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# Sapienta Country Analysis

## Cyprus

March 2023

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*Comprehensive monthly analysis of politics, economic policy and economics*

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# Executive summary Next section

*31 March 2023*

- Political analysis and outlook. Expectations have been toned down about high-level EU involvement in the Cyprus problem and a "common defence doctrine" with Greece but we do expect increasing high-level EU involvement in broader regional issues that touch on the Cyprus problem. The opposition DISY party has said that it will be supportive in parliament.

- Energy and structural reforms. Edison has made a pitch to revive the East Med pipeline. The new energy minister has signalled a re-think of natural gas policy that focuses less on geopolitics and more on cutting energy costs, and is making a number of moves to prepare the electricity grid for both gas and renewables. Parliament faces a tight schedule on green transition legislation.

- Fiscal performance and forecast. Reforms to VAT on property should be passed shortly after Orthodox Easter. Negotiating wage indexation (COLA) will be a key government focus. The promised sustainable bond has not yet been issued. Cyprus had the lowest interest payment burden on record in 2022. We forecast a debt/GDP ratio below 60% by 2025.

- Banking sector. Bank assets and liabilities data do not suggest any immediate vulnerabilities for Cyprus. Hellenic Bank reported a net loss in the fourth quarter owing to staff cuts. The sector-wide NPE ratio is now in single digits but tourism-related NPEs are creeping up as interest rates rise. The governing parties are shifting attention to a special foreclosures court.

- Macroeconomic trends and forecast. In the fourth quarter of 2022 household consumption declined compared with the previous period, while non-housing construction and dwelling permits fell year on year. Although employment growth reached 3.0% in the same period, we have cut our real GDP growth forecast to 2.7% in 2023, 1.3% in 2024 and 1.8% in 2025.

- Economy of northern Cyprus*. A voluntary salary levy for earthquake resilience has been passed. Aid from Turkey has been declining while hard-currency Treasury bills have been rising. Arrivals were strong in January-February. The new airport terminal has not yet been opened. PDO hellim needs to pass a few more hurdles before it can be sold to EU markets.

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

**Table S.1**

**Sapienta Economics macroeconomic forecast**

| | 2021 | 2022 | *2023* | *2024* | *2025* |
|---|---|---|---|---|---|
| GDP at current prices (€ m) | 24,019 | 27,012 | *29,020* | *30,562* | *32,038* |
| GDP per capita (€) | 26,677 | 29,723 | *31,637* | *33,010* | *34,295* |
| GDP at constant 2005 prices (€ m) | 22,938 | 24,230 | *24,890* | *25,225* | *25,673* |
| Real GDP growth (%) | 6.6 | 5.6 | *2.7* | *1.3* | *1.8* |
| Harmonized consumer price inflation (%) | 2.3 | 10.9 | *4.6* | *3.9* | *3.0* |
| Unemployment rate (%) | 7.5 | 6.8 | *6.1* | *5.9* | *6.1* |
| Budget balance (ESA2010) (€ m) | -408 | 610 | *764* | *910* | *1,044* |
| % of GDP | -1.7 | 2.3 | *2.6* | *3.0* | *3.3* |
| Primary balance (ESA2010) (€ m) | 30 | 1,017 | *1,138* | *1,287* | *1,383* |
| % of GDP | 0.1 | 3.8 | *3.9* | *4.2* | *4.3* |
| Gross public debt (€ m) | 24,271 | 23,366 | *22,214* | *19,949* | *18,491* |
| % of GDP | 101.0 | 86.5 | *76.5* | *65.3* | *57.7* |
| Current-account balance (% of GDP) | -7.1 | *-10.1* | *-9.4* | *-8.3* | *-8.0* |

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

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**Expectations are toned down about EU involvement in the Cyprus problem—**

The new president of the Republic of Cyprus, Nikos Christodoulides, who took office on 1 March, visited Brussels on 22-24 March for a summit of the European Council heads of government on 23-24 March. Ahead of the summit, the Greek Cypriot media made much of the expectation that he would be holding separate meetings with the presidents of the European Council, European Commission and European Parliament. According to media reports, he would present a written plan for high-level involvement of the EU to "break the deadlock" on the Cyprus problem and would propose specific individuals who might do the job. He also hoped to have a formal meeting with the UN Secretary-General, Antonio Guterres, who was also attending the summit.

Mr Christodoulides did meet the three presidents and other EU leaders. He also briefed the European Council and the European People's Party (EPP)—which is his *de facto* "family" group in the European Parliament—on the issue and he told the media at home that his proposals had been well received. However, even before the meetings had taken place, expectations were toned down, with reassurances that the EU would not be replacing the UN and that the discussions were about how the EU might contribute to a resumption of negotiations to solve the Cyprus problem. By the time of the National Council meeting on 30 March, Mr Christodoulides was saying that an EU envoy was not essential.

According to media reports, Mr Christodoulides did not submit any documents, did not formally suggest any names and seems to have met Mr Guterres only for a brief handshake. This suggests that he was encouraged ahead of time not to put anything in writing. As regards a meeting with Mr Guterres, the UN was doubtless wary about meeting one of the leaders of the two communities in the context of the Cyprus problem negotiations without meeting the other leader, or giving the impression that there was any movement. The UN Under-Secretary-General (USG), Rosemary DiCarlo, had visited the island on 15-18 March. This was the first visit from someone at USG level since September 2021 but according to media reports, Ms DiCarlo essentially said that the Secretary-General would not be directly involving himself in the Cyprus problem again, as he did in 2017, unless there was going to be a concrete outcome.

**—but we do expect increasing high-level EU involvement in broader regional issues**

Mr Christodoulides' argument is that the EU is the only institution that has the capacity to offer incentives to Turkey on both the Cyprus problem and related issues but also to keep Turkey closer to the EU than Russia. According to media reports he intended to propose that an EU appointee would be able to work on issues that were "of direct interest to Ankara", such as its desire to expand the EU-Turkey customs union, visa liberalization for Turkish citizens and Turkey's participation in the EU's Permanent Structured Cooperation (PESCO) defence cooperation programme. While EU leaders are no doubt considering various incentives to keep Turkey in the "Western camp", including announcing €7bn of support to Turkey and Syria after the earthquakes in February, it is likely that EU leaders will be hesitant to pursue Mr Christodoulides' proposal in isolation. As noted by the British High Commissioner in Cyprus, Irfan Siddiq, in a recent interview with *Phileleftheros*, Turkey and the Turkish Cypriots are still insisting on a two-state solution. This raises the risk of the EU spending political capital for no gain. Turkey and the Turkish Cypriots have also been historically been reluctant to have EU involvement in the formal Cyprus problem negotiations because the Republic of Cyprus is already a member. It is also likely that, after the shifting stance of the Greek Cypriot leadership since the collapse of high-level talks in 2017, EU leaders are not yet convinced that the Greek Cypriots are serious about rapprochement and/or a comprehensive settlement of the Cyprus problem, at least not without some moves that will demonstrate good intent. So far the government has made some moves, for example, by not blocking aid to Turkey from the European Investment Bank (EIB) and contributing €500,000 to the abovementioned €7bn in earthquake support.

Despite these reservations, we believe that the EU will eventually become involved at a high level in broader issues that touch on the Cyprus problem. One reason is the rapid rapprochement between Greece and Turkey. On 21 March they reached an agreement whereby Turkey will support Greece's bid to become a non-permanent member of the UN Security Council, while Greece will support Turkey's bid to lead the International Maritime Organization (IMO). This is despite the fact that Turkey continues to prevent ships with the Republic of Cyprus flag or those managed from the Republic of Cyprus from docking in its ports. The warming of relations, which is said to be strongly encouraged by the US, looks set to lead to a resumption of discussions on a range of issues over which the two countries differ. After the elections due in Turkey on 14 May and Greece on 21 May, it is expected that the two countries will move into discussing more thorny issues, such as maritime delimitation, and from there to regional energy issues. Given the EU's involvement in financing large energy initiatives, such as the EuroAsia Interconnector submarine electricity cable that will run from Israel via Cyprus to Greece, the EU is bound to play a role in helping to finance any regional energy deals that arise, as long as such initiatives support green transition or help diversify Turkey and EU member states from Russia. For that reason we believe that the EU will ultimately be drawn into increasing high-level involvement in issues that touch upon the Cyprus problem, even if the European Council does appoint an envoy solely focused on Cyprus. Steps are already being taken within Cyprus to work on energy cooperation across the divide (see Energy and structural reforms).

**Expectations are also lowered over a "common defence" with Greece**

The rapprochement between Turkey and Greece might also explain lowering expectations by Mr Christodoulides after his trip to Greece on 13 March. During a joint press conference with Greece's prime minister, Mr Christodoulides said that the two countries would create a Supreme Cooperation Council, which would include meetings of the entire cabinets of the two countries. The announcement prompted a strong reaction from the opposition Progressive Party of Working People (AKEL). AKEL saw it both as an attempt at achieving *enosis* (union of Cyprus with Greece), which these days is only promoted by far-right nationalists, and also as undermining the government's claim to represent all Cypriots, including Turkish Cypriots. The announcement seemed to revive the 1990s notion of the "common defence doctrine", whereby an attack on one country would be a considered an attack on both. According to media reports, Mr Mitsotakis told Mr Christodoulides that now was not the time for such a revival, and since the initial announcement Mr Christodoulides has said that it would not be the entire cabinet but specific ministers.

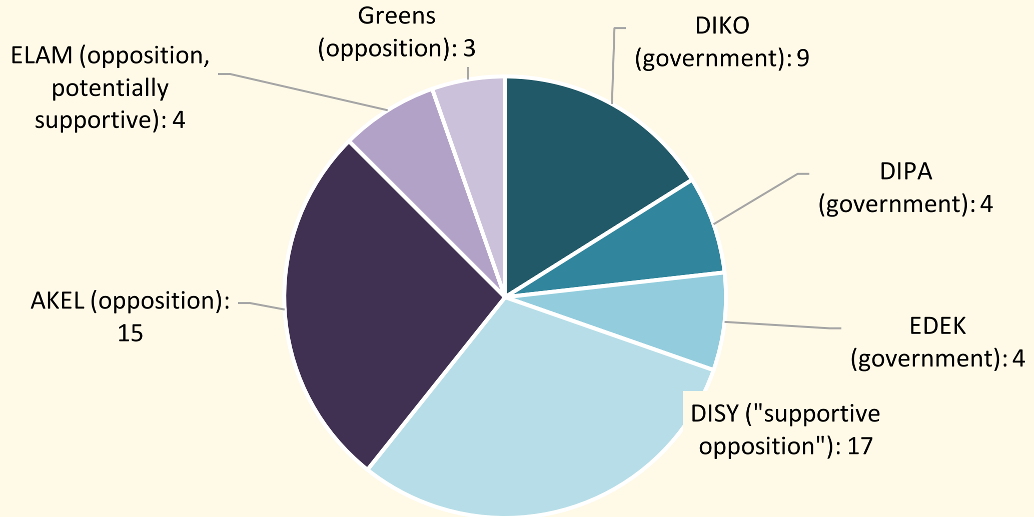
**New DISY leader indicates that the party will be supportive in parliament**

As we had expected in our last issue, Annita Demetriou won the leadership of the opposition Democratic Rally (DISY) in the election held on 11 March. The next battle will be for the vice-president, for which elections will be held in May. Ms Demetriou, who will retain her post as president of parliament (and therefore the acting president in the absence of the president of the republic), has indicated that the party will be supportive of the government. DISY probably took this move to ensure party unity, since around 79% of DISY members voted for Mr Christodoulides in the second round. The support of DISY will make it easier for the government to pass legislation, given that the parties supporting Mr Christodoulides do not hold a majority in parliament (see chart). However, Ms Demetriou doubtless also has presidential ambitions, and, as the next presidential election in 2028 approaches, it might be in DISY's interests to make like more difficult for Mr Christodoulides in parliament.

| **Council of Ministers from 1 March 2023** | **(With official name spellings)** |
|---|---|
| Agriculture, Rural Development & Environment | Petros Xenophontos |
| Culture (deputy ministry) | Michael Hadjiyiannis |
| Defence | Michalis Giorgallas |
| Education, Youth and Sport | Athina Michaelidou |
| Energy, Commerce and Industry | Giorgos Papanastasiou |
| Finance | Makis Keravnos |
| Foreign Affairs | Constantinos Kombos |
| Health | Popi Kanari |
| Interior | Konstantinos Ioannou |
| Justice & Public Order | Anna Koukkides-Prokopiou |
| Labour & Social insurance | Yiannis Panayiotou |
| Research, Innovation & Digital Policy (deputy ministry) | Philippos Hadjizacharias |
| Shipping (deputy ministry) | Marina Hadjimanolis |
| Social Welfare (deputy ministry) | Marilena Evangelou |
| Tourism (deputy ministry) | Kostas Koumis |
| Transport, Communications & Works | Alexis Vafeades |
| | |
| Government Spokesperson | Konstantinos Letymbiotis |
| Deputy Government Spokesperson | Doxa Komodromou |
| Deputy Minister to the President | Irene Piki |
| Secretary to the Council of Ministers | Penelope Papavassiliou |
| | |
| **Other non-cabinet positions** | |
| Director of the Diplomatic Office | Marilena Raouna |
| Director of the President's Office | Charalambos Charalambous |
| Director of the Press Office | Viktoras Papadopoulos |

Source: https://www.presidency.gov.cy/

**Political party support for the government in parliament**



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**Edison makes a pitch to revive the East Med pipeline—**

Edison, which is the Italian partner in the Greek-Italian IGI Poseidon East Med pipeline project, made a pitch to revive the East Med pipeline project in an interview with Reuters on 20 March. In the interview, Fabrizio Mattana, Edison's executive vice president for gas assets, said, "We expect to take the final investment decision (FID) [on the project] by the end of this year." He added that the project could be "realised by 2027". The East Med pipeline remains on the EU list of Projects of Common Interest (PCI) and has received €1.9m in EU financing for "pre-FEED" studies—studies before the pre-front end engineering and design (FEED) report. It is eligible for another €34.5m to cover 50% of the fully fledged FEED studies. Mr Mattana said that Edison would conduct a market test to assess interest later this year and that, depending on interest from producers, buyers and transport operators, the company would apply for the additional EU financing (presumably the FEED finance).

The East Med pipeline has had a varied history. There have long been questions about its viability (see below) and Turkey, which fears being isolated by its neighbours, has objected to the pipeline. According to the former foreign minister, Ioannis Kasoulides, Turkey interfered in maritime environmental studies on the pipeline, which he said had prompted the pipeline project managers to consider other routes that would bypass the Cyprus Exclusive Economic Zone (EEZ). The fortunes of the pipeline had already taken a blow after remarks by the US Under Secretary of State, Victoria Nuland, in April 2022, when she said, "I think that the piece that we are moving away from now is this heavy pipeline at the bottom of the sea that'll be very expensive and take 10 years to build." These remarks may also be related to concerns about regional tensions.

**—there are a number of likely reasons for the move—**

There are a number of potential reasons for the move by Edison to revive the project now. The first is the potential opportunity of delivering gas from Israel to Cyprus, which the new energy minister, Giorgos (George) Papanastasiou, has made clear is a priority (see below). In January 2020 Energean had already signed an agreement with Public Gas Corporation of Greece (DEPA)—the Greek arm of the IGI Poseidon project—to cooperate on the East Med Pipeline. Energean has long been lobbying the Cyprus government to bring gas to Cyprus from its fields offshore Israel. Energean and the East Med pipeline consortium could therefore conceivably join forces for what Mr Papanastasiou had termed, at a conference in December prior to his appointment, the "first leg" of the East Med pipeline.

A second possible reason is that the EU is rapidly moving away from investment in hydrocarbons, as evidenced in its proposal for the Net Zero Industry Act announced on 16 March. This means that the window of opportunity for natural gas investment is closing very quickly. However, the EU is interested in "green hydrogen", which would explain why Mr Mattana mentioned in his interview that the pipeline would be able to carry hydrogen. A third possible reason is to put pressure on the Italian government to join the political agreement on the pipeline that was signed by Cyprus, Greece and Israel but not by Italy in January 2020. Mr Mattana mentioned in the interview that he hoped Italy would sign it. The East Med pipeline is still formally alive, although even the Cypriot government seems to be playing it down. During a meeting of the foreign ministers of Cyprus, Greece on Israel on 31 March Cyprus' foreign minister, Constantinos Kombos, said that the three countries were striving to promote a reliably, sustainable energy corridor and that "the EuroAsia Interconnector and the East Med pipeline remain two significant strategic options".

 

The Reuters interview in March mentioned the oft-cited estimated cost of €6bn for the pipeline. As we have noted in the past, this seems like an underestimate (see Table E.1), especially given that it would require compressor stations at various points to maintain pressure in the pipeline. We assume, therefore that the €6bn estimate refers only to a smaller section of the 1,900-km pipeline. The part that has attracted EU funding so far runs from "Levantine Basin gas fields to Greece via mainland Crete".

**Table E.1**

| East Med gas pipeline, cost estimates | |
|---|---|
| **Baseline: pipeline from Aphrodite to Vasilikos based on historical estimates** | |
| Length (km) | 185 |
| Estimated cost ($ m) | $850 |
| Implied cost per km of Aphrodite to Vasilikos pipeline ($ m) | $4.59 |
| **Pipeline length to Megalopoli, Peloponnese, Greece (a)** | |
| Leviathan/Aphrodite to Vasilikos in Cyprus (km) | 200 |
| Cyprus to Crete (km) | 700 |
| Crete to landfall in Greece (km) | 400 |
| Landfall in Greece to Peleponnese (km) | 600 |
| **Total length of pipeline to Greece** | **1,900** |
| **Implied costs per km of East Med pipeline** | |
| Rported costs of €6bn converted into US dollars ($ m) | $6,800 |
| Implied cost per km of pipeline from Leviathan to Megalopoli ($ m) | $3.58 |

(a) The section to Italy is under a different budget.
Sources: Media sources for estimated total costs.


### —and Greece-Turkey rapprochement might make some sections of it more plausible—

Given Turkey's obstruction of environmental studies, it seems unlikely that the full length of the pipeline will be practically possible without an agreement with Turkey, which in turn we believe is unlikely without a broader regional energy deal. Even if the focus is only on the "first leg" to Cyprus, this would still be problematic if there were no benefits for Turkish Cypriots. Regional dynamics are changing, however. For example, relations between Greece and Turkey are thawing rapidly (see Political analysis and outlook). Turkey is also bolstering relations with Cyprus' allies Egypt and Israel. These changing dynamics might therefore be conducive to regional cooperation.

### —while smaller steps for energy cooperation begin to be made in Cyprus

Smaller steps at energy cooperation within Cyprus are already taking place, with plans for the joint production of solar-powered electricity in the UN-monitored buffer zone. We understand that the capacity would be between 35 megawatts (MW) and 50 MW. The head of the European Commission's Directorate-General for Structural Reform Support (DG Reform), Mario Nava, visited Cyprus in mid-March and told *Kathimerini* in an interview published on 19 March that the European Commission had issued a tender for a pre-feasibility study for what is being dubbed a "bi-communal solar park", that the Commission hoped to launch the study in early April and receive the results by November. In an earlier interview with *Politis*, the representative of the European Commission in Cyprus, Myrto Zambarta, said that two options being considered were photovoltaics using batteries for storage, or concentrated solar technology (which uses mirrors) combined with thermal energy storage. The leader of the Turkish Cypriot community and president of the unrecognized Turkish Republic of Northern Cyprus (TRNC), Ersin Tatar, also mentioned the cooperation during remarks on television that were published on 22 March. Noting plans for the EuroAsia Interconnector that will link Israel, Cyprus and Greece, he also called for the two grids to be connected via a submarine electricity cable between Cyprus and Turkey. Turkey has been stating its intentions to build such a cable for some years but building it would probably need assent from other members of the ENTSO-E grid.

**New energy minister has signalled a re-think of natural gas policy—**

The new energy minister, Mr Papanastasiou, has signalled a rethink of natural gas policy that looks set essentially to sideline the delayed floating, storage and regasification unit (FSRU), put more emphasis on bringing gas to Cyprus by pipeline, as well as on exports, and may even involve a change in plans for the Aphrodite field (see below). During a televised interview with Alpha TV on 20 March he said that the ministry was preparing a new overall plan for natural gas and that he planned a consultation with all of the energy companies involved in the region and interested in cooperating with Cyprus. In the same media report *Phileleftheros* said that the ministry is also examining using Cyprus as a hub for either onshore LNG or offshore floating LNG (FLNG) production and export. Noting that Energean had made a proposal to pipe gas to Cyprus from Israel, the newspaper article suggested that the minister intended to consult more widely.

As regards supply to Cyprus, Mr Papanastasiou said that he would prioritize the import of cheap natural gas by pipeline, either from Cyprus or from neighbours, and that this would take approximately 36 months. He said the expectations of low prices from imports of liquefied natural gas (LNG) were not justified, given current prices. At the same time however, he said that the new plan did not mean the total abandonment of the delayed FSRU (which would import gas as LNG and then convert it into gas form), but that it would be used more as a back-up for the purposes of security of supply. In an earlier interview with Astra radio reported on 17 March, Mr Papanastasiou suggested that gas from Aphrodite could come to Cyprus in addition to being sent to Egypt for liquefaction. To date the consortium led by Chevron has focused only on sending gas to Egypt.

**—as cutting electricity costs becomes the top priority**

In the past, natural gas policy has tended to be conducted through the lens of the Cyprus problem, which sometimes meant pursuing projects more for their geopolitical than commercial value. However, with electricity prices rising steeply and threatening to become politically toxic, the focus is now clearly on cutting costs. The state-owned Electricity Authority of Cyprus (EAC) faces €300m in emissions penalties this year and since it is the near monopoly provider of households, it passes the costs onto consumers. Speaking to Energy Committee of the House of Representatives (parliament) in early March, Mr Papanastasiou said that the need to cut electricity costs was urgent and that, while he would exert pressure to ensure that the electricity grid could take more electricity from renewable energy sources (RES), he would also intensify efforts to bring natural gas. He was even more blunt in his inaugural speech on 1 March, saying that before transitioning to green energy they would have to go through a transitional period of using natural gas.

**The energy regulator CERA makes changes to increase electricity competition**

The emphasis on natural gas, which is quicker to bring to scale than renewables, is also influenced by the delays in fully liberalizing electricity supply. *Phileleftheros* reported on 19 March that it was now doubtful whether the fully liberalized electricity market could be implemented before 2025. The head of the TSO, Stavros Stavrinos, told the parliament finance committee earlier in March that that a third test of the software system would be needed, after the failure of the first two conducted in 2022. As a stopgap measure, the Cyprus Regulatory Authority (CERA) has made a number of adjustments to the current "transitional" system, first introduced in 2017, with the aim of increasing competition and therefore reducing prices. The first involves allowing photovoltaic parks that have not yet secured licences within the transitional arrangements to participate in the transitional system. As the absence of RES storage is a key obstacle to raising RES penetration and led again to short power cuts in March, independent RES storage operators will also be allowed into the transitional system. There will also be tenders for new storage systems. Another key change will be to allow customers to have contracts with more than one supplier, while the issue of customers switching providers without having paid off debts to previous providers will also be resolved. A fully updated new regulatory system is promised by the end of May.

Another pending issue, which now looks as though it will be addressed, is the full transfer of employees of the Electricity Authority of Cyprus (EAC) to the Transmission Service Operator (TSO). Under EU rules the TSO is supposed to be functionally and legally independent of the producer. However, owing to disagreements about pensions and other rights, EAC employees have continued to work at the TSO. Mr Papanastasiou told the parliamentary Energy Committee on 14 March that he intended to ensure that all the rights of those moving from the EAC to the TSO would be retained and that this would require new legislation to implement.

With questions having been raised about the independence of the TSO, the general manager of the EAC, Adonis Yiasemides, was keen during the same meeting to declare the EAC's support for the TSO's independence. The EAC issued a statement after the meeting confirming its support for independence. The EAC was probably particularly sensitive about claims following revelations that one of its board members had commercial interests in photovoltaics—something which the EAC board said it was not aware of, because declarations of interest are not submitted to the board.

**New finance minister admits tight timetables for EU transition funds—**

The new finance minister, Makis Keravnos, has admitted that the timetable for meeting all of the reforms required in the EU-funded Recovery and Resilience Facility (RFF) is a challenge. So far Cyprus has received only one pre-financing tranche of €157m and one reform-related tranche of €85m from the €1bn in grants and €200m in loans allocated under the Cyprus RFF programme. Media reports about his remarks at the ECOFIN group of EU finance ministers suggest that Cyprus is hoping to revise the schedule. We understand that Irene Piki, the Deputy Minister to the President, has responsibility for ensuring that the RFF is implemented. She is considered to be a capable technocrat, therefore this reduces the risk of giving the responsibility to some of the less experienced new ministers. Passing the legislation will need the support of the Democratic Rally (DISY), which is now technically in opposition. However, the new DISY leader, Annita Demetriou, has indicated that DISY will be supportive of the new government. Moreover, if she retains her position as parliamentary leader, as she has indicated that she intends to do, this will also help in getting the necessary legislation through.

**—and parliament prepares for passing "Fit for 55" legislation**

Relatedly, parliament is due to pass five EU directives and eight regulations before the end of 2023 in order to meet its "Fit for 55" targets to reduce by 2030 net greenhouse gas emissions by 55% relative to 1990 levels. A bill was submitted on 23 March to introduce "traffic rings"—zones around cities that will prevent higher-polluting vehicles from entering certain areas. Meanwhile, the registration of electric and hybrid vehicles is rising rapidly from a low base.

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### VAT on property will be voted on after Orthodox Easter—

The entry of political parties that had previously been in opposition into government seems to have unlocked solutions for some of the most politically contentious issues, including value-added tax (VAT) on property and the suspension of foreclosures (see Banking sector). Thus, the new finance minister, Makis Keravnos, reached a deal with Members of Parliament (MPs) on 28 March to push through the long-pending bill that will remove the blanket reduced VAT rate of 5% on all first-purchase primary residences and replace it with one that is more targeted and therefore compatible with EU legislation. After earlier warnings that had gone unheeded, the European Commission sent a letter of formal notice to the government about the reduced VAT rate on 15 December, with a deadline of 15 February to alter the legislation. This did not happen because of the presidential election. But with court action and potentially large fines pending, it became clear that the government and parliament had little for manoeuvre. It therefore looks as though the bill last presented by the government will be presented to the House Finance Committee on 3 April and will be passed unchanged immediately after Orthodox Easter on 16 April. The bill will differentiate between houses and flats for first-time buyers. For houses that are not larger than 220 square metres and not worth more than €350,000, a VAT rate of 5% VAT rate will be levied on the first 170 square metres. For apartments not larger than 110 square metres and not worth more than €200,000, a VAT rate of 5% is levied on the first 90 square metres.

### —and tax reform is promised

The previous government had intended to implement a wide-ranging tax reform before the end of 2022, not least to meet its international obligations to raise the corporate income tax rate from 12.5% to 15%. The reform was not implemented, probably because of distractions relating to the Ukraine war and the upcoming election in February 2023. In the context of the VAT deal, Mr Keravnos mentioned the intention to introduce tax reform, pledging that the tax-free threshold of income tax would be raised from its current level of €19,500. He has also proposed cutting VAT on products for infants such as food and nappies.

**Table F.1**

**Public-sector employment**

| | 2018 | 2019 | 2020 | 2021 | 2022 |
|---|---|---|---|---|---|
| Total employment | 400,878 | 416,478 | 417,354 | 431,716 | 450,541 |
| Public-sector employment | 62,165 | 62,773 | 63,516 | 64,916 | 66,287 |
| % of total | 15.5 | 15.1 | 15.2 | 15.0 | 14.7 |
| Compensation of employees including pensions (€ m) | 2,484 | 2,736 | 2,899 | 3,005 | 3,148 |
| % of expenditure | 26.9 | 31.0 | 29.7 | 29.0 | 29.2 |

Sources: Cystat; Eurostat.



### Wage-indexation will be the main focus in the coming months—

A key focus for the new government in the coming months will be negotiations with unions over the wage-indexation mechanism known as COLA (or ATA in Greek). COLA was suspended in late 2012, ahead of the 2013-15 bailout programme, and was only partially produced from January 2017, so that wages are adjusted by 50% of the change in cost-of-living index (the consumer price index minus excise taxes). Unions want a full restoration, while the government is arguing for a staggered approach, so that lower-income groups receive a 100% adjustment, while higher-income groups receive less than a full adjustment. The new labour minister, Yiannis Panayiotou, has also spoken of increasing the lowest pensions by 5%. We expect negotiations are likely to continue for at least several months. Unions are also trying to restrict the range of areas in which people from non-EU countries can work. However, demand for labour is likely to continue to rise. Although job vacancies have fallen from their peak in the first quarter of 2022, the job vacancy rate, at 1.9% in the fourth quarter, remains high by historical standards.

### —as the public-sector pay bill inches up

The negotiations come at a time when the public-sector wage bill is inching up. Compensation of employees, including pensions, reached €3.2bn in 2022 and accounted for 29.2% of expenditure, compared with €3.0bn, or 29.0% of expenditure, in 2021 (see Table F.1). The slight increase is probably related to an increase in overall public-sector employment, which rose to 66,287 in 2022 from 64,916 in 2021. As a proportion of the total, however, public-sector employment has been on a downward trend, falling below 15% in 2022.

### The sustainable bond has not yet been issued

The previous government had envisaged issuing a €1bn sustainable bond (a bond that wil be spent on environmentally and socially responsible projects) in early March and Mr Keravnos told StockWatch on 6 March that he had already approved it for issuance. The timing would normally have been favourable. Cyprus government bond yields have been falling since a recent peak in February and on 10 March FitchRatings upgraded Cyprus one notch to BBB from BBB- (one notch above investment grade). On 3 March Standard & Poor's had kept the rating one notch above investment grade, while Moody's kept it at junk in its review on 31 March (see Table F.2). As of 31 March the bond had not yet been issued, however, possibly because of uncertainty in global financial markets during March (see Banking sector) and perhaps because the government wanted to wait for the ratings reviews. The government has no immediate need to issue debt, as it is running a primary surplus (see below) and, as noted in previous reports, has several billion in cash with the Central Bank. The main reason for issuing one now is to create a benchmark for an instrument that will become increasingly popular. Demand for sustainable bonds is likely to grow rapidly in future as both commercial and central banks review their portfolios for "green" credentials. For example, the European Central Bank (ECB) announced the results of climate stress tests on central bank balance sheets on 28 March. While it found that the main climate impact was on corporate bonds, the ECB is bound to become more cautious about buying "non-green" sovereign debt in future.

**Table F.2**

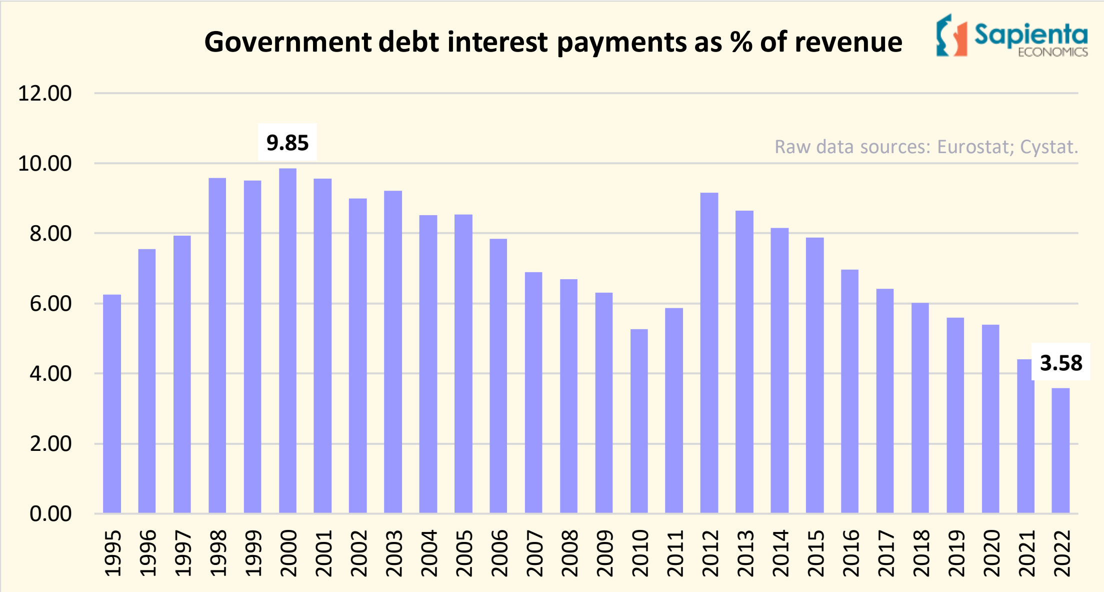
**Cyprus sovereign credit ratings: major agencies**

| Last change in rating or outlook | Last confirmation of rating & outlook | Rating agency | Long-term rating | Current outlook | Notches above (+)/below (-) investment grade |
|---|---|---|---|---|---|
| 19-Aug-22 | 31-Mar-23 | Moody's | Ba1 | Positive | -1 |
| 10-Mar-23 | 10-Mar-23 | Fitch | BBB | Stable | 1 |
| 02-Sep-22 | 03-Mar-23 | S&P | BBB | Stable | 1 |

Sources: Rating agency press releases.


### Government had the lowest interest payment burden on record in 2022

Despite rising global and local interest rates, the government had the lowest interest payment burden on record in 2022. Total debt interest payments amounted to €407m according to Cystat data, which accounted for just 3.6% of revenue, compared with a peak of 9.9% in 2000. As a proportion of GDP, debt interest payments were just 1.5% of GDP, compared with a peak of 3.3% in the pre-crisis year of 2012. The interest burden has fallen owing to a combination of falling global interest rates that are still low by historical standards, as well as improved credit ratings in Cyprus.




### The public finances start the year on a positive note

The public finances for January show that the year started on a strong footing, with total revenue rising year on year by 21.6% and total expenditure rising by 11.5%. The budget in January therefore recorded a general government surplus of €343m and a primary surplus of €384m. In 2022 the year ended with a general government surplus of €609m and a primary surplus of €1bn.

**Table F.3**

**General government finances (ESA 2010)**

| | 2021 Q4 | 2022 Q1 | 2022 Q2 | 2022 Q3 | 2022 Q4 |
|---|---|---|---|---|---|
| **€ million** | | | | | |
| Revenue | 3,113 | 2,464 | 2,312 | 3,306 | 3,295 |
| Expenditure | 3,061 | 2,214 | 2,641 | 2,569 | 3,342 |
| **General government balance** | **52** | **249** | **-330** | **737** | **-48** |
| Interest payable | 82 | 83 | 116 | 124 | 84 |
| **Primary balance** | **134** | **333** | **-213** | **861** | **36** |
| **% change over same period of previous year** | | | | | |
| Revenue | 24.2 | 14.6 | 17.5 | 22.1 | 3.8 |
| Expenditure | -3.1 | -1.9 | 1.3 | 7.5 | 10.2 |

Source: Cystat.



### Debt/GDP ratio should drop below 60% by 2025

The general government surplus in 2022 ended the year at 2.3% of GDP—rather higher than the government's expectation of 1.2% in its 2023 state budget. We have made some adjustments to our fiscal forecast on the basis of the latest figures for nominal GDP, inflation and our expectations for real GDP growth. We continue to expect the debt/GDP ratio to fall over the forecast period and to drop below 60% by 2025 (see Table F.4). Thus, although the EU's "escape clause" from its normal Stability and Growth Pact rules is expiring at the end of 2023, Cyprus should be in a position to meet the original targets.

**Table F.4**

| **Sapienta Economics budget and debt forecasts (ESA 2010)**<br>€ m unless otherwise indicated | | | | | | |
|---|---|---|---|---|---|---|
| | **2020** | **2021** | **2022** | **2023** | **2024** | **2025** |
| General government revenue | 8,501 | 9,938 | 11,376 | *12,077* | *12,782* | *13,460* |
| % change | -6.9 | 16.9 | 14.5 | *6.2* | *5.8* | *5.3* |
| General government expenditure | 9,764 | 10,346 | 10,767 | *11,313* | *11,872* | *12,416* |
| % change | 10.5 | 6.0 | 4.1 | *5.1* | *4.9* | *4.6* |
| General government budget balance | -1,263 | -408 | 610 | *764* | *910* | *1,044* |
| % of GDP | -5.8 | -1.7 | 2.3 | *2.6* | *3.0* | *3.3* |
| Primary balance | -742 | 30 | 1,017 | *1,138* | *1,287* | *1,383* |
| % of GDP | -3.4 | 0.1 | 3.8 | *3.9* | *4.2* | *4.3* |
| Gross government debt | 24,852 | 24,271 | 23,366 | *22,214* | *19,949* | *18,491* |
| % of GDP | 113.5 | 101.0 | 86.5 | *76.5* | *65.3* | *57.7* |

Sources: Eurostat; Cystat; Sapienta Economics estimates and forecasts in italics.



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# Banking sector Next section Previous section

**Bank assets and liabilities do not suggest any immediate vulnerabilities for Cyprus—**

The Central Bank of Cyprus published the annual asset and liability (balance sheet) data for the Cyprus banking system on 24 March. The data show a continued decline in the value of both assets and liabilities as the banking system sheds non-performing loans (NPLs). This is a trend that has been ongoing since at least 2010 (latest available data), before accelerating during the Cyprus financial crisis of 2013 (see Charts). The slow shrinking of assets is something that has been encouraged by EU supervisors. In 2010, assets had reached at 800% of GDP, which created significant risks for a small country. During the 2013-15 bailout programme the banks were encouraged to reduce this ratio and indeed by the end of 2022 assets had dropped to 236% of GDP (€63.8bn). Based on available data, assets in Cyprus today seem to be closer as a proportion of GDP to German or Belgian ratios.

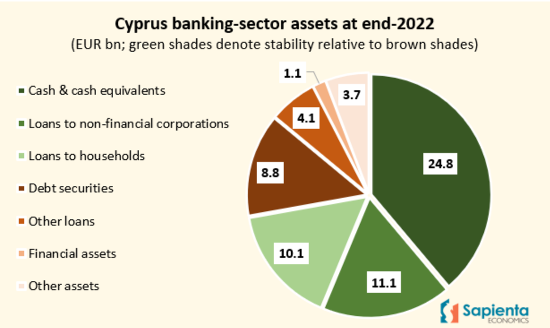
There are a number of reasons why the balance sheet statistics for the banking system in Cyprus do not raise any immediate concerns about Cyprus' potential vulnerability to the kind of deposit runs that brought down the US-based Silicon Valley Bank (SVB) and the Switzerland-based Credit Suisse in March. First, banks in Cyprus are extremely liquid, with the second highest liquidity ratio in the EU in the third quarter of 2022 according to European Banking Authority (EBA) data. Second, unlike SVB, rising interest rates are supporting the profitability of banks in Cyprus (see below). SVB had an unusual business model. On the asset side (which must match liabilities), it depended heavily for revenue on the value of volatile securities investments, rather than on interest paid on classic long-term loans. On the liability side, it depended on large, mobile depositors, which also made its liabilities potentially volatile. Credit Suisse, meanwhile, had been in trouble for some time.

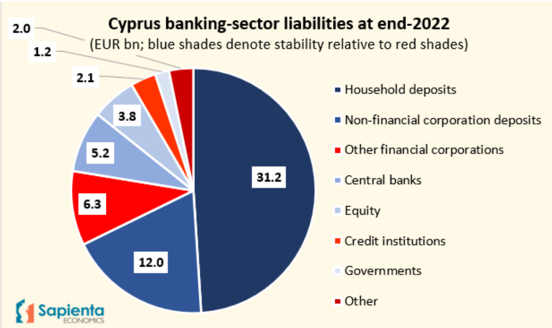
By contrast the asset and liability profile of the banking system in Cyprus reflects the fact that, these days, it is a fairly straightforward retail banking system focused on traditional deposit-taking and lending. Thus, €46.0bn (72%) of the system's €63.8bn assets are long-term in nature and therefore a fairly stable source of revenue. For example, the largest assets comprise €24.8bn cash and "cash equivalents"—mainly deposits placed with the European Central Bank (ECB) (see chart below). On the liability side €53.3bn (84%) are long-term in nature, with the largest comprising €31.2bn in household deposits. EU rules on moneylaundering, as well as the now notorious hurdles to opening new bank accounts within Cyprus, make it difficult for households and small businesses to open bank accounts outside Cyprus or shift large amounts of deposits out of the country. Thus, a bank run would take longer to accelerate, as it would involve either shifting deposits between already existing bank accounts in Cyprus or keeping large amounts in cash.

**—but public messaging by the Central Bank of Cyprus was a little slow**

Nevertheless, residents of Cyprus have a tendency to become nervous about bank stability, given that memories are still fresh of empty cash machines (ATMs), severe capital controls and banks not opening their doors for 12 straight days only 10 years ago in March 2013. Frequent rumours of "another haircut" circulated for years after the crisis and can still arise on occasion. This raises the risk of depositors pulling money out of banks and keeping it in cash, even if they will find it difficult to deposit it elsewhere. In that context, and given that bank runs often happen when there is only partial information, the Central Bank of Cyprus was a little slow to make a statement reassuring bank customers that Cypriot banks were safe. While the government was clearly messaging the media to say that it had been reassured by the Central Bank of Cyprus, the governor, Constantinos Herodotou, only issued a short statement in Greek on 20 March. This was 10 days after the Silicon Valley Bank closure and days after Credit Suisse ran into serious trouble. The statement said that Cypriot banks were not exposed to the Additional Tier 1 capital (AT1) bonds of Credit Suisse and that the banking system enjoys high capital adequacy and liquidity ratios.

The main issue seems to be one of communications. When asked by journalists if he was late in making a statement Mr Herodotou defended himself, saying that the banks had immediately run stress scenarios, both after the developments in the US and in Switzerland, and that he had immediately informed the Republic of Cyprus president and president of parliament that there was not a problem. Thus, although work was being done to ensure that the system was stable, it was the swift communication to the public that was lacking.




## Bill to clarify role of MREL bondholders is submitted

Two bills will were put before the Parliamentary Finance committee on 20 March to regulate the status of bonds issued as part of the EU's minimum requirement for own funds and eligible liabilities (MREL). Under the proposed new laws, in case of bank liquidation, bonds issued as MREL may not be netted against any debit balances. This is in any case not the current practice but the laws are required to ensure that bonds issued by banks count as MREL. This issue of how bonds are treated has become pertinent since holders of AT1 at Credit Suisse were given higher protection than shareholders in its recent takeover by UBS. Hellenic Bank issued €200m in Tier 2 bonds to meet is MREL requirements on 8 March, paying a coupon (interest rate) of 10.25% per year. Although the interest rate is very high compared with government bonds, strong international demand for the bond, which was almost 4.5 times oversubscribed, meant that the final coupon paid was lower than had initially been offered.

## Hellenic Bank reports a loss in the fourth quarter owing to lay-off costs—

Hellenic reported a net loss of €52.2m in the fourth quarter (see Table B.1), largely owing to restructuring costs, as operating income actually rose. Bank of Cyprus reported a net profit of €80m for the fourth quarter on 31 March, which we shall cover in more detail in our April issue. Hellenic Bank said that it had shed €30m in annual staff expenditure at a total cost of €70.9m. For the year as a whole, however, the bank reported a net profit of €24.2m, thanks largely to rising net interest income. Net interest income rose for the whole year by €45m, or 17.5%. In the fourth quarter, growth in interest income accelerated by 30.2% to €22m. While we have no particular concerns about Hellenic Bank's balance sheet given the recent turmoil in the global banking sector, it is more exposed to the changing value of securities assets than BOC. Of Hellenic Bank's €20.0bn in assets at the end of 2022, 73% were stable, comprising €8.5bn cash and balances held mainly with the ECB and €6.0bn loans to customers. Some 22% (€4.4bn) comprised debt securities, which can change in value. By contrast, BOC's €2bn of securities (at amortized cost) at the end of 2022 accounted for only 8% of its €25bn assets. Most of the Cyprus government bonds that Hellenic Bank acquired when it received the "good" part of the Cyprus Cooperative Bank (co-op) have matured, therefore only €0.8bn of this total is Cyprus government bonds. In its investor presentation Hellenic Bank says that €2.1bn of the remainder is securities of financial institutions; €761m is mainly highly rated securitizations, while another €816m is classified as "other".

### —while reports still circulate of a Eurobank takeover

Demetra Holdings, which is the largest shareholder of Hellenic Bank with 21.02%, announced an increase in profits from €5.3 in 2021 to €9.1m in 2022 thanks in large part of its investment in Hellenic Bank. Reports continue to circulate that Eurobank, which gradually raised its stake in Hellenic from 9.88% in July 2021 to 15.8% in January 2023 to become the fourth largest shareholder, is planning a takeover of Hellenic Bank.

**Table B.1**

**Hellenic Bank Group financial statement highlights**
€ million unless otherwise stated

| | 31-Dec-22 3 mths | 30-Sep-22 3 mths | 31-Dec-22 12 mths | 31-Dec-21 12 mths |
|---|---|---|---|---|
| Profit/loss before impairment of loans and advances | 57.6 | 30.8 | 133.8 | 95.5 |
| New provisions on financial instruments | 30.7 | 1.3 | 18.5 | 102.0 |
| Post-tax profit/loss for the period | -52.2 | 21.0 | 24.2 | -11.7 |
| Net interest income | 94.9 | 72.9 | 300.8 | 256.0 |
| Common Equity Tier 1 capital | 1,037 | 1,085 | 1,037 | 1,058 |
| Risk weighted assets | 5,674 | 5,670 | 5,674 | 5,479 |
| Common Equity Tier 1 capital ratio transitional basis (%) | 18.3 | 19.1 | 18.3 | 19.3 |
| Customer deposits | 15,928 | 15,561 | 15,928 | 14,942 |
| Gross loans | 6,963 | 6,990 | 6,963 | 6,728 |
| NPEs: EBA definition, including held for sale (a) | 1,335 | 1,362 | 1,335 | 1,414 |
| NPE ratio: EBA definition (a) (%) | 19.2 | 19.5 | 19.2 | 21.0 |
| Accumulated provisions | 738 | 739 | 738 | 755 |
| Coverage ratio (provisions as % of NPEs under EBA definition) | 55.3 | 54.3 | 55.3 | 53.4 |
| Net interest margin (%) | 1.97 | 1.54 | 1.60 | 1.52 |

(a) Includes, inter alia, loans restructured and less than 90 days past due.

Sources: Hellenic Bank financial statements and investor presentations; Sapienta calculations in italics.


**Table B.2**

**Hellenic Bank reported NPE ratios, December 2022**

| | |
|---|---|
| **Levels (€ m)** | |
| Gross loans without adjustments including held for sale (HFS), as reported | 6,963 |
| Gross loans excluding HFS, as reported | 6,223 |
| NPEs including held for sale (HFS), as reported | 1,335 |
| APS-guaranteed loans, as reported | 388 |
| HFS NPEs, as reported | 726 |
| NPEs excluding only APS, inferred | *948* |
| NPEs excluding only HFS, as reported | 610 |
| NPEs excluding both APS and HFS, as reported | 280 |
| APS NPEs that are HFS, inferred | *-58* |
| **Ratios (%)** | |
| NPE ratio without adjustments including held HFS, as reported | 19.2 |
| NPE ratio excluding only APS, as reported | 13.5 |
| NPE ratio excluding only HFS, as reported | 9.8 |
| NPE ratio excluding both APS and HFS, as reported | 3.6 |

Source: Hellenic Bank statements; Sapienta calculations and estimates in italics.

### Starlight sale will cut Hellenic's unadjusted NPE ratio to single digits

Hellenic Bank managed another small cut in its non-performing exposures (NPEs) in the fourth quarter to €1.3bn. Without adjustments and under EBA definitions, its NPE ratio fell to 19.2% in the fourth quarter, from 19.5% in the third. The finalization of the "Starlight" deal announced on 30 March will have brought that ratio down to around 9.8%. As of the fourth quarter accounts, €726m of the €1.3bn NPE total comprised loans "held for sale" (for the Starlight deal) and €388m comprised NPEs under the Asset Protection Scheme (APS). The APS loans are those that enjoy a government guarantee under the 2018 co-op deal. Without the NPEs held for sale and excluding those under the APS scheme, Hellenic Bank reports its NPE ratio as only 3.6%. This is closer to BOC's ratio (see Table B.2).

### NPE ratio of the banking system drops to single digits—

The NPE ratio in the whole banking system dropped into single digits in the fourth quarter for the first time since public records began, reaching 9.5%, compared with 10.6% in the previous quarter (see Table B.3). In absolute terms, NPEs declined by €423m during the quarter to €2.3bn by the end of December, compared with €2.7bn in the previous quarter and a peak of €28.9bn in February 2015, when the NPE ratio was 46.0%.

**Table B.3**

**Non-performing exposures (NPEs) in the banking system**

| | 2021 Q4 | 2022 Q1 | 2022 Q2 | 2022 Q3 | 2022 Q4 |
|---|---|---|---|---|---|
| **Levels (€ million)** | | | | | |
| Total NPEs, of which: | 3,022 | 2,944 | 2,921 | 2,732 | 2,310 |
| Non-financial corporations | 1,199 | 1,195 | 1,161 | 1,048 | 964 |
| Construction | 196 | 202 | 179 | 144 | 132 |
| Wholesale & retail trade | 297 | 291 | 281 | 237 | 222 |
| Transportation & storage | 205 | 212 | 228 | 252 | 234 |
| Accommodation & food services | 58 | 58 | 73 | 73 | 81 |
| Real estate | 200 | 190 | 188 | 135 | 104 |
| Households | 1,567 | 1,492 | 1,431 | 1,358 | 1,283 |
| **Ratios (%)** | | | | | |
| Total NPEs, of which: | 11.1 | 11.4 | 11.2 | 10.6 | 9.5 |
| Non-financial corporations | 8.2 | 9.1 | 8.7 | 8.0 | 8.0 |
| Construction | 16.2 | 16.1 | 14.6 | 12.3 | 11.9 |
| Wholesale & retail trade | 12.6 | 12.5 | 11.6 | 10.1 | 10.2 |
| Transportation & storage | 14.8 | 15.3 | 16.7 | 16.4 | 17.2 |
| Accommodation & food services | 2.3 | 2.3 | 2.9 | 3.0 | 3.5 |
| Real estate | 8.5 | 8.2 | 8.2 | 6.1 | 4.9 |
| Households | 14.8 | 14.0 | 13.4 | 12.7 | 12.1 |
| **Memorandum items** | | | | | |
| Total loans (€ million) | 27,249 | 25,800 | 26,058 | 25,847 | 24,371 |
| Accumulated provisions (€ million) | 1,476 | 1,492 | 1,482 | 1,409 | 1,207 |
| Coverage ratio (%) | 48.8 | 50.7 | 50.8 | 51.6 | 52.3 |

Source: Central Bank of Cyprus.



### —but tourism-related NPEs rise for the third consecutive quarter

The main reason for the reduction is likely to have been large loan-sales by Bank of Cyprus (BOC). As we noted in our February issue, BOC's €550m "Helix 3" loan-sale was finalized in November. Since total NPEs declined by less than this amount during the fourth quarter, it could mean that NPEs are rising at other banks. However, the NPE data published by the Central Bank of Cyprus are not always strictly comparable with statistics reported elsewhere, including by the EBA, therefore one should be cautious in drawing such conclusions. Nevertheless, while there was no repeat of the increase in transportation NPEs, there was an increase in NPEs for the third consecutive quarter in the accommodation and food services sector. Heating, cooling and food costs will have risen sharply for tourist establishments at a time when interest rates, and therefore borrowing costs, are also rising. In addition, although overall tourism arrivals increased by 65.3% in 2022, this pace of increase had slowed to 3.6% by in the fourth quarter. Certain establishments that focused almost exclusively on Russian package tourists will have been particularly hit by the 91.3% decline in this market for the whole of 2022.

### Borrowing rates continue to rise

Borrowing costs are of course increasing both for businesses and households, in response to rising official interest rates set by the European Central Bank (ECB). Since July 2022 the ECB has raised its deposit facility rate five times and by 300 basis points, from 0.00% on 27 July 2022 to 3.00% on 22 March. Banks in Cyprus have not raised borrowing rates by anywhere near as much. Between January 2022 and January 2023, average rates on outstanding enterprise loans rose by 128 basis points, while rates on outstanding housing loans of more than five years rose by 113 basis points. Anecdotal reports suggest that most of this increase came from BOC, which bases its rates on the ECB's Euribor, whereas Hellenic Bank uses its own base rate for 85% of loans, which is calculated using the cost of deposits. The increase in rates was even lower for new loans. Nevertheless, rising interest rates will come as a shock to borrowers who had experienced falling and then very low interest rates for more than two decades. This has led the new finance minister, Makis Keravnos, to put pressure on banks by sending them letters that ask them, *inter alia*, to keep lending rates low and increase deposits rates. These issues are outside the competence of a finance minister, therefore it is not clear why he has made such interventions. It is possible that his public declarations are being made to compensate for fact that the governmental parties did not back another suspension of foreclosures (see below). As noted in previous reports, banks in Cyprus have only just started to offer fixed-rate mortgages that are common elsewhere.

**Table B.4**

**Lending rates**
%; average, outstanding amounts

| | 2021 Q4 | 2022 Q1 | 2022 Q2 | 2022 Q3 | 2022 Q4 |
|---|---|---|---|---|---|
| Enterprise loans up to 1 year (%) | 3.42 | 3.34 | 3.30 | 3.56 | 4.30 |
| Housing loans of 5+ years | 2.04 | 2.04 | 2.06 | 2.28 | 2.75 |

Source: Central Bank of Cyprus.


### Parliament appears to shift from foreclosure suspension to a special court

A newly installed government supported by different political parties in parliament (see Political analysis and outlook) appears to have spelt the end of attempts to continue the suspension on foreclosures on bad loans that had been in force between March 2020 and the end of February 2022. The suspension had applied to primary residences with a value of up to €300,000, commercial premises with a turnover of up to €750,000 and plots of land worth €100,000. The new ruling parties—the Democratic Party (DIKO), the Democratic Front (DIPA) and the Movement of Social Democrats (EDEK)—had all supported the suspension of foreclosures prior to the election. However, thanks no doubt to the fact that DIKO picked the finance minister, Makis Keravnos, an attempt on 9 March by the opposition Progressive Party of Working People (AKEL) and the alliance that includes the Greens to continue the suspension until the end of 10 June was unsuccessful.

The issue is not over, however, as the focus has now shifted to ensuring that there is no abuse by credit acquisition companies as well as efforts to establish a special court. Probably as part of the deal to lift the suspension, Mr Keravnos told the parliamentary finance committee in late March that he intended to upgrade the powers of the Financial Ombudsman. The Financial Ombudsman, currently Pavlos Ioannou, receives complaints from, *inter alia*, borrowers in default who believe that they have been maltreated by banks or credit acquisition institutions. It is not clear how his powers will be increased but the Association for the Protection of Bank Borrowers (SYPRODAT) has proposed that decisions by the Financial Ombudsman should be binding, that his term of service should be the same as that of judges (at present it is five, renewable years) and that borrowers and creditors should have a right of appeal to the Supreme Court.

DIKO, EDEK and DIPA have also brought back to parliament a bill for a special expropriations court. Mr Keravnos has said that he supports such a court, as long as it examines cases quickly (which to date has never been the case in the Cyprus court system). In practice, setting up such a court will be difficult given the ongoing justice reforms and the shortage of qualified judges and staff. Special courts would also favour strategic defaulters, who currently benefit from the fact that banks do not have the power to check assets in other institutions without the borrower's consent. This is probably also why Mr Keravnos has emphasised the need to tackle strategic defaulters. In the abovementioned letter to commercial banks, he asked them to compile a list of strategic defaulters.

Separately, the Central Bank of Cyprus told reporters that it had contracted an international firm to advise on a "mechanism" for the management of NPLs. This follows a pledge to parliament back in 2019 and pressure on him from parliamentarians to produce results. No details have emerged on the content of the mechanism but statements noting that most of the NPL reduction has come from bigger banks suggest that it will focus on smaller banks.

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# Macroeconomic trends and forecast Next section Previous section

### Household consumption declines compared with the previous quarter—

The full national accounts published on 1 March revised up the "flash" estimate for real GDP growth in the fourth quarter of 2022 from 4.4% to 4.5%. At the same time, the Statistical Service, Cystat, issued its first estimate for real GDP growth for the whole of 2022, putting it at 5.6%: just a little lower than our February estimate of 5.7%. Growth in household consumption, which accounts for 80% of GDP at current prices, slowed to 6.8% compared with the same period of the previous year (see Table M.1). Household consumption actually declined by a seasonally adjusted 1.9% compared with this previous quarter. Although a fourth-quarter decline is not unprecedented, it tends to happen at a time when there are either external or internal shocks, such as in late 2008 in the early months of the global financial crisis and in late 2012 just before the Cyprus financial crisis.

The external shock in this case is high global energy prices that have lifted the inflation rate. The EU-harmonized consumer price inflation rate rose to 10.9% in 2022 compared with 2.3% in 2021. Borrowing costs have also begun to rise (see Banking sector) and this is likely to have a longer-term impact on household consumption. On the other hand, inflation is on its way down, reaching 6.8% in January, and this seems to have had a positive impact on consumer sentiment. The economic sentiment indicator produced by the Economics Research Centre of the University of Cyprus shows improving confidence in January and February, which it said was "was mainly driven by confidence gains in services and among consumers".

**Table M.1**

**Real GDP growth by expenditure, seasonally adjusted**

% change over the same period of the previous year

| | 2021 Q4 | 2022 Q1 | 2022 Q2 | 2022 Q3 | 2022 Q4 |
|---|---|---|---|---|---|
| Household consumption | 5.3 | 6.5 | 8.2 | 9.7 | 6.8 |
| Non-profit institutions serving households | 5.4 | 4.5 | 3.5 | 0.2 | 0.1 |
| General government consumption | 1.1 | 1.5 | 1.6 | 6.9 | 3.9 |
| Gross fixed capital formation, of which: | -42.2 | -9.0 | 31.3 | 6.5 | -2.3 |
| Dwellings | -4.4 | -3.0 | -1.0 | 14.8 | 13.5 |
| Other buildings and structures | 7.3 | 2.1 | -5.2 | -13.2 | -11.6 |
| Transport equipment | (a) | -65.5 | 392.4 | (a) | (a) |
| *Inventories (contribution to growth) (b)* | *8.0* | *4.5* | *2.9* | *3.5* | *1.1* |
| Exports of goods & services | 17.8 | 22.3 | 16.0 | 9.9 | 10.4 |
| Exports of goods | 64.5 | 57.5 | 18.2 | 10.6 | 18.1 |
| Exports of services | 10.2 | 17.1 | 15.6 | 9.8 | 8.6 |
| Imports of goods & services | 10.0 | 21.7 | 26.7 | 18.4 | 12.2 |
| Imports of goods | -2.1 | 20.4 | 42.9 | 25.4 | 12.8 |
| Imports of services | 19.2 | 22.5 | 16.6 | 13.9 | 11.8 |
| *Foreign balance (contribution to growth) (b)* | *6.2* | *-0.2* | *-8.7* | *-6.6* | *-1.1* |
| **GDP** | **6.6** | **6.7** | **6.1** | **5.3** | **4.5** |
| % change over previous quarter | 1.9 | 1.9 | -0.2 | 1.6 | 1.1 |

(a) The current or year-earlier period includes a negative number (disinvestment), therefore percentage changes would be meaningless. (b) Inferred.

Source: Cystat.



### —non-housing construction shrank year on year—

The main national accounts indicator that clearly showed a decline in the fourth quarter was non-housing construction, which shrank year on year by 11.6% in the fourth quarter of 2022, compared with a decline of 13.2% in the third. The construction of apartments and houses, on the other hand, has been growing strongly, thanks no doubt to the continued expansion of the resident population, as shown in quarterly Labour Force Survey figures which we discussed in our February issue. Growth in housing construction has not been enough to prevent a decline in the overall construction sector, however. The national accounts by sector figures show that gross value-added in construction declined by 2% in the fourth quarter, following a contraction of 1.6% in the third (see Table M.2). The large sector that encompasses wholesale and retail, tourism and transport grew by a robust 9.7% in the fourth quarter, although growth rates were not as high as earlier in the year, when growth rates were positively affected by a "post-lockdown bounce".

**Table M.2**

**Real GDP growth by sector, seasonally adjusted**
% change over the same period of the previous year

| | % of total (a) | 2021 Q4 | 2022 Q1 | 2022 Q2 | 2022 Q3 | 2022 Q4 |
|---|---|---|---|---|---|---|
| Agriculture, hunting, forestry & fishing | 1.7 | 0.9 | 0.7 | 0.6 | 0.9 | 1.0 |
| Industry excl. construction | 7.7 | 3.5 | 6.2 | 2.5 | 1.3 | 0.8 |
| of which: manufacturing | 5.7 | 2.2 | 1.5 | 2.0 | 1.6 | 1.5 |
| Construction | 5.5 | 0.2 | -1.7 | -3.5 | -1.6 | -2.0 |
| W/sale & retail trade, hotels & rest's, transport & communications | 17.4 | 19.5 | 16.4 | 15.4 | 14.1 | 9.7 |
| Information & communication | 7.6 | 6.1 | 16.1 | 16.5 | 13.4 | 14.0 |
| Financial & insurance activities | 9.5 | 6.7 | 4.8 | 6.5 | 5.0 | 3.9 |
| Real estate inc. imputed rent | 8.1 | 0.8 | 0.6 | 0.5 | 0.6 | 1.0 |
| Professional, scientific, technical & support services | 9.9 | 4.9 | 3.9 | 3.5 | 3.3 | 3.4 |
| Public services inc. defence, educ'n, health & social | 17.5 | 0.6 | 1.1 | 1.2 | 1.5 | 2.0 |
| Other services | 3.1 | 20.4 | 13.8 | 8.5 | 2.0 | 0.8 |
| **Gross value added** | **88.0** | **6.6** | **6.7** | **6.1** | **5.4** | **4.5** |
| Taxes on products net of subsidies | 12.0 | 6.6 | 6.5 | 6.1 | 5.3 | 4.4 |
| **GDP** | **100.0** | **6.6** | **6.7** | **6.1** | **5.3** | **4.5** |
| % change, quarter on quarter | - | 1.9 | 1.9 | -0.2 | 1.6 | 1.1 |

(a) In 2022 at current prices.
Source: Cystat.


**Table M.3**

**Dwelling units authorized by district**
% change over same period of previous year unless otherwise indicated

| | 2022 Year (total) | 2021 Q4 | 2022 Q1 | 2022 Q2 | 2022 Q3 | 2022 Q4 |
|---|---|---|---|---|---|---|
| Nicosia | 2,760 | 42.6 | 6.7 | 18.5 | 0.9 | -29.9 |
| Famagusta | 354 | 15.2 | 228.6 | -72.4 | 133.3 | 57.5 |
| Larnaca | 1,209 | 66.7 | -22.5 | -29.4 | -0.3 | 3.8 |
| Limassol | 2,321 | -21.1 | -0.9 | -2.5 | -20.4 | -7.0 |
| Paphos | 1,198 | -16.6 | 33.9 | -42.4 | -19.2 | 27.5 |
| **Total** | **8,164** | **11.0** | **4.4** | **-12.4** | **-4.8** | **-10.3** |
| **Memorandum item** | | | | | | |
| Total building permits (a) | 8,164 | 12.5 | 2.8 | -7.0 | -10.7 | -11.7 |

(a) One permit may include several dwelling units. Includes non-housing permits.
Source: Cystat; Sapienta Economics calculations inferred from year-to-date figures.


## —and the construction of dwellings also looks set to ease in certain districts—

The construction of dwellings also looks set to ease. Building permits for dwellings fell year on year by 10.3% in the fourth quarter of 2022, marking their third consecutive quarter of decline (see Table M.3). Dwelling permits are normally a leading indicator of future construction activity. There is a marked difference in performance by district, however. Dwelling permits in Paphos rose by

27.5% in the first quarter, while those in Nicosia dropped by 29.9%. Paphos remains a popular destination for holiday homes and retirees and available data suggest that prices are not as high in Paphos as they are in Limassol, which has a higher number of higher-paid non-Cypriot workers.

### —but employment growth remains buoyant

One factor that will temper the economic slowdown coming from construction and rising interest rates is expanding employment. Total employment rose year on year by 3.0% in the fourth quarter, following a similar rise of 3.1% in the third. Moreover, the number of jobs rose in all major sectors of the economy (see Table M.4).

**Table M.4**

**Employment among major categories**
Absolute number unless otherwise indicated; national accounts basis

| | 2022 % of total | 2021 Q4 | 2022 Q1 | 2022 Q2 | 2022 Q3 | 2022 Q4 |
|---|---|---|---|---|---|---|
| Wholesale & retail trade | 18.1 | 70,552 | 71,842 | 71,993 | 72,462 | 72,803 |
| Accommodation & food services | 13.0 | 46,006 | 42,822 | 51,149 | 58,085 | 48,661 |
| Construction | 10.6 | 40,685 | 41,094 | 40,858 | 40,897 | 41,010 |
| Manufacturing | 9.5 | 35,795 | 36,484 | 36,543 | 37,121 | 37,123 |
| Public administration & defence | 8.8 | 33,890 | 33,576 | 33,731 | 34,294 | 34,362 |
| Education | 8.6 | 33,993 | 34,786 | 34,119 | 29,382 | 34,627 |
| Professional services & technical-scientific | 8.8 | 32,891 | 33,499 | 33,635 | 33,819 | 34,340 |
| **Total** | **100.0** | **447,999** | **449,218** | **457,365** | **464,391** | **461,345** |
| % change over same period of previous year | - | 1.6 | 2.6 | 2.7 | 3.1 | 3.0 |

Source: Cystat.


### We have revised real GDP growth down to 2.7% in 2023

Employment growth and real GDP growth tend to be closely correlated. Although there was some divergence between the two during the pandemic-related lockdowns as a result of job support schemes, the impact of this effect is now fading, therefore they are likely to grow at similar rates again. Given the abovementioned quarterly contraction in household consumption, the year-on-year fall of construction, the employment growth rate in the fourth quarter, as well as the contraction in real earnings that we noted in our February issue, we have revised down our real GDP growth forecast to 2.7% in 2023, from 3.5% previously. This has also led to a downward revision to our forecast in 2024 and 2025. We now expect a real GDP growth rate of 1.3% in 2024, rising to 1.8% in 2025 as the global slowdown eases off.

**Table M.5**

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

| | 2021 | 2022 | *2023* | *2024* | *2025* |
|---|---|---|---|---|---|
| Private consumption | 4.5 | 7.7 | *2.7* | *2.2* | *3.1* |
| Government consumption | 6.6 | 3.5 | *2.0* | *2.3* | *2.1* |
| Gross fixed capital formation | -4.2 | 6.6 | *5.5* | *3.6* | *3.7* |
| Inventories (contribution to growth) | -0.1 | 3.0 | *-0.6* | *0.0* | *0.0* |
| Exports of goods & services | 13.6 | 14.3 | *13.2* | *8.7* | *9.1* |
| Imports of goods & services | 9.0 | 19.5 | *12.1* | *9.7* | *10.0* |
| **Net exports of goods & services (contribution to growth)** | **3.5** | **-4.1** | ***0.7*** | ***-1.2*** | ***-1.3*** |
| **Gross domestic product** | **6.6** | **5.6** | ***2.7*** | ***1.3*** | ***1.8*** |
| Average quarter-on-quarter growth rate, seasonally adjusted | 1.6 | 1.1 | *0.0* | *0.5* | *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*

**Table T.1**

| Northern Cyprus: key macroeconomic indicators | 2017 | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|
| GDP (TL million) | 14,545 | 18,324 | 21,395 | 21,407 | 30,144 |
| GDP (€ million, converted at annual average exchange rate) | 3,530 | 3,210 | 3,365 | 2,658 | 2,868 |
| Population, mid-year ('000) | 345,722 | 362,226 | 377,358 | 382,533 | 386,790 |
| GDP per capita (€) | 10,210 | 8,863 | 8,918 | 6,948 | 7,414 |
| Real GDP growth (%) | 5.4 | 1.3 | 0.2 | -16.2 | 3.9 |
| Consumer price inflation (annual average, %) | 15.1 | 23.1 | 19.5 | 11.7 | 25.5 |
| Unemployment rate (%) | 5.8 | 6.9 | 6.3 | 10.1 | 5.8 |
| Fiscal balance (% of GDP) | -0.3 | 0.3 | -1.3 | -2.5 | -3.2 |
| Public debt (€ million, converted from $ and ₺) (a) | 4,893 | n/a | n/a | n/a | n/a |
| of which debt to Turkey (a) | 3,409 | n/a | n/a | n/a | n/a |
| Public debt (% of GDP) (a) | 138.6 | n/a | n/a | n/a | n/a |
| of which debt to Turkey (% of GDP) (a) | 96.6 | n/a | n/a | n/a | n/a |
| Number of tourists ('000) | 1,734 | 1,760 | 1,750 | 389 | 552 |
| Exports of goods ($ million) | 106 | 95 | 82 | 101 | 129 |
| Imports of goods ($ million) | 1,778 | 1,816 | 1,588 | 1,221 | 1,572 |
| **Memorandum items** | | | | | |
| Turkish lira per euro (ECB) | 4.1206 | 5.7077 | 6.3578 | 8.0547 | 10.512 |
| Turkish lira per US dollar (ECB-derived) | 3.6475 | 4.8329 | 5.6791 | 7.0519 | 8.8881 |

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

Sources: İstatistik Kurumu; Maliye Bakanlığı; Türkiye Cumhuriyeti Lefkoşa Büyükelçiliği.



### Northern Cyprus authorities introduce a salary levy after the earthquakes—

Following the earthquakes in Turkey, on February 6, in which 49 Turkish Cypriots died, the elected assembly of the internationally unrecognized Turkish Republic of Northern Cyprus (TRNC) passed legislation on 27 March to raise funds for earthquake and natural disaster resilience at home. The legislation, which aims to raise more than TL1bn (€47.9m at current exchange rates), involves what amounts to a temporary levy on salaries and pensions, as well as tax rises and budget cuts. The funds raised will be earmarked mainly for the education and health sectors: for example, to repair and maintain school buildings or build new schools, and to maintain and repair hospitals and health centres. The bill passed will come into force once it has been published in the *Official Gazette*.

More than half of the funds raise will come from budget cuts. The prime minister, Ünal Üstel, said that TL504m will come from budget savings, TL465m through additional taxes over the next nine months and TL123m through salary and pension cuts that apply to both the public and private sectors. Those earning gross salaries or pensions of less than TL15,000 per month (€719) are exempt from the cuts. The threshold is therefore slightly above the minimum wage, which was raised in January to TL13,563 (gross). The *de facto* levies are for a fairly short period. Those with a monthly salary between of TL15,000-55,000TL will have 2% wage deduction only in April; those earning TL55,000-TL75,000 will have a 2% deduction for nine months, while those earning more than TL75,000 will have a 5% deduction for nine months.

The wage cuts are "voluntary", in so far as people can choose to opt out by submitting a written request in person to their employer or relevant authority within 15 days of the bill being published in the *Official Gazette*. It is therefore unclear how much will be raised from salaries, especially as an earlier attempt to introduce salary levies failed. Although there are widespread concerns about the safety of schools and most of the Turkish Cypriots who died in Turkey were children, a general mistrust in the capacity of the ruling coalition (or indeed any coalition) to govern could lead to widespread opt-outs. Another reason why some will opt out is resistance to plans to build a new presidential palace. The protocol (financial aid agreement) signed with Turkey in April 2022 included a budget of TL620m for the presidential and parliament service buildings. However, opponents said that the full cost of the complex would be TL2.85bn.

### —and support for Turkish students affected by them

Separately, the authorities announced that they would be supporting some 13,000 students who are enrolled at universities in northern Cyprus and who are from the areas affected by the earthquakes. These include support payments for those continuing with face-to-face education, online lessons for those currently unable to stay in the north, and the right to freeze registration for free for those unable to continue with their studies.

### Discussions start on a new financial protocol agreement with Turkey

Mr Ustel visited Turkey on 15 March for discussions with Turkey's vice president, Fuat Oktay, on a new financial aid protocol between Turkey and northern Cyprus. It is likely that amounts pledged in previous years will be rolled over, as is often the case. Under the protocol signed in April 2022, Turkey was budgeted to provide TL4.5bn (€822m at current exchange rates), of which TL3.2bn were grants and TL1.05bn were loans denominated in US dollars. An additional protocol was signed in November, comprising TL448m in grants and TL2.052bn in loans. Based on published budget figures we calculate that, in practice, TL3.8bn was received in the whole of 2022, accounting for about 18.4% of revenues (see Table T.2). We estimate that in 2022 grant and aids amounted to 6.2% of GDP. Support is therefore lower than it has been in the past (see Charts).

In previous protocols Turkey has pledged to build a submarine electricity cable to northern Cyprus. There remains an intention to do so, with the Turkish Cypriot leader and president of the unrecognized TRNC suggesting that it should be linked to joint electricity production that is currently being planned in the UN-monitored buffer zone (see Energy and structural reforms).

**Table T.2**

| **Turkey–northern Cyprus financial aid protocol, 2022**<br>TL million | |
|---|---|
| **Actual paid according to public finances** | |
| Grants from Turkey | 2,612 |
| Credit from Turkey | 1,192 |
| **Total** | **3,804** |
| % of annual budget revenue received | 18.4 |
| **Protocol April 2022** | |
| Grants pledged from Turkey | 3,200 |
| Credit pledged from Turkey | 1,050 |
| **Total** | **4,250** |
| **Additional protocol November 2022** | |
| Grants pledged from Turkey | 448 |
| Credit pledged from Turkey | 2,052 |
| **Total** | **2,500** |
| **Received compared with pledged** | |
| Total amount received from Turkey | 3,804 |
| Total amount pledged from Turkey | 6,750 |

Sources: KKTC Maliye Bakanlığı; media reports for protocol amounts.

### Hard-currency Treasury bill issues amount to €36m in the first quarter

The authorities continue to issue Treasury bills in hard currency, with total issuance amounting to the equivalent of €35.9m in the first three months of the year (see Table T.3). Issuing bills in dollars, sterling and euro instead of Turkish lira began only in August 2022 and had reached €52.7m by the end of 2022. With the exception of the very first one in August, all foreign-currency issues have been oversubscribed, meaning that they enjoy strong demand. This is probably why the authorities continue to issue them despite the exchange-rate risk of borrowing in foreign currency. There have been no Turkish lira bills since June 2022.

The authorities also continue to take out hard-currency loans from the Turkish Cypriot central bank (KMB), borrowing $12m so far this year. The amounts are denominated in US dollars, are between $3m and $5m each time and are issued for approximately 90 days (the exact number varies). The borrowing has been mainly for the soil products authority, which we assume is for farmers buying seeds or seed potatoes, and to a smaller extent for fruits and vegetables. Borrowing of this kind only began in August 2022 and since September 2022 it has only been in US dollars. The announcements say that the finance ministry converts the amounts borrowed into Turkish lira with a SWAP transaction “in order not to assume the exchange rate risk”.

Finally, since January 2022 the authorities have been undertaking regular central bank liquidity operations (where banks are offered to place foreign currency deposits with the central bank), in order to mop up the large amount of foreign-currency deposits in the system (see Table T.6). These are offered in euro, US dollars and sterling. For the whole of 2022 operations reached €1.4m and amounted to €120m in the first quarter.

**Table T.3**

**Northern Cyprus: hard currency Treasury bills**

| **Issue date**<br>**Maturity date** | **28-Nov**<br>**10-Mar** | **28-Nov**<br>**17-Mar** | **28-Feb**<br>**09-Jun** | **31-Mar**<br>**14-Jul** | **30-Mar**<br>**18-Aug** |
|---|---|---|---|---|---|
| Maturity (days) | 102 | 109 | 101 | 105 | 141 |
| Currency | USD | EUR | USD | USD | EUR |
| Amount offered (m) | 10.0 | 10.0 | 10.0 | 15.0 | 10.0 |
| Bids received (m) | 18.9 | 19.3 | 16.0 | 17.3 | 12.5 |
| Amount sold (m) | 12.0 | 8.0 | 10.1 | 17.3 | 10.5 |
| *in euro equivalent* | *11.5* | *8.0* | *9.5* | *15.9* | *10.5* |
| Weighted average yield (%) | 3.85% | 2.92% | 3.77% | 3.88% | 2.95% |

Source: KKTC Merkez Bankası.



### Both revenue and expenditure surge in the first two months of 2023

Total revenue rose by 109.6% in the first two months of the year, while total expenditure increased in the same period by hundred and 28.8% (see Table T.4). Both revenue and expenditure have risen faster than inflation rate of 87.0% in the same period that the budget balance was stable at TL263m, compared with TL276m in the same period of 2022.

### No date for new terminal as new airline is launched

There is as yet no date for the opening of the new terminal at Ercan/Tymbou. Unconfirmed reports suggest that there is an issue with obtaining insurance. Nevertheless, the promised new airline, called Fly Kıbrıs Havayolları, or Fly KHY, was launched in March. Its inaugural flight was due on 16 April but this may have to be put back given the uncertainties about the opening of the airport. The charter flights are being operated by Freebird Airlines, a company based in Turkey, and the plan is for two daily flights to Istanbul, one daily flight to Ankara and one daily flight to İzmir. There are plans to expand the routes by May to Erbil, the capital of the Kurdistan Region of Iraq; Tehran, the capital of Iran; Pristina, the capital of Kosovo; Amman, the capital of Jordan; and Baku, the capital of Azerbaijan.

### Hellim cheese gains EU PDO authorization

On 28 March the first Turkish Cypriot producer of hellim cheese, known as halloumi in Greek, was awarded the EU's protected designation of origin (PDO) certificate. This was a scheme agreed in April 2021, which will allow hellim with the PDO certificate to be sold in the EU via the EU's Green Line regulation (Regulation 866/2004). The PDO designation will not lead to immediate sales, however, as producers must also meet animal and public health requirements. The European Commission said that this was expected by the end of 2024. A separate statement by the Cyprus Turkish Chamber of Industry said the company awarded PDO status was Gülgün Dairy Products. In the southern part of the island 59 producers have received the designation.

**Table T.4**

| **Northern Cyprus: central budget outturns**<br>TL million; excludes social insurance | | | | | | |
|---|---|---|---|---|---|---|
| | **2021**<br>**Year** | **2022**<br>**Year** | **% change** | **2022**<br>**Jan-Feb** | **2023**<br>**Jan-Feb** | **% change** |
| Total revenue, of which: | 9,419 | 20,622 | 118.9 | 1,913 | 4,010 | 109.6 |
| Taxes, of which: | 5,938 | 13,427 | 126.1 | 1,308 | 2,711 | 107.3 |
| Income tax | 1,975 | 3,898 | 97.4 | 383 | 759 | 98.4 |
| Corporation tax | 603 | 1,355 | 124.8 | 127 | 253 | 100.2 |
| Value-added tax (VAT) | 633 | 1,190 | 88.0 | 126 | 276 | 119.2 |
| Excise duties on fuel | 710 | 1,676 | 136.2 | 126 | 293 | 132.4 |
| Collections of receivables (deposit insurance fund) | 120 | 26 | -78.7 | 0 | 0 | 0 |
| Aid (grants) from Turkey (a) | 1,342 | 2,612 | 94.7 | 0 | 4 | - |
| of which: defence (Turkish Cypriot military) | 677 | 1,206 | 78.0 | 0 | 4 | - |
| Credit from Turkey (b) | 492 | 1,192 | 142.5 | 0 | 0 | 0 |
| Total expenditure, of which: | 10,386 | 20,797 | 100.2 | 1,638 | 3,747 | 128.8 |
| Personnel expenses | 3,123 | 5,930 | 89.9 | 620 | 1,347 | 117.4 |
| Transfers to households | 2,271 | 4,544 | 100.1 | 435 | 956 | 119.9 |
| Pensions | 1,314 | 2,430 | 84.9 | 289 | 617 | 113.9 |
| Defence (Turkish Cypriot military) | 677 | 1,200 | 77.2 | 93 | 229 | 145.9 |
| ***Balance inferred*** | ***-967*** | ***-175*** | - | ***276*** | ***263*** | - |
| **Memorandum item** | | | | | | |
| Consumer price inflation rate (%) | - | - | 99.7 | - | - | 87.0 |

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

Source: KKTC Maliye Bakanlığı; Sapienta inferences in italics.


### Arrivals rise strongly but might be boosted by those displaced by the earthquakes

The number of arrivals in northern Cyprus rose year on year by 72.6% to 211,151 in the first two months of 2023, with 81% of those coming from Turkey (see Table T.5). It should be noted that the statistics on arrivals do not distinguish between those coming for holidays and those coming for other purposes such as studying or short-term work. It is possible, therefore, that these figures include between 5,000 and 10,000 displaced people who are said to have come to northern Cyprus since 6 February. The presence of tens of thousands of newcomers in an economy with fewer than 400,000 civilian inhabitants (see Table T.1) will probably act as a positive boost to the economy.

**Table T.5**

| **Northern Cyprus: selected short-term statistics**<br>% change over the same period of the previous year | | | | |
|---|---|---|---|---|
| | **Latest period** | **YoY % change in latest period** | **Value in YTD period** | **YoY % change in YTD period** |
| Consumer prices (% change) | Feb | 84.9 | - | 87.0 |
| Tourism arrivals (absolute number) | Feb | 60.1 | 211,151 | 72.6 |
| of which from Turkey (absolute number) | Feb | 63.0 | 171,118 | 75.2 |
| Plastic card spending south of the Green Line (€ '000) | 2022Q2 | 128.6 | 4,572 | 189.6 |
| Plastic card spending north of the Green Line (€ '000) | 2022Q2 | 912.7 | 20,151 | 1239.8 |
| Imports of goods ($ m) | May | 23.3 | 720 | 39.0 |
| of which from Turkey ($ m) | May | 51.2 | 493 | 59.4 |
| Exports of goods ($ m) | May | 17.1 | 68 | -3.2 |
| of which to Turkey ($ m) | May | 27.5 | 41 | 2.9 |

Note: YTD means year-to-date.

Sources: İstatistik Kurumu; Turizm Planlama Dairesi; JCC Payments Systems; Ticaret Dairesi.



**Table T.6**

| **Key indicators of the Turkish Cypriot banking system**<br>TL million unless otherwise stated | | | | | |
|---|---|---|---|---|---|
| | **Sep-21** | **Dec-21** | **Mar-22** | **Jun-22** | **Sep-22** |
| Gross loans | 32,152 | 42,006 | 45,162 | 48,836 | 50,868 |
| In Turkish lira | 14,881 | 16,438 | 17,158 | 18,507 | 19,759 |
| In foreign exchange | 17,271 | 25,568 | 28,004 | 30,329 | 31,109 |
| Deposits | 48,805 | 66,179 | 73,368 | 80,963 | 90,576 |
| In Turkish lira | 15,770 | 15,309 | 16,245 | 16,454 | 17,787 |
| In foreign exchange | 33,035 | 50,870 | 57,123 | 64,509 | 72,789 |
| NPLs (90+ days past due) (a) | 1,539 | 1,585 | 1,682 | 1,801 | 1,911 |
| NPLs in € million equivalent (a) | €149 | €104 | €103 | €104 | €106 |
| NPL ratio (%) (a) | 4.8 | 3.8 | 3.7 | 3.7 | 3.8 |
| Coverage ratio (%) | 57.4 | 60.7 | 58.6 | 56.5 | 58.5 |
| **Memorandum item** | | | | | |
| TRY per EUR (end-period) | 10.2981 | 15.2335 | 16.2823 | 17.3220 | 18.0841 |

(a) Does not include arrears of public organizations.

Source: KKTC Merkez Bankası.

## Charts [Previous section](#)