Euler Hermes Economic Research

Country Report

Cyprus

Successfully emerging from a deep financial crisis

General Information

GDP	USD19.3197bn (World ranking 109, World Bank 2015)
Population	1.17mn (World ranking 158, World Bank 2015)
Form of state	Republic
Head of government	Nicos ANASTASIADES
Next elections	2018, presidential

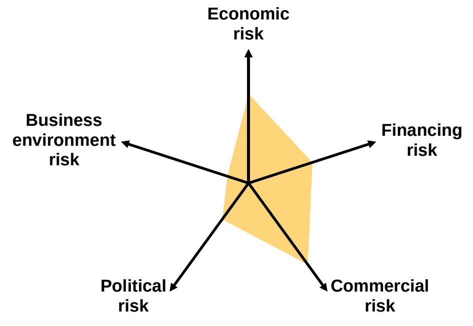
Strengths

- Strong and stable business environment
- Attractive fiscal system for corporates (12.5% corporate tax rate, the lowest in the EU along with Ireland)
- Potentially large deposits of natural resources
- Highly skilled workforce

Weaknesses

- Overreliance in the services sector, especially financial sector (i.e. 80% of GDP mostly rely on tourism, financial services and real estate)
- Very high gross external debt due to still significant non-resident bank deposits
- Consolidated assets held by the banking sector reduced, but stand above 500% of GDP
- High public debt
- High level of "shadow economy" (26% of GDP in 2012)
- Still fragile banking sector due to the high share of non-performing loans (around 60% of total)

Country Rating B2



Source: Euler Hermes

Trade Structure

By destination/origin (% of total)

Exports		Rank		Imports
Russia	61%	1	45%	Russia
Greece	6%	2	9%	Greece
Israel	5%	3	6%	China
Poland	3%	4	5%	Israel
United Kingdom	3%	5	4%	Germany

By product (% of total)

Exports		Rank		Imports
Aeronautics	15%	1	20%	Refined Petroleum Products
Specialized Machines	7%	2	14%	Coals
Ships	7%	3	8%	Ships
Pharmaceuticals	6%	4	6%	Non Ferrous Metals
Refined Petroleum Products	4%	5	5%	Toiletries

Source: Chelem (2014)

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Economic Overview

A successful exit from the bailout

Cyprus concluded the 3-year long bailout program ahead of schedule. It exited the EUR10bn scheme in March 2016, two months before it was due to run its course. The move has proven sustainable. Since the beginning of the year, Cyprus has issued medium to long-term bonds three times. Demand for the 2-yr, 7-yr and 10-yr bonds has been strong. The country is subject to post-program surveillance (PPS) by the European Commission and the ECB. Semi-annual economic reviews will continue until at least 75% of the financial aid received has been repaid. Estimated completion: 2029.

GDP growth above the eurozone average

The economy returned to growth in 2015 after three consecutive years of recession and is expected to grow by +2.5% in 2016 and +2.6% in 2017. These figures stand well above the eurozone average of +1.6%. Consumer spending and investment were key contributors. Yet export performance has also been boosted by the lower euro: non-eurozone countries represent more than 70% of Cyprus's total exports. Nominal GDP growth remains below 1% but has recovered over the past quarters.

Vulnerabilities: non-performing loans and high public and private debt

Non-financial corporations and households service debts among the highest in the EU: 130% and 140% of GDP respectively. Households' debt-to-income ratio is around 150%, the second-highest in the eurozone after Netherlands.

Credit to private sector continues to contract. Why? Because as much as 60% of the banks' portfolio of loans to households and non-financial corporations are non-performing loans (NPLs). For the latter, the highest NPLs are concentrated in sectors such as construction, trade and tourism, and real estate.

The fiscal balance will register a slight surplus in 2016, the first in eight years. Interest expenditures on public debt should moderate yet remain at a relatively high level.

Carrying out the privatization plan, which includes prize assets such as the port of Limassol, Electricity Authority of Cyprus, Cyprus Telecommunications Authority, State Lottery, would help reduce the fiscal deficit and public debt.

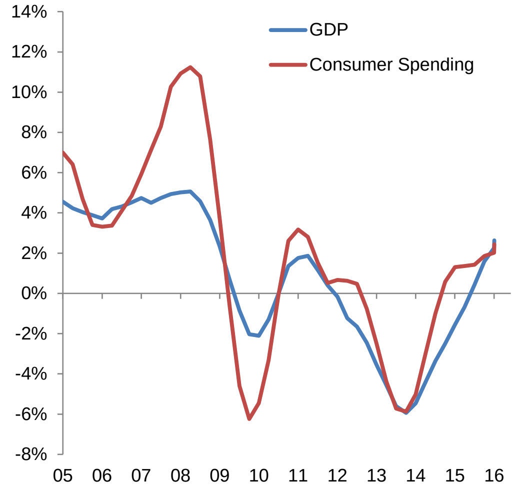
The current account has improved significantly over the past years. It is up from about -15.6% in 2008 to -4.5% in 2014. The oil trade deficit represented about 6% of GDP in 2014. The fall in energy prices has helped to reduce the energy bill and supported the current account deficit reduction.

Figure 1 - Key economic forecasts

	2014	2015	2016f	2017f
GDP growth (% change)	-2.5%	+1.6%	+2.5%	+2.6%
Inflation (%, average)	-0.5%	-1.0%	-0.7%	+1.2%
Fiscal balance (% of GDP)	-8.9%	-1.0%	+0.1%	+0.5%
Public debt (% of GDP)	108.2%	108.7%	107.5%	105.3%
Current account (% of GDP)	-4.5%	-3.9%	-3.3%	-3.0%

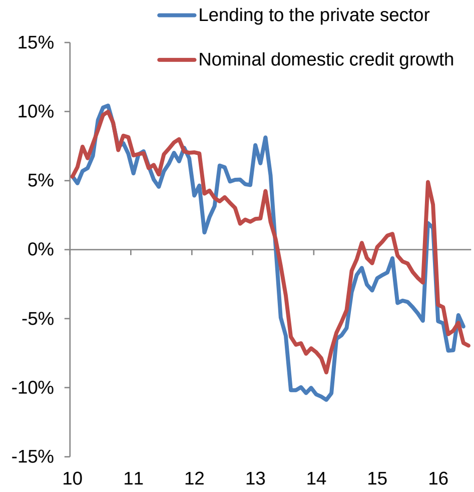
Sources: National sources, IHS, Euler Hermes

Figure 2 - Real GDP and consumer spending (4Q/4Q growth)



Sources: National sources, IHS, Euler Hermes

Figure 3 - Credit growth (y/y, %)



Sources: National sources, IHS, Euler Hermes

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