Economics | Analysis | Research

Sapienta Country Analysis

Cyprus

June 2020

Comprehensive monthly analysis of politics, economic policy and economics

ISSN 2301-2439

Sapienta ECONOMICS

Economics | Analysis | Research

About Sapienta Country Analysis

Sapienta Country Analysis provides you with a comprehensive but concise monthly analysis, risk assessment and forecasts of domestic and international politics, fiscal and structural policy, and macroeconomic and sectoral trends. The reports are written by Fiona Mullen, an analyst with over 20 years' experience producing clear, reliable and independent analysis for an international audience.

Subscription options

Please check our website for subscription options. Each subscription is valid for up to 5 users within a single institution or organization.

Standard subscription (monthly analysis and forecast): Analysis and outlook for domestic and international politics, fiscal policy, structural reforms and natural gas, the banking sector, macroeconomic and sectoral trends; tables and charts of recent economic trends and medium-term forecast.

Premium subscription (monthly analysis and critical updates): Analyst will alert you by email of critical developments as they occur, include two to three lines of comment, and be available for a brief email or phone follow-up.

Bespoke service: We also offer a bespoke service for clients who require a more personal service, such as consultation by email, phone, Skype or personal briefings.

ISSN 2301-2439, Sapienta Country Analysis, Cyprus

Disclaimer

No part of this publication should be construed as a recommendation to buy or sell any asset or security. The publisher takes no responsibility for any loss arising from dependence on this report.

The publisher and author confirm that, to the best of their knowledge, this report does not contain material non-public information, nor does it contain information acquired as a result of a breached duty of confidence owed to the individual or third party disclosing such information.

Contact

research@sapientaeconomics.com, Tel +357 99 338 224, www.sapientaeconomics.com

Overview Next section

30 June 2020

- Political analysis and outlook A cabinet reshuffle could boost judicial reform and provide an opportunity for a re-think on energy policy. Turkish Cypriot politicians are gearing up for the October leadership election in northern Cyprus. While little movement on the Cyprus problem is expect before that, regional developments and potential deals could have a significant impact on the future direction of the Cyprus problem.

- Structural reforms and natural gas The government has extended gas licences again and plans for gas exports from Aphrodite look set to be adjusted. Gas import infrastructure has received EIB and EBRD financing to proceed and the authorities are resisting any interim measures. The second phase of the GESY healthcare system is now in operation. A new bus fleet promises to modernize an outdated system.

- Fiscal performance and forecast Elements of the third Covid-19 economic package have now been implemented. Budget revenues have declined sharply largely as a result of furlough (income support) schemes and expenditure has risen. In northern Cyprus, the Turkish Cypriot coalition has borrowed money from local banks as it awaits the promised finance from Turkey.

- Banking sector New loans collapsed by 71% year on year during the April lockdown but deposits stabilized in May. Loan suspensions have reached an absolute value of €1.3bn, or 3.9% of all facilities. Hellenic Bank recorded an increase in non-performing exposures in the first quarter. Both Hellenic and Bank of Cyprus have capital ratios well in excess of supervisory targets. In northern Cyprus, loan support schemes have been extended.

- Macroeconomic trends and forecast Retail sales dropped by 28.9% in the full lockdown month of April, which was broadly in line with our expectations. Tourism arrivals have resumed from selected countries. Real estate sales fell by 74.4% in April-May and official indices about prices point in different directions. We expect a real GDP decline of 5.7% in 2020. In northern Cyprus flights will resume on 1 July but all arrivals from or via Turkey will have to bring recent negative Covid-19 tests.

Table 1

Sapienta Economics macroeconomic forecast

	2018	**2019**	***2020***	***2021***	***2022***
GDP at current prices (€ m)	21,138	21,944	*20,612*	*20,383*	*20,729*
GDP per capita (€)	24,294	24,925	*23,226*	*22,786*	*22,989*
GDP at constant 2005 prices (€ m)	20,678	21,346	*20,138*	*20,015*	*20,255*
Real GDP growth (%)	4.1	3.2	*-5.7*	*-0.6*	*1.2*
Harmonized consumer price inflation (%)	0.8	0.4	*-0.4*	*-0.5*	*-0.2*
Unemployment rate (%)	8.4	7.1	*10.3*	*9.6*	*9.1*
Budget balance (ESA2010) (€ m)	-926	603	*-1,340*	*-370*	*-40*
% of GDP	-4.4	2.7	*-6.5*	*-1.8*	*-0.2*
Primary balance (ESA2010) (€ m)	-267	1,142	*-899*	*83*	*348*
% of GDP	-1.3	5.2	*-4.4*	*0.4*	*1.7*
Gross public debt (€ m)	21,256	20,958	*23,863*	*22,805*	*21,731*
% of GDP	100.6	95.5	*115.8*	*111.9*	*104.8*
Current-account balance (% of GDP)	-4.4	-7.6	*-1.2*	*-4.7*	*-2.8*

Sources: Cystat, Ministry of Finance, Sapienta Economics estimates and forecasts in italics.

Political analysis and outlook Next section Previous section

Mr Anastasiades enacts his first major cabinet reshuffle in his second term—

On 22 and 23 June the president of the Republic of Cyprus, Nicos Anastasiades, enacted his biggest cabinet reshuffle since his second term began in March 2018. Mr Anastasiades used the opportunity of the retirement of the Attorney General, Costas Clerides, and the departure to the private sector of the longstanding energy minister, George Lakkotrypis, to bring four new ministers into the Council of Ministers. The dates of inauguration differ slightly but all new posts will be in place by early July.

- Natasa Pilides replaces Mr Lakkotrypis as energy and commerce minister. Ms Pilides had won praise for her record as deputy shipping minister since its establishment in March 2018. Before that, she had served as head of the Cyprus Investment Promotion Agency (CIPA) in 2016-18.
- Emily Yiolitis replaces George Savvides as justice minister. Ms Yiolitis is a commercial lawyer and founding partner of the Cyprus office of Harneys. Mr Savvides moves from the justice ministry to replace Mr Clerides as Attorney General.
- Charalambos Petrides, a real estate professional who was until now the mayor of Aglantzia (part of Nicosia), replaces Savvas Angelides as defence minister. Mr Angelides will move from the defence ministry to become deputy Attorney General, a post which has been vacant since the suspension of the former deputy in 2015.
- Vassilis Demetriades replaces Mr Pilides as deputy minister of shipping. Mr Demetriades has worked in several maritime affairs posts in Brussels, including most recently as policy officer at the European Commission's Directorate-General for Transport (DG MOVE).

—in a move that some suggest prepares Mr Anastasiades for a third term

The appointments of primarily technocrat ministers headed off a range of potential criticisms of Mr Anastasiades over the reputations of other potential candidates. With a commercial lawyer at the helm and a new attorney general, the new appointments may also give a renewed boost to attempts to reform the judiciary and tackle slow-moving court cases, which have been a key obstacle to foreign investment. A new energy minister could provide the opportunity to re-think energy policy, now that investment in renewables is gaining in importance at EU level and the prospects for natural gas exports are increasingly uncertain (see Structural reforms and natural gas). On the other hand, energy is an area in which there are many influencers, both in terms of the relationship between energy policy and the Cyprus problem, and in terms of individuals' commercial interests, therefore significant changes in this area are not guaranteed.

There are also suggestions that Mr Anastasiades picked this team in order to launch a bid for a third presidential term from February 2023. Parliament passed amendments to the constitution in December 2019 to limit the presidency (and vice-presidency, which is vacant because of the Cyprus problem) to two terms. However, the law comes into effect only after the next presidential election. Mr Anastasiades would turn 77 years old later in 2023 and we understand that any decision on re-running would depend on his health at the time.

Turkish Cypriot political scene prepares for leadership elections in October

Movements on the ground to solve the longstanding Cyprus problem remain stagnant, and mistrust between and within the two communities, and between the Greek Cypriot leadership and the UN, has been aggravated by differences over the uncoordinated and therefore confusing reopening of crossing points across the UN-monitored buffer zone, which were closed by both sides as a result of the Covid-19 pandemic. No moves within Cyprus to tackle the Cyprus problem are expected before the elections to the presidency of the unrecognized Turkish Republic of Northern Cyprus (TRNC), which was postponed from 26 April to 11 October in response to the pandemic. The incumbent, Mustafa Akinci, attempted on 19 June to gain parliamentary approval to move the election forward to 16 August, arguing that, since the lockdown was effectively over, there was no excuse to maintain the delay. There was little support among parties for bringing the election any earlier, therefore it seems more likely to take place on 11 October, with a second round on 18 October assuming no candidate receives more than 50% in the first round.

Mr Akinci's move was done partly to answer to those who accused him, at the time of the delay, of holding onto his post unnecessarily. It was also partly done to take advantage of the fact that he is doing well in opinion polls. The most recent poll reported on social media via video put Mr Akinci in the lead at 35.1%. The head of the ruling coalition, Ersin Tatar, remained in second place but had slipped to 17.6%. Despite a strong record in rapidly containing the virus, Mr Tatar's coalition has not benefited from the "rally round the leader" effect, perhaps not least because he has little fiscal room for manoeuvre, and has had to resort to public-sector pay cuts among other measures (see Fiscal performance and forecast). The coalition has also been tainted by an undeclared visit during lockdown of a private jet, which led to the sacking of the tourism minister, Unal Ustel.

Table 2

Comparative Covid-19 reported data
Data as of 26 June 2020 unless otherwise indicated

	CYn (a)	CYs (b)	GR	IL	DE	TR	RU	UK
New cases/million, rolling three-day average	0	1.5	1.1	50.8	6.7	16.7	49.6	13.2
Total confirmed cases/million	270	1,127	319	2,588	2,298	2,290	4,207	4,537
Total reported deaths/million	10.0	21.6	18.3	35.7	106.8	59.8	59.0	638.8
Total tests/thousand (latest dates vary slightly)	92	174	28	93	65	37	124	67
Days since first case	107	108	120	125	150	106	146	147

(a) Northern Cyprus. (b) South: Republic of Cyprus government-controlled area.
Sources: Media and official announcements (Cyprus); Our World in Data (others).

Regional developments seem set to affect maritime issues and/or the Cyprus problem—

While little happens on the ground in Cyprus, regional developments mainly relating to Libya and maritime issues could have a more significant impact on the future direction of the Cyprus problem. The conflict in Libya has drawn in many well armed countries. What makes this conflict somewhat different from Syria is that interests and alliances have not fallen along the usual US-Russia fault lines. Moreover, in its determination to be seen as a key player in the Eastern Mediterranean, Turkey has adopted a policy of escalation, including drilling offshore Cyprus and signing a maritime delimitation agreement with the Government of National Accord (GNA) in Libya; encouraging migrants to try to cross into Greece; engaging and seeking a foothold in Libya; and engaging in other activities that heighten the risk of conflict between Turkey and Egypt, and with fellow NATO allies such as Greece and, more recently, France.

These risks probably explain the recent flurry of diplomatic activity in the region, which includes numerous calls and visits, as well as deals and discussions on maritime zones. On 9 June Greece and Italy overcame longstanding disagreements to sign a maritime accord on the Ionian Sea. On 15 June the US Secretary of State, Mike Pompeo, took part in a meeting of the EU Foreign Affairs Council. Although the official US statement did not mention Libya, unconfirmed reports suggest that the issue was discussed. On 18 June Greece's foreign minister, Nikos Dendias, visited Egypt to discuss maritime delimitation. On 19 June the Italian foreign minister, Luigi Di Maio, visited Turkey and on 24 June, he visited Libya. Greece's prime minister, Kyriacos Mitsotakis, visited Israel on 18 June and Cyprus' foreign minister, Nicholas Christodoulides helicoptered to Israel on 23 June, when the planned visit by Mr Anastasiades was cancelled. The EU's High Representative for Foreign Affairs, Josep Borrell, visited Greece on 24 June, Cyprus on 25 June and is due to visit Turkey in the coming days.

—various actors work on maritime delimitation—

Certain statements that have been made in recent weeks lead us to believe that these meetings could culminate in a broader deal on maritime zones in the Eastern Mediterranean. Officials in both Greece and Turkey said in June that they are willing to discuss maritime delimitation with each other and also pledged on 26 June to keep communication lines open. Various debates in Greece, echoed in remarks by the former Cyprus foreign minister, Ioannis Kassoulides, have centred on a "partial" agreement that would essentially leave out the sensitive island of Kastellorizo, so that Greece and Turkey could strike a deal. A partial agreement was the approach taken by Greece and Italy in resolving longstanding differences to come to a deal on the Ionian Sea. The handling of sensitive areas may be why Turkey's foreign minister, Mevlut Cavusoglu, appeared to welcome the Greece-Italy deal. Turkey has also attempted to persuade Israel to renegotiate its maritime borders with the Republic of Cyprus.

—Mr Anastasiades makes an offer on gas revenues—

Other signs of a potential deal in the making came in a *Politico* interview with Mr Anastasiades on 6 June, where Mr Anastasiades said that if Turkey recognized the Republic of Cyprus Exclusive Economic Zone (EEZ), he was prepared to open an escrow account for natural gas revenues, and that Turkish Cypriots could draw on it even without a solution of the Cyprus problem. There are currently no gas revenues and Turkey will not recognize the EEZ under the current Greek Cypriot only set-up. However, the offer is significant because the suggestion of an escrow account by Mr Anastasiades is unprecedented, although it has been suggested by others in the past. The opposition Progressive Party of Working People (AKEL) attempted to include an explicit provision for sharing revenues with Turkish Cypriots in the national investment fund (sovereign wealth fund) law that was passed in March 2019 but there was not enough support from other parties.

—and the EU seeks a role in mediation between Turkey and the Republic of Cyprus

The most potentially significant development was that Mr Borrell noted in his statement upon visiting Cyprus that the Republic of Cyprus had invited Turkey to discuss delimitation and that the EU "will also be engaging" on the issue. An EU-mediated negotiation would suit the Greek Cypriots because they have always desired to negotiate directly with Turkey in their capacity as the internationally recognized government of the Republic of Cyprus, rather than as the Greek Cypriot community negotiating with the Turkish Cypriot community, which is what the UN mandate requires for any UN-led negotiation. It would also allow for negotiations on hydrocarbons issues without linking them to Cyprus settlement negotiations—something which the Greek Cypriots have long resisted, arguing that hydrocarbons resources is a sovereign issue that should not be discussed at the negotiating table on the Cyprus problem. However, Turkish officials quickly quashed the idea of such a mediation. Time will tell whether Mr Borrell had not been briefed on the sensitivities, or that an EU role had indeed been agreed but that Turkey was forced to save face by issuing a statement, following Turkish Cypriots complaints that Mr Borrell, unlike his predecessor, Federica Mogherini (and other high-ranking EU officials), had not visited Mr Akinci or consulted Turkish Cypriots during his visit.

Structural reforms and natural gas Next section Previous section

Government extends gas licences again—

As we had anticipated in our May issue, the government made use of the parliamentary authorization it had obtained in 2019 to extend contracts for gas drilling, following the collapse in gas prices brought about by the Covid-19 pandemic and moves by oil and gas companies to cut capital expenditure. It emerged on 29 June that the Council of Ministers (cabinet) had approved a one-year extension to the contracts of the ENI-Total consortium the previous week. ENI and Total hold the licences for Blocks 2, 3, 6, 7, 8, 9 and 11, some of which are jointly held with Kogas. As noted in previous reports, the ExxonMobil-Qatar Petroleum had also postponed planned drilling in Block 10 in April. With the confirmatory drilling by Noble also in question (see below), this means that the "intensive" drilling programme which the government had initially said would start in late 2019 will not take place. It also means that Turkey is now the only power drilling in the Republic of Cyprus Exclusive Economic Zone (EEZ), without of course the authorization of the Republic of Cyprus government. Yavuz, the drill ship of the Turkish Petroleum Corporation (TPAO), continues its explorations in an area that overlaps the Republic of Cyprus Block 6 and Block 7. The new energy minister, Natasa Pilides, will therefore assume her post in early July in a difficult global and geopolitical setting (see Political analysis and outlook).

—the plans for Aphrodite look set to be adjusted

In response to speculation about its financial status, Noble Energy has also indicated that its plans for the development of the Aphrodite reserve (licensed to Noble Energy, Royal Dutch Shell and Delek Drilling) could need to be adjusted, while reiterating its continued commitment to the project. The Aphrodite discovery was first made in 2011. Under the revised plan approved after long negotiations only as recently as November 2019, construction of a pipeline to the Idku liquefied natural gas (LNG) plant in Egypt was due to start in 2023 and Noble was tied to strict deadlines. In an interview with the state Cyprus Broadcasting Corporation on 16 June, the outgoing energy minister, George Lakkotrypis, was eager to stress binding timeframes. The government technically has the right to take back the field (the government took part of Block 12 which surrounds it some years ago) but if market conditions are such that a renegotiation of the contract will be deemed necessary, the threat of withdrawal will be a weak one. Additional problems for the consortium arise from the fact that the Idku LNG plant in Egypt has stopped shipping LNG cargoes since prices fell below production costs. The issue of the neighbouring Israeli Yishai reserve is also still pending. If the consortium does remain committed to the reserve's development, therefore, the government might well be dragged into a new negotiation on the Production Sharing Agreement (PSA). Another project with an even bleaker outlook is the East Med pipeline, which aims to link Israel, Cyprus, Greece and eventually Italy. Despite its significant commercial challenges, the parties involved continue to promote it, as it has geopolitical value. Greece, which is currently facing a threat by Turkey to drill in blocks Greece has licensed south of Crete, is currently particularly keen to assert that the project remains alive.

Gas import infrastructure gets the financing to proceed—

The changing fortunes of natural gas in the Eastern Mediterranean have not affected the government's plans to import natural gas for electricity production and its intention to build an LNG import terminal by 2022 with finance from the European Investment Bank (EIB) and

European Bank for Reconstruction and Development (EBRD). Cyprus still uses heavy pollutants for well over 90% of electricity production and will face steep penalties from 2021 as the EU's emissions trading scheme becomes more restrictive. Despite challenges within the EIB, primarily because of the Chinese participation in the consortium, but also because it was considered by the challengers as an uncompetitive bid, the EIB approved a €150m loan to the Natural Gas Infrastructure Company (ETYFA) during June to fund the construction of an Floating Storage and Regasification Unit (FSRU) terminal in Vasilikos on the south coast. ETYFA has also secured a grant of €101m from the Connecting Europe Facility (CEF), while local media reported that the European Bank for Reconstruction and Development (EBRD) had approved additional funding of €80m. The financing of the project had been in doubt owing to pledges by European financial institutions to focus on green investment but the Covid-19 pandemic appears to have prompted the EBRD in particular to ramp up all of its investments. We understand that the consortium has two years to build the infrastructure. The launch of the terminal project is scheduled for 9 July, with a ceremony that will take place at Vasilikos. This will be the last act of the departing energy minister, Mr Lakkotrypis, who had declared the import of natural gas for electricity production as one of his goals when he received his ministry's portfolio, but who will leave without its completion.

—as an offer from Hoegh is declined

Developments with the state-owned FSRU project come at a time when Hoegh LNG of Norway applied to the authorities for an LNG infrastructure ownership, operations, and development licence in Cyprus. Hoegh insisted that it was offering merely an interim solution, until the LNG import terminal had been constructed. In the application Hoegh said that it was able to meet the government's deadline of installing an FSRU and a pipeline to serve the state-owned Electricity Authority of Cyprus (EAC) power plant in Vasilikos within the first quarter of 2021—that is, well ahead of what can be achieved by the Natural Gas Public Company (DEFA) with the abovementioned LNG import terminal. During June Hoegh reportedly sent detailed data on the financial aspects of its proposal to DEFA. Owing to the state monopoly on natural gas supply, Hoegh would have to sign a memorandum of understanding with ETYFA on the LNG supply and regasification, before the Cyprus Energy Regulatory Authority (CERA) would consider Hoegh's offer.

The authorities have been reluctant to embrace Hoegh's offer, however, and while declaring that they are willing to consider it, statements by officials have indicated that DEFA believes that the interim period (between early 2021 and 2022 assuming the LNG import terminal is built on time) is too short a period for Hoegh's offer to be worthwhile. While Hoegh's offer does not challenge the state monopoly on the LNG supply, the various power plays over gas and electricity have long avoided considering alternative scenarios. Cypriot businesses pay the highest electricity prices in the EU. The challenge for DEFA and the government that have chosen the FSRU construction project against other options, therefore, is to keep to the schedule that Cyprus can reach the long-delayed goal of importing gas for electricity production, cutting the cost of emissions (at least in relative terms) and reducing the price of electricity.

Second phase of National Health System rolls out as planned

The second phase of the National Health System (GESY) with in-patient care was eventually launched as planned, on 1 June, with last-minute deals still being made between the doctors union (PASYDY) and the state-health services (Okypy) on 29 June. As of June 2020 GESY beneficiaries are allowed to change their GP (family doctor) every six months, compared with every three months from October 2019. As in the first phase of GESY, complaints have also been raised about reported abuses by some doctors. Nevertheless, while the system is still adapting to a setting in which Covid-

19 is still part of people's lives, it is evident that GESY has belied the most ardent of critics and has managed to prove itself resilient in the face of the various interests that tried to prevent its launch.

New fleet promises to modernize an outdated bus system

Cyprus will take some steps towards modernizing an outdated and underused public transport system on 5 July, when the new public transport company, Cyprus Public Transport (CPT), begins operating routes in Nicosia and Larnaca. As is often the case with attempts to reform, the concessions process was plagued by obstacles and objections from other bidders, in this case the 2010-20 service-holders. The legal disputes are also why the changes will only take place for Nicosia and Larnaca. CPT says that the new buses will have lower emissions, better accessibility for people with mobility difficulties, air-conditioning, WiFi, USB ports and a location tracking system. While these might be obvious changes, Cyprus has seriously lagged behind on the quality and public acceptability of public transport. The CPT's chief executive officer, Julio Tironi, said that only around 2% of the population currently uses a bus. In the initial phase of the transition that starts in July, existing routes will remain in place, with new routes expected from October.

Fiscal performance and forecast Next section Previous section

Table 3

Fiscal and banking measures taken in response to Covid-19, updated June 2020 € million	
Fiscal support	
Direct grants to smaller businesses	100.0
Cyprus contribution to EIB Pan-European Guarantee Fund (worth €300m-€400m for Cyprus)	32.5
VAT reduction for tourism enterprises	20.0
Airline subsidies	6.4
Tourism promotion	10.0
Tax return postponement (payments due within 2020)	0.0
Measures announced at the end of March 2020 (a)	813.0
Measures taken in April-May (extensions to wage support schemes & rental tax deduction)	*318.1*
Total fiscal support as reported	**1,200.0**
% of GDP Sapienta-estimated GDP in 2020	5.8
Liquidity support	
Interest-rate subsidies over four years	180.0
Cyprus Enterprise Fund SME loans (of which the government takes 50% of the risk)	800
Government guarantees for €500m of mid-cap EIB-related loans	500
EIB Pan-European Guarantee Fund (top end of government €300m-€400m estimate)	400
Total liquidity support	**1,880**
% of GDP Sapienta-estimated GDP in 2020	9.1
Total fiscal and liquidity support	**3,080.0**
% of GDP Sapienta-estimated GDP in 2020	14.9

(a) Detailed in Table 4 of April 2020 issue.

Sources: Ministry of Finance; PIO; Sapienta inferences in italics.

Elements of a third economic support package are rolled out

The finance minister, Constantinos Petrides, announced on 26 June the formal launch of two parts of the third economic package which we had detailed in our May issue, following approval from the European Commission state aid authorities. The first measure involves interest-rate subsidies ranging from 1.5% to 3.5% for small and large businesses, new businesses and the self-employed, and a separate measure for new housing loans. According to the European Commission, the interest-rate subsidies amount to €180m (down from an earlier estimate of €200m). The second part, amounting to €100m, involves direct grants of €1,250-€6,000 to businesses. In a statement on 17 June, Mr Petrides said that total fiscal support announced to date had reached €1.2bn and total liquidity support had reached amounted to €1.7bn. In another statement, he said these both amounted to 15.1% of GDP, which is close to our estimate of 14.9% of GDP (see Table 3). Adding the €180m in interest-rate subsidies to the fiscal support, this amounts to a direct fiscal impact of €1.4bn, or 6.7% of GDP (revised down from an estimated 7% of GDP in our May issue).

Yields on Treasury bills continue to rise—

The latest fiscal accounts put public debt at the end of April at €24.4bn, or 118.6% of Sapienta-estimated GDP for 2020, compared with 95.5% of GDP in 2019. As we have noted in previous issues, the high level of debt issuance in the first few months of this year means that government has very considerable cash reserves. They amounted to €4.5bn at the end of May, which is enough to cover debt payments until the end of 2022, and even much of 2023. Nevertheless, the combination of a shift from budget surplus to budget deficit, together with the sharp increase in the debt/GDP ratio, has been reflected in a rise in yields on 13-week Treasury bills (see Charts). The yield reached 0.14% on 26 June, compared with -0.02% on 3 January. International markets seem to be more sanguine, however: yields on secondary market 10-year international bonds have been generally down since their peak of 2.189% on 22 April, reaching 0.93% on 29 June. The spread of yields against the benchmark German Bund have also generally been falling since 20 April, although they saw an uptick in late June.

There have been some suggestions by academics that the government should have waited to issue the €1.75bn international bond that it issued on 7 April, given that bond yields eventually fell, and that it therefore cost the taxpayer tens of millions of euros more than it should have done. The Public Debt Management Office (PDMO) issued a lengthy defence to the article. It is true that there was a great deal of uncertainty at the time: it was not clear that the eurozone authorities would be able to agree on significant fiscal support; Fitch Ratings agency, which rates Cyprus one notch inside investment grade, had just shifted its outlook on Cyprus from positive to stable; and the European Central Bank (ECB) did not clarify that it could accept junk-rated assets until later in April. While the size of current cash reserves suggests that government might not have needed to borrow as much as it did at the time, it also seems unlikely that the government could have successfully timed the market during such a volatile period. The size of the issue, therefore, rather than the specific timing, is probably a more pertinent criticism.

—as revenues drop again in May on the back of declining social insurance contributions

The government is now indicating that it will not be able to afford to support a second wave of infections, should that occur. The latest fiscal accounts show another sharp year-on-year decline in revenues of 38.5% in May, following a drop of 35.1% in April. Expenditure, meanwhile, rose by 31.8% in May, following a rise of 22.7% in April. This led to a general government deficit of €457m in May alone and €529m for the first five months of the year. The primary balance (balance excluding interest payments) recorded a deficit of €718m in May and €359m in the first five months of the year.

The main reason for the collapse in revenues has been the decline in social insurance contributions, which shrank year on year by €162m or 40% in April-May. While there was no suspension of social insurance payments as such, contributions will have been affected by the large number of retail and tourism workers on furlough (income support) schemes. These two sectors alone account for 20% of employment. Announcing the third support package on 17 June, the labour minister, Zeta

Emilianidou, said that the scheme would involve 50,000 beneficiaries, which is just under 12% of all employment. Revenue from social insurance contributions should start to recover from June, as more parts of the economy opened up again, although there is an expectation that large numbers of seasonal tourism workers will not be hired at all this year. One factor that will offset the expected decline from employment contributions will be the delayed increase in contribution rates for the national health system (GESY). From 1 July rates are due to increase by from 1.85% to 2.90% for employers and 1.70% to 2.65% for employees. In absolute terms the other major decline was in VAT receipts, which fell year on year by €72m or 24.5% in April-May. The decline in VAT was probably exacerbated by the fact that, at the start of the Covid-19 crisis, few retailers had the infrastructure for online sales and delivery, although this is beginning to change. According to a report by KMPG Cyprus, only 17% of Cypriot consumers regularly bought online, compared with an EU average of 55%.

Table 4

General government accounts (ESA2010)
€ million unless otherwise stated

	Jan-Dec 2019	Jan-May 2019	Jan-May 2020	% change year on year
Total revenue	**9,047**	**3,340**	**2,933**	**-12.2**
VAT on products & services	2,122	798	712	-10.8
Personal income tax: public sector	180	65	71	9.5
Personal income tax: private sector	310	128	128	0.1
Defence contribution (a)	307	182	149	-18.4
Total corporate tax	894	144	145	1.0
Social security contributions	2,348	936	823	-12.1
Property income	148	64	5	-92.0
Revenue classified as "other"	1,131	370	379	2.6
Total expenditure	**8,667**	**3,139**	**3,462**	**10.3**
Compensation of employees	2,734	1,007	1,056	4.8
of which: public-sector pensions	573	214	213	-0.1
Intermediate consumption	1,183	302	497	64.8
Social payments	2,836	1,055	1,111	5.3
Pensions	1,371	519	542	4.5
Unemployment	83	53	54	1.5
Other social transfers	1,382	484	516	6.6
Interest	551	144	169	18.0
Gross fixed capital formation	370	86	130	51.0
Expenditure classifed as "other"	924	527	286	-45.8
General government balance	**380**	**201**	**-529**	**-363.2**
% of GDP	1.7	-	-	-
Primary balance	**931**	**344**	**-359**	**-204.4**
% of GDP	4.2	-	-	-

(a) Mainly dividends and interest income.
Source: Cystat.

We have revised our fiscal forecast

Assuming that the pace of decline in revenues starts to slow from June as employees return to work, tourism arrivals slowly begin to rise and the GESY contributions boost income, we expect total revenues to shrink by 11.5% for the whole year. The pace of expenditure growth should also ease for the same reasons. However, data for April and May, combined with the third support package indicating that some elements of support will continue until October and possibly beyond, have led us to revise our forecast and we now expect a significant increase in expenditure for the whole of 2020. An expenditure rise of 10.2% will push the general government budget into a forecast deficit of €1.3bn, or 6.5% of GDP, and the public debt to 115.8% of GDP. Our forecast public/debt ratio is a little lower than the government's estimate of 116.8% of GDP announced on 12 June. The debt/GDP ratio will only come down again from 2021 if the government manages to post primary surpluses. This will depend to a large degree on the course of the Covid-19 virus and whether or not there is a second wave that continues to shut out key tourism markets.

Table 5

Sapienta Economics budget and debt forecasts (ESA 2010)
€ m unless otherwise indicated

	2018	2019	2020	2021	2022	2023
General government revenue	8,287	9,258	*8,196*	*8,024*	*8,136*	*8,448*
% change	7.2	11.7	*-11.5*	*-2.1*	*1.4*	*3.8*
General government expenditure inc. one-offs (a)	9,213	8,655	*9,536*	*8,395*	*8,176*	*8,448*
% change	24.6	-6.1	*10.2*	*-12.0*	*-2.6*	*3.3*
General government budget balance inc. one-offs	-926	603	*-1,340*	*-370*	*-40*	*1*
% of GDP	-4.4	2.7	*-6.5*	*-1.8*	*-0.2*	*0.0*
Primary balance inc. one-offs	-267	1,142	*-899*	*83*	*348*	*327*
% of GDP	-1.3	5.2	*-4.4*	*0.4*	*1.7*	*1.5*
One-off expenditure (a)	1,564	0.0	*0.0*	*0.0*	*0.0*	*0.0*
Gross government debt inc. one-offs	21,256	20,958	*23,863*	*22,805*	*21,731*	*21,217*
% of GDP	100.6	95.5	*115.8*	*111.9*	*104.8*	*99.1*
Memorandum item: balances excluding one-offs						
General government expenditure exc. one-offs	7,649	8,655	*9,536*	*8,395*	*8,176*	*8,448*
% change	3.4	13.2	*10.2*	*-12.0*	*-2.6*	*3.3*
General government balance exc. one-offs	638	603	*-1,340*	*-370*	*-40*	*1*
% of GDP	3.0	2.7	*-6.5*	*-1.8*	*-0.2*	*0.0*
Primary balance exc. one-offs	1,298	1,142	*-899*	*83*	*348*	*327*
% of GDP	6.1	5.2	*-4.4*	*0.4*	*1.7*	*1.5*

(a) €1.6bn fiscal impact of co-op deal (2018).
Sources: Ministry of Finance; IMF; Sapienta Economics estimates and forecasts in italics.

Turkish Cypriot coalition announces another set of Covid-19-related measures

As of the end of June, the ruling coalition of the unrecognized Turkish Republic of Northern Cyprus (TRNC) had not received any of the promised three-year financing amounting to ₺2.28bn (around €300m) from Turkey (see our May 2020 issue) and there were few expectations that it would come any time soon. The coalition has instead issued another ₺88m in 190-day Treasury bills at a yield of 9.665%, following the ₺71m 189-day bill issued in May (at 9.71%). Clearly, short-term borrowing is expensive, therefore the coalition is in discussions about establishing a local bond market.

On 22 June the coalition announced a new set of measures amounting to ₺1,144m (€148m) of economic support to tackle the Covid-19 pandemic. This follows ₺750m of measures implemented in March to May. The largest of these measures, such as the pandemic hospital and full reimbursement of cuts to municipalities and the public sector, are likely to depend on funds arriving from Turkey.

- **Social security contributions.** 75% coverage from June to December for all private-sector employees apart from those working in banks, casinos, nightclubs, betting offices and GSM operators.

- **100% social security coverage** plus ₺500 (€65) per month salary subsidy between March and September for TRNC citizens (only) employed by established businesses.
- **100% social security coverage for 24 months** plus ₺500/month salary subsidy for 12 months for TRNC citizens employed by new businesses.
- **Direct grants.** Micro businesses of up to five employees (excluding the abovementioned sectors) will be eligible for direct payments of ₺2,000 (€260) per month in July and August. This measure excludes the abovementioned sectors, as well as supermarkets, butchers, pharmacies and doctors.
- **Wage support.** The ₺1,500 (€195) per month for business that had to suspend operations will continue to apply to business that had to remain closed in May (such as hotels, tourism agents, public transport, sport centres). However, so far only payments for the month of March had been made.
- **Electricity subsidies.** Increased subsidy on electricity from 10 KR cents to 25 KR per KwH for industry, tourism, higher education and agriculture.
- **Unemployment benefit** levels will be returned back from ₺1,500 to the previous level of ₺2,500 by August.
- **Reinstating other cuts.** The 25% cut in public-sector salaries and ₺8,500 cap will be lifted and cuts made will be reimbursed. Salary cuts made in March have already been reimbursed. These cuts had saved the coalition ₺60m-65m per month but, with a presidential election coming, it was considered politically untenable to continue with them. The 20% cut in municipality funding will also be reimbursed, although this is likely to depend on funds coming from Turkey.
- Other measures include construction of a pandemic hospital, subsidies for dairy exports, lower stamp duties, renewal of the lower 5% VAT rate for car sales, postponement of court fines and the establishment of an economic plan to prepare the three-year plan for Turkey by October. There were also measures relating to loans (see Banking sector).

Table 6

Turkish Cypriot central budget outturns
₺ million; excludes social insurance

	2018 Year	2019 Year	% change	2019 Jan-May	2020 Jan-May	% change
Total revenue, of which:	5,506	7,403	34.5	2,444	2,643	8.2
Taxes	3,799	4,969	30.8	1,669	1,589	-4.8
Excise duties on fuel	647	787	21.6	298	267	-10.4
Collections of receivables	0	166	-	0	266	-
Grants from Turkey (a)	447	579	29.5	0	54	-
of which: defence (Turkish Cypriot military)	170	512	200.3	0	54	-
Credit from Turkey (b)	41	0	-100.0	0	0	-
Total expenditure, of which:	5,452	7,688	41.0	2,549	2,653	4.1
Personnel expenses	1,873	2,480	32.4	865	926	7.0
Transfers to households	1,273	1,723	35.4	676	626	-7.5
Pensions	777	1,032	32.9	381	429	12.4
Defence (Turkish Cypriot military)	170	512	200.3	131	144	9.9
Balance inferred	***53***	***-286***	-	***-106***	***-10***	-
Memorandum item						
Consumer price inflation rate (%)	-	-	19.5	-	-	11.3

(a) Grants for infrastructure, defence and the real sector.
(b) Budget support.

Source: KKTC Maliye Bakanlığı; Sapienta inferences in italics.

Banking sector Next section Previous section

New loans collapsed during the April lockdown—

The most recent data from the Central Bank of Cyprus show that new pure loans (that is, excluding restructured loans) dropped by 71% year on year in April to just €84m, compared with €289m in April 2019. A steep fall is not surprising, given the economic uncertainty and that physical movement was severely restricted at that time. However, new loans were already declining in the fourth quarter, reflecting the general slowdown and fall in real estate demand. The quarterly Bank Lending Survey reported that demand for both business and household loans had increased in the fourth quarter of 2019, and had been expected to increase in the first quarter for all but non-housing loans. The national and EU authorities have put considerable resources into either preventing an increase in non-performing loans (NPLs) or encouraging new loans (see box). But we expect it will be well into 2021 before this is reflected in new lending figures.

Table 7

Pure new banking loans in key segments (a)
€ million unless otherwise stated

	2019 Q1	2019 Q2	2019 Q3	2019 Q4	2020 Q1	Apr-20
Consumer credit	35	44	43	40	38	4
Year-on-year % change	*-18%*	*-1%*	*12%*	*8%*	*9%*	*-67%*
House purchase	219	235	215	205	160	19
Year-on-year % change	*4%*	*0%*	*15%*	*-13%*	*-27%*	*-75%*
Other household loans	41	62	49	29	40	13
Year-on-year % change	*-13%*	*53%*	*16%*	*-46%*	*-3%*	*-14%*
Business loans under €1 million	113	119	96	109	80	16
Year-on-year % change	*-11%*	*-8%*	*-16%*	*-19%*	*-29%*	*-63%*
Business loans over €1 million	442	448	321	329	217	32
Year-on-year % change	*45%*	*13%*	*3%*	*-20%*	*-51%*	*-78%*
Total pure new loans	**849**	**909**	**723**	**713**	**535**	**84**
Year-on-year % change	*16%*	*8%*	*5%*	*-19%*	*-37%*	*-71%*

(a) Pure new loans exclude restructured loans.

Source: Central Bank of Cyprus.

—and deposits stabilize in May

After a drop of €365m in March to €38.7bn, domestic deposits in the banking system fell by a milder €74m in April and rose by €11m to reach €38.6bn by the end of May. Total deposits including eurozone and non-eurozone residents amounted to €47.8bn at the end of May, compared with €48.4bn at the end of February. The kinds of shifts are less extreme than in the run-up to the banking crisis in March 2013, when €2.7bn left the system in January and February (before the deposit haircut/bail-in). The banking system is also much more liquid than it was in 2013, with €15bn in excess deposits, compared with a shortfall of €6.7bn in February 2013. However, the sheer size of the excess deposits is also a reflection of a much tougher environment for lending, which in turn will ultimately hurt bank profits. In the banking system as a whole, net interest income accounted for 69% of total net operating income in 2019.

Loan suspensions reach €3.9% of all facilities by the end of May

By 28 May the amount of loans under the loan-suspension scheme had reached €1.3bn according to Central Bank of Cyprus data, while the gross carrying amount of loans affected had reached €10.8bn (see Table 8). The suspended €1.3bn is equivalent to around 5.4% of all performing loans or 3.9% of all loans. Households accounted for 88% of the borrowers who had taken up the scheme but only 30% of the €1.3bn suspended. As would be expected, tourism, real estate and wholesale and retail trade have been the biggest users of the scheme. The wholesale and retail trade sector also accounts for the largest share of non-performing exposures (NPEs), having overtaken construction in mid-2018. This could be a sector that will see a slower decline in NPEs in the future, especially as inflation data show that the clothing sector in particular has already seen a great deal of price competition in recent years.

Table 8

Loan suspensions as of 22 May 2020

	Suspended amount (€ million)	Gross carrying amount (€ million)	Absolute number of instruments	Absolute number of borrowers
Households	381	4,366	69,042	40,775
Non-financial corporations	888	6,405	13,939	5,562
Accommodation & food services	n/a	1,682	n/a	668
Real estate services	n/a	1,199	n/a	612
Wholesale & retail trade	n/a	950	n/a	1,609
Total	**1,269**	**10,771**	**82,891**	**46,337**
% of performing loans as of January 2020	5.5	46.3	-	-
% of all loans as of January 2020	3.9	33.3	-	-

Source: Central Bank of Cyprus.

Table 9

Bank result highlights
Year-to-date

	BOC 31-Mar-20	**HB 31-Mar-20**
Net profit/loss (€ m)	95	-2
Customer deposits (€ m)	16,246	14,136
Gross loans (€ m)	12,709	7,256
% of total banking loans	37.9	21.6
Year-on-year change in net interest income (%)	0.4	-8.1
NPEs EBA definition (€ m)	3,738	2,293
NPE ratio EBA definition (%)	29.4	31.6
Provisions/gross loans EBA definition (coverage ratio) (%)	56.0	57.7
Common equity Tier 1 (CET1) ratio (%)	14.3	19.2
Net interest margin (%)	1.9	1.8

Sources: Financial statements, investor presentations and key performance indicators.

Hellenic Bank sees an increase in NPEs in the first quarter

Hellenic Bank reported a net loss of €2m in the first quarter of 2020, while Bank of Cyprus (BOC) reported a net profit of €95m. One key development in the first quarter for Hellenic Bank was an increase in non-performing exposures (NPEs), which the bank said was the result of both defaults and interest accrual. While the increase was not large, one can infer from the financial statement that the increase came from loans acquired from the Cyprus Cooperative Bank, which are covered by a state guarantee (the Asset Protection Scheme). The bank also said that the schedule for disposing of bad loans had been disrupted by the Covid-19 pandemic—something which also affected BOC. Hellenic Bank is generally in a much more comfortable position than BOC, however, with a coverage ratio (accumulated provisions as a proportion of NPEs) of 57.7%, compared with 56% for BOC and a common equity tier 1 (CET1) ratio of 19.2%, compared with 14.3% for BOC.

However, BOC's ratio is still well above the supervisory target of 14.3%, therefore it seems unlikely to be called upon to raise capital in the short term.

Liquidity support measures for the banking sector

• €180m of interest-rate subsidies from the government. Two schemes for new equity and business investment and new housing loans.

• 50:50 risk-sharing by the government on the €800m Cyprus Enterprise Fund (new loans only).

• State guarantees to the EIB on €500m of mid-cap EIB loans (new loans only).

• €300m-€400m from the Pan-European Guarantee Fund (new loans only).

• The €1.35bn ECB pandemic emergency purchase programme (PEPP).

• ECB easing of collateral requirements.

• More favourable ECB rates for longer-term refinancing operations known as TLTRO III.

• Liquidity support via pandemic emergency longer-term refinancing operations (PELTROs)

• EBA easing of capital requirements.

Table 10

Key indicators of the Turkish Cypriot banking system
₺ million unless otherwise stated

	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19
Gross loans	18,906	19,824	20,347	20,200	22,573
In Turkish lira	9,406	9,610	9,807	9,962	10,934
In foreign exchange	9,499	10,214	10,542	10,238	11,640
Deposits	26,442	28,449	29,572	30,225	32,837
In Turkish lira	10,605	10,729	11,338	12,171	13,014
In foreign exchange	15,837	17,721	18,234	18,054	19,823
NPLs (90+ days past due) (a)	1,045	1,085	1,103	1,104	1,266
NPLs in € million equivalent (a)	€172	€171	€168	€180	€189
NPL ratio (%) (a)	5.5	5.5	5.4	5.5	5.6
Coverage ratio (%)	68.3	67.4	66.5	67.0	60.6
Memorandum item					
TRY per EUR (end-period)	6.0588	6.3446	6.5655	6.1491	6.6843

(a) Does not include arrears of public organizations.
Source: KKTC Merkez Bankası.

Covid-19 measures in the Turkish Cypriot banking system, updated June 2020

A number of measures are in place to support borrowers in northern Cyprus during the Covid-19 crisis, and more adaptions were agreed during June.

A three-month suspension for principal and interest payments on loans from 31 March to 30 June and until 30 September for tourism and student accommodation loans under the Development Bank. All loans are eligible. The amount due will be added at the end of the payment period, and therefore effectively extends the maturity of the loan. Banks (which are not under IFRS rules) will count the deferred interest as receivables in their accounts.

Subsidized interest rates up to ₺1.5bn (€195m) (formerly ₺1bn) for new 36-month loans (up from 15 months) via the Interest Rate Differential Fund. The initiative is essentially being financed by banks, as the Turkish Cypriot central bank increased the quarterly premium on deposit insurance from 1.5% to 1.75% of deposits and will use the extra revenue from March and June to finance the fund. Borrowers will pay 9% interest on loans (below inflation) and the fund will pay 3%. They will also enjoy a six-month grace period. The higher subsidy and longer maturity were implemented in response to low demand, as so far take-up has reportedly amounted to only around ₺100m-₺200m (€13m-€26m).

Another measure, which we understand is also financed by the banks, is the Credit Guarantee Fund. This fund, administered by the Turkish Cypriot central bank, provides a 80% guarantee on loans to small and medium-size enterprises (SMEs), as long as the NPL ratio does not exceed 15%, thus allowing cheques to be cleared. There is also some discussion about how much of the guarantee can be taken on by the Turkish Cypriot administration.

A new measure agreed with banks is to restructure non-performing loans, which have been rising in recent months. Stamp duty fees on new loans and the transfer of loans to other banks have also been reduced.

The minimum payment on credit cards has been reduced until September to 1% from 10% and the interest rate has been cut to 1% from 2.35%.

Macroeconomic trends and forecast Next section Previous section

Retail sales drop by 28.9% in the severest lockdown month of April

The volume of retail sales fell year on year by 28.9% in April, as most of the economy was under a strict lockdown, following a decline of 1.4% in March. As we had expected, retail sales of food were the exception, rising year on year by 7.1% in April, following an even higher increase of 23.3% in March, probably as consumers stockpiled ahead of the severest part of the lockdown, which lasted from 31 March to 4 May. However, despite strong demand, even food retailers were discounting during the lockdown. The breakdown of data on retail values shows that the value of food sales rose by 5.7% in April, implying an overall price-cut for food items of 1.8%.

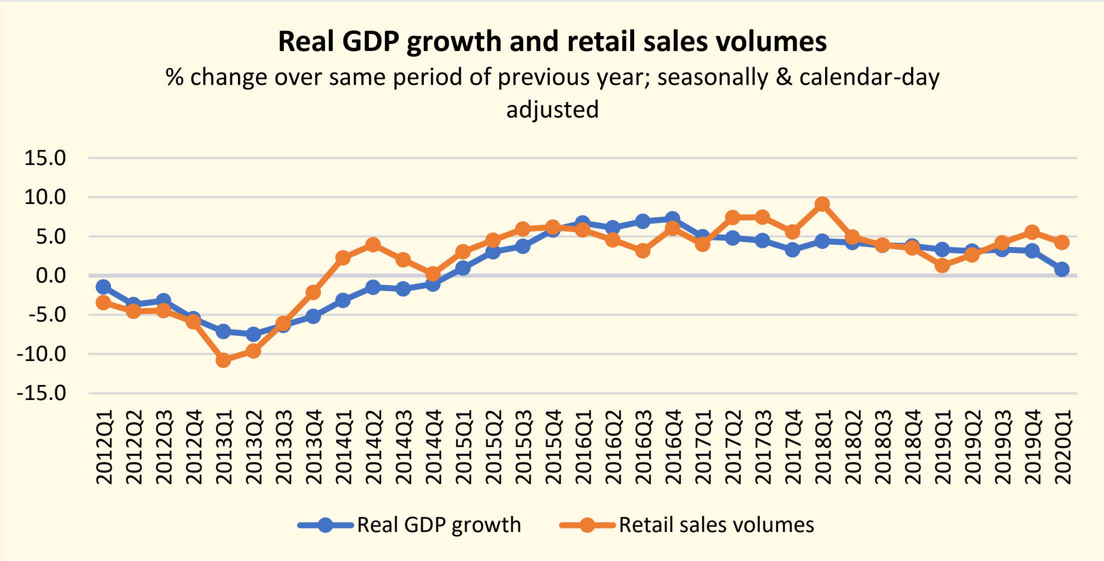
Table 11

Retail trade volume excluding motor vehicles
% change over same period of previous year; not seasonally adjusted

	2019 Q3	2019 Q4	2020 Q1	Mar-20	Apr-20
Food, drink & tobacco	4.5	4.9	14.8	23.3	7.1
In non-specialized stores	5.3	5.1	15.6	-10.8	-56.3
In specialized stores	-1.1	3.2	8.3	10.0	9.4
Non-food products (except auto fuel)	4.6	6.9	-3.8	-26.8	-64.9
Textiles, clothing & footwear	8.9	6.8	-10.3	-59.2	-97.3
Electrical goods & furniture	1.0	5.8	-6.0	-31.2	-68.6
Computer equipment, books & other	3.8	6.4	-2.2	-17.4	-61.7
Other trade in non-specialized stores	-0.5	4.8	1.9	-10.8	-56.3
Auto fuel in specialized stores	2.4	2.5	-7.6	-24.5	-60.7
Total retail trade volumes	**4.3**	**5.6**	**4.7**	**-1.4**	**-28.9**
Retail trade values	1.6	3.5	4.6	-2.3	-30.2

Source: Cystat.

The April data broadly support the assumptions made in our May issue about the pace of real GDP decline. Inferring from the quarter-on-quarter real GDP contraction of 1.3% in the first quarter, the ban on incoming flights and the first stage of the lockdown implemented on 21 March, we had estimated that GDP fell by 23% relative to the previous period in the final week of March, and that the output decline for the whole of April was similar, *relative to February*, to the last week of March. These assumptions translate into an estimated year-on-year GDP decline of 21.6% for the month of April. As retail sales tend to follow real GDP growth, but drop less severely during downturns, the 28.9% fall in retail sales in April is broadly compatible with our real GDP forecast produced in May.



Real GDP growth and retail sales volumes
% change over same period of previous year; seasonally & calendar-day adjusted

We have revised down our forecast slightly

Registered unemployment rose sharply again in May compared with the same period of the previous year (see Charts). However, as in April, this was again the result of an automatic rollover of seasonal tourist workers who would typically have returned to work. There are so far no statistics on income support schemes by sector, therefore it is difficult to tell how much of this unemployment increase is permanent. Nevertheless, given the steep decline in government revenue (see Fiscal performance and forecast) and continued uncertainties about tourism (see below), we have revised down our forecast slightly. We now expect a real GDP contraction of 5.7% in 2020, and a smaller contraction of 0.6% in 2021.

Table 12

Real GDP growth forecast
Seasonally adjusted; % change over period indicated

	19Q1	19Q2	19Q3	19Q4	20Q1	*20Q2*	*20Q3*	*20Q4*	2019	*2020*	*2021*
Previous year	3.4	3.2	3.2	3.2	0.8	*-8.3*	*-7.3*	*-7.7*	3.2	*-5.7*	*-0.6*
Previous quarter	1.0	1.1	0.0	1.0	-1.3	*-8.0*	*1.0*	*0.6*	-	-	-

Source: Cystat; Sapienta Economics forecasts in italics.

Tourism resumes amid uncertainty

As regards tourism, passenger flights for a continuously updated list of "Category A" and "Category B" countries began from 9 June, and a range of procedures are in place for testing and isolating those who come. Travel agents have said that they hope to reach 1 million tourists in 2020. This would be equivalent to an annual decline in arrivals of 75%. One early negative development for potential tourism demand came when Israel was downgraded from Category A to Category B, following a rise in Covid-19 cases there. Category B does not preclude arrivals from Israel outright but means that tourists must arrive with proof of a negative Covid-19 PCR test conducted within the past 72 hours. Israel was the third largest tourism market in 2019, accounting for 7.4% of all arrivals, after the UK (33.5%) and Russia (19.7%). Neither the UK nor Russia is on the list of allowable countries, and tourism operators had been focusing among others on Israel and Germany to fulfil most of the demand.

Real estate sales drop across all regions as parliament examines the passport scheme—

Real estate sales dropped by 74.4% year on year in April-May. The hardest hit region was Limassol, which was already feeling the after-effects of a boom related to the citizenship by investment (passport) scheme. The scheme's rules were tightened in May 2019, following bad publicity in a series of international news reports about the probity of those who had received passports, in addition to pressure from the EU. While there were initially calls to speed up citizenship approvals at the beginning of the Covid-19 crisis, the government has in practice proceeded more cautiously. It emerged during a parliamentary debate on 30 June that no citizenships had been approved so far this year. The debate in parliament centres on codifying the requirements for passports, including giving the state the ability to withdraw citizenship within the first 10 years for serious criminal cases. Local and international media had reported in 2019 that the government would revoke some 26 citizenships, following the scandal about issuing citizenship to a Malaysian fugitive. However, revoking citizenship is more tricky in practice and is likely to need changes to the constitution. The new rules will also require a higher donation of €150,000 (up from €75,000 introduced in May 2019), which will go to social housing and entrepreneurship programmes. The real estate market will still be buoyed by the requirement to invest €500,000 in residential housing but a broader range of investment options will now be available for the remaining €1.5m-€2m.

Table 13

Real estate sales by region
Contracts of sale unless otherwise indicated

	2019Q2	2019Q3	2019Q4	2020Q1	2020 Apr-May
All Cyprus	**3,194**	**2,176**	**2,630**	**1,991**	**635**
% change year on year	36.4	-2.7	3.7	-15.8	-74.4
Nicosia	527	414	571	514	138
% change year on year	26.7	7.5	30.7	5.8	-63.9
Limassol	1,193	722	808	548	184
% change year on year	37.8	-12.7	-12.5	-31.0	-81.1
Larnaca	415	352	444	371	83
% change year on year	26.1	7.6	22.7	3.9	-73.5
Famagusta	226	119	162	138	38
% change year on year	17.7	-23.7	8.0	-5.5	-79.2
Paphos	833	569	645	420	192
% change year on year	54.8	5.2	-2.9	-28.0	-69.4
Memorandum items					
All Cyprus transfers of sale (cases)	3,897	3,810	4,373	2,701	862
% change year on year	-1.7	7.3	3.7	-19.7	-65.9
All Cyprus value of transfers(a) (€ million)	943	798	960	580	171
% change year on year	-0.9	31.3	-2.8	-32.1	-71.4

(a) Price accepted by the Land Registry.

Source: Land Registry.

While the passport scheme helped banks reduce non-performing loans and kept employment rates buoyant in the construction sector, it has attracted three key criticisms. First, it has reinforced persistent perceptions in the international media about Cyprus' reputation as an international business centre. Second, it has focused largely on unproductive investment (construction). Third, there are accusations that it has kept real estate prices artificially high. At the beginning this helped banks, as it meant that they did not have to reduce the value of collateral on their books and adjust capital levels accordingly. However, if the real estate market is overpriced, it is arguably standing in the way of banks and managers of bank assets from selling loans backed by property.

—and real estate price indices differ starkly

One of the problems with assessing real estate prices is that they are produced with a lag of around six months. Another is that the two official sources differ starkly from each other. According to the more detailed index produced by the Central Bank of Cyprus, which is based on bank valuations, prices were still rising in the fourth quarter of 2019, including in Limassol. However, the index produced by Cystat, which is based on actual transactions but does not give a regional breakdown, showed a decline in prices of 4.8% year on year in the fourth quarter. It is possible that banks have an unconscious bias towards overpricing real estate, given that they would have to increase provisions if they reduced valuations. On the other hand, as the figures from Cystat are based on actual sales, they are also based on a much smaller sample.

The government's schemes to subsidize interest payments on new housing loans (see Fiscal performance and forecast), and the suspension of payments on performing loans by the Central Bank of Cyprus, may temper a decline in real estate prices in the short term. However, we expect that by the end of the year, there will be a clearer downturn in property prices.

Table 14

Real estate prices based on Central Bank of Cyprus index (a)
% change over same period of previous year

	2018Q4	2019Q1	2019Q2	2019Q3	2019Q4
Nicosia	1.1	1.9	2.0	2.5	2.2
Limassol	3.3	5.5	5.6	4.7	5.0
Larnaca	0.9	2.8	2.5	2.8	3.1
Paphos	0.0	1.9	2.8	4.9	3.2
Famagusta	3.7	2.0	2.6	2.1	3.3
Cyprus	1.5	2.9	3.1	3.3	3.4
Flats	3.2	4.8	5.3	5.5	5.8
Houses	0.8	2.1	2.3	2.5	2.7
Memorandum item					
Real estate prices: Cystat index (b)	1.6	4.3	8.0	2.3	-4.8

(a) Based on bank valuations. (b) Based on actual transactions.
Source: Central Bank of Cyprus.

Northern Cyprus restarts flights but puts Turkey in Category B

Having enjoyed no new cases of Covid-19 since 16 April, tourist flights to northern Cyprus were due to resume on 1 July amid disagreements about how strict procedures should be with incoming tourists from Turkey. The ruling coalition of the unrecognized Turkish Republic of Northern Cyprus (TRNC) initially decided to put Turkey in the Category A list, meaning that visitors would be required to present a negative PCR test for Covid-19 that had been conducted within the past 72 hours but would not be subject to stricter measures. (The same requirement applies to anyone crossing to the north from the south of the island across the UN-monitored buffer zone.) However, as cases in Turkey started to trend upwards again, Turkey was placed in Category B, meaning that passengers arriving either from or via Turkey would be subject to a second test upon arrival. Since all air flights to northern Cyprus have to touch down in Turkey first because of recognition issues, this essentially means all arrivals, with the exception of a few arrivals by sea, will be in Category B. Visitors arriving from Category C countries, which includes the UK, must go into 14-day quarantine. As Turkey accounts for three-quarters of all arrivals (many of whom may be students, given the way arrivals are measured), another uncertainty about tourism for northern Cyprus is the health of Turkish economy, in particular the level of foreign exchange reserves and whether Turkey can earn enough foreign-exchange revenue during the summer months to prevent a serious crisis and an even steeper decline in the Turkish lira.

Table 15

Northern Cyprus: selected short-term statistics
% change over the previous period indicated in the column heads

	Latest month	Period measured	YoY % change latest month	YoY % change year-to-date
Consumer price inflation	May	y/y	8.6	11.3
Tourism arrivals	Feb	y/y	0.6	3.1
Plastic card spending south of the Green Line	Mar	y/y	n/a	-5.2
Plastic card spending north of the Green Line	Mar	y/y	n/a	-0.6
Imports of goods (expressed in US dollars)	Dec	y/y	-0.3	-12.7
of which from Turkey	Dec	y/y	5.8	-13.1
Exports of goods (expressed in US dollars)	Dec	y/y	24.2	-13.8
of which to Turkey	Dec	y/y	34.0	-17.6

Sources: SPÖ; Turizm Planlama Dairesi; JCC Payments Systems; Ticaret Dairesi.

Table 16

Northern Cyprus: key macroeconomic indicators

	2014	2015	2016	2017	2018
GDP (₺ billion)	8,859	10,222	11,601	14,545	18,324
GDP (€ billion, converted at annual average exchange rate)	3,048	3,379	3,470	3,530	3,210
Population ('000, year-end)	320,884	331,432	339,487	351,965	372,486
GDP per capita (€)	9,498	10,194	10,222	10,029	8,619
Real GDP growth (%)	4.8	3.9	3.6	5.4	1.3
Consumer price inflation (%)	6.5	7.8	10.2	14.7	23.1
Unemployment rate (%)	8.3	7.4	6.4	5.8	6.8
Fiscal balance (% of GDP) (a)	-4.0	-3.2	-1.1	-0.3	n/a
Public debt (€ million, converted from $ and ₺) (a)	4,348	5,060	5,129	4,893	n/a
of which debt to Turkey (a)	2,730	3,362	3,424	3,409	n/a
Public debt (% of GDP) (a)	142.7	149.8	147.8	138.6	n/a
of which debt to Turkey (% of GDP) (a)	89.6	98.9	98.8	96.6	n/a
Number of tourists ('000)	1,366	1,483	1,577	1,734	1,760
Exports of goods ($ million)	134	118	106	106	111
Imports of goods ($ million)	1,784	1,501	1,557	1,778	2,081
Memorandum items					
United Cyprus debt (% of GDP)	*108.3*	*112.7*	*114.3*	*113.2*	-
United Cyprus debt if debt to Turkey written off (% of GDP)	*96.0*	*99.4*	*98.3*	*97.3*	-
Turkish lira per euro (ECB)	2.9065	3.0255	3.3433	4.1206	5.7077
Turkish lira per US dollar (US Forex and ECB-derived)	2.1885	2.7119	3.0249	3.6475	4.8329

(a) Based on figures published by the government of Turkey.

Sources: Devlet Planlamar Örgütü (SPO); Maliye Bakanligi; Turkiye Cumhuriyeti Lefkosa Buyukelciligi.

The Turkish Cypriot economy is unlikely to get any boost from the opening of some of the crossing points across the UN-monitored buffer zone, as the Greek Cypriots effectively insist on a test every 72 hours. Anyone entering from the north, including anyone living in the south who is re-entering after a visit to the north, must show proof of a negative PCR test within the past 72 hours every time they cross. (The Turkish Cypriots only require it once.) The cost of obtaining the tests will put off those who crossed regularly for shopping or petrol, effectively limiting visits only to those with strong social connections. As the issue of crossing points has become a point of contention not just between Greek Cypriots and Turkish Cypriots but between the Turkish Cypriot coalition and the Turkish Cypriot leader, Mustafa Akinci, it seems likely that it will continue to fester.

Charts Previous section