONOMIC ADJUSTMENT - NPEs

Non-performing exposures peaked in Feb. 2015 at 28.9 bn euro and dropped by 13.3% to 25.1 bn euro in Aug. 2016

Total NPE ratio to gross loans has been stable due to deleveraging - other NPE indicators have been improving

Loans and selected NPE related ratios

- Ratio of NPEs to gross loans: 48.2%
- Ratio of exposures past due 90 days to gross loans: 36.1%
- Ratio of total restructured facilities to gross loans: 27.0%
- Ratio of total restructured facilities NPEs, to total NPEs: 41.7%
- Ratio of total impairment to total NPEs: 38.5%
- Ratio of total impairment to exposures past due 90 days: 51.4%

Sources: Central Bank of Cyprus; Bank of Cyprus Economic Research
Economic growth will remain positive but will moderate in the medium term and unemployment will fall further.

In public finances, a near balanced budget and primary surpluses will reduce the ratio of public debt to GDP.

**Real GDP growth and Unemployment (European Commission)**

<table>
<thead>
<tr>
<th>Year</th>
<th>Real GDP (% change)</th>
<th>Unemployment rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>1.7</td>
<td></td>
</tr>
<tr>
<td>2016</td>
<td>12.5</td>
<td>2.8</td>
</tr>
<tr>
<td>2017</td>
<td>11.1</td>
<td>2.5</td>
</tr>
<tr>
<td>2018</td>
<td>10.0</td>
<td>2.3</td>
</tr>
</tbody>
</table>

**Public finances (European Commission)**

<table>
<thead>
<tr>
<th>Year</th>
<th>Public debt (% of GDP)</th>
<th>Budget balance (% of GDP)</th>
<th>Primary balance (% of GDP)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>107.5</td>
<td>-0.2</td>
<td>1.7</td>
</tr>
<tr>
<td>2016</td>
<td>107.1</td>
<td>-0.3</td>
<td>2.3</td>
</tr>
<tr>
<td>2017</td>
<td>103.7</td>
<td>-0.4</td>
<td>2.0</td>
</tr>
<tr>
<td>2018</td>
<td>100.6</td>
<td>0.0</td>
<td>2.5</td>
</tr>
</tbody>
</table>

Sources: European Commission, European Forecasts, Autumn 2016