CYPRUS

ALPHA BANK

ECONOMIC & FINANCIAL OUTLOOK

ECONOMIC RESEARCH DIVISION

Real GDP growth in Cyprus fell into negative territory in 2020 after five years of growth due to the coronavirus (Covid-19) pandemic. The negative growth incorporates the disruption in economic activity due to restrictions on mobility and social distancing measures enacted by the Cypriot government last spring to curb the spread of the Covid-19 virus. The tourism sector has been devastated by Covid-19, with arrivals down by an annual 84% in 2020, whereas domestic demand has shown resilience. The harmful effects of the crisis on the labour market have been mitigated by income support schemes adopted by the Ministry of Labour, Welfare and Social Insurance. The fiscal position deteriorated drastically in 2020, although is expected to be ameliorated with more contained general government deficits throughout 2021 and 2022. Economic output is expected to recover in 2021, reflecting the resumption of economic activity and vaccine deployment.

**** cut-off date 05.03.2021***

GDP contracted less than expected in 2020

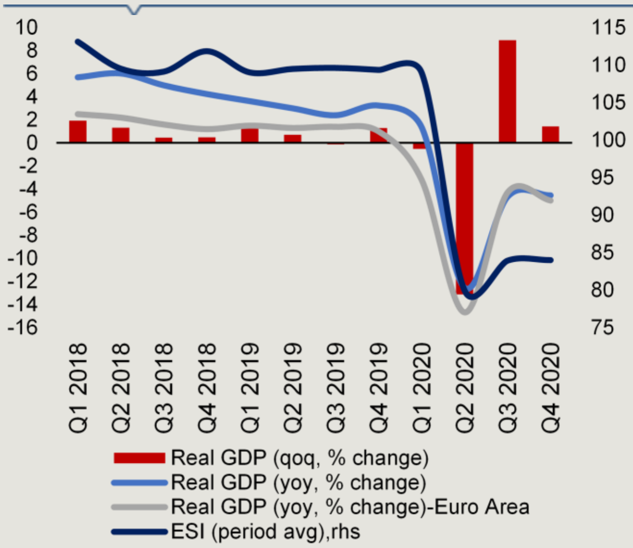
Available economic data suggests that economic activity remained subdued in Q4 2020 following the unprecedented GDP drop in Q2. Cyprus' gross domestic product (GDP) contracted in the fourth quarter of 2020 for a third consecutive period by 4.5% (Graph 1) on an annual basis (chain-linked measure, s.a.) due to renewed Covid-19 containment measures, which affected domestic demand and prevented economic recovery. A second wave of the coronavirus epidemic prompted the Cypriot government to impose new nationwide restrictions in mid-October (e.g. social distancing, movement restrictions, partial lockdowns) in order to prevent new outbreaks of Covid-19. The preventive measures were imposed initially in the districts of Limassol and Paphos and extended gradually across the whole island.

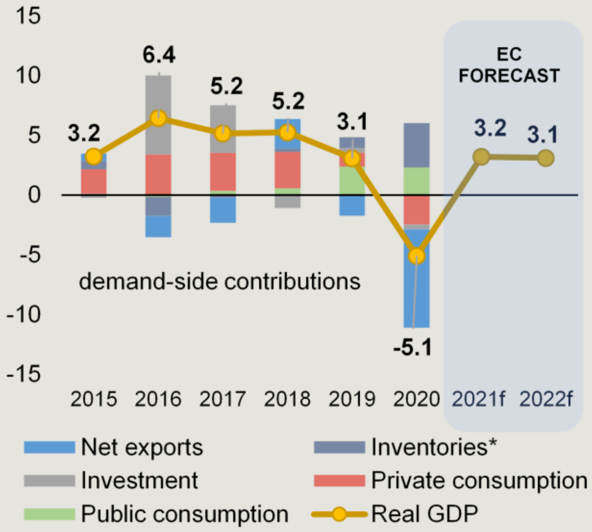
On a quarterly basis, economic activity showed signs of improvement, with GDP increased by 1.4% in Q4 2020 – the second positive reading in a row – in contrast to the second quarter's 13.1% sharp decline. The negative GDP growth rate in Q4 2020 was mainly attributed to contractions in the hospitality, manufacturing and transport industries, as well as in the retail trade sector. Private consumption declined by 2% on an annual basis in the fourth quarter after a drop of 2.3% in the previous quarter (Q2: -14.8% year-on-year). Additionally, fixed investment rose at a significant rate of 23.2% in Q4 after the 5.9% drop recorded in the previous quarter. Meanwhile, public consumption moderated noticeably in Q4 2020, growing 10.8%, below the 16.8% annual increase noted in Q2 2020.

GRAPH 1

GRAPH 2

The adverse impact of Covid-19 on economic activity in 2020 and the pace of recovery in 2021-2022





Sources: CYSTAT, European Commission

Note: * including statistical discrepancies

International tourist arrivals declined annually by more than 83% on average in Q4 2020, while exports dropped at a noticeably steeper pace of 27.9% (Q3 2020: -26.6% year-on-year), as Covid-19 continued to reduce foreign demand. Domestically, consumers became increasingly pessimistic in Q4 2020 compared to the previous period, as the unemployment rate reached its highest level for the year in October 2020. Real GDP growth is expected to be finalised at -5.1% for 2020, lower than the European Commission's forecast due to a stronger than anticipated rebound in economic activity, and it is expected to recover in 2021 and 2022 (Graph 2). Public consumption (+2.3 pps) and inventories (+3.7 pps) contributed positively to GDP, while net exports (-8.2 pps), private consumption (-2.5 pps) and investment (-0.4 pps) contributed negatively.

Economic development is likely to be very subdued in Cyprus as in many EU countries in the first quarter of 2021 due to Covid-19 containment measures. The island has been in a strict lockdown since 10 January 2021 after a spike in Covid-19 cases and the detection of the new strain of the SARS-CoV-2 virus first identified in the United Kingdom. However, the fall in the number of confirmed Covid-19 cases will allow Cypriot Authorities to announce a gradual easing of restriction measures, as the country's infection rate remains slightly above safety limits set by the EU's disease prevention agency. Since the pandemic began, there have been 36,004 confirmed infections with 232 related deaths in Cyprus (World Health Organisation, 5 March 2021).

As the vaccination process gains momentum and restriction measures are gradually relaxed, the economic recovery is expected to begin. However, the recovery will be moderate as containment measures are expected to be lifted gradually and to be driven mainly by domestic demand. Private consumption is expected to rebound in line with the gradual abolition of the imposed restrictions, mainly in the second half of 2021. Public consumption is projected to keep growing due to the stimulus measures extended into 2021 and planned employment support schemes. At the same time, the accommodative monetary conditions should support investment to recover. However, the abolition of the controversial citizenship-by-investment scheme known as the Golden Visa scheme should slow down demand for high-end residences affecting construction activity.

Revenue from tourism is expected to partially recover in 2021 after a significant decline of around 85% in 2020. Airlines seat capacity and vaccination progress in Cyprus' main tourist markets are expected to weigh on the industry's recovery. Additionally, net exports should also improve this year, exerting a slight drag on economic growth. We envisage economic growth to recover firmly in 2021 on the back of strengthening domestic and foreign demand as economies reopen, and new inflows of EU funding activate.

However, real GDP will not return to pre-crisis levels before late 2022, due to the epidemiological situation prevailing in the EU. The forecasts at this time are accompanied by high uncertainty as economic outcomes largely depend on the evolution of the pandemic, in particular controlling the new infections in Cyprus and abroad. However, the unpredictable course of the pandemic, the uncertainty surrounding the new trade relationship between United Kingdom (UK), as Cyprus' major trading partner, and the EU and the country's significant public debt load could negatively affect economic outlook.

Gas potential reserves to stimulate economic growth

The Covid-19 pandemic crisis that affected global economy also has an impact on scheduled exploration gas drillings in Cyprus. However, Cyprus retains its status as a key-player in the region. Cyprus is located in an area of the Eastern Mediterranean thought to be rich in largely untapped oil and gas reserves. The involvement of prominent oil and gas companies in explorations in conjunction with Cyprus' geographical location have strengthened the country's profile as an energy hub.

Cyprus, which discovered hydrocarbons at sea in December 2011, has successfully issued licences covering three offshore areas lying south and southeast of the island. ExxonMobil has decided to postpone an appraisal well at the Glaucus site (block 10) until September 2021, which is so far considered the largest gas find (with an estimated gas-bearing reservoir of approximately 5-8 trn cubic feet) in Cyprus' Exclusive Economic Zone (EEZ). A second appraisal, at the same site, will take place later this or early next year.

Delays in the drilling have occured while Cyprus has secured funding for its floating storage and regasification LNG unit terminal, which is planned to be operational by the end of 2022. The terminal will enable Cyprus to ensure its energy supply, end its reliance on oil imports, fuel its main power generation plant at Vassilikos and, at the same time, reduce the cost of electricity to consumers to achieve environmental goals and strengthen the island's economy. This is the most expensive project undertaken by the Cypriot government.

The Natural Gas Infrastructure Company of Cyprus (ETYFA) has received a EUR 101 million subsidy from the EC, loans of EUR 150 million from the European Investment Bank and EUR 80 million from the European Bank for Reconstruction and Development, and an investment of EUR 43 million from the Electricity Authority of Cyprus (EAC). The government will own the LNG terminal through the Natural Gas Infrastructure Company of Cyprus (ETYFA), a subsidiary of the Natural Gas Public Company (DEFA), and supply gas to the Electricity Authority of Cyprus (EAC).

Favourable labour market conditions on pause due to Covid-19

Until the outbreak of Covid-19, labour market conditions were improving steadily. Employment had increased since 2016 on the back of solid economic growth, mainly in the supportive sectors (construction, trade, transport, hotels and restaurants). Rising labour demand had repressed unemployment, while the improved economic environment provided employment opportunities for the most vulnerable groups, youth and the long-term unemployed. In 2019, according to the CYSTAT employment increased by 3.9% compared to 5.6% in 2018 and unemployment fell to 7.1% from 8.4% in 2018. The prospects for the future were favourable, as the European Commission (Autumn 2019 Economic Forecast) predicted further improvement for the labour market for both 2020 and 2021.

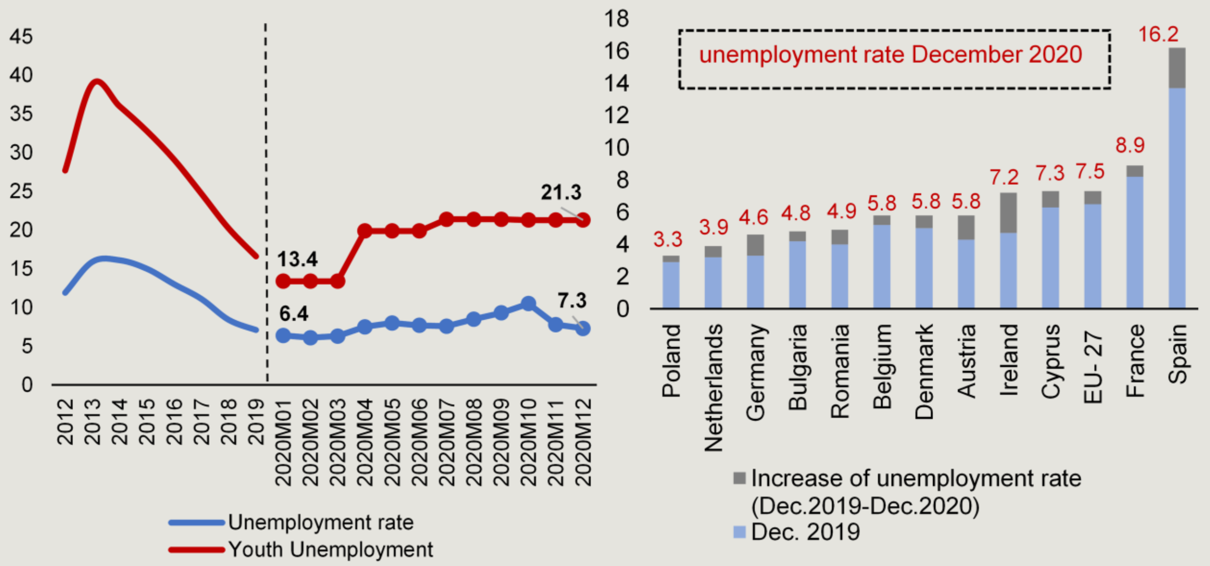
The containment measures that national governments have taken since March 2020 in order to limit the spread of the coronavirus resulted in a sharp deterioration of labour market conditions in European countries, including Cyprus. In May 2020, in an effort to protect employment, the Cypriot government implemented an interest rate subsidy programme for new business loans, provided that jobs are maintained. Despite government measures, the unemployment rate increased during the pandemic, although to a limited extent. According to the latest Eurostat data, the unemployment rate in Cyprus stood at 7.3% in December 2020 (Graph 3), lower than both the euro area (8.3%) and the EU (7.5%) average. In contrast, youth unemployment stood at 21.3%, higher than the euro area average (18.5%), as well as the EU average (17.8%). Compared to December 2019 (6.3%), the unemployment rate increased by 1 percentage point in line with rising unemployment in European countries (Graph 4).

It was noted that during the containment measures (lockdown), many unemployed people, for various reasons, stated that they were not available to work and, as a result, became part of the economically inactive population (2020/2019: +2%). Rising economic activity and the end of emergency government measures to support employment may, in the short term, put upward pressure on the unemployment rate. The European Commission (Autumn 2020 Economic Forecast) predicts an increase in the unemployment rate in Cyprus to 7.8% in 2021 and a de-escalation to 7.2% in 2022. The same pattern is expected for both the euro area and the EU, as their unemployment rates are predicted to rise to 9.4% and 8.6% in 2021, falling to 8.9% and 8% respectively, in 2022.

GRAPH 3

GRAPH 4

Unemployment rate increased between December 2019 - December 2020 in EU Member States



Sources: Eurostat

A new tool in the arsenal of European governments against rising unemployment is the SURE programme (Support to mitigate Unemployment Risks in an Emergency). It is an emergency programme of the European Commission for the subsidisation of jobs and the unemployed, amounting to EUR 100 billion. The European Commission will borrow EUR 100 billion through bonds from the markets with guarantees from Member States and will provide them with 10-year loans, with the possibility of extending the repayment period. The aim of the mechanism is to provide financial assistance to a Member State facing financial distress caused by the Covid-19 crisis, to finance part-time work or similar measures to protect workers and the self-employed and, thereby reduce unemployment and loss of income. The Cypriot government submitted to the European Commission a request for a loan of EUR 479 million, which was accepted to finance government employment support projects. The first of the two loan instalments was paid on 17 November 2020 (EUR 250 million) and the second on 2 February 2021 (EUR 229 million).

Deflationary pressures driven by weak demand and lower energy prices in 2020

Annual HICP inflation turned into negative territory in 2020 after three consecutive years of moderate but positive inflation. Average HICP inflation stood at -1.1% (Graph 5) compared to +0.5% in 2019, recording intense deflationary pressures since the outbreak of the pandemic crisis, which peaked in August 2020 (-2.9%). Energy (-9.4%) and service prices (-0.8%) recorded a drop in 2020 compared to 2019, as well as prices on industrial goods (-2.8%) and non-energy industrial goods (-0.5%). On the contrary, food prices rose slightly (+0.8%). In the euro area, annual HICP inflation also retreated from 1.2% in 2019 to 0.3% in 2020. Inflation was negative in eight Member States with the lowest measurement was recorded in Greece (-1.3%) and the highest in Slovakia (2%). The downward trend of HICP inflation in Cyprus is attributed to:

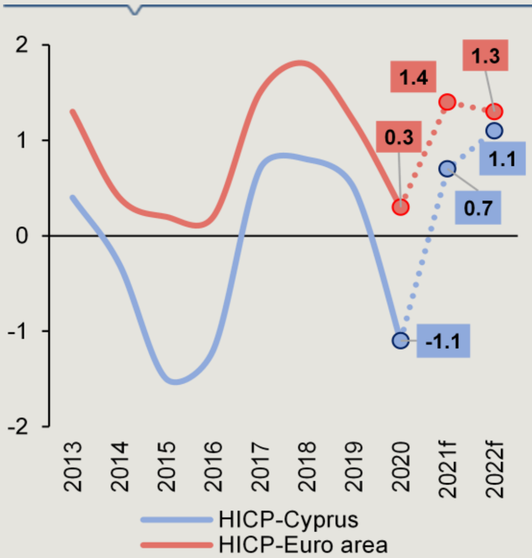
- **Weak domestic and external demand.** The lockdown that the Cypriot government was forced to introduce in order to limit the spread of coronavirus had a negative impact on economic activity. As a result, the unemployment rate rose and incomes shrunk, while uncertainty dominated amongst households. In such a deteriorating economic environment, households changed their spending habits drastically, driving domestic demand and prices to lower levels. Additionally, the collapse of tourist arrivals and revenues exerted further downward pressure on prices. In an effort to support the tourism sector, the Cypriot government reduced the VAT rate from 9% to 5%, for the period 01.07.2020-10.01.2021 on restaurants and hotel accommodation, pushing down service prices after the summer months.

- **Lower energy prices.** The sharp decline in global oil demand due to travel restrictions (the transport sector represents more than 60% of total oil consumption in the European Union, according to 2018 data) and reduced demand for industrial goods resulted in the fall in energy prices overall. Furthermore, the appreciation of the euro by 8.9% against the dollar in 2020, favoured euro area Member States as energy prices are expressed in dollars.

Amongst the main groups of goods and services, transport (-5%) and housing (-3.8%, including water supply, electricity and LPG) prices recorded a significant drop in 2020 compared to 2019, followed by prices in hotels and restaurants (-1.9%). Conversely, prices in recreation and culture (+2%), food and non-alcoholic beverages (+1.3%) and education (+1%) recorded the strongest increase (Graph 6).

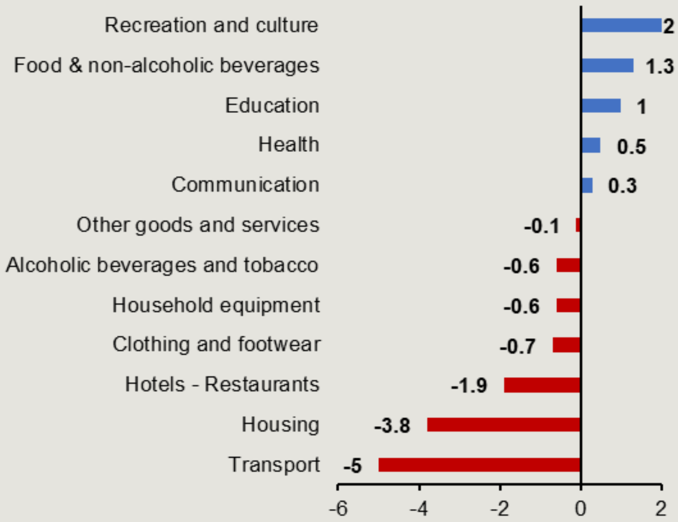
GRAPH 5

Inflation in Cyprus and Euro area (y-o-y % change)



GRAPH 6

Main groups of goods and services (2020/2019)



Sources: Ministry of Finance, European Commission

According to the European Commission (Winter 2021 Interim Economic Forecast), annual HICP inflation is predicted to rebound in 2021 and 2022 at 0.7% and 1.1%, respectively, mainly driven by increasing food and service prices. The normalisation of economic activity is expected to boost domestic demand, while external demand will be enhanced on the back of improved tourism product performance and strengthening export trade. The expected rebound of HICP inflation in Cyprus is in line with the expected recovery of HICP inflation in the euro area. The European Commission predicts an increase of 1.4% in 2021 and 1.3% in 2022 in inflation within the euro area as European economies recover from the pandemic, supported by the low interest rate environment.

Fiscal disruptions and the decisive role of the European Central Bank

Fiscal developments in Cyprus were notably positive until the outbreak of Covid-19, driven by solid economic expansion on the back of declining unemployment and growing employment and incomes. In 2019, according to the European Commission (Autumn 2020 Economic Forecast), the general government surplus stood at 1.5% of GDP from a deficit of 3.5% in 2018. Social security revenues increased by 29.5%, both due to increases in contribution rates from 1 January 2019 and due to the introduction of contributions for the General Healthcare System (GHS) from 1 March 2019. However, the collapse in economic activity in March-April 2020, as a result of strict containment measures, forced the Cypriot government to adopt an expansionary fiscal policy in order to support the economy, disrupting fiscal stability.

Fiscal support can be summarized in four main categories (Ministry of Finance, October 2020):

- **income support for employees,**
- **protection of employment with an emphasis on avoiding redundancies,**
- **enhancing liquidity for households and businesses,**
- **health sector support.**

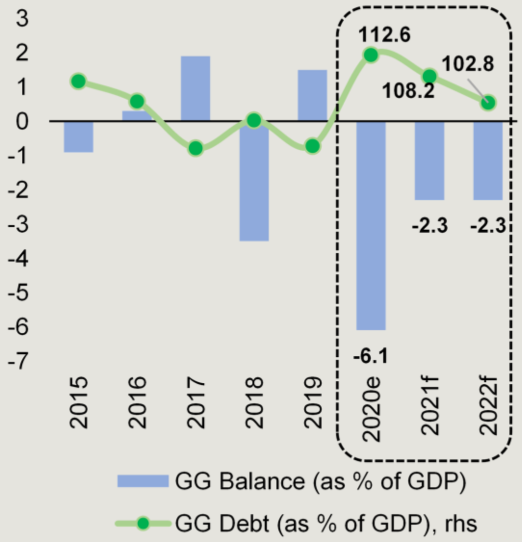
The total fiscal package exceeds EUR 1 billion or 5% of GDP for 2020, according to the Central Bank of Cyprus (Economic Bulletin, December 2020). It is noted that the expansionary fiscal policy was in line with the adoption of the general escape clause by the European Commission, which allows for a temporary relaxation of the fiscal rules of the Stability and Growth Pact for 2020 and 2021. As a result of the aforementioned developments, the general government fiscal balance was in deficit in 2020. According to the latest available data of CYSTAT, in January-December 2020 fiscal deficit was stood at EUR 1,059 million, compared to a fiscal surplus of EUR 326 million, in January-December 2019. Total revenues decreased by 3.8% (EUR 355 million), on an annual basis, to a total of EUR 8,888 million, as taxes on production and imports declined by 9% (EUR 300 million), of which net VAT revenues decreased by 8% (EUR 165 million). On the other side, total expenditure increased by 11.5% (EUR 1,030 million), to a total of EUR 9,947 million, mainly due to the rise by 19.3% (EUR 585 million) on social payments and by 725% (EUR 508 million) on subsidies, as a result of the support measures to enterprises due to the consequences of the Covid-19 pandemic. The European Commission (Autumn 2020 Economic Forecast) estimates that the general government deficit will reach 6.1% of GDP in 2020 (Graph 7). For 2021 and 2022, recovering economic activity, increasing investment and employment and consequently higher disposable incomes are expected to improve fiscal performance, although some measures will be extended in the current year. The European Commission envisages fiscal balance to be in deficit by 2.3% of GDP for both 2021 and 2022.

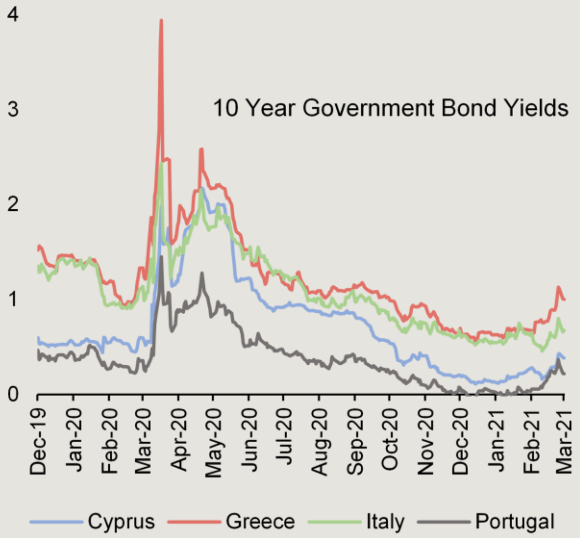
In 2019, public gross debt declined to 94% of GDP (EUR 21 billion) from 99.2% in 2018 (EUR 21.3 billion). The result is attributed to the high primary surplus, as well as the early repayment of the Russian loan (EUR 1.56 billion), which the government carried out to reduce the public debt after the increase in 2018 due to developments related to the Cooperative Bank. In 2020, according to the European Commission (Autumn 2020 Economic Forecast), the gross public debt-to-GDP ratio is expected to peak at 112.6% as a result of the expansionary fiscal policy. It is mentioned that in February 2020, the Cypriot government carried out early repayment of a loan from the International Monetary Fund, which was granted during the period 2013-2016. The repayment amount was EUR 716.7 million, resulting in a total benefit of EUR 13.4 million for the period 2020-2025, according to the Ministry of Finance. For 2021 and subsequent years, the gross public debt-to-GDP ratio will follow a downward trend, although it is not projected to fall below the pre-pandemic level until 2028 (European Commission Debt Sustainability Monitor, February 2021). Cyprus is favoured by low financing needs for 2021 and 2022 (9.4% and 7.4% of GDP, respectively), while average financial needs for the period 2023-2031 are predicted to rise to 11.5% of GDP. We expect the budgetary position to improve gradually from 2021-2025, helping to lower the public debt-to-GDP ratio.

GRAPH 7

GRAPH 8

Despite fiscal disruptions in 2020 due to Covid-19, Cypriot 10Y bond yield followed international trends





Sources: CYSTAT, Eurostat, European Commission Autumn 2020 Economic Forecast

Despite fiscal disruptions, Cyprus maintained an investment grade credit rating in 2020. This development, combined with the quantitative easing from the European Central Bank (ECB), allowed Cyprus to borrow a total of EUR 4.5 billion from capital markets at a low cost. Furthermore, in February 2021, the Republic of Cyprus introduced a new 5-year fixed-rate bond on the market, borrowing EUR 1 billion, priced with a yield of 0.053% and a zero-coupon rate, which are the lowest since 2014. The issuance was successful, as the demand exceeded EUR 8.5 billion, representing the largest orderbook the Republic of Cyprus has achieved in a single-tranche syndicated transaction since its return to the capital markets in 2014. It is worth noting the key role of the ECB. In March 2020, the ECB activated a non-standard monetary policy measure as a response to Covid-19 called the Pandemic Emergency Purchase Programme (PEPP). The PEPP is a temporary asset purchase programme of private and public sector securities amounting to EUR 1.85 trillion. From the beginning of the programme until January 2021, the ECB has purchased EUR 1.7 billion of Cypriot government bonds cumulatively. The ECB, through these purchases, has limited government bond yields to a historically low level for the majority of euro area Member States, enabling them to finance their fiscal packages at a low cost. After a rise in March 2020, the Cypriot 10-year government bond yield retreated significantly during the year, almost reaching zero in December 2020 (Graph 8). Additionally, the Cypriot 5-year government bond yield has retreated into negative territory since October 2020.

Current account deficit to widen further

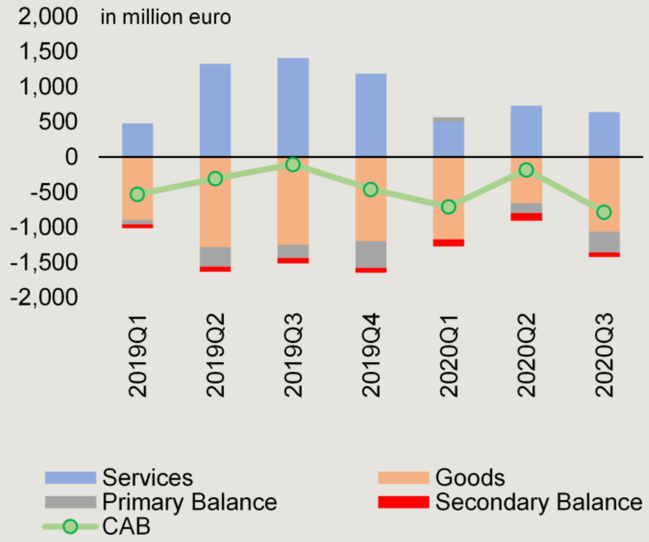
In Q3 2020, the current account deficit increased to EUR 784.2 million from EUR 105.5 million in Q3 2019 (Graph 9). The widening deficit is attributed to the lower surplus in services and larger deficit in primary income balance. In contrast, the reduction of both the trade deficit and secondary income deficit partly offset the deterioration of the current account balance. More specifically:

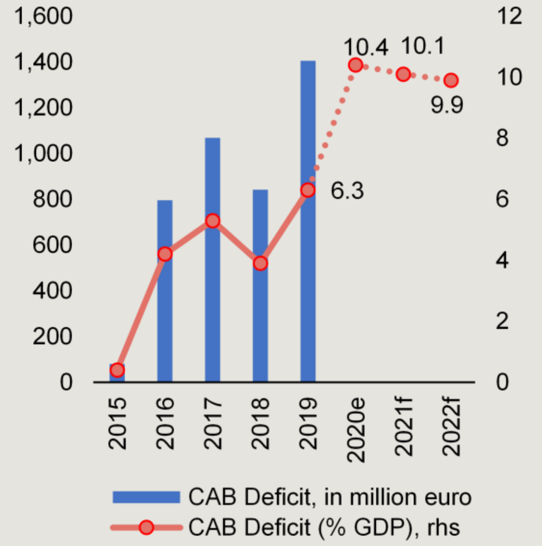
- **Goods:** The trade deficit shrunk by EUR 189.4 million (15.1%) as imports decreased more than exports. Imports and exports of both general merchandise and movable equipment (i.e. vessels, yachts and airplanes) recorded a decline.
- **Services:** The surplus in services dropped significantly by EUR 770.9 million (-54.7%). This adverse development was the result of the collapse in net travel receipts, which turned into negative territory in Q3 2020. The increase in the surplus of transport and financial services mitigated the deterioration of the service surplus.
- **Primary income:** The deficit of primary income balance increased by EUR 114.5 million (61.9%), mainly due to the sharp decline in portfolio and other investment income, despite the improvement in direct investment income.
- **Secondary income:** The deficit of secondary income declined by EUR 17.3 million (22.4%) due to the decrease in funds contributed to the EU and payments in other sectors which surpassed the respective decreases in receipts.

GRAPH 9

GRAPH 10

Current Account Balance (CAB) and its Components





Sources: Central Bank of Cyprus, Eurostat, European Commission Autumn 2020 Economic Forecast

Cumulatively, from January-September 2020, the current account deficit stood at EUR 1,676.1 million, compared with a deficit of EUR 944.9 million in the corresponding period of 2019. The deterioration of EUR 731.2 million (77.4%) reflects the catalytic effect of the collapse in tourist receipts. According to the European Commission (Autumn 2020 Economic Forecast), the current account deficit is forecasted to rise from 6.3% of GDP in 2019 to 10.4% of GDP in 2020 and decline slightly to 10.1% of GDP in 2021 and further to 9.9% of GDP in 2022 (Graph 10) as the economic activity normalises.

The collapse of tourism in 2020 and future perspectives

Cyprus' economy is heavily reliant on the services sector and more specifically on the tourism industry. In 2019, the travel and tourism sector accounted for 13.8% of GDP according to estimates from the World Travel and Tourism Council. Tourism, one of the pillars of the Cypriot economy, has been on an upward trend for a long time, in line with growing demand in international tourism. Since 2014, tourist arrivals increased significantly with double-digit growth in 2016 and 2017. In 2019, tourist arrivals were the highest ever recorded in a period of one year after a historic high of 3.98 million tourists visited Cyprus. Additionally, tourism revenues rose in 2015-2018 followed by a slight decrease of 1% in 2019 (Graph 11).

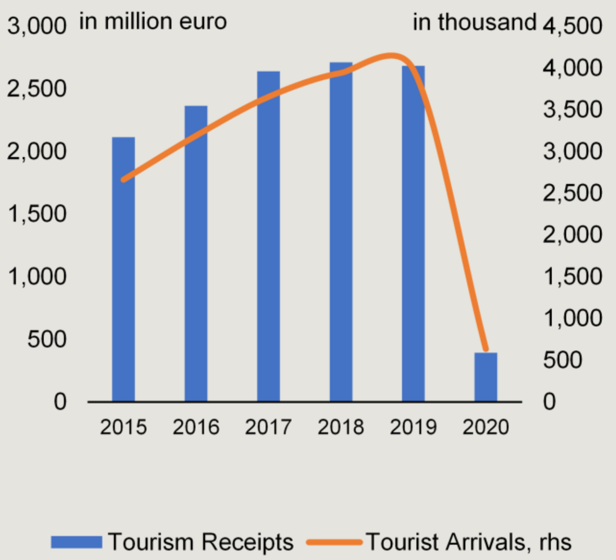
However, the outbreak of the coronavirus halted the expansion of Cypriot tourism, causing an unprecedented collapse both in terms of arrivals and revenues. During the period 15.03.2020-08.06.2020, tourists were prohibited from entering Cyprus and hotels were closed. As a result of these measures, there were no tourist arrivals from April-May 2020. The good epidemiological situation in the country allowed the government to gradually ease containment measures after May, signalling the reopening of the economy. However, tourist arrivals and revenues during the summer remained sluggish as tourist demand from the UK and Russia, the main tourist markets, was limited. This development was due to the maintenance of travel restrictions, to some extent, on travellers coming from these two countries. According to the latest CYSTAT data, 631,609 tourists visited Cyprus in 2020, which translates into an annual decrease by 84.1%. A total of 228,047 travellers arrived from the UK (-82.9%), 62,788 (-63.4%) from Greece, 60,430 (-60.1%) from Germany and 280,344 (-87.9%) from the rest of the world. Tourism revenues fell to EUR 392 million in 2020, 85.4% below the revenues of 2019.

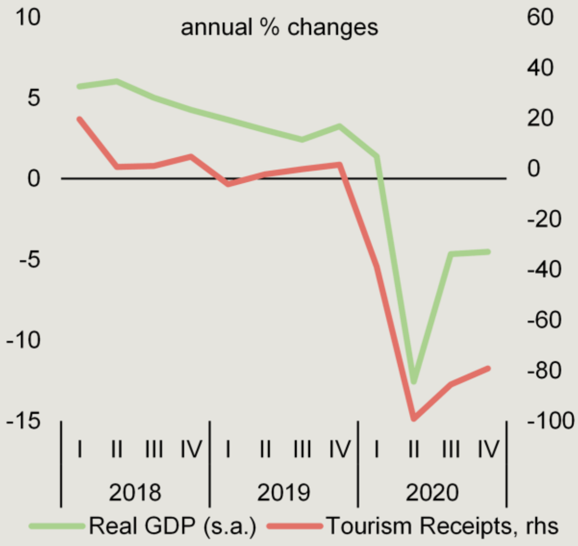
Despite these adverse developments, efforts to upgrade the quality of the tourism product continued through hotel renovations and new infrastructure, such as the construction of marinas and luxury hotels. The completion of a casino resort and its operation, scheduled to launch in autumn of 2022, is expected to boost the tourism industry. It will be the first multi-themed casino resort in Cyprus and could attract 300,000 additional tourists annually, contributing positively to addressing tourism seasonality. Moreover, the establishment of a Deputy Ministry of Tourism in 2019 was a significant step by the government of Cyprus to ensure its strong focus on the tourism industry.

GRAPH 11

GRAPH 12

The collapse of tourism sector in 2020 and its strong relationship with GDP





Source: CYSTAT

The new ministry, in conjunction with the implementation of a new national agenda for tourism, will support Cyprus' rebranding in the coming years. Interestingly, the new tourism agenda is the most comprehensive restructuring of the sector since 1960 and is targeted at opening new mass and niche markets, new legislation for the classification of hotels, as well as confronting seasonality issues.

With respect to 2021, tourism in Cyprus is expected to recover, although the extent of that recovery is subject to a high degree of uncertainty. The most important factor that is expected to affect the evolution of the world economy, as well as the global tourism industry, is the speedy distribution of vaccines. Their rapid rollout worldwide and the vaccination of a sufficient number of citizens could ease travel restrictions before the summer. A positive development for Cyprus is the satisfactory vaccination rate of the population in the UK, which represented about 1/3 of tourist arrivals in 2019. Another benefit is the good reputation of Cyprus resulting from its successful response to the pandemic crisis, as the epidemiological data prove. Cypriot authorities face a major challenge in taking advantage of these facts as economic activity has a strong positive correlation with tourism (Graph 12).

Real estate market remains resilient, supported by domestic demand

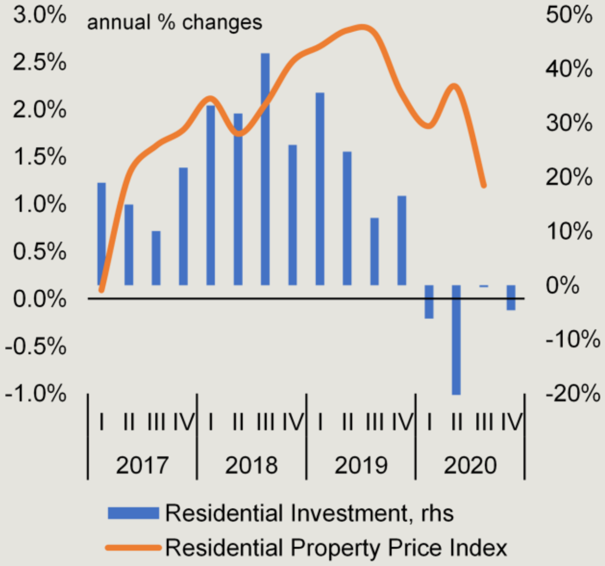
Another main pillar of the Cypriot economy beyond tourism is the real estate market (construction and real estate activities). Until the outbreak of the coronavirus, the real estate market continued to experience a recovery, which started in 2016 and was supported by higher demand for properties, increased building activity, new loans and foreign investment. In 2018 and 2019, GDP growth rate stood at 5.2% and 3.1%, while the contribution of construction was 0.7 and 0.8 percentage points respectively, representing about 13% and 26% of the economic expansion during those years.

However, the pandemic slowed the upward trend in the real estate market. The fall in incomes, lower foreign demand for property and high economic uncertainty caused a decline in real estate transactions with a negative effect on residential property prices. On the other hand, domestic demand remained resilient, supporting residential property prices due to government measures to support the labour market, low interest rates and the interest rate subsidy scheme on mortgages loans. The last began in Q3 2020, resulting in an impressive increase in new housing loans of around 50% compared with Q2 2020 according to the Central Bank of Cyprus.

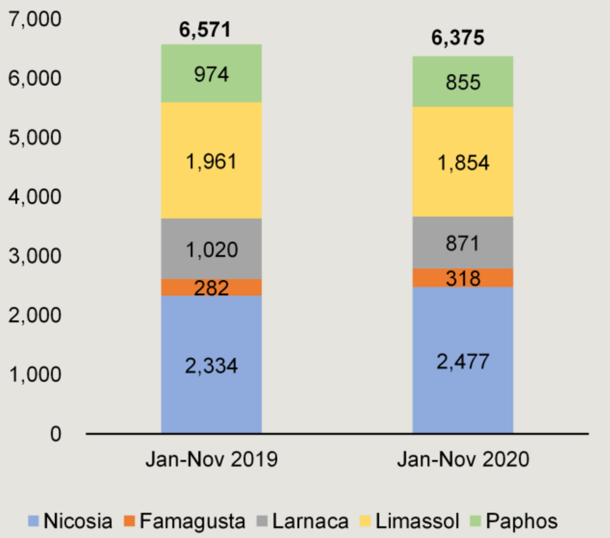
GRAPH 13

GRAPH 14

Residential Investment and Residential Prices



Building permits per region in Jan.-Nov. 2020/2019



Sources: CYSTAT, Central Bank of Cyprus

In Q3 2020 the residential property price index increased by 1.2% (Graph 13) on an annual basis (Q1 2020: 1.8%, Q2 2020: 2.2%), but declined by 0.4% on a quarterly basis (Q1 2020: 0.4%, Q2 2020: 0,9%). It is noteworthy that this is the first quarterly decline after sixteen consecutive quarters of increases. With respect to residential property prices per region, Limassol registered the largest increase (1.9%, y-o-y), followed by Larnaca (1.6%, y-o-y), Nicosia (1.1%, y-o-y) and Famagusta (0.4%, y-o-y). In contrast, residential property prices in Paphos declined (-1.6%, y-o-y) for the first time since Q3 2018. Cumulatively, in the first nine months of 2020, residential property prices increased in all regions compared with the corresponding period of 2019. Prices in Larnaca rose by 2.4%, in Limassol by 2.1%, in Famagusta by 1.9%, in Nicosia by 1.5% and in Paphos by 0.5%.

The issuance of new building permits reveals steady growth in numbers and value over the last few years. Building activity is broadly based as it includes both residential projects, as well as productive infrastructure projects such as marinas, offices, shopping centres, casinos, hotels and renewable energy projects. In 2019, 7,218 (+12.6%, y-o-y) building permits were issued with a total value of EUR 3.7 billion. According to the latest data by CYSTAT, from January-November 2020, total building permits stood at 6,375, compared to 6,571 in the corresponding period of the previous year (Graph 14). This 3% y-o-y drop corresponds to the 7.9% y-o-y decrease in residential investment in 2020. Building permits declined in Larnaca, Limassol and Paphos, but increased in Nicosia and Famagusta.

Looking forward to 2021, domestic demand is expected to continue to support the real estate market to the extent that favourable financial conditions and government measures continue to exist. Downside risks for the real estate market are prolonged uncertainty related to Covid-19, which could negative affect employment and incomes, and the abolition of the investor citizenship scheme that would weaken foreign demand for property.

as of 5 March 2021

Macroeconomic Environment / Business Economy	ANNUAL				QUARTERLY			
					2020			
	2017	2018	2019	2020	I	II	III	IV
AGGREGATE DEMAND								
GDP at current prices (€ billion), SA [1]	20.1	21.4	22.3	21.0	5.6	4.9	5.2	5.3
(annual % change)	6.3	6.5	4.0	-5.8	1.6	-12.9	-5.9	-5.7
GDP at constant prices 2010 (€ billion), SA [1]	19.9	21.0	21.6	20.5	5.4	4.7	5.1	5.2
(annual % change)	5.2	5.2	3.1	-5.1	1.4	-12.6	-4.7	-4.5
Components (annual % change, at constant prices)								
Private Consumption	4.9	4.7	1.8	-3.9	3.6	-14.8	-2.3	-2.0
Public Consumption	2.1	3.5	15.1	13.0	15.8	16.8	9.1	10.8
Gross Fixed Capital Formation	21.3	-5.2	2.0	-2.1	28.3	-44.5	-5.9	23.2
Exports of Goods and Services	9.9	8.0	-0.4	-17.4	1.3	-15.8	-26.6	-27.9
Imports of Goods and Services	12.9	4.5	2.0	-5.8	11.5	-16.4	-13.8	-5.3
LABOUR MARKET (annual % change)								
Nominal Unit Labour Costs [2]	1.9	0.9	2.0	1.6	2.2	5.3	-0.5	-0.3
REER Unit Labour Costs [3]	2.6	1.4	-1.5	-1.3	-2.8	-2.4	-0.9	0.9
Unemployment Rate (%), NSA	11.1	8.4	7.1	7.6	7.3	6.8	8.2	8.0
Youth Unemployment (less than 25, as a percentage of active population), NSA	24.7	20.2	16.6	18.2	14.5	17.8	20.4	19.9
Long-term Unemployment (>12 months, as a percentage of total unempl.), NSA	40.6	31.7	29.1	28.0	28.2	27.1	27.1	29.7
Employment Growth (%), NSA	4.6	5.6	3.9	0.2	1.9	-0.1	-0.5	-0.4
PRICES (average annual % change)								
National CPI	0.5	1.4	0.3	-0.6	1.1	-1.6	-1.2	-0.8
HICP (Harmonised Index)	0.7	0.8	0.5	-1.1	0.7	-1.6	-2.3	-1.1
PUBLIC FINANCES								
General Government Primary Balance (€ billion) [4,5]	0.9	-0.2	0.8	-0.6	0.3	-0.7	0.2	-0.3
G.G. Primary Balance (% of GDP)	4.4	-1.1	3.8					
General Government consolidated Gross Debt (€ billion)	18.8	21.3	21.0	24.8	21.5	24.4	25.3	24.8
G.G. Gross Debt (% of GDP)	93.5	99.2	94.0					
EXTERNAL BALANCE								
Current Account Balance (€ billion)	-1.1	-0.8	-1.4		-0.7	-0.2	-0.8	
Current Account Balance (% of GDP)	-5.3	-3.9	-6.3					
SERVICES								
Tourism Receipt (€ billion)	2.6	2.7	2.7	0.4	0.1	0	0.2	0.1
Tourism Receipt (% change)	11.7	2.7	-1.0	-85.4	-38.9	-99.2	-85.6	-79.3
Tourist Arrivals (in millions of people)	3.7	3.9	4.0	0.6	0.2	0	0.3	0.1
Tourist Arrivals (% change)	14.6	7.8	1.0	-84.1	-31.0	-99.3	-84.3	-83.3

Sources: Cystat, Eurostat, Central Bank of Cyprus

(1) Provisional historical figures for 2019-2020.

(2) Nominal Unit Labour Cost based on hours worked.

(3) Compared to 37 countries.

(4) Annual data defined here as General Government balance (according to ESA 2010) minus interest payments.

(5) 2018 - Including the fiscal burden of EUR 1.725 billion of the Cyprus Cooperative Bank Ltd (CCB) - Hellenic Bank deal.

ALPHA BANK ECONOMIC RESEARCH AND ANALYSIS

11, Sophocleous Street

GR 105 59 Athens

T +30 210 517 8963, F +30 210 348 7873

Email: AlphaBankEconomicResearch@alpha.gr

Web site: http://www.alpha.gr/