

Cyprus Economy Developments December 2018 Treasury and Correspondent Banking Department

Major recent developments in Cyprus

Cyprus Macroeconomic Developments

- Cyprus' Real GDP growth rate (seasonally adjusted) is positive and is estimated at 3.7% in the third quarter of 2018. It recorded a positive rate of growth of 4.0% in the second quarter of 2018. Growth is expected to reach 4.2% in 2018 and 4.1% in 2019 (IMF's December projections).
- Unemployment decreased to 8.5% in October 2018 compared to 10.0% in October 2017. It is expected to average at around 8.5% in 2018 and 7.0% in 2019 (IMF's December projections).
- Inflation (HICP) increased by 1.6% in November 2018 compared to November 2017, while compared to October 2018 decreased by 1.5%. For the period January – November 2018, HICP recorded an increase of 0.8% compared to the correspondent period of the previous year. HICP is expected to be around 0.9% in 2018 and 1.8% in 2019 (IMF's December projections).
- Cyprus' current account recorded an improvement with the deficit declining to €391.2 million (1.9% of GDP) in the first half of 2018 from a deficit of €707.8 million (3.6% of GDP) in the first half of 2017. This development was mainly attributed to the trade balance, which recorded a surplus of €85.1 million (0.4% of GDP) in the first half of 2018 compared to a deficit of €316.0 million (1.6% of GDP) in the first half of 2017. Primary and secondary income accounts contributed to the current account deficit by 2.3% of GDP in the first half of 2018 compared to 2.0% of GDP in the first half of 2017.
- Arrivals of tourists totalled 3,832,062.0 recording an increase of 7.8% for the period January – November 2018, compared to the corresponding period of 2017.
- For January – September 2018, revenue from tourism is estimated at €2,268.5 million compared to €2,216.7 million in the corresponding period of 2017, recording an increase of 2.3%.
- In January – November 2018, property sales increased by 17.3% to 8,442 property sales compared to the corresponding period of 2017 (7,197 property sales). The highest number of property sales is recorded in Limassol with 3,121 property sales. The highest percentage increase of property sales is recorded in Famagusta by 28.9%.
- Eurostat's Residential Property Price Index for Cyprus recorded an increase of 1.6% in the 2nd quarter of 2018 (83.74 units) compared to the 2nd quarter of 2017 (82.40 units).
- The Turnover Volume Index of Retail Trade for January – October 2018 is estimated to have recorded an increase of 5.8% compared to the period January – October 2017.
- In January – November 2018, the total registrations of motor vehicles increased by 13.6% to 45,940, from 40,427 in the corresponding period of 2017. Registration of new cars remained unchanged with 16,535 registered new cars, whilst the registration of used cars increased by 23.1% reaching 29,405 registered used cars.

Cyprus Fiscal Developments

Developments in public finances continue to exceed expectations.

- **General government budget balance (GGBB)**, also known as Fiscal Balance, indicates a surplus of €779.6.8 million (c. 3.8% of GDP) from January – November 2018 compared to a surplus of €477.1 million (2.4% of GDP) in January – November 2017.

- **General government primary balance (GGPB)**, also known as Primary Balance, during January – November 2018, GGPB indicates a surplus of €1,211.0 million (c. 5.9% of GDP) compared to a surplus of €934.4 million (4.8% of GDP) for January – November 2017.

Cyprus Public Debt and Financing:

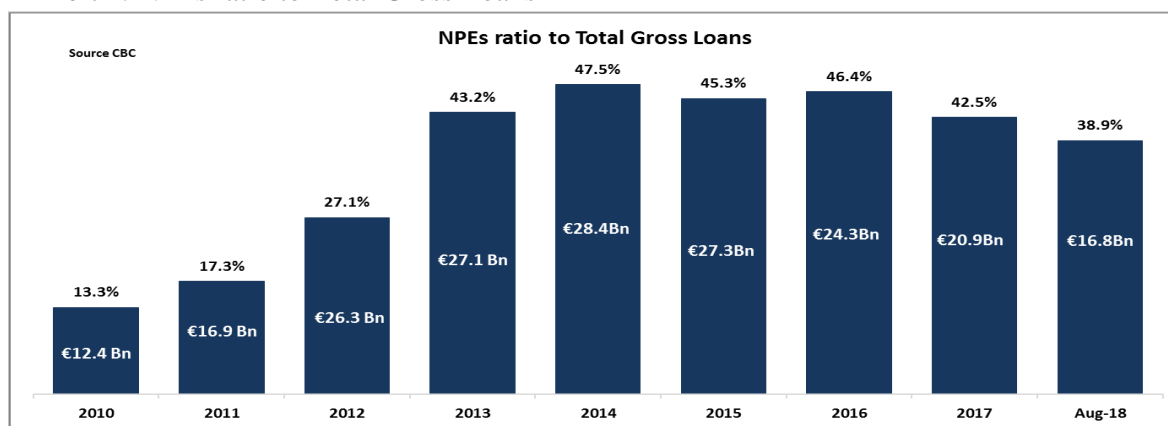
The General Government Debt reached €22.4 billion in September 2018 recording an increase over the end of the 2017 debt stock of €18.7 billion due to the bond issuance as part of the Cyprus Cooperative Bank-Hellenic Bank transaction.

- Cyprus is rated ‘‘BBB-’’ by S&P with a stable outlook, ‘‘Ba2’’ by Moody’s with a stable outlook, ‘‘BBB-’’ by Fitch with a stable outlook and ‘‘BBB’’ by DBRS with a stable outlook.
- Latest Treasury Bills auction of 13-week duration that took place on the 26th of November 2018 with settlement date the 30th of November 2018 had an average yield of -0.21% and a bid to cover ratio of 1:0.7.

Banking Sector

- Deposits in the banking system amounted to €47.8 billion in October 2018 compared to €47.4 billion in September 2018 and €49.4 billion as at the end of 2017. The decrease is mainly attributed to the concerns surrounding the Cooperative Central Bank in the first half of the year.
- The outstanding amount of loans in October 2018 decreased to €39.9 billion from €51.4 billion in December 2017. This is mainly attributed to write offs in the context of debt restructurings, Cooperative Central Bank’s NPEs carve out and the NPEs sales.
- Restructurings were €9.3 billion at 31/08/2018 (€11.9 billion on 31/12/2017 and €13.5 billion on 31/12/2016).
- The outstanding amount of Cyprus banks on ECB’s Open Market Operations, amount to €0.83 billion in November 2018, down from its peak of €13.6 billion in September 2012.
- The Non-Performing Exposures (NPEs) (Exhibit 1) amounted to €16.8 billion as at August 2018 compared to €20.9 billion in December 2017 and €24.3 billion in December 2016 relating mainly to sale of NPEs to entities outside the domestic banking sector. The impact from the Cooperative Central Bank’s NPEs carve-out is expected to be recorded in the September figures.

Exhibit 1: NPEs ratio to Total Gross Loans



- Total New Lending for the period January – October 2018 decreased by 2.0% compared to the period of January – October 2017, to €2,396.0 from €2,449.0 million. Housing loans increased by 25.0%, consumption loans decreased by 1.0%, whilst Corporation loans decreased by 11.0%.

Table 1: New Loans (excluding renegotiation)

New Loans (excluding Renegotiation) Amounts in € millions	2009	2010	2011	2012	2013	2014	2015	2016	2017	Jan - Oct 2017	Jan - Oct 2018	%Δ Jan - Oct 2018/17
	Consumption Loans	1,273	764	693	547	267	89	78	112	169	138	137
Housing Loans	2,098	3,017	1,907	1,518	1,399	480	268	543	723	559	697	25%
Corporations Loans	4,953	4,398	3,734	3,253	3,122	1,414	1,158	1,479	2,143	1,752	1,562	-11%
Total	8,324	8,179	6,334	5,318	4,788	1,983	1,504	2,134	3,035	2,449	2,396	-2%

Cyprus upgraded to investment grade by DBRS Ratings Limited

On November 23, 2018, DBRS upgraded Cyprus' long-term foreign and local currency-issuer ratings from BB to BBB (low). DBRS also changed the trend from Positive to Stable. According to the agency, the upgrade is driven by the material reduction in Cypriot banks' non-performing loans (NPLs) in recent months, reflecting the government and the banks' stepped up efforts. The rating upgrade is also driven by the continued solid performance of the Cypriot economy. Cyprus is on track to post real GDP growth of close to 4.0% in 2018, among the strongest in the euro area. Growth is driven by investment, consumption and exports of services. The ratings are supported by Cyprus' solid budget position, its enhanced public debt management framework, its Eurozone membership fostering sustainable macroeconomic policies, and its openness to investment encouraging a favourable business environment. Nevertheless, Cyprus also faces significant credit challenges related to still sizable NPLs in the banking sector, still high levels of private and public sector debt, external imbalances, and the small size of its service-driven economy, which exposes Cyprus to adverse changes in external demand. The Stable trend reflects DBRS's view that risks to the ratings are currently broadly balanced.

IMF: banking sector still facing one of highest NPL ratios in Europe

On November 28, 2018, the IMF Executive Board concluded its latest consultation with Cyprus saying the near-term outlook for the economy was favourable, with growth expected to remain at around 4.2% in 2018–19, supported by the services sector and largely foreign-financed investments. Economic

growth is projected to slow to its long-run potential rate of around 2.5%, as the transitory effects of the investment boom gradually dissipate. Fiscal performance is expected to improve with a primary surplus of around 5.0% in 2018–19. Public debt is thus expected to be on a firm declining path, falling below 70.0% of GDP by 2023, despite a sharp increase earlier this year following the resolution of the Cyprus Cooperative Bank. However, the economic outlook could weaken if implementation of NPL resolution is delayed, while public debt sustainability could be undermined by realization of contingent liabilities or erosion of fiscal discipline. Directors observed that private and public debt remain large while NPL ratios were still among the highest in Europe. They encouraged the authorities to make further efforts to address these legacy problems and strengthen economic growth over the medium term. The IMF report, highlighted the need for banks to continue efforts to strengthen their balance sheets. They urged banks to diversify income sources and consolidate operations to improve cost-income ratios and better position themselves against increased competition. Directors recommended strengthening regulatory guidance on loan restructuring and exercising vigilance over bank lending policies, the adequacy of provisioning, and debt-to-asset swap policies.

Table 2: Major Macroeconomic Indicators: 2017 Actual Figures, 2018/19/20 Projections

	2017 (Provisionals)	2018 (Projections)*	2019 (Projections)*	2020 (Projections)*
<i>Real GDP</i>	3.9%	4.2%	4.1%	3.6%
<i>Consumer Prices</i>	0.7%	0.9%	1.8%	1.9%
<i>Unemployment</i>	11.1%	8.5%	7.0%	6.0%
<i>Debt to GDP</i>	97.5%	106.1%	99.7%	90.3%
<i>General Government Balance</i>	1.9%	2.7%	2.5%	2.6%
<i>General Government Primary Balance</i>	4.5%	5.1%	5.0%	5.0%

* IMF's December 2018 Projections

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Appendix 1: Graphical presentation of the key Cyprus Economy figures.

