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Comprehensive monthly analysis of politics, economic policy and economics

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Overview Next section

31 March 2021

- Political analysis and outlook. Political stability on the island of Cyprus will be largely determined by an increasingly unpredictable Turkey. An agreement to continue talking seems to be the most likely outcome of the UN-led meeting in April. Opinion polls point to a disparate parliament after the 30 May election.

- Sectoral policies, reforms and energy. Electricity liberalization is increasing pressure on the Electricity Authority of Cyprus (EAC), while the focus is shifting towards submarine electricity interconnectors. Reform efforts continue but local government reform is at risk. The Covid-19 vaccine dose rate has reached 26% in the north and 15% in the south of the island.

- Fiscal performance and forecast. The budget deficit ended 2020 at 5% of GDP and public debt rose to 118% of GDP but the cost of debt-service has fallen. Reforms to the tax system and pension entitlements are being considered as part of a broader effort to implement a new long-term strategy and to qualify for EU funds.

- Banking sector. Foreclosure discussions may be shelved until after the election. Preparations for a bad bank are prompting questions about governance following revelations about the Cyprus Cooperative Bank (co-op). Hellenic Bank has a new CEO and the employers' pension fund has cut its stake. New housing loans have climbed but overall indebtedness has fallen.

- Macroeconomic trends and forecast. Real GDP declined by 5.1% in 2020, as all sectors apart from public consumption contracted. Household spending is being supported by growth in public-sector incomes. Halloumi exports did well in 2020 but may be vulnerable to Brexit. We expect real GDP growth of 2.1% in 2021.

- Economy of northern Cyprus*. Budget revenue started the year in steep decline. Businesses are becoming vocal about the challenging economic situation, which may make it difficult for the authorities to implement the reforms promised in the financial agreement (protocol) with Turkey. PDO designation for hellim could be a significant boon to exports in the long term.

**Areas not under the effective control of the government of the Republic of Cyprus.*

Table 1

Sapienta Economics macroeconomic forecast

	2019	2020	*2021*	*2022*	*2023*
GDP at current prices (€ m)	22,287	21,000	*21,589*	*22,230*	*23,027*
GDP per capita (€)	25,270	23,576	*24,044*	*24,562*	*24,993*
GDP at constant 2005 prices (€ m)	21,632	20,528	*20,966*	*21,237*	*21,577*
Real GDP growth (%)	3.1	-5.1	*2.1*	*1.3*	*1.6*
Harmonized consumer price inflation (%)	0.5	-1.1	*0.7*	*1.1*	*0.0*
Unemployment rate (%)	7.1	7.6	*7.2*	*6.1*	*7.1*
Budget balance (ESA2010) (€ m)	327	*-1,060*	*-650*	*-247*	*181*
% of GDP	1.5	*-5.0*	*-3.0*	*-1.1*	*0.8*
Primary balance (ESA2010) (€ m)	1,142	*-565*	*-128*	*169*	*535*
% of GDP	5.1	*-2.7*	*-0.6*	*0.8*	*2.3*
Gross public debt (€ m)	20,958	24,823	*24,473*	*23,606*	*22,912*
% of GDP	94.0	118.2	*113.4*	*106.2*	*99.5*
Current-account balance (% of GDP)	-6.3	*-7.0*	*-5.2*	*-4.6*	*-3.7*

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

Political analysis and outlook Next section Previous section

Uncertainty in Turkey raises risks for Cyprus—

Political stability on the island of Cyprus will be largely determined in the short to medium term by developments in Turkey, where the fall in popularity of the ruling Justice and Development Party (AKP) policy is leading the president, Recep Tayyip Erdoğan, to pursue policies that are increasingly unpredictable and potentially de-stabilizing. On the one hand, developments at the regional level are tending towards stabilization. Turkey is clearly making overtures towards its rival, Egypt, and there is also a hint of rapprochement between Turkey and Saudi Arabia. Israel has also made recent gestures towards Turkey, with Israel's energy minister, Yuval Steinitz, saying in early March that he hopes Turkey can join the Eastern Mediterranean Gas Forum (EMFG) in future. The EMGF seems to be growing in importance: on 9 March the founding members of the EMGF (Cyprus, Egypt, Greece, Israel, Italy, Jordan and the Palestinian Authority) added France as a new member and the US as an observer. Greece and Turkey are also engaged in talks on maritime boundaries, while Turkish drilling and seismic vessels are currently absent from the Republic of Cyprus Exclusive Economic Zone (EEZ). The absence of hydrocarbons activity by Turkey is thanks in large part to international pressure, including the EU's "positive agenda" approach to Turkey, which essentially involves rewarding Turkey for good behaviour.

On the other hand, the decision by Mr Erdogan to remove Turkey's central bank governor, Naci Ağbal, on 20 March has led to a sharp depreciation of the Turkish lira. This, in turn, could lead to a full-scale banking or balance-of-payments crisis that would doubtless harm Mr Erdogan's re-election chances. Such a risk would increase the temptation to appeal to the nationalist vote ahead of Turkey's national elections, which are currently due in 2023. Moves could include resuming hydrocarbons activity in the Eastern Mediterranean, developing the fenced-off district of Varosha—in defiance of UN Security Council Resolutions, including the resolution issued at the end of January—or, in a worst case scenario, annexing northern Cyprus and absorbing it into Turkey. The foreign minister, Nicos Christodoulides, spoke in late 2020 about the possibility of Turkey annexing northern Cyprus ahead of the anniversary of the foundation of the Republic of Turkey in October 1923. Those who are more sceptical about the Republic of Cyprus' commitment to a federal settlement fear that annexation would even be desired among some in the Greek Cypriot establishment, and see the recent laying of barbed wire across the buffer zone, ostensibly to deter asylum-seekers and undocumented migrants, as a way of preparing the ground for such an eventuality.

However, annexation of northern Cyprus would be unpopular with voters in northern Cyprus according to a recent report on politics and society in northern Cyprus published by the Friedrich Ebert Foundation. Only 17% of Turkish Cypriot voters (who account for around 70% of the voting population) and 45% of voters of Turkish origin were "totally in favour". Annexation would also upset Turkey's relations with both the EU and the US, as it would create a new land border between the EU and Turkey and potentially embolden Russia after the annexation of Crimea in 2014. At present Turkey is keen to improve relations with the EU and the US is also making overtures. However, annexation cannot be discounted given Turkey's increasingly erratic policies, which also explain the EU's conditional incentives to Turkey.

—which puts the onus on progress at the 5+1 UN-led conference—

These risks increase the pressure on the international community to support progress at the UN-led "informal 5+1" conference that will be held on 27-29 April in Geneva—or at least to ensure that an acrimonious collapse is avoided. The conference will be attended by the Greek Cypriots, Turkish

Cypriots, the three guarantor powers (Greece, Turkey and the UK) and the EU as an observer. The international community is engaging quite closely on the issue. The UK foreign secretary, Dominic Raab, visited Cyprus on 4 February and the European Commission's High Representative, Josep Borrell, visited on 5 March, meeting both the Greek Cypriot leader and president of the Republic of Cyprus, Nicos Anastasiades, and the Turkish Cypriot leader and president of the unrecognized Turkish Republic of Northern Cyprus (TRNC), Ersin Tatar. The US Secretary of State, Anthony Blinken, also said on 10 March that the US would be "fully engaged" on Cyprus.

—but an agreement on the basis of talks is unlikely in the first meeting

Despite the pressure, it seems unlikely that the conference will lead to an agreement on the basis for a resumption of negotiations to solve the Cyprus problem. As noted in our February issue, Mr Tatar and Mr Erdogan are insisting on a two-state solution. In addition, the British proposal for an adapted model, which we outlined in our February issue, seems to have fallen foul of an internal battle in the Greek Cypriot community. The leader of the ruling Democratic Rally (DISY), Averof Neophytou, who has lately come out strongly in favour of a solution, initially said that the interest of the international community was "welcome", without specifically endorsing the plan. In a later interview with *Alithia* on 28 February he said that security could only be achieved through political equality. However, in an interview with *Phileleftheros*, the establishment newspaper, on 22 March, the influential former director-general of the foreign ministry, Tasos Tzionis, suggested that current discussions surrounding political equality had gone beyond the definition endorsed by UN Security Council Resolution 716 of 1990 and would destroy the Republic of Cyprus (an accusation often made by Greek Cypriot hawks on the Cyprus problem). Mr Tzionis has also been picked as one of Mr Anastasiades' key advisers on the Cyprus problem. The team is led by the longstanding chief negotiator, Andreas Mavroyiannis, and includes two (more dovish) members: the former foreign minister, Ioannis Kasoulides, and a former senior member of the negotiating team from the opposition Progressive Party of Working People (AKEL), Toumazos Tsielepis.

We understand that the most likely scenario for the moment is an agreement to continue talking and to reconvene beyond the Republic of Cyprus parliamentary election on 30 May this year. There may also be some movement on confidence-building measures. The European Commission has been working on registering both halloumi and hellim (the Turkish name) as a product of designated origin (PDO), and an agreement was formally announced on 29 March. Although this may make little difference in practice to Turkish Cypriot producers' ability to export hellim to the EU (see Economy of northern Cyprus), it will go some way to improving trust, both between Turkish Cypriots and the EU and between Turkish Cypriots and Greek Cypriots, as the latter have a *de facto* veto over many aspects of the EU's assistance to Turkish Cypriots.

Opinion polls suggest a disparate parliament after May

Recent opinion polls on the election due on 26 May indicate that both the ruling Democratic Rally (DISY) and the main opposition Progressive Party of Working People (AKEL) are likely to lose seats and vote-shares relative to the previous parliamentary election in 2016. The Ecologists (Greens) have benefited most from the spate of scandals and widespread disillusionment with politicians and seem likely to obtain around five seats, according to our calculations based on a recent poll (see Table 2). The far-right National Popular Front (ELAM) also seems set to double its representation in parliament, while the Movement of Social Democrats (EDEK), having supported the government to pass the revised budget in early 2021, is expected to benefit from the practice of "lending votes", whereby party activists of a dominant party privately encourage certain voters to pick candidates from allied parties. Policy-making seems set to be far more difficult after the election, as DISY will need the support of several smaller parties in order to pass legislation.

Table 2

Parliamentary election results CyBC poll of 25 March 2021	2016 seats	2016 % of vote	2021 poll % of support	2021 est seats	2021 est % of vote
DISY	18	30.69	19.0	*15*	*24.8*
AKEL	16	25.67	17.0	*14*	*22.2*
DIKO	9	14.49	10.5	*8*	*13.7*
Greens	2	4.81	6.0	*5*	*7.8*
ELAM	2	3.71	4.5	*4*	*5.9*
Independents/Hunters (MP broke from Citizen's Alliance	-	-	5.0	*4*	*6.5*
EDEK	3	6.18	4.0	*3*	*5.2*
DIPA (break-off from DIKO)	-	-	3.0	*2*	*3.9*
Solidarity Movement	3	5.24	1.5	*1*	*2.0*
Citizen's Alliance (running with EDEK in 2021)	3	6.01	-	*0*	-
Others	-	3.20	2.5	*0*	*7.8*
Undecided	-	-	9.5	*0*	-
Intention to abstain/vote "blank"	-	-	17.5	*0*	-
Total	**56**	**100.00**	**100.0**	***56***	***100.0***

Sources: Ministry of Interior (2016); CyBC poll; Cyprus Mail; Sapienta Economics estimates in italics.

Sectoral policies, reforms and energy Next section Previous section

Electricity liberalization increases pressure on the dominant electricity provider—

Construction of the terminal to import liquefied natural gas (LNG), which will mark the transition from a system in which more than 90% of electricity is produced by diesel and heavy fuel oil to electricity largely produced by natural gas, seems to be on track. Early-stage works on the terminal have begun and the terminal is due to be completed by the end of 2022. The expectation of gas imports, as well as the construction of submarine electricity interconnectors, have brought into focus weaknesses at the Electricity Authority of Cyprus (EAC), the dominant state-owned electricity supplier. According to media reports, four electricity unions wrote to EAC managers in March complaining about a combination of understaffing, following early retirements during the international bailout programme, and the EAC's lack of readiness for a liberalized market. The electricity market is technically liberalized in law but will not be ready in practice until the Transmission Service Operator (TSO) has installed the necessary software, which is not expected until early 2022—beyond the initial end-2021 goal for liberalization. The TSO has come under criticism for delays but has also been pointing the finger at the EAC, saying that the Vasilikos power station is unreliable owing to delays in upgrading the three steam 390 MW turbines. According to *Phileleftheros*, there are frequent outages at EAC's two 450 MW combined cycle units. As noted in our December 2020 issue, Power Energy Cyprus (PEC), a private company connected with the property developer, Cyfield, is due to finish constructing a 260 MW combined cycle power plant by the end of 2022, which will make it the first independent power producer (IPP) in Cyprus.

—as Cyprus worries about being by-passed for natural gas

Pressure on the EAC may also be related to the fact that the emphasis on energy exports is shifting increasingly towards electricity interconnectors rather than exports of natural gas. Cyprus, Greece and Israel signed a Memorandum of Understanding (MoU) on the 2,000 MW EuroAsia

Interconnector on 8 March. This is the submarine electricity cable that will run from Israel via Cyprus to Crete and connect to what will now be a separate interconnector running from Crete to mainland Greece. Officials say the interconnector will also transport renewable energy. An MoU on the 2,000 MW EuroAfrica Interconnector had not yet been signed as of 31 March but we understand that it is imminent. The focus on interconnectors may also be related to fading hopes that Cyprus can be a major natural gas exporter. Greece's *To Vima* reported on 28 February that Egypt, Israel and Greece had been in discussions about a "virtual" gas pipeline that would involve sending gas via pipeline from Israel to Egypt and then exporting it as LNG from Crete. This may be connected to the agreement between Chevron and Israel Natural Gas Lines (INGL) to sign a deal to expand natural gas pipeline capacity between Israel and Egypt. The article in *To Vima* was published a few days later by *Politis*, sparking concerns in Cyprus that this meant that the much touted East Med gas pipeline, on which the political leadership has spent much political capital, was no longer planned, although the government insisted that there had been no change in plans.

An agreement is finally reached on handling the Aphrodite-Yishai reservoir

However, one positive development for natural gas is that Cyprus and Israel finally reached agreement on 9 March on how to address the reservoir that straddles the Cypriot Aphrodite and Israeli Yishai fields. Negotiations have been handed to the licensees, who will have six months to come to an agreement, otherwise the matter will be sent to arbitration. The government is still hoping that gas can start to be produced from Aphrodite in 2025-26 and then exported via pipeline to LNG plants in Egypt, although the energy minister, Natasa Pilides, has also noted that it will depend on market conditions. In an interview with *Haravghi* on 14 March she said that an appraisal well for Aphrodite is due to be drilled in the fourth quarter of 2021, although drilling programmes have been slipping and could be affected by political developments on the Cyprus problem. For example, a resumption of talks could lead to a *de facto* moratorium on drilling.

Regulated companies will be inspected for passport business

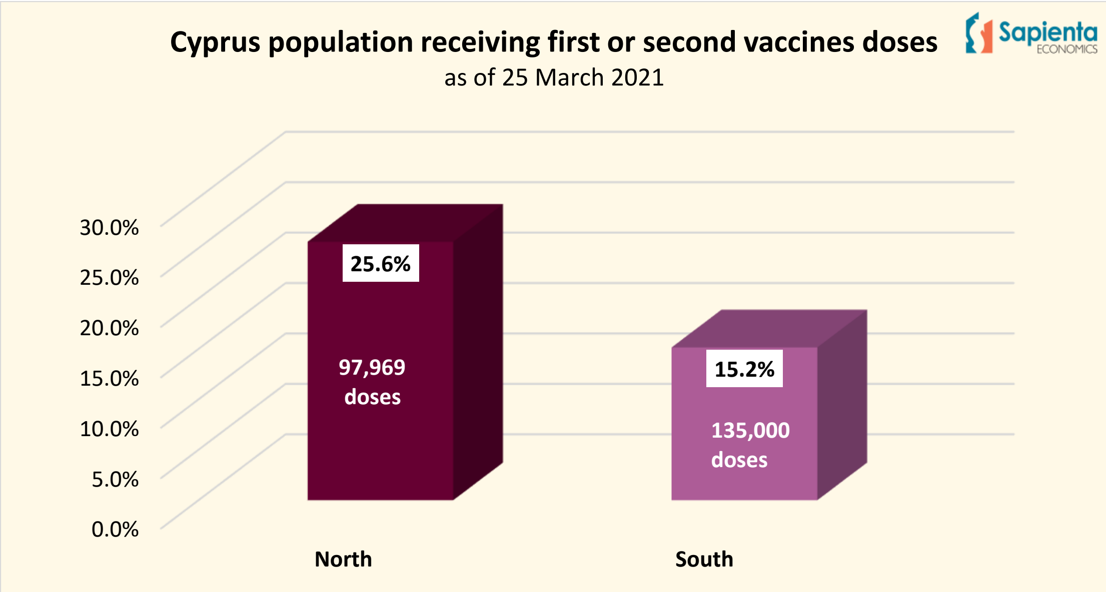
As the political fallout from the golden passports continues, the chairwoman of the Cyprus Securities and Exchange Commission (CySEC)—the national supervisor for investment, forex and other financial firms—Demetra Kalogerou, announced on 17 March that CySEC will be scrutinizing any supervised companies that have been connected with naturalizations under the Cyprus Investment Program (CIP). CySEC will be conducting both on-the-spot and remote audits for money-laundering. At the same press conference, Ms Kalogerou said that there were currently no statistics on the number of investors who had been naturalized and who were trading either with Cyprus investment firms (CIFs) or administrative service providers (ASPs). CySEC currently supervises 779 entities, up from 746 at the end of 2019. Of this total, 242 are CIFs.

Local government reform risks losing the referendum on 30 May—

In addition to the parliamentary election, a referendum on local government reform will also be on the ballot on 30 May. Reforms include reducing the number of municipalities to 17, from 30 today, as well as merging hundreds of smaller "communities" in rural areas. Reform of local government should in theory support the green transition, especially in areas such as transport. However, there is a risk that the referendum will not pass. Legislation for the referendum was passed only in March, there has been little in the way of government promotion of the idea to date and reform is likely to be seen by local leaders as losing influence. Separately, a delegation from the Congress of Local and Regional Authorities of the Council of Europe (CoE) conducted an online mission on 29-30 March to monitor Cyprus' application of the European Charter of Local Self-Government.

—while justice reform is now pushed back until after the election

Reform of the justice system will be taken up again after the election. After reports that there had been objections from members of the Supreme Court, the Republic of Cyprus president, Nicos Anastasiades, met Supreme Court justices on 12 March to discuss reforms in detail. While no breakthrough was reported, all agreed that reform of the system was a national priority. The proposals include splitting the Supreme Court into a Constitutional Court and a Supreme Court; an advisory council for nominating judges; a Supreme Judicial Council in which citizens will participate; and a school for training judges.



Covid-19 vaccine doses reach 15% of the population in the south and 26% in the north

The National Health System (GESY)—Cyprus' first universal healthcare system launched in 2019—has proven popular with the public. Figures published by *Phileleftheros* on 1 March report that 853,422 individuals have now registered with the National Health System (GESY). This is equivalent to 96% of the population according to the latest population figures from Cystat, the Statistical Service. Of the total registered, 756,440 beneficiaries (89%) had visited personal physicians and 574,007 beneficiaries had visited specialists. More than 70% of doctors and 88% of beds are now part of the GESY system.

Both parts of the island are rolling out Covid-19 vaccines. As of 25 March 2021, 97,969 individuals had received at least one dose in the northern part of Cyprus, while 135,000 had received at least one dose in the south. Based on the most recent published for population figures, this is equivalent to 26% of the population in the north and 15% of the population in the south. The Republic of Cyprus health ministry said on 25 March that 60% of the population will have will have received at least one dose by June. While the absolute number of positive cases continues to be higher than in 2020, the positive case-rate (positive cases per tests conducted) has fallen sharply in 2021. The 7-day positive rate was 0.7% for the north and 0.8% for the south at the end of March. The north is conducting around 7,000-8,000 tests per day, while the south is conducting around 45,000-50,000 per day. Notwithstanding the improving picture, neither side seems ready to open the crossing points across the UN-monitored buffer zone, which remain effectively closed to all but a small number of people.

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Budget deficit ends the year at 5% of GDP—

The general government budget ended 2020 with a deficit of €1.1bn (compared with our February estimate of €1.2bn), or 5.0% of GDP, following a surplus of 1.5% of GDP in 2019. In absolute terms, the difference between the two balances was €1.4bn and is explained almost entirely by pandemic-related spending: the finance minister, Constantinos Petrides, said on 12 March that the government had so far spent €1.6bn on pandemic-related support. His remarks came in the context of the government announcing another €70m support package, with €30m going to companies and €40m to employees. The latest package includes one-off payments to companies of between €1,200 and €15,000 depending on the number of staff, and €700 to the self-employed. With uncertainty about how soon the tourism season will take off (see Macroeconomic trends and forecast), it seems likely that support will continue for some time yet. Separately, an updated bill on overdue social payments is due to go to parliament in April. The new law will include the self-employed and will continue to allow payments plus interest in 54 monthly instalments. According to StockWatch, the amount overdue is "tens of millions of euros".

Table 3

General government accounts
€ million unless otherwise stated; these figures no longer match ESA 2010

	Jan-Dec 2019	Jan-Dec 2020	% change year on year
Total revenue	**9,243**	**8,888**	**-3.8**
VAT on products & services	2,066	1,900	-8.0
Personal income tax: public sector (a)	152	163	7.2
Personal income tax: private sector (a)	285	281	-1.3
Defence contribution (a) (b)	282	223	-20.8
Total corporate tax (a)	619	498	-19.4
Social security contributions	86	2,404	2,705.0
Property income	213	150	-29.7
Revenue classified as "other"	1,166	1,180	1.2
Total expenditure	**8,917**	**9,947**	**11.5**
Compensation of employees	2,733	2,892	5.8
of which: public-sector pensions	573	612	6.8
Intermediate consumption	1,022	1,057	3.4
Social payments	3,034	3,619	19.3
Pensions	1,371	1,423	3.8
Unemployment	83	109	31.8
Other social transfers	1,580	1,817	15.0
Interest	511	495	-3.0
Gross fixed capital formation	543	607	11.8
Expenditure classified as "other"	1,005	699	-30.5
General government balance	**326**	**-1,059**	**-**
% of GDP	1.5	-5.0	-
Primary balance	**836**	**-564**	**-**
% of GDP	3.8	-2.7	-

(a) January-November. (b) Mainly dividends and interest income.

Source: Cystat.

In 2020 the largest expenditure increase in absolute terms came from (pandemic-related) subsidies, which rose from just €70m in 2019 to €578m in 2020. Another €410m of increases came from social transfers "in kind", which might relate to deferred taxation. There was also a €175m rise in regular social transfers. Some €159m came from increases in salaries and pensions, as the government met its commitments to unions to begin restoring the pay-cuts that were implemented in 2012-16, as part of the 2013-15 international bailout programme. More spending on the public-sector payroll is coming, as around 180 promotions are also due to be unfrozen in 2021.

Total revenue dropped by €355m or 3.8% to €8.9bn in 2020, with the bulk of the decline coming from a €166m fall in VAT. VAT was hit by a 1.9% decline in retail sales and what is likely to have been decreased business-to-business activity (see Macroeconomic trends and forecast). In its latest release of budget data, the Statistical Service, Cystat, removed the monthly data on corporate tax and the defence contribution for 2020. Inferring from its January-November statistics, however, it is likely that declines in these categories explain most of the remainder of the revenue fall in 2020.

—and public debt rises to 118% of GDP

The primary balance (balance excluding interest payments) recorded a deficit of €564m (2.7% of GDP) in 2020, compared with a surplus of €836m in 2019. A positive primary balance allows for reduction in debt stock. By the end of 2020 total debt had reached €24.8bn (118.2% of GDP), up from €21.0bn (94.0% of GDP) according to the most recently issued GDP figures, owing to €4.5bn of new debt issuance in 2020 minus some redemptions. Despite the sharp increase in debt stock, the cost of servicing debt fell by €16m thanks to lower global interest rates. Global interest rates are now on the rise (from a very low base), owing to expectations about an increase in inflation, therefore the government could have to pay higher interest rates on any debt issued in future. There is no immediate rush for the government to issue any debt, however. As of January 2021, the government held just under €4bn cash with the Central Bank, which will cover debt payments until the end of 2023 excluding Treasury bills (see Table 4). Since policy is to hold around two years' worth of debt payments, the government has the luxury of waiting for opportune moments to enter the market. The European Central Bank has purchased a net €3.4bn of government bonds under the asset purchase programme and €1.7bn under the pandemic emergency purchase programme (PEPP).

Table 4

Debt redemptions due as of end-December 2020
€ million

	2021 Year	2022 Year	2023 Year	2024 Year	2025 Year	2026 Year
European Medium Term Notes (EMTN)	0	1,000	1,000	1,850	1,000	1,100
Gov't Registered Development Stock (GRDS)	679	663	225	300	92	0
Retail bonds	132	184	70	114	81	0
Bilateral exc. ESM & SURE	0	0	14	0	24	48
ESM	0	0	0	0	0	1,000
SURE	0	0	0	0	150	0
Total redemptions exc Treasury bills	**812**	**1,847**	**1,309**	**2,264**	**1,347**	**2,148**
Treasury bills	1,475	*100*	*100*	*100*	*100*	*100*
Total redemptions inc Treasury bills	**2,287**	***1,947***	***1,409***	***2,364***	***1,447***	***2,248***

Sources: Public Debt Management Office; IMF Post-Programme Monitoring Reports; Sapienta Economics estimates in italics.

After the redemption of the extraordinary €1.25bn, 52-week Treasury bill issued in April 2020, which will be mostly paid with the €1bn international bond issued in February 2021, we expect Treasury bill issuance to drop back to normal levels. All the Treasury bills issued so far this year have been 13-week Treasury bills, at a level of €75m each time. Despite the direction of global interest rates, yields have also been getting more negative, reaching -0.24% on 22 March, compared with -0.22% in February and -0.18% in January. Both Standard & Poor's on 5 March and Fitch Ratings on 26 March confirmed the BBB- credit rating with stable outlook for Cyprus' long-term sovereign debt and both kept the outlook at stable. These ratings are just inside investment grade, while Moody's Investor Service still rates Cyprus two notches below investment grade (Ba2).

Cyprus has received all of its SURE instalments and is gearing up for other funds—

The Public Debt Management Office (PDMO) has now started to publish debt due under the EU's Support to mitigate Unemployment Risks in an Emergency (SURE) programme. Cyprus has received all of the €479m to which it was eligible (see Table 5). The debt has an average maturity of 14.7 years and interest-rate savings of €48m according to a report by the European Commission published on 22 March. According to the same report, just under 50% of all employees are currently being covered by the SURE scheme, while Cyprus has already spent well in excess of SURE funds on overall employment support.

Cyprus is also eligible for up to €968m under the EU's pandemic-related Recovery and Resilience Facility (RFF). As noted in our February issue, the government has established a cross-party committee to find consensus on the reforms required to receive funds from the RFF. It has also been consulting social partners (union and employer representatives), while the National Economic and Competitiveness Council is receiving technical assistance from the European Commission to work on a long-term strategy.

Table 5

Cyprus disbursements under the EU's SURE programme

	Date of issue	Date of disbursement	Amount € m	Maturity years
Second SURE issuance	10-Nov-20	17-Nov-20	0.15	5
Second SURE issuance	10-Nov-20	17-Nov-20	0.10	30
Fourth SURE issuance	26-Jan-21	02-Feb-21	0.16	7
Fourth SURE issuance	26-Jan-21	02-Feb-21	0.07	30
Total			**0.48**	**14.7**

Source: European Commission, SURE.

—which may include reform to the taxation system—

In the context of the "green transition", the government is also beginning to argue for tax reform. At an event hosted by FMW Financial Media Way on 23 March, a finance ministry official and others made the case for the modernization of the tax system in line with international norms. Cyprus last overhauled its tax system in 2002, when it abolished differential taxation for the "offshore" sector. The Inland Revenue Service and the VAT Service were merged into a single Tax Department in July 2014 as part of the bailout programme. One part of the reform will involve digitization, for which a New Zealand company has been selected. With the EU's push for greater corporate tax harmonization, another part of the reform is likely to focus on ensuring that Cyprus can remain attractive as a business centre, especially in its relatively recent drive to promote headquartering of large businesses in Cyprus. One can expect the reform also to address the €2.5bn of tax receivables that have been on the books for years but are not expected to be recovered, owing to insolvencies, bankruptcies and deaths.

—and to pension entitlements

Public-sector pensions are also likely to come under review. The Ministry of Finance presented proposals to unions on 26 March. Reform is likely to involving bringing into the system around 15,000-18,000 public-sector workers (media reports differ on the number) who started work from 1 October 2011 but who were initially excluded from the previous generous pension system. To offset this, there will be adjustments to the current system. For example, pensions are likely to be based on years of service and salary scale, rather than the current "final salary" system, which tends to encourage sudden promotions just before retirement age. While pensions based contributions has become the global standard, it can also inadvertently discriminate against women retirees if they have had periods out of the workforce owing to childcare or elderly care. The large lump sum paid to new retirees is also likely to be reduced, but will be tax-free, in line with other provident (pension) funds. According to *Politis*, the state contribution will be around 6.0%-6.5%, while the employee contribution will be 5% to 6%. Details on the degree of retroactivity, if any, are still being worked out.

Table 6

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

	2018	2019	2020	2021	2022	2023
General government revenue	8,471	9,256	*8,900*	*9,629*	*9,241*	*9,573*
% change	8.8	9.3	*-3.8*	*8.2*	*-4.0*	*3.6*
General government expenditure inc. one-offs (a)	9,213	8,929	*9,960*	*10,279*	*9,489*	*9,392*
% change	24.6	-3.1	*11.5*	*3.2*	*-7.7*	*-1.0*
General government budget balance inc. one-offs	-742	327	*-1,060*	*-650*	*-247*	*181*
% of GDP	-3.5	1.5	*-5.0*	*-3.0*	*-1.1*	*0.8*
Primary balance inc. one-offs	-235	1,142	*-565*	*-128*	*169*	*535*
% of GDP	-1.1	5.1	*-2.7*	*-0.6*	*0.8*	*2.3*
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	24,823	*24,473*	*23,606*	*22,912*
% of GDP	99.2	94.0	118.2	*113.4*	*106.2*	*99.5*

Sources: Ministry of Finance; IMF; Sapienta Economics estimates and forecasts in italics.

Banking sector Next section Previous section

The foreclosure issue seems likely to be pushed beyond the election

At the time of writing seemed as though there would be no compromise between the government and Central Bank of Cyprus on the one hand and opposition parties on the other over amendments to the legislative framework on foreclosures. As noted in our February issue, opposition parties had been pushing for specialist financial court. However, there were questions about whether such a court would draw talent away from the separately planned commercial court. In addition, according to media reports the supervisory authorities in Frankfurt took a dim view of attempts to alter the legislative framework, indicating that it would result in higher capital requirements for the banks. StockWatch reported on 26 March a compromise proposal that involved "special jurisdiction" for existing courts to hear cases within a set period of 60 days. A decisive factor for opposition parties was that courts would have the authority to decide on any credit balances due—primarily, to what extent banks could impose penalty charges. However, the notion of special jurisdiction is also problematic and the IMF warned against reversing reforms on 30 March. With parliament heading for recess on 22 April, it seems likely that the issue will now be pushed beyond the parliamentary election on 30 May. There is now discussion of an *ad hoc* parliamentary committee to examine the entire legal framework relating to foreclosures, as well as issues relating to penalty charges. It is conceivable that, with the pressure of the election behind, the foreclosure issue will be quietly dropped by parliamentarians. Meanwhile, suspension of foreclosures on primary residences up to a value of €350,000 and on small business loans with property collateral up to €150,000 will be further extended until 31 July.

Probably as part of the package, other banking laws are also in play. These include a bill on protecting consumers from abusive clauses by banks and three bills that grant licensed asset management companies access to the Department of Lands and Surveys (land registry) and the Artemis credit database to assess the creditworthiness of borrowers.

Bad bank preparations raise governance questions

As noted in our February issue, the government is pushing ahead with the establishment of a bad bank, using the already existing state asset management company, KEDIPES, as a basis. Academics and others have urged the government to ensure that governance of the bad bank will be water-tight. Concerns about governance of the bad bank are underlined by investigations into the demise the Cyprus Cooperative Bank (co-op), which closed in 2018, after it had received €1.68bn in capital injections from the state in 2014-15, followed by €3.5bn in bonds in 2018 as part of the process of absorbing the "good" part of the co-op into Hellenic Bank. An auditor-general report released on 18 March itemized loans from the co-op to 161 politically exposed persons (PEPs), 783 close relatives, and 49 connected companies in the period 2013-18. It found that some €4.2m in loans of PEPs had been written off by the co-op management, with varying degrees of conditionality. Separately, parliamentarians have also been questioning the involvement of the law firms of the head of the Democratic Party (DIKO), Nicholas Papadopoulos, and the government spokesperson, Kyriacos Koushos, in an untendered contract for Altamira to manage the assets. The investigation has prompted the parliamentary audit committee to send letters to the finance minister, the chairman of the board of the state asset management company, KEDIPES, and the superintendent of the cooperative companies about various governance issues, such as agreements with Altamira and appointments of non-executives to the board of directors of KEDIPES and the Cooperative Asset Management Company (SEDIPES), of which KEDIPES is a subsidiary.

We expect that the bad bank will eventually include some 700 borrowers who did not qualify for the ESTIA subsidy scheme, as these borrowers were found unable to pay their debts. The Ministry of Finance classified these borrowers as a special case in March. For these special cases, banks are permitted to impair the loans up to 60% (compared with 30% for standard ESTIA loans), with the state and the borrower paying 50% each of the remainder. The ESTIA scheme was originally intended to support just over 13,000 borrowers and €3.4bn loans. The final number of applications came to 6,380 borrowers for loans worth €1.9bn.

Hellenic Bank gets a new CEO while the employers' pension fund cuts its stake

After a hiatus of almost seven months, Hellenic Bank announced on 23 March that it had appointed Oliver Gatzke, formerly of Hamburg Commercial Bank (a large lender in the shipping sector), as chief executive officer (CEO). Mr Gatzke has been described as having experience in financial restructuring and fintech. The CEO position became vacant after the departure of Ioannis Matsis in early September 2020, who seems to have fallen foul of rivalries among the major shareholders, Demetra Investment (local), Wargaming (Belarussian interests), and Third Point and Pimco (both US-based). Initial rumours that Mr Matsis would be replaced by Constantinos Loizides, the previous chairman of AstroBank (formerly Piraeus), turned out to be false.

The provident fund of the bank employers' union, ETYK, reduced its stake in Hellenic Bank to 4.95% from 6.26%, selling shares worth €4.6m on 9 March. While the ETYK fund denied media reports that it had lost money on the sale, or been forced to sell by supervisors, we understand that the shareholding does now comply with requirements that provident funds should not hold more than 5% in the institution where members are employed. ETYK also owns shares in AstroBank, having bought shares in both AstroBank and Hellenic from 7Q Invest, a local investment company which is partly owned by Demetra Investments, the largest shareholder in Hellenic Bank. Demetra is also partly owned by 7Q and Logicom, while Logicom is partly owned by Demetra. The sales of share by the ETYK fund did not result in any changes to the major shareholders of Hellenic Bank, which remain Demetra (21.01%), Wargaming (20.61%), Pimco via Poppy Sarl (17.3%) and Third Point (12.59%).

Interest-rate subsidies help new loans rise by 7.4% in the fourth quarter

Pure new loans (excluding restructured loans) rose year on year by 7.4% in the fourth quarter of 2020, following four consecutive quarters of decline. The level of new lending, at €776m, was close to the quarterly average in 2018. The fastest increase was for housing loans, which have been supported by interest-rate subsidies. For new housing loans, borrowers enjoy a cut of up to 1.5 percentage points for up to four years and may consolidate new loans with older, performing housing loans. The criteria for businesses are a little stricter and may explain the lower growth rate. Businesses "not in difficulty" at the end of December 2019 may take out new loans for working capital or investments and may not use them to repay non-performing loans. These business loans enjoy a subsidy of up to 3.5 percentage points in the first two years and up to 2 percentage points in the third and fourth years. In January the subsidy scheme was extended until 31 December 2021. Approval for €25m worth of interest-rate subsidies via the European Investment Bank (EIB) came from the European Commission on 25 March. There is also talk of another attempt to introduce state guarantees on loans, which the minority government attempted in 2020 but was unable to pass through parliament.

Table 7

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

	2019 Q3	2019 Q4	2020 Q1	2020 Q2	2020 Q3	2020 Q4
Consumer credit	43	40	37	25	41	45
Year-on-year % change	*11.7*	*7.8*	*7.6*	*-41.8*	*-2.8*	*12.2*
House purchase	215	207	165	142	212	265
Year-on-year % change	*14.7*	*-12.5*	*-24.8*	*-39.8*	*-1.3*	*27.8*
Other household loans	49	29	41	35	33	32
Year-on-year % change	*15.7*	*-45.3*	*1.1*	*-43.8*	*-32.6*	*8.0*
Business loans under €1 million	96	110	81	72	94	118
Year-on-year % change	*-15.9*	*-17.7*	*-28.3*	*-40.0*	*-1.4*	*7.6*
Business loans over €1 million	321	335	217	174	259	316
Year-on-year % change	*3.5*	*-18.9*	*-50.9*	*-61.2*	*-19.4*	*-5.9*
Total pure new loans	**723**	**722**	**541**	**447**	**639**	**776**
Year-on-year % change	*4.6*	*-17.5*	*-36.3*	*-50.8*	*-11.6*	*7.4*

(a) Pure new loans exclude restructured loans.

Source: Central Bank of Cyprus.

Household and corporate debt has more than halved since 2013

While pure new loans have begun to climb again, total debt stock has continued to fall, owing to sales of non-performing loans (NPLs) and debt repayments. Total debt stock at the end of 2020 was €31.7bn, compared with €33.7bn at the end of 2019 and a peak of €72.5bn at the end of 2012—just before the local banking crisis. As a percentage of GDP, both corporate and household debt has more than halved since 2013, to 74% of GDP for corporate debt and 64% of GDP for household debt at the end of 2020.

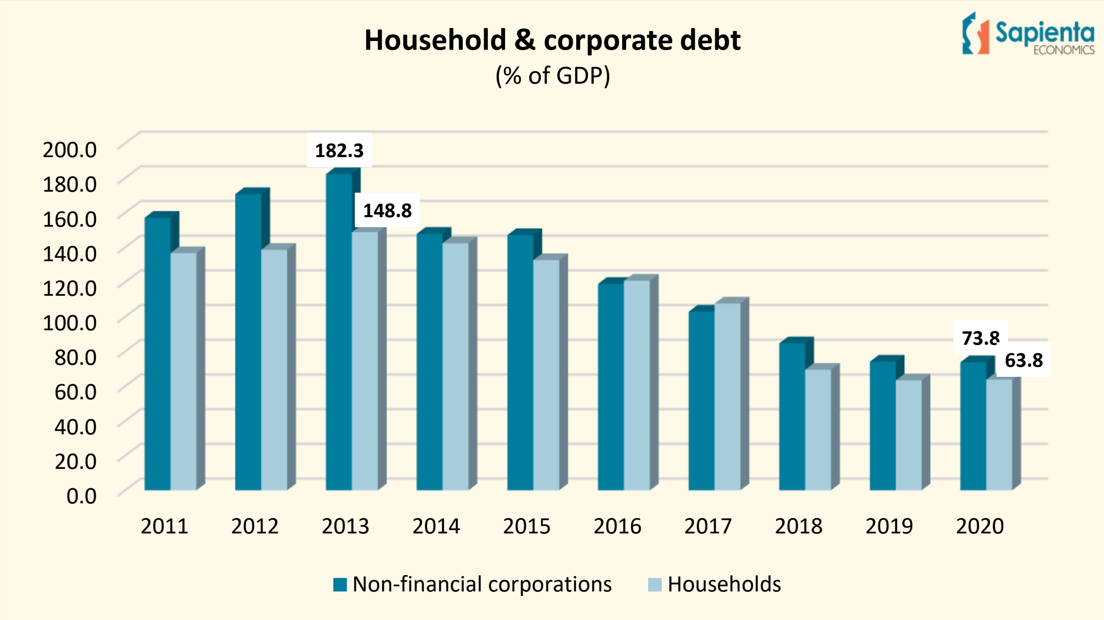

Table 8

Bank of Cyprus Group financial statement highlights (a) € million unless otherwise stated	**30-Dec-20** **3 mths**	**30-Sep-20** **3 mths**	**31-Dec-20** **12 mths**	**31-Dec-19** **12 mths**
Operating profit	44	43	196	240
New loan-loss provisions	31	30	149	145
Post-tax profit/loss	-50	4	-172	-70
Net interest income	80	82	330	344
Common Equity Tier 1 capital	1,723	1,735	1,723	1,909
Risk weighted assets	11,635	11,888	11,635	12,890
Common Equity Tier 1 capital ratio (%)	14.8	14.6	14.8	14.8
Customer deposits	16,533	16,384	16,533	16,692
Gross loans	12,261	12,309	12,261	12,822
NPEs: EBA definition	3,086	3,238	3,086	3,880
NPE ratio: EBA definition (b) (%)	25.2	26.3	25.2	30.3
Accumulated provisions	1,902	1,933	1,902	2,096
Coverage ratio (provisions as % of NPEs under EBA definition)	61.6	59.7	61.6	54.0
Net interest margin, annualized (%)	1.75	1.79	1.84	1.90

(a) Before fair value on initial recognition.
(b) Includes, inter alia, loans restructured and less than 90 DPD.

Sources: Bank of Cyprus financial statements and investor presentations; any inferred data in italics.

Bank of Cyprus audited results are unchanged from February release

Bank of Cyprus (BOC) published its audited accounts for 2020 on 30 March, with no visible changes to the unaudited statement issued in February. The net loss to shareholders remained at €172m for the whole of 2020, compared with €70m in 2019. In line with the abovementioned increase in new loans, BOC noted that new lending was up 30% over the previous three months in the final quarter of 2020. BOC now has €1.46bn of acquired real estate on its books, compared with €1.6bn at the end of 2017. It acquired €1.3bn worth of properties in 2020 but disposed of €1.1bn. In an interview with the Cyprus News Agency on 9 March, the CEO, Panicos Nicolaou, said that the bank had acquired property at around 20% below market rate, which seems fairly high for the collateral of distressed assets. He added that the bank intended to reduce the stock "dramatically" in the next few years. Hellenic Bank will publishing its 2020 accounts on 8 April.

Macroeconomic trends and forecast Next section Previous section

The full national accounts show a real GDP decline of 5.1% in 2020—

The first full release of national accounts for 2020 was published on 2 March, showing a real GDP decline of 5.1%—a slightly larger contraction than the 4.8% implied by the quarterly "flash" estimate published in February. As would be expected, the largest decline was in accommodation and food services (dominated by tourism), which dropped year on year by 39% (see Table 9), following a fall in tourism revenue of 84%. The difference in degree between the two measures is partly explained by the fact that accommodation and food services is measured on a value-added basis (meaning roughly €0.6 of value-added is created for every €1 of gross output depending on the sector) and partly that local residents also use these services. Local residents will have partly replaced non-resident tourists in much of 2020, as outbound tourism declined by 1.1 million, while incoming tourism arrivals fell by 3.3 million. Transport, which is dominated by shipping, was the second worst performer, as repeated lockdowns had a negative impact on trade in goods and therefore on shipping. World trade is estimated to have contracted by 9.6% in 2020 according to the IMF's *World Economic Outlook Update* published in January.

Table 9

Real GDP by main sector
real % change

	2018	2019	2020
Construction	14.1	13.6	-6.4
Wholesale & retail trade & auto repairs	5.8	3.8	-3.1
Transportation & storage	12.0	2.2	-10.4
Accommodation & food services	6.3	1.3	-39.1
Information & communication	9.5	9.8	1.4
Financial and insurance activities	-13.4	-5.1	-0.5
Real estate activities	8.9	0.8	1.0
Professional, scientific and technical activities	3.2	3.8	-0.7
Public administration & defence; compulsory social security	0.4	0.6	1.1
Healthcare	9.8	4.1	1.9
All other sectors	*6.0*	*2.3*	*-7.1*
Gross value-added	5.2	3.1	-5.1
Net taxes & statistical discrepancy	0.9	0.8	-8.3
GDP	**5.2**	**3.1**	**-5.1**

Sources: Cystat; Sapienta inferences in italics.

Two sectors that did not grow as fast as might have been expected were healthcare services and public administration. Healthcare rose in real terms by just 1.9%, perhaps because increased resources spent on the pandemic were offset by fewer surgical operations, and also potentially because of the growth relating to the introduction of the National Health System (GESY) in previous years. Since hospitals are still in transition to audited accounts it is also conceivable that there are measurement issues. Public administration expanded by 1.1%, despite the 11.5% nominal increase in budgetary expenditure. Some staff from other parts of the public sector were reallocated to the labour ministry, which would have meant no net increase in value-added, while output in the public sector will also have been affected by lockdowns.

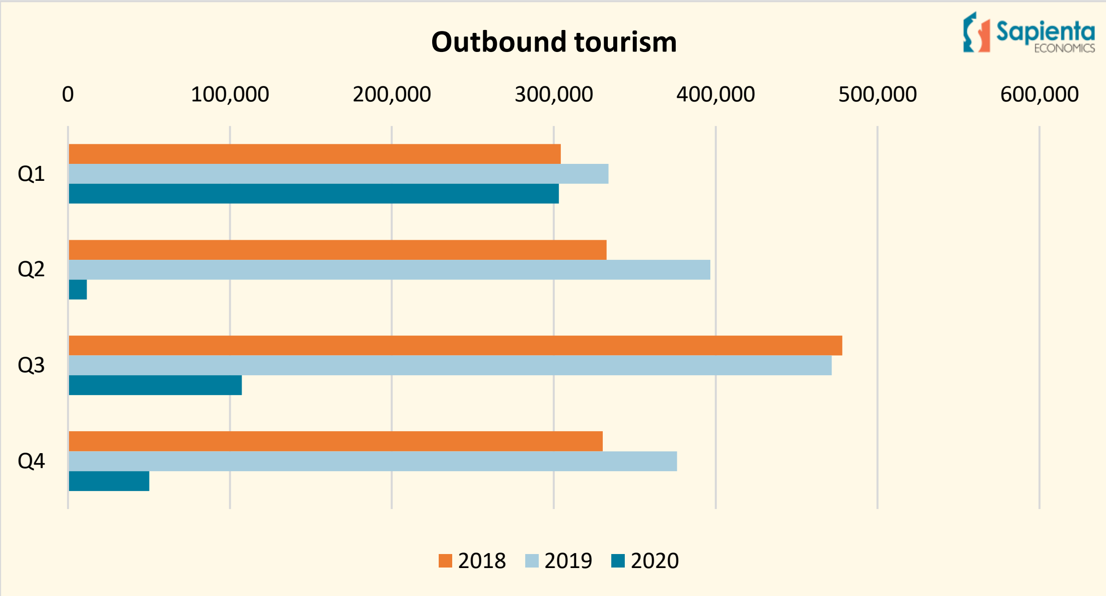

Table 10

Real GDP growth by expenditure % change over the previous year			
	2018	**2019**	**2020**
Private consumption	4.7	1.8	-3.9
Government consumption	3.5	15.1	13.0
Gross fixed investment	-5.2	2.0	-2.1
Increase in stocks (a)	*0.2*	*1.1*	*3.8*
Exports of goods & services	8.0	-0.4	-17.4
Exports of goods	32.2	-16.3	-8.8
Exports of services	2.4	4.3	-19.5
Imports of goods & services	4.5	2.0	-5.8
Imports of goods	3.5	-7.3	-6.4
Imports of services	5.5	12.0	-5.3
Foreign balance (a)	*2.5*	*-1.8*	*-8.2*
Statistical discrepancy	0.1	-0.2	-0.1
GDP	**5.2**	**3.1**	**-5.1**

(a) Contribution to growth, inferred.

Source: Cystat.

—with all categories apart from government consumption declining

Where government budgetary expenditure does show up in the figures is in GDP by expenditure. General government consumption expanded in real terms by 13% for the whole of 2020, having already risen significantly in 2019, probably as a result of the introduction of GESY in that year. On an expenditure basis, government consumption was the only category which showed an increase in 2020 apart from stockbuilding (a feature that is typical at the beginning of a recession). Both exports of goods and exports of services declined in 2020 and the net foreign balance acted as a significant drag on growth.

Halloumi exports do well but Brexit may be a vulnerability despite the PDO

Total exports also declined in nominal euro terms in 2020, to €2.7bn, compared with €3.1bn in 2019. However, the largest export, pharmaceuticals, continued to do well, rising year on year in euro terms by 18.8% to €353m. Exports of halloumi also increased despite transport difficulties, to €266m, from €224m in 2019. Of the €266m halloumi exports in 2020, almost half (€124m) went to the UK. No detailed breakdown of exports has been published yet for 2021, but total exports fell year on year by 29.6% in January, which could point to difficulties for halloumi exports to the UK after the end of the post-Brexit transition period. One factor that ought to be in halloumi's favour is that halloumi and hellim (the Turkish name) achieved the EU protected designation of origin (PDO) status on 29 March after many years of local resistance. The resistance to the designation came not only from politicians but also from producers on both sides, as they must now meet strict requirements for the proportions of more expensive goat and sheep milk, while Turkish Cypriot producers have also asked for transition periods to meet health standards (see Economy of northern Cyprus).

Table 11

External trade in goods
€ million unless otherwise indicated

	Jan-Dec 2019	Jan-Dec 2020	% change
Imports for home consumption			
Consumer goods, of which:	2,182	2,080	-4.7
non-durables	1,469	1,400	-4.7
durables	340	333	-2.0
Intermediate inputs	1,800	1,784	-0.9
Capital goods	468	471	0.5
Transport equipment & parts	1,911	1,923	0.6
Fuels & lubricants	895	534	-40.3
Unclassified	118	75	-36.2
Total imports for home consumption	**7,374**	**6,866**	**-6.9**
Domestically produced exports			
Raw agricultural products, of which:	96	80	-17.0
potatoes	48	37	-23.2
citrus fruits	12	13	16.2
Industrial products of agricultural origin	295	328	11.1
halloumi cheese	224	266	18.9
Minerals	4	4	5.6
Industrial products of mineral origin	383	301	-21.6
Manufacturing, of which:	499	530	6.1
pharmaceuticals	297	353	18.8
scrap metal, glass & paper exc. precious metals	41	40	-1.0
Total domestic exports incl unclassified	**1,291**	**1,258**	**-2.6**
Memorandum items			
Total imports inc re-imports	8,200	7,504	-8.5
Total exports in re-exports	3,137	2,741	-12.6
Trade balance	**-5,063**	**-4,763**	**-5.9**

Source: Cystat.

Household spending is supported by rising public-sector incomes

Private consumption, which is dominated by household consumption, fell in real terms by 3.9% in 2020. However, the pace of decline of household consumption slackened in the fourth quarter, to 1.9%, compared with 2.3% in the third quarter and 14.7% in the (lockdown-heavy) second. The relative improvement in household consumption is being supported by real growth in earnings, which is probably dominated by the public sector, following the gradual reinstatement of salary cuts imposed in 2012-16. While the freeze on seniority-based increments and promotions was lifted in 2017 and reinstatements began for salaries below €2,000 in 2018, it was only from 2020 that higher pay brackets were included. Inferring from total public-sector employment, government spending on the payroll (excluding pensions) and average earnings, we estimate that average gross earnings for the public sector (including overtime) were €2,531 per month in 2020—around 1.5 times larger than average private-sector gross earnings, which we estimate at €1,691 per month.

Table 12

Average monthly earnings of employees
seasonally adjusted; % change over the same period of the previous year unless otherwise stated

	2019 Q3	2019 Q4	2020 Q1	2020 Q2	2020 Q3
Average earnings (€)	1,985	1,995	2,007	1,988	2,025
% change over same period of previous year	0.5	0.5	0.6	-0.9	1.9
Real earnings based on national CPI	3.7	1.0	2.5	1.4	4.2
Real earnings based on HICP	2.3	2.2	1.8	2.2	4.3
Memorandum items					
National consumer price inflation	-1.3	1.4	0.0	-0.8	-2.2
EU-harmonized consumer price inflation	0.1	0.2	0.6	-1.6	-2.3

Source: Cystat.

We expect real GDP growth of 2.1% in 2021

Tourism is likely to see somewhat of a recovery in 2021. From 1 April Cyprus will accept vaccinated travellers from Israel and the UK without PCR tests and will accept non-vaccinated tourists from a range of other countries, including the UK, if they have taken a PCR test within the past 72 hours. However, with severe restrictions still in place on outbound travel from the UK, which accounts for one-third of all tourists, tourism is unlikely to take off until high summer. Primarily for this reason we continue to be more cautious than consensus about growth prospects in 2021, forecasting real GDP growth of just 2.1% in 2021 and 1.3% in 2022.

Table 13

Sapienta real GDP growth forecast
% change over same period of previous year

	2018	2019	2020	*2021*	*2022*
Private consumption	4.7	1.8	-3.9	*1.8*	*1.9*
Government consumption	3.5	15.1	13.0	*5.8*	*3.4*
Gross fixed capital formation	-5.2	2.0	-2.1	*4.6*	*3.0*
Inventories (contribution to growth)	0.2	1.1	3.8	*-0.8*	*0.0*
Exports of goods & services	8.0	-0.4	-17.4	*2.3*	*5.0*
Imports of goods & services	4.5	2.0	-5.8	*2.3*	*6.1*
Net exports of goods & services (contribution to growth)	**2.5**	**-1.8**	**-8.2**	***-0.2***	***-1.3***
Gross domestic product	**5.2**	**3.1**	**-5.1**	***2.1***	***1.3***
Average quarter-on-quarter growth rate, seasonally adjusted	1.0	0.8	-0.8	*-0.3*	*0.6*

Source: Cystat; Sapienta estimates and forecasts in italics.

Economy of northern Cyprus* Next section Previous section

**Areas not under the effective control of the government of the Republic of Cyprus*

Budget revenue starts the year in steep decline

Continued pandemic-related lockdowns, including the closure of cafés for part of February, took their toll on public finances of the unrecognized Turkish Republic of Northern Cyprus (TRNC) at the beginning of the year, with total revenue dropping year on year by 16.7% in the first two months of 2021. Taxation has been falling across all categories, with the largest category, income tax, dropping year on year by 28.4% in January-February. Funds from the deposit insurance fund, which is going towards pandemic-related loan subsidies, offset some of the decline. The promised ₺2.5bn in grants from Turkey (€258m at current exchange rates), plus ₺1bn in loans should also close some of the gap later in the year, although as of February these funds had not been released. Nevertheless, if pandemic-related restrictive measures continue indefinitely, the administration is likely to struggle to meet public-sector salary payments in the coming months.

Table 14

Turkish Cypriot central budget outturns
₺ million; excludes social insurance

	2019 Year	2020 Year	% change	2020 Jan-Feb	2021 Jan-Feb	% change
Total revenue, of which:	7,403	8,160	10.2	1,321	1,100	-16.7
Taxes, of which:	4,970	4,869	-2.0	822	620	-24.5
Income tax	n/a	1,752	n/a	310	222	-28.4
Corporation tax	n/a	500	n/a	64	42	-35.0
Value-added tax (VAT)	n/a	598	n/a	129	95	-26.0
Excise duties on fuel	787	864	9.7	104	89	-15.1
Collections of receivables (deposit insurance fund)	166	120	-27.6	0	146	-
Grants from Turkey (a)	579	1,050	81.5	54	0	-
of which: defence (Turkish Cypriot military)	512	704	37.6	54	0	-
Credit from Turkey (b)	0	564	-	0	0	-
Total expenditure, of which:	7,688	8,696	13.1	1,086	1,155	6.4
Personnel expenses	2,846	2,691	-5.5	367	416	13.3
Transfers to households	1,724	1,875	8.8	241	281	16.6
Pensions	1,032	1,125	9.0	172	194	12.9
Defence (Turkish Cypriot military)	512	704	37.5	62	61	-0.6
Balance inferred	***-285***	***-536***	-	***235***	***-55***	-
Memorandum item						
Consumer price inflation rate (%)	-	-	25.7	-	-	12.0

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

Source: KKTC Maliye Bakanlığı; Sapienta inferences in italics.

Businesses become vocal about the challenging economic situation—

The sudden departure of Turkey's central bank governor, Naci Ağbal, on 20 March, which led to a renewed sharp depreciation of the Turkish lira, has not had any visible impact on reserves at the Turkish Cypriot central bank (KMB). Foreign exchange reserves at the KMB rose to ₺2.4bn (€254m) on 26 March from €248m on 26 February. Before the latest depreciation, which will raise the cost of imports, businesses had started to become more vocal about the increasingly challenging economic situation. The head of the Turkish Cypriot Chamber of Commerce (KTTO), Turgay Deniz, spoke on 14 March of an estimated real GDP decline of 14.3% (from newspaper reports it was not clear whether he was referring to 2020 or 2021), while the head of the Chamber of Industry, Candan Avunduk, said on 12 March that the authorities had abandoned industrialists. The head of the Cyprus Turkish Building Contractors' Association (KTIMB), Cafer Gürcafer, said on 11 March that 25,000 accommodation units were empty as a result of the pandemic. The Chamber of Artisans and Shopkeepers published a survey on 4 March estimating that 5,000 businesses had closed and that unemployment had reached 50,000. In a later statement it said that the salary support scheme was insufficient and there were problems with the timeliness of payments. There are also reports of businesses being at risk of eviction owing to overdue rental payments.

An unemployment figure of 50,000 may be an overestimate, as the most recent labour force survey of October 2020 puts unemployment at 14,950, with another 9,950 outside the labour force who would like to work but are not currently seeking employment. Nevertheless, the fact that these criticisms are coming from a sector that would normally support the ruling National Unity Party (UBP) suggests that the situation is becoming serious.

—which may make it difficult to implement the Turkey financial protocol agreement

If the administration is at risk of losing support from its natural allies, this is likely to make it more difficult to pass some of the politically sensitive reforms that form part of the financial support agreement (protocol) with Turkey. Planned reforms include the following and will be closely monitored by Turkish government officials.

- Tax reform, including casino taxation.
- Expropriation of land for public works on the Famagusta, Kyrenia and Kalecik (Gastria) ports.
- Digitization of land records, including properties of the Evkaf (Islamic foundation that dates from Ottoman times).
- Amendments to the criteria for promotion in the public sector and limits on overtime.
- Minimum standards for trade union annual financial accounts.
- A reorganization of teacher grades.

Plans for a natural gas pipeline and a submarine electricity interconnector with Turkey were also included again in the most recent protocol.

Table 15

Northern Cyprus: selected short-term statistics
% change over the same period of the previous year

	Latest period	YoY % change in latest period	YoY % change for year-to-date
Consumer price inflation	Feb	12.9	12.0
Tourism arrivals	Dec	-93.6	-77.8
of which from Turkey	Dec	-94.8	-77.3
Plastic card spending south of the Green Line	Q3	-75.2	-58.3
Plastic card spending north of the Green Line	Q3	-90.2	-67.7
Imports of goods (expressed in US dollars)	Dec	-22.3	-23.1
of which from Turkey	Dec	-17.8	-21.1
Exports of goods (expressed in US dollars)	Dec	27.7	22.6
of which to Turkey	Dec	17.8	14.7

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

PDO designation for hellim could be a significant boon to exports in the long term

With large parts of the economy remaining closed, the authorities are putting their efforts into Covid-19 vaccinations to be able to open up again. As noted above, 97,969 individuals had received at least one vaccine dose as of 25 March, which we calculate is around 25% of the population—rather higher than the southern part of Cyprus as well as many EU countries.

One development that could have a significant positive impact on exports in the longer term is the announcement on 29 March that both halloumi and hellim (the Turkish name) had received the EU's protected designation of origin (PDO) status. Producers on both sides of the island have been somewhat reluctant to accept the status because it means increasing the proportion of more expensive sheep and goat milk in the cheese. Mr Avunduk of the Chamber of Industry said that the PDO requires that at least 51% of the cheese is made from goat or sheep milk, compared with typically only 11-12% for Turkish Cypriot producers and 15%-20% for Greek Cypriot producers. In addition, it is currently not clear whether Turkish Cypriot producers yet meet the EU's stringent food safety standards, nor whether they will be able to sell directly to EU markets or must export via the south under the Green Line regulation (which would need to be amended as it currently does not allow trade in animal products). Nevertheless, global demand for halloumi and hellim has been growing rapidly in recent years, therefore in the longer term PDO registration could be a significant boon for exports. Hellim is already the largest single export from northern Cyprus, having risen to ₺186.4m in 2019 (around €19m at today's exchange rate) from just ₺34.2m in 2012.

Table 16

Northern Cyprus: key macroeconomic indicators

	2015	2016	2017	2018	2019
GDP (₺ million)	10,222	11,601	14,545	18,324	21,395
GDP (€ million, converted at annual average exchange rate)	3,379	3,470	3,530	3,210	3,365
Population ('000)	331,432	339,478	351,965	372,486	382,230
GDP per capita (€)	10,194	10,222	10,029	8,619	8,804
Real GDP growth (%)	4.0	3.6	5.4	1.3	1.9
Consumer price inflation (%)	7.8	10.2	14.7	30.0	11.7
Unemployment rate (%)	7.4	6.4	5.8	6.9	6.3
Fiscal balance (% of GDP)	-3.2	-1.1	-0.3	0.3	-1.3
Public debt (€ million, converted from $ and ₺)	5,060	5,129	4,893	n/a	n/a
of which debt to Turkey	3,362	3,424	3,409	n/a	n/a
Public debt (% of GDP) (a)	149.8	147.8	138.6	n/a	n/a
of which debt to Turkey (% of GDP)	98.9	98.8	96.6	n/a	n/a
Number of tourists ('000)	1,483	1,577	1,734	1,760	1,750
Exports of goods ($ million)	118	106	106	95	82
Imports of goods ($ million)	1,501	1,557	1,778	1,816	1,588
Memorandum items					
Turkish lira per euro (ECB)	3.0255	3.3433	4.1206	5.7077	6.3578
Turkish lira per US dollar (US Forex and ECB-derived)	2.7119	3.0249	3.6475	4.8329	5.6791

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

Sources: Devlet Planlama Örgütü (SPO); Maliye Bakanlığı; Türkiye Cumhuriyeti Lefkoşa Büyükelçiliği.

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