



Gikas Hardouvelis

Professor of Finance &
Economics

University of Piraeus

+30 210 4142323

ghardouv@unipi.gr

Ioannis Gkionis

Senior Economist

Eurobank Ergasias

+30 210 3337305

igkionis@eurobank.gr

DISCLAIMER

This report has been prepared by Professor Gikas Hardouvelis for Eurobank Cyprus Ltd and may not be reproduced or publicized in any manner. The information contained and the opinions expressed herein are for informative purposes only and they do not constitute a solicitation to buy or sell any securities or effect any other investment. Eurobank Cyprus Ltd, as well as its directors, officers and employees may perform for their own account, for clients or third party persons, investments concurrent or opposed to the opinions expressed in the report. This report is based on information obtained from sources believed to be reliable and all due diligence has been taken for its process. However, the data have not been verified by Eurobank Cyprus Ltd and no warranty expressed or implicit is made as to their accuracy, completeness, or timeliness. All opinions and estimates are valid as of the date of the report and remain subject to change without notice. Investment decisions must be made upon investor's individual judgment and based on own information and evaluation of undertaken risk. The investments mentioned or suggested in the report may not be suitable for certain investors depending on their investment objectives and financial condition. The aforesaid brief statements do not describe comprehensively the risks and other significant aspects relating to an investment choice. Eurobank Cyprus Ltd, as well as its directors, officers and employees and Professor Hardouvelis accepts no liability for any loss or damage, direct or indirect that may occur from the use of this report.

Key points

- **During 2015 and 2016 the Cypriot economy expanded much faster than previously perceived, with the Cyprus Statistical Service revising the GDP growth rate up to 2.0% and 3.0% respectively, from the earlier estimates of 1.7% and 2.8%**
- **In 2017 Q2 the economy expanded by 3.5% on an annual basis, bringing the 1H-2017 performance to 3.6%**
- **The solid economic performance continues into the third quarter of 2017 with particularly visible positive signals emanating from the property market**
- **Cyprus is an inch away from investment grade status with S&P upgrading the outlook of Cyprus from stable to positive within the long-term sovereign rating of BB+**
- **Fiscal performance is impressive for an election year as the general government primary balance came to 2.3% of GDP in the first eight months of the year**
- **NPEs remain the single largest vulnerability of the economy with banks lagging slightly behind the Central Bank's restructuring targets for 2017 Q1**

1. The latest GDP estimate of 2017 Q2 confirmed the economy has switched to a faster growth path than previously envisaged

The second and latest estimate of CYPSTAT about the seasonally adjusted Q2 GDP reading confirmed the flash estimate of 0.9% QoQ/3.5% YoY. This strong reading compares to 1.0% QoQ/3.7% YoY in Q1-2017, up from 0.7% QoQ/2.9% YoY in Q4-2016 vs. 1.2% QoQ/2.8% YoY in Q2-2016. Real GDP growth marked the 9th consecutive positive reading on a both quarterly and annual basis after a previous three-year recession. The GDP growth rate of Q2 is among the highest in EA-19 and EU-28, both on a quarterly and an annual basis (Figure 2 & 3) and, for a seventh consecutive quarter in a row, above that of EA-19 (Figure 1).

The output performance of the second quarter is the second highest during the post-Lehman period following that of the first quarter, bringing and surpassing analysts' expectations and international organizations full year initial and revised forecasts. This latest statistic signals the economy has embarked on a faster growth path than previously envisaged.

CYSTAT also revised upward the national accounts of 2015 and 2016 in both nominal and real terms.¹ The revision showed that the economy rebounded much faster in 2015-16 than previously thought: the Statistical Service revised the GDP growth rate of FY2015 from 1.7% up to 2.0% and that of FY2016 from 2.8% up to 3%. As a result, the level of GDP in 2016 stood only 5% below that in 2011 and is expected to surpass the level of 2008 by the end of 2018 under the assumption of real GDP growth averaging 3.5% YoY in 2017-2018. Overall, the 2017 H1 YoY GDP growth reached 3.6%, which makes us optimistic that risks to our initial 3% forecast for 2017-2018 are already skewed to the upside.

Table 1: Revised national accounts data 2011-2016

	2011	2012	2013	2014	2015	2016
GDP nominal (Current Prices, €)	19,731.1	19,489.7	18,140.5	17,605.9	17,742.0	18,122.5
GDP nominal (%, YoY)	2.2	-1.2	-6.9	-3.0	0.8	2.1
GDP real (2005 Prices, €)	16,838.3	16,323.3	15,354.7	15,139.1	15,438.8	15,907.0
GDP real (%, YoY)	0.3	-3.1	-5.9	-1.4	2.0	3.0

Source: CYPSTAT October 2017

IMF brings full year GDP growth projections in 2017-2018 closer to reality, yet highlights downside risks for the medium-term outlook

The concluding statement of the most recent IMF mission to Cyprus in early October, which took place as part of the article IV report consultation, contained optimistic forward looking findings.² The mission forecasts GDP growth to average 3.75% in 2017-2018. The growth is driven by private consumption, which mirrors the rise in disposable income and the improvement in the economic conditions. Yet it also mirrors a weak payment discipline by a large fraction of borrowers. Growth is also driven by foreign financed investment in large construction projects. Strong foreign demand propels the sectors of tourism, construction and professional services.

¹<http://www.cystat.gov.cy/mof/cystat/statistics.nsf/All/A875EF7C036ED39BC22581B10031AD93?OpenDocument&sub=1&sel=1&e=&print>

² <http://www.imf.org/en/News/Articles/2017/10/06/ms100617-cyprus-staff-concluding-statement-of-the-2017-article-iv-mission>

The IMF mission also warns of the ongoing contraction in domestic financial intermediation—reflecting deleveraging by banks. It also emphasizes that downside risks to growth in the medium-term could be sizeable, making the economy vulnerable to a sudden-stop of external financing.

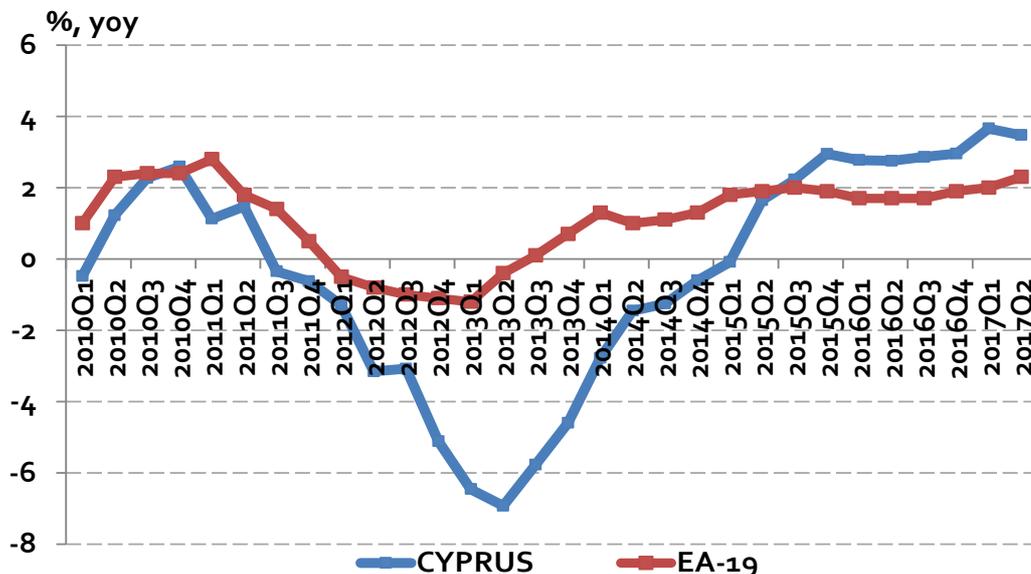
According to the IMF’s most recent flagship publication, the October World Economic Outlook (WEO), full year GDP growth in 2017 is projected at 3.4%, up from 2.5% last April (Table 2). Yet, its GDP growth forecast of next year remains conservative. GDP growth is expected to ease to 2.6% in 2018, up from 2.3% in the April forecast. Unemployment is forecasted to further decline from a projected 11.8% in 2017 to 10.7% in 2018. After staying in negative territory in 2016 at -1.0%, average inflation is projected to average at 0.8% in 2017 and stay subdued at 0.7% in 2018.

Table 2: IMF World Economic Outlook Forecasts for Cyprus

IMF WEO	2017		2018	
	April Forecast	October Forecast	April Forecast	October Forecast
GDP growth (%, YoY)	2.5	3.4	2.3	2.6
Consumer Prices (%, average)	1.5	0.8	1.4	0.7
Unemployment (% of Labour Force)	11.3	11.8	10.2	10.7
Current Account Deficit (% of GDP)	-2.5	-3.8	-2.5	-2.7

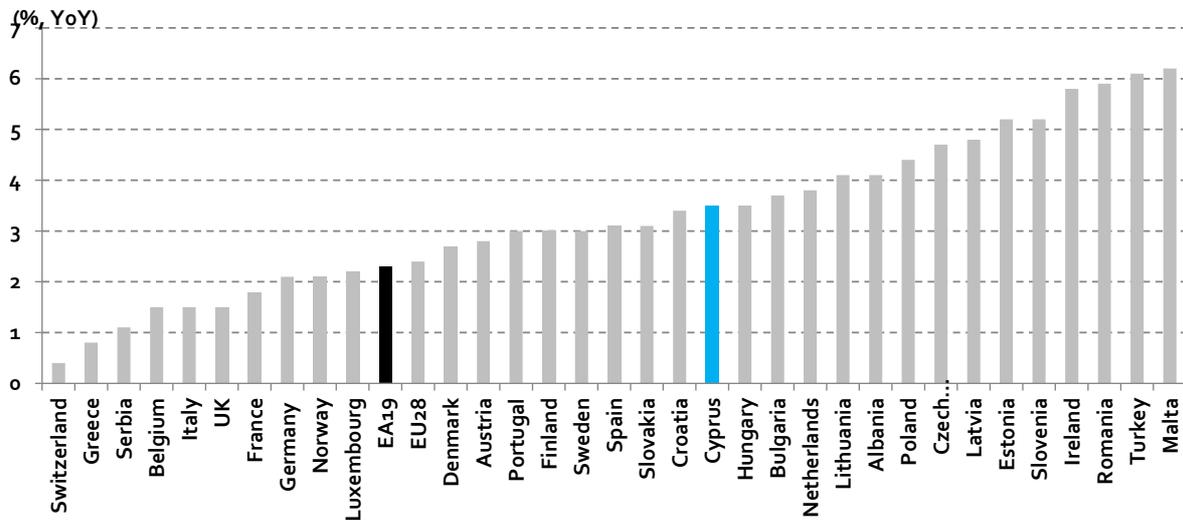
Source: IMF World Economic Outlook April & October 2017

Figure 1: GDP growth (YoY) in Cyprus above that in EA19 since Q3-2015



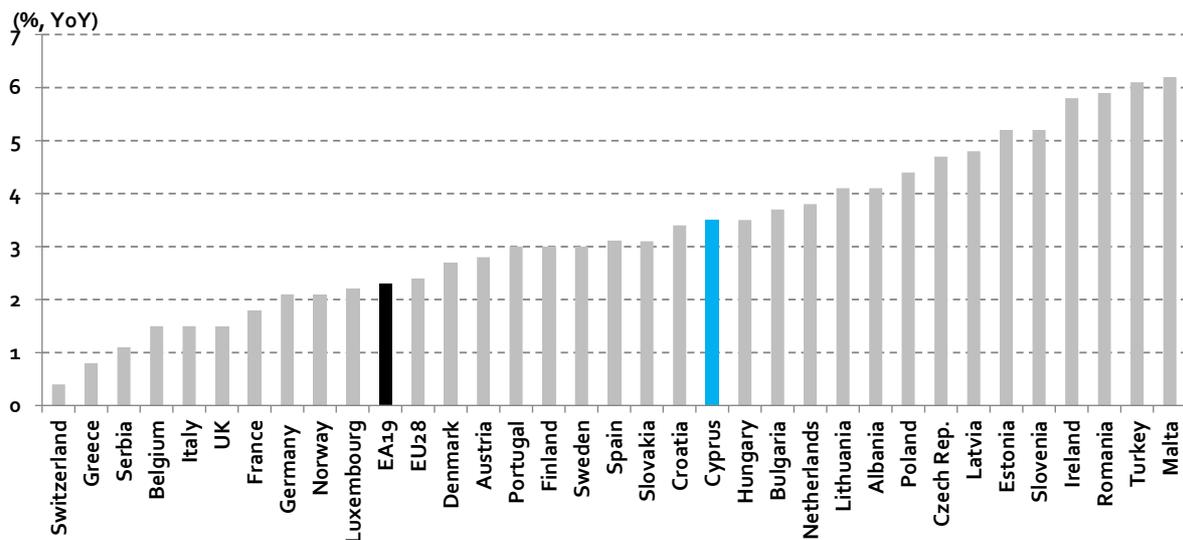
Source: Eurostat, CYSTAT, Eurobank Research

Figure 2: Second Quarter GDP growth (YoY) in Cyprus among the highest in EA19 & EU28



Source: Eurostat, CYSTAT, Eurobank Research

Figure 3: First Quarter GDP growth (QoQ) in Cyprus above EA19 & EU28



Source: Eurostat, CYSTAT, Eurobank Research

2. Consumption remains in the driver's seat of the ongoing GDP growth rebound for yet another quarter in Q2-2017. The solid economic performance continues into the third quarter of 2017 with more visible signs of improvement from the property market

From a demand point of view, the consumption rebound continued into Q2-2017 making a +3.4ppts contribution to growth. Final consumption expanded by +2.2% QoQ/+4.1% YoY in Q2-2017, up from +0.4% QoQ/+2.2% YoY in Q1-2017, compared to +0.6% QoQ/+2.8% YoY in Q4-2016, vs. +1.7% QoQ/+1.4% YoY in Q2-2016. The consumption rebound is underpinned by a number of factors, namely the strong sentiment improvement mirroring the earlier lasting progress within the programme, a flourishing tourism sector, improved labor market conditions, further property market stabilization, the impact from the envisaged fiscal relaxation, and the further normalization of banking sector conditions.

As far as other growth components are concerned, lower imports of transportation equipment –likely due to ship & airplane purchases–weighed heavily on the imports side (imports:-12.7% YoY vs. exports: +2.4%YoY), leading net exports' contribution to turn positive (+11.5 ppts in Q2) but also resulting in lower investment spending on an annual basis (-41.9% YoY, -11.4 ppts in Q2), thereby broadly offsetting the positive contribution of the external sector.

On the supply side, GDP dynamics were shaped by the steady performance of key sectoral pillars of the economy. Output in the combined sectors of “wholesale and retail trade, transport, accommodation and food service activities,” expanded by +4.3% YoY in Q2-2017, unchanged compared to Q1-2017 and down from +5.0% YoY in Q4-2016, +4.9% YoY in Q3-2016 and +4.5% YoY in Q2-2016. The performance of these national accounts items reflects largely the contribution of the flourishing tourism industry to the ongoing consumption recovery. Tourist arrivals increased by +14.7% YoY in Jan-Aug2017. Similarly, tourism-revenues expanded by +15.3% YoY in Jan-July2017.

Manufacturing and professional services slowed down to +2.4% YoY in Q2-2017 vs. +5.8% YoY in Q1-2017 (up from +5.0% YoY in Q4-2016, +4.9% YoY in Q3-2016 and down from +5.7% YoY in Q2-2016) and +3.6% YoY in Q2-2017 vs. +3.8% YoY in Q1-2017 (down from +5.3% YoY in Q4-2016, +5.7% YoY in Q3-2016 and +5.9% YoY in Q2-2016) respectively. Furthermore, construction accelerated its dynamic double-digit recovery, expanding by +17% YoY in Q2-2017 vs. +28.7% YoY in Q1-2017, up from +10.8% YoY in Q4-2016 compared to 10.3% YoY in Q3-2016 and 10.6% YoY in Q2-2016.

Financial Services is the exception to the upward momentum: They remained a drag on economic recovery, recording negative growth for a sixth quarter in a row. Nevertheless, the pace of contraction slowed down in Q1. Financial services contracted by -2.4% YoY in Q2-2017 down in absolute terms from -3.7% YoY in Q1-2017, from -5.6% YoY in Q4-2016, -6.0% YoY in Q3-2016, and compared to -2.7% YoY in Q2-2016. The negative contribution to GDP growth by the financial sector reflects largely the bank restructuring activities (debt to asset swaps), write-offs and the ongoing deleveraging.

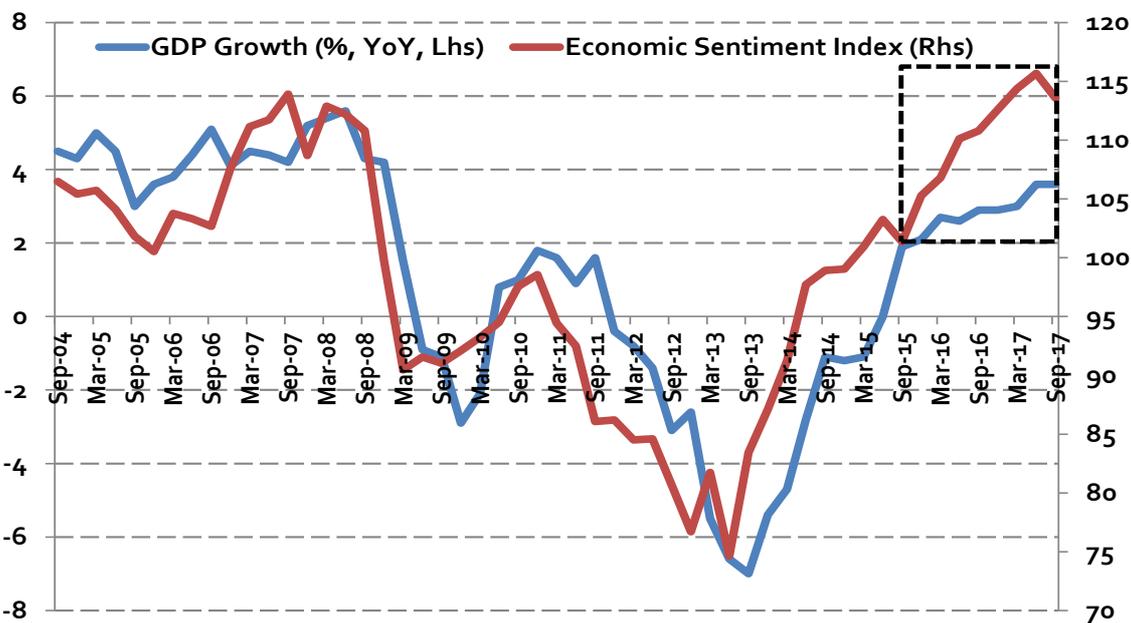
Economic activity continued its upward trend in Q3-2017, albeit at a bit slower pace than in previous quarters. High frequency and leading indicators, particularly the consumer related ones, were performing very well. More specifically:

- **Sentiment:** After a temporary slump of the Economic Sentiment Index (ESI) in August 2017, the index rebounded strongly in September, so it is still fluctuating close to the levels observed prior to the 2008 Lehman Brothers international crisis. The improvement so far mirrors the lasting progress within the economic adjustment program, as well as general optimism for the short-term prospects of the Cypriot economy.
- **Retail Trade:** Retail sales, except for motor vehicles and motorcycles, expanded in volume terms by +8.2% YoY in May, bringing the year performance to May at +3.2%. Similarly, retail sales in value terms expanded by +8.9% YoY in May, bringing the year performance to May at +4.9% YoY.
- **Credit-card transactions:** The value of credit-card transactions by Cypriots and foreigners expanded by 12.6% YoY and 20.5% YoY respectively in 7M2017 (JCC Payments Ltd).
- **Tourism:** The positive momentum in the tourism industry continued in 9M-2017. Tourist arrivals increased by +14.7% YoY in 9M-2017, up from +13.5% YoY in Q1-2017. Similarly, tourism revenues expanded by 15.3% YoY in Jan-July2017.
- **Industrial sector:** After expanding by 8.6% YoY in Q1-2017, industrial production on a calendar - not seasonally adjusted- terms, slowed down to 4.9% YoY in Q2. Nevertheless, industrial production rebounded by 8.2% YoY in July, so that the headline index reached the highest nominal level since July 2011 (Index July2017: 105, 2010=100). After climbing last March to its highest pre-crisis level of June 2008 – the highest since April 2013, industrial confidence retreated to lower levels in Q2. As of Q3, industrial confidence has started rebounding as well.
- **Labor market:** Unemployment continued its downward trend in Q3-2017. The unemployment rate in seasonally adjusted terms declined further to 10.7% in August 2017, down from 11.3% in May and 17% at its peak in October 2013.
- **Deposits:** Deposits growth continued to be in positive territory on an annual basis in Q3-2017. The annual rate of expansion slowed down to 3.7% YoY in August, down from 7.1% YoY in March, up from +6.2% YoY in February and 6.0% YoY in January.
- **Property-market:**
 - **Construction:** According to the latest release by Eurostat, construction output expanded by a hefty +1.1% QoQ/+32.5% YoY in Q2-2017 compared to +13.5%

QoQ/+45.6% YoY in Q1-2017 up from +8.6% QoQ/+18.4% YoY in Q4-2016. As a result, Cyprus was ranked first among other EU-28 member countries in terms of the aforementioned reading in Q2. The latest building permits release predisposes for a continuation in the construction output rebound. According to CYPSTAT, the total value of building permits issued in the first seven months of the year increased by 49.2% YoY, while total area rose by 41.6% YoY. During the period January – July 2017, 3.362 building permits were issued up from 3.053 in the corresponding period of the previous year.

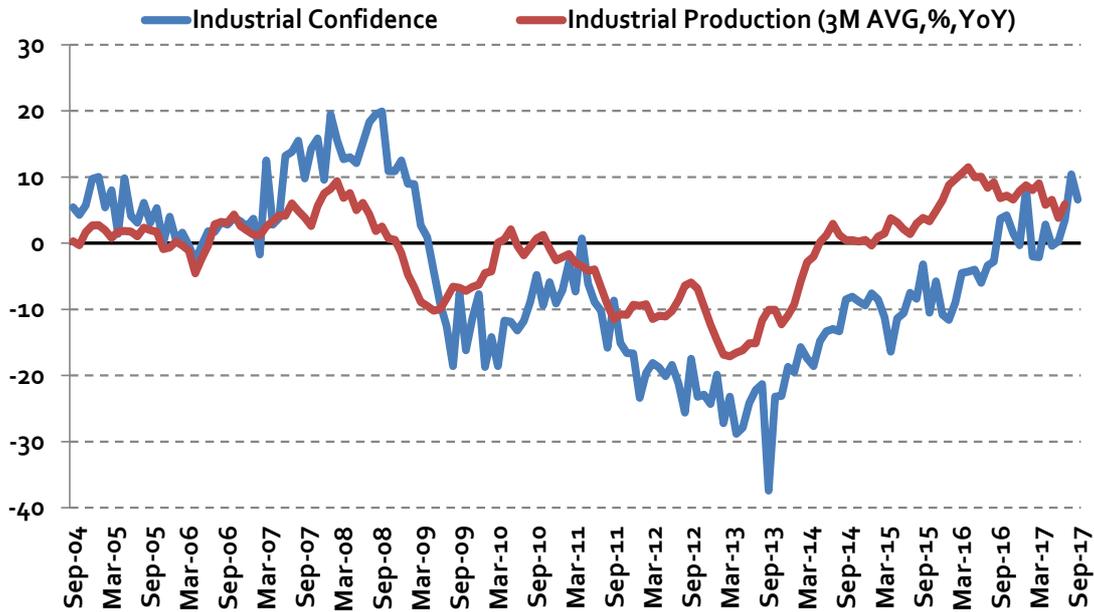
- **Real estate transactions & prices:** The number of real-estate market sale contracts has risen by 20% YoY in 9M-2017 (from 3,610 to 3,012). The reading of 843 in June 2017 only, was a new multi-year monthly high of the last six years (Department of Lands and Surveys). Property prices were on an increasing path in Q1-2017. The Residential Property Price Index (RPPI) recorded its third quarterly increase and the first annual increase in Q1-2017 since 2009 (Central Bank of Cyprus). The House Price Index According to the latest

Figure 4: Economic Sentiment & Economic Growth in Cyprus



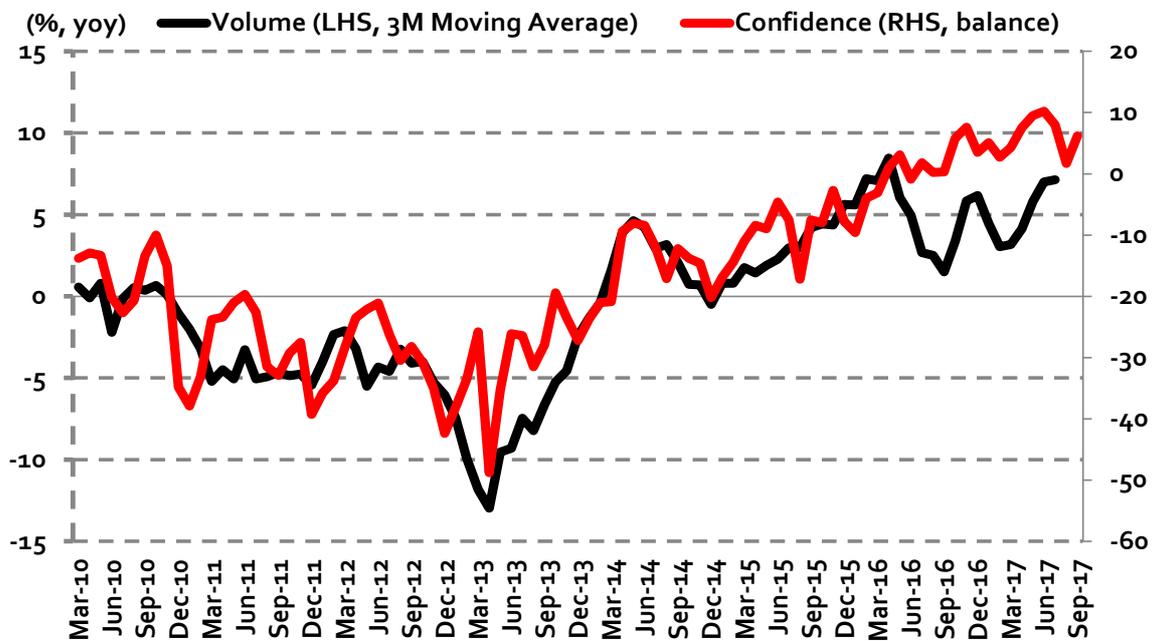
Source: Eurostat, CYPSTAT, Eurobank Research

Figure 5A: Industrial Production & Confidence in Cyprus



Source: Eurostat, CYSTAT, Eurobank Research

Figure 5B: Retail Trade & Confidence in Cyprus



Source: Eurostat, CYSTAT, Eurobank Research

3. Non Performing Exposures (NPEs)

Despite the intense restructuring effort of the banks and the continuing decline in the stock of bad loans, NPEs remain the elephant in the room

Despite the intense restructuring efforts of the banks on their portfolios, the ratio of non-performing exposures (to total exposures) remains at relatively high levels. According to the data released by the Central Bank of Cyprus, the stock of non-performing exposures (NPEs) declined by €630mn in June relative to May, bringing the stock of NPEs down by 18% in the period between December 2014-June 2017. The decline in NPEs reflects three main factors: (i) increased repayments, (ii) the migration of successful restructurings to performing loans after the completion of the observance period, and (iii) write-offs and settlements through immovable property exchange.

Total loan exposures (performing plus non-performing) decreased by only €38mn in June, which together with the much higher drop in non-performing exposures led to an overall decline in the ratio of NPEs to total facilities from 46.0% in March 2017 to 45.0% in June 2017, compared to 47.2% in December 2016. Recall that according to the EBA conservative definition, a restructured NPE is still classified as an NPE for a probation period of at least 12 months, even if it is properly serviced without incurring new arrears. As a result, a large fraction of the restructured loans are still classified as NPEs (€8.9bn out of €12.8bn in June 2017). At the end of the second quarter of 2017, out of the 20,148 accumulated applications for restructuring, agreements with the borrowers had been concluded in 3,587 cases (17.8%), another 15,769 cases (78.3%) were carried forward in order to be examined during the next quarter, while the remaining 792 cases (3.9%) were rejected either by the bank or by the borrower.

By the end of Q1-2017, banks were lagging behind their restructuring targets. The Central Bank uses a set of four indicators to monitor the compliance of the banks in the NPEs restructuring process. In its press release, the Central Bank noted that there is an over-performance of the target for the first indicator (“Proposed sustainable solutions”), pointing to the huge effort that is being made in sustainable restructuring of loans in arrears over 90 days. Specifically, the target for the first indicator was set at 14.62% and the actual realization was 16.7%. However, a sizeable under-performance was observed in the second indicator (“Concluded sustainable solutions”) whose target was 15.07% and the actual realization was 7.17%. A smaller under-performance was observed for the third indicator (“Loans that have been restructured and present arrears of less than 8 days”) whose target was set at 72.19% and the actual realization was 68.68%. The biggest under-performance was observed in the fourth indicator (“Loans that presented arrears of 31-90 days at the beginning of the quarter but by the end of the quarter do not present any arrears”), which was 44.53% whereas the actual realization was 33.27%.

Overall, the NPE ratio remains extremely high, and in December 2016 the next highest in the Euro Area behind Greece. It is important to note that the stock of NPEs is even larger when measured relative to the size of the economy. The NPEs as a percentage of GDP stood at

132.4% in December 2016, down from 155.1% in December 2014. This has not escaped the attention of the Central Bank of Cyprus, which noted there is a long road ahead, towards the eventual resolution of the NPE problem.³

4. The long-term sovereign rating of Cyprus stands an inch below investment grade. S&P sovereign review: long term sovereign rating at one notch below investment grade affirmed, outlook changed to positive

The new round of reviews by the rating agencies for autumn-winter of 2017 has already started: S&P (September 15, 2017), Fitch (October 20, 2017), Moody's (November 17, 2017), DBRS (December 1, 2017). On September 15th, in line with expectations, S&P affirmed the long-term sovereign rating of Cyprus at BB+ but, at the same time, it changed the outlook from stable to positive. According to S&P, the positive outlook reflects its expectation that it could raise the ratings on Cyprus over the next 12 months if budgetary consolidation continues unabated, and the economy continues to recover toward pre-crisis output levels. The agency currently forecasts GDP growth to average 3% in 2017-2020, as investments and employment recover, and services exports continue to perform well. The previous action by S&P occurred on March 17, when S&P had upgraded the sovereign rating of Cyprus by one notch (from BB to BB+) with a stable outlook.

On October 20th, Fitch upgraded the long-term sovereign rating of Cyprus by one notch from BB- to BB with a positive outlook. According to Fitch, the decision reflects primarily the strong improvement in public finances performance and outlook and the fact that realized GDP growth has been consistently outperforming forecasts over the recent years. On the other hand, Fitch warns that the banking sector's exceptionally weak asset quality remains a key weakness and a material downside risk to the ongoing recovery. The agency concludes that key factors that may lead to a positive or negative rating action in the future are ongoing developments on NPEs and private sector indebtedness.

Earlier on, DBRS and Moody's were the last rating agencies to upgrade the sovereign rating of Cyprus in the previous round of reviews in spring-summer of 2017. On June 2, 2017, DBRS upgraded the long-term sovereign rating of Cyprus Republic by two notches (from B to BB low) with a stable outlook (trend). The DBRS rating decision-an upgrade by two notches-was more aggressive than anticipated so that DBRS is no longer the rating agency that assigns the lowest rating. More recently, on July 28, Moody's upgraded the rating of Cyprus by one notch to Ba3 from B1 with a positive outlook after having deferred its scheduled assessment of Cyprus in late last March.

³ https://www.bankingsupervision.europa.eu/press/interviews/date/2017/html/ssm.in171016_1.en.html

Table 3

Foreign Currency Long Term Sovereign Ratings of Cyprus

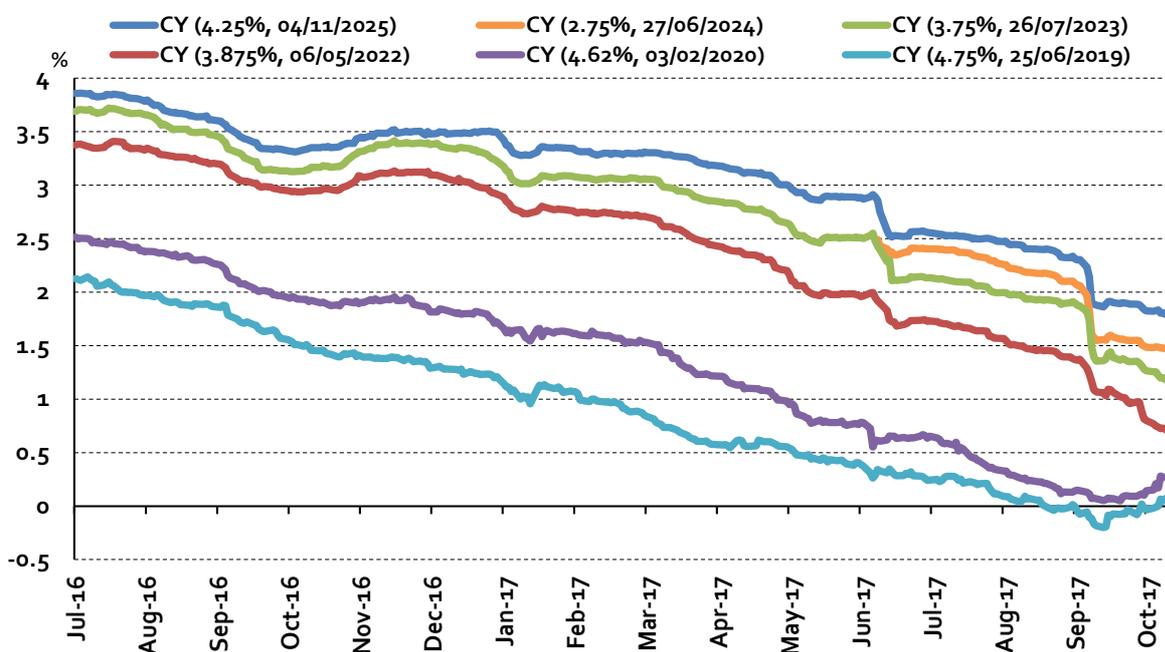
Moody's	S&P	Fitch	DBRS	Rating Description
Aaa	AAA	AAA	AAA	Prime
Aa1	AA+	AA+	AA High	High Grade
Aa2	AA	AA	AA	
Aa3	AA-	AA-	AA Low	
A1	A+	A+	A High	Upper Medium Grade
A2	A	A	A	
A3	A-	A-	A Low	
Baa1	BBB+	BBB+	BBB High	Lower Medium Grade
Baa2	BBB	BBB	BBB	
Baa3	BBB-	BBB-	BBB Low	
Ba1	BB+	BB+	BB High	Non-Investment Grade
Ba2	BB	BB	BB	
Ba3	BB-	BB-	BB Low	
B1	B+	B+	B High	
B2	B	B	B	
B3	B-	B-	B Low	
Caa1	CCC+	CCC+	CCC High	
Caa2	CCC	CCC	CCC	
Caa3	CCC-	CCC-	CCC Low	
Ca	CC	CC	CC High	
			CC	
			CC Low	
C	C	C	C High	
			C	
			C Low	
C	SD	DDD	D	Default
C	D	DD		
C	D	D		

Source: Rating Agencies

(Upgrade within the last review is marked with green color. Affirmation is marked with grey color)

Following the last round of assessments, the divergence of views between the rating agencies on the sovereign rating of Cyprus, remains (Table 3). The distance from government bond investment grade status is one notch for S&P (currently at BB+), two notches for Moody’s (currently at Ba3), and three notches for Fitch (currently at BB) and DBRS (currently at BB Low) respectively. The lack of investment grade status prevents Cyprus from qualifying to join ECB’s Quantitative Easing (QE). Earlier, when Cyprus was still in a Program, an ECB waiver allowed participation in QE. The Program and the waiver no longer exist.

Figure 6A: Annualized Yields to Maturity of outstanding Cypriot Government Bonds



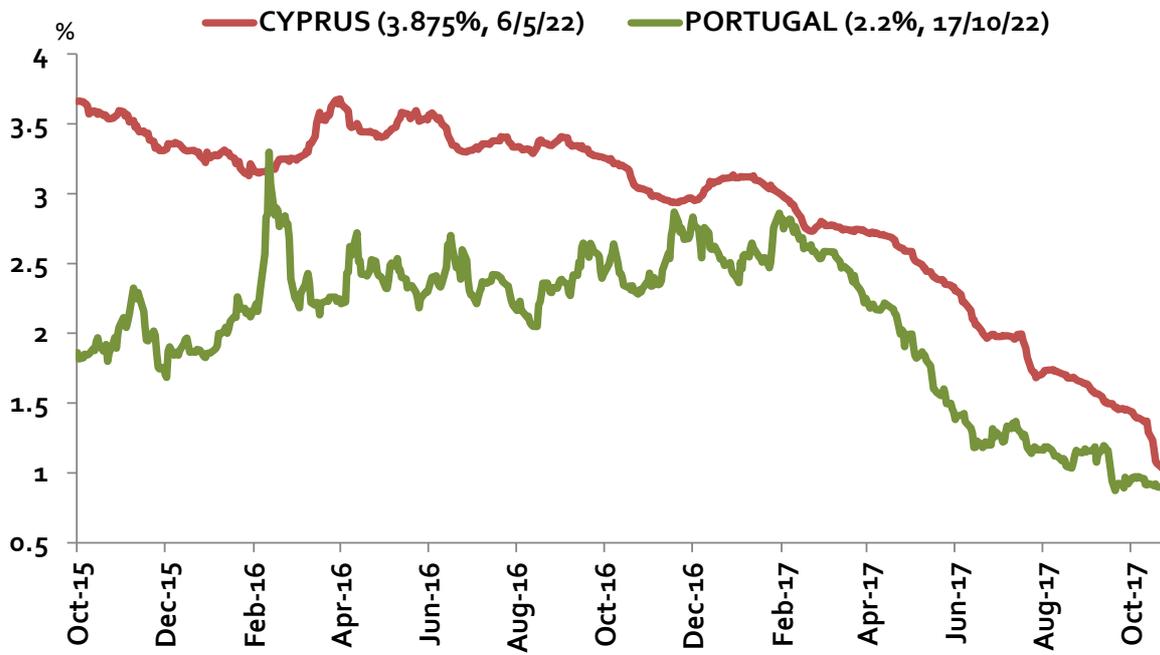
Source: Bloomberg, Eurobank Research

Note: The maturity of each bond declines as we move from left to right on the diagram. The first observation is on July 20, 2016 and the last observation is on October 25, 2017. On that date, the longest 04/11/2025 bond had a maturity of 8 years. At the other end, the shortest 25/06/2019 bond had a maturity of 18 months.

Nevertheless, the medium-term Cypriot bond yields have been on a declining trend since March 2016 (Figure 6A-6B). Cyprus enjoys uninterrupted access to international markets.

In late June, Cyprus tapped international markets with a new 7Y-Eurobond for the second time after exiting from the Economic Adjustment Programme in March 2016. It was issued at the lowest cost ever achieved in a benchmark bond issuance

**Figure 6B: Annualized Yields to Maturity of Government Bonds maturing in 2022:
Cyprus vs. Portugal**



Source: Bloomberg, Eurobank Research

Note: The Cypriot bond matures in May 2022 and the Portuguese about six months later, in October 2022. Thus on October 25, 2017 the Cypriot bond had an approximate maturity of 4.5 years and the Portuguese 5 years.

5. Interpreting the latest Cypriot Economic News (August-September 2017)

The real economy continues to surprise positively

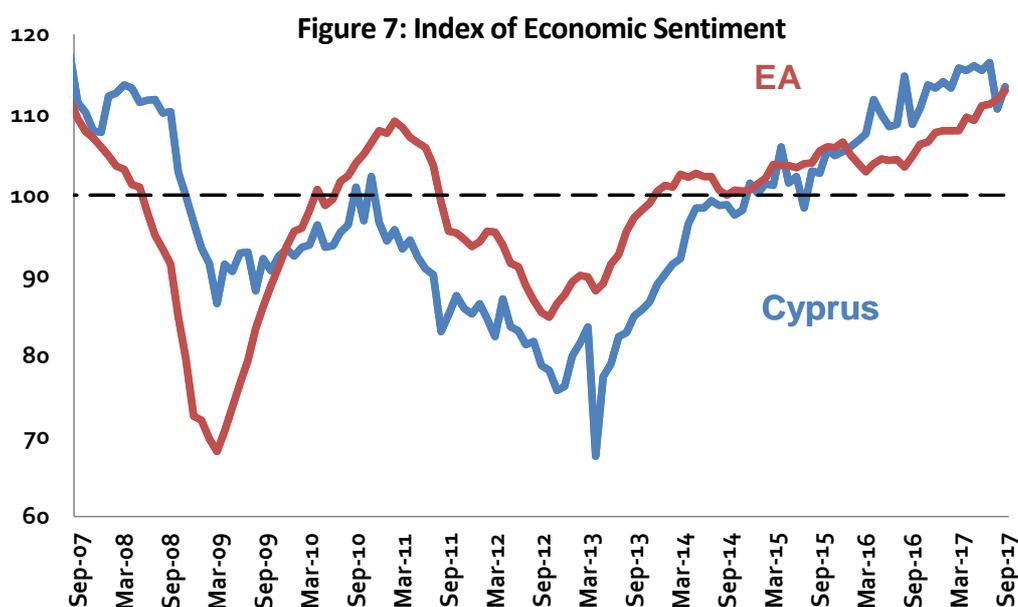
Economic Sentiment Index (ESI Index)

Confidence rebounds in September, after a temporary slump in August

The ESI Index rebounded strongly in September after a temporary slump in August. In more detail, ESI expanded by 2.8 points to 113.5 in September, up from 110.7 in August, vs. 116.5 recorded in last July which is a multi-month high. The more pronounced improvement in expectations came from services which expanded by 8.7 points. All other components of the index remained broadly unchanged. Retail trade and consumer sentiment edged up by 0.6 points and 0.5 points respectively. On the other hand, industry and construction edged down by 0.1 points and by 0.9 points respectively.

Including the latest reading, the ESI index still stands at a very high level- comparable to the levels recorded in the pre-Lehman Brothers period (the pre-Lehman period peak stood at 117.3, which was recorded in August 2007), yet it has retrenched a bit back to the level of November 2016. All in, the ESI Index stands above its long-term average, spurring optimism for the prospects of short-term economic activity. The improvement recorded in the past three years – a total of 46 points since the crisis period in April 2013- is still the highest among all countries in EU-28 over the same sample period. Sentiment improvement is one of the key drivers of the consumption rebound, which feeds into output growth.

The sentiment improvement is illustrative of the progress of the Cypriot economy in the past three years within the economic adjustment program. This progress is evident in a number of areas, including but not limited to, restoring the health of the banking sector, a complete lift of capital controls, the rebalancing of public finances and the correction of all other macroeconomic imbalances.



Source: Eurostat, Eurobank Research

Consumer prices (HICP)

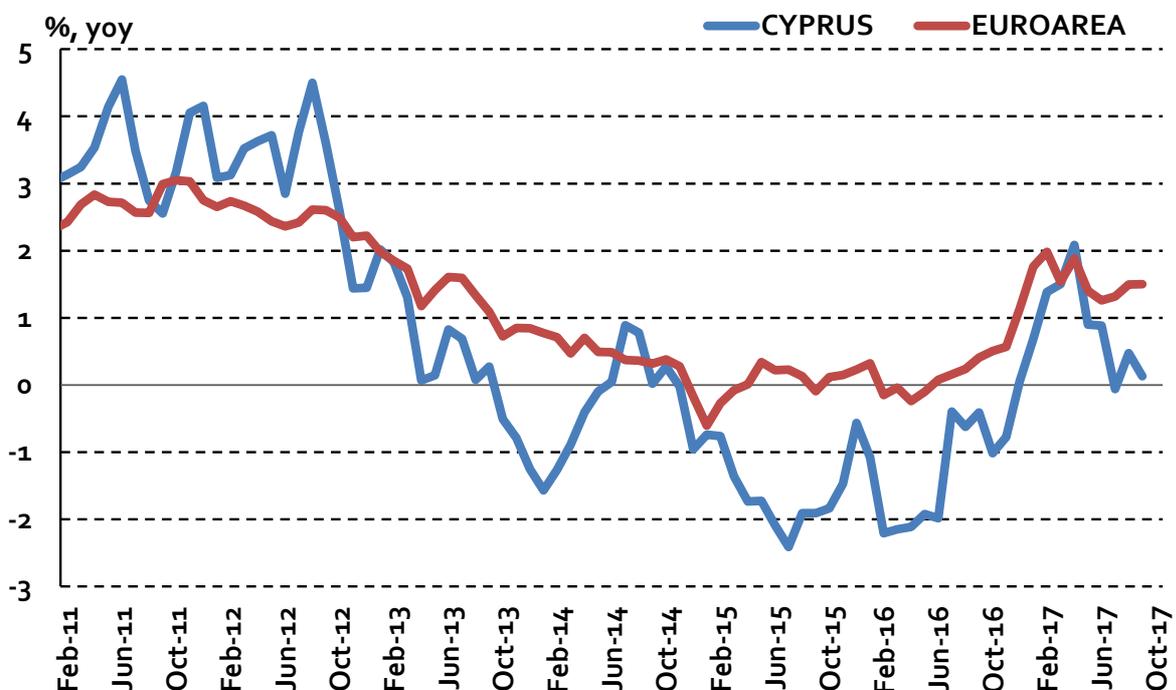
Further inflation moderation in Q3

Consumer prices, measured by HICP, have entered positive territory since December 2016, thus marking the end of the prolonged-four year- period of deflation, and subsequently started accelerating in the first quarter of 2017. Having jumped to a multi month high at +1.0% MoM/+2.1% YoY in April, compared to only +0.3% MoM/+0.1% YoY in last December, HICP moderated further in Q3. In turn, HICP came to -0.8% MoM/+0.1% YoY in September down from +1.0% MoM/+0.5% YoY in August compared to +0.3% MoM/+0.9% YoY in June.

The biggest increases on an annual basis were observed in the categories of “Restaurants & Hotels” (-2.8% MoM/+3.6% YoY in September vs. +2.4% MoM/+3.1% YoY in August) and “Utilities” (-2.1% MoM/+2.4% YoY in September vs. +0.3% MoM/+4.7% YoY in August). The rise in “restaurants & hotels” most probably reflects the increased demand for catering and accommodation services stemming from the flourishing tourist arrivals. The rise in “utilities” reflects the past pass through of world energy prices and the subsequent increase in the local electricity tariffs by the state-owned energy company.

As of September, the rise of energy prices and prices of services accounted for 0.3ppts and 0.6ppts respectively while volatile food (fruit and vegetables) and non-energy industrial goods subtracted another 0.6 ppts and 0.3ppts from the headline respectively. Overall, the average annual HICP declined to +0.2% YoY in Q3-2017 down from +1.3% YoY in Q2-2017 compared to +1.2% YoY in Q1-2017 up from -1.2% YoY in the 2016, -1.4% YoY in 2015 and -0.7% YoY in 2014.

Figure 8: HICP in Cyprus vs. EA-19



Source: Eurostat, Eurobank Research

Deposits & Loans

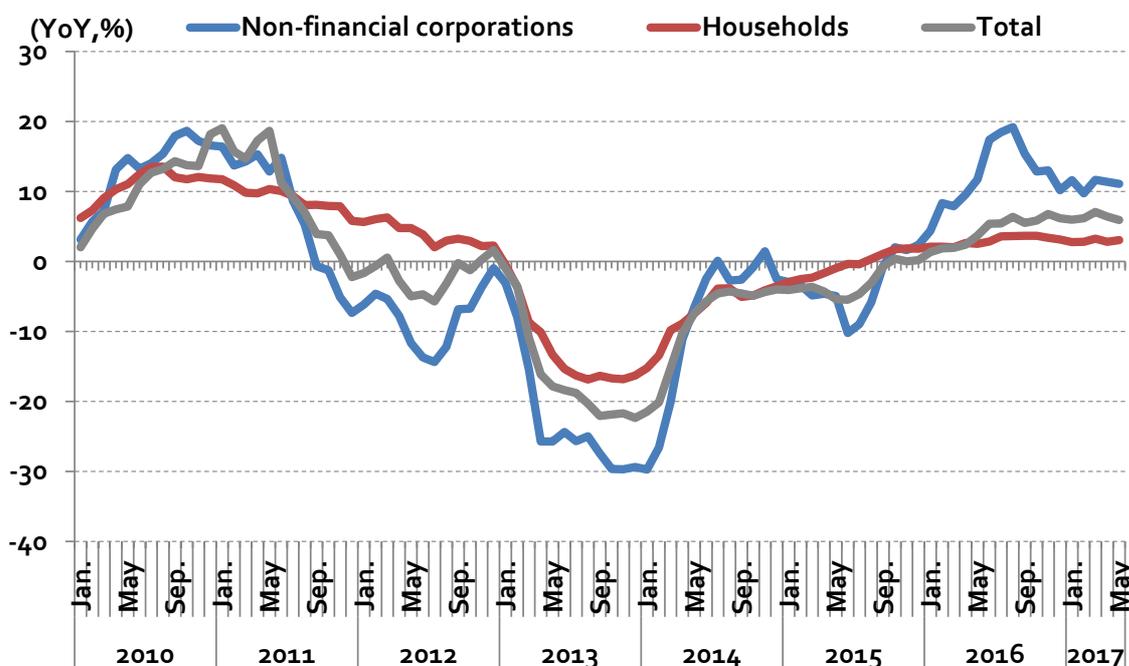
Deposit growth remained in positive territory on an annual basis in the first eight months of 2017

The Central Bank of Cyprus published on September 27th the Monetary and Financial Statistics (MFS) of August.⁴ From a flow point of view, total deposits recorded a net increase of €428.8mn in August on top of a net increase of €513.4mn in July, up from a temporary decline of €432.9 in June, compared to €332mn in March, and €148.9mn in January, up from €872.7mn in August 2016.

The annual rate of expansion-*which has been in positive territory since October 2015*- has slowed down to 3.7% YoY in August down from 4.7% YoY in July, 4.2% YoY in June vs. 7.1% YoY in March, compared to 6.2% YoY in Dec2016 and only 0.2% YoY in Dec2015. The outstanding amount of total deposits reached €49.1bn in August, €48.8bn in July, €49.6bn in March, compared to €49.0bn in December 2016 and €45.97bn in December 2015.⁵

Total loans in May exhibited a net decrease of €193.6mn, up from a net decrease of €91.6mn in April and a net decrease of €28.6mn in March. The annual growth rate of contraction narrowed to -2.1% YoY in August, -1.1% YoY in July, among *the lowest readings since April 2013*- up from -0.7% YoY in June and -5.0% YoY in March, compared to -10.7% YoY in December 2016 and only -3.4% YoY in December 2015. A substantial part of these repayments concern previous transfers of loans from non-resident MFIs and are not related to the domestic economic activity. The outstanding amount of loans reached €52.9bn in August, €53.6bn in July compared to €54.3bn in June and €55.0bn in March compared to €55.3bn in December 2016 and €62.7bn in December 2015.

Figure 9: Annual growth of deposits



Source: Central Bank of Cyprus, Eurobank Research

⁴ https://www.centralbank.cy/images/media/xls_el/2ndMFSSept2017gr.xls

⁵ The Central Bank is using ECB methodology to calculate the annual growth with a special formula taking into account the monthly transactions

Residential Property Price Index (RPPI)-Q1-2017

The RPPI Index recorded in Q1-2017 the first increase on an annual basis since 2010

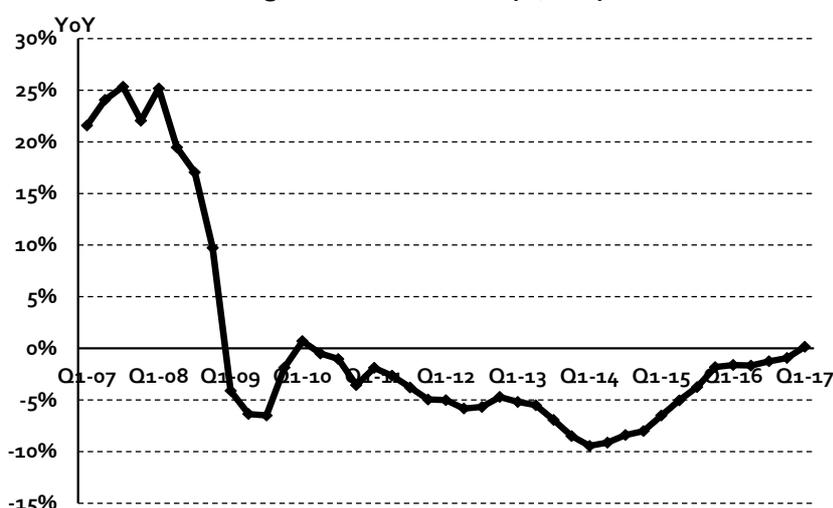
The Central Bank of Cyprus published in mid-August the residential property price index (RPPI) for Q1-2017. On a quarterly basis, the RPPI increased by +0.3% QoQ, recording the third consecutive quarterly rise since 2009 vs. -0.5% QoQ in Q2-2016 compared to -0.8% QoQ in Q1-2016. The quarterly rise reflects the combined effect of a negligible increase in both flat apartments and house prices by +0.3% QoQ. On an annual basis, the RPPI recorded the first increase since Q1-2010. The RPPI Index expanded by +0.2% YoY in Q1-2017 up from -0.9% YoY in Q4-2016, -1.3% YoY in Q3-2016 compared to -1.7% YoY in Q2-2016, -1.6% YoY in Q1-2016, and smaller in absolute terms than -1.8% YoY in Q4-2015, -3.7% YoY in Q3-2015 and -5.0% YoY in Q2-2015.

Overall, the RPPI trajectory in the past quarters, in combination with other high frequency data from the construction industry and real estate transactions, point to a further stabilization of the real estate sector. According to CYPSTAT, the construction output index has accelerated further by 17.9% YoY in Q4-2016 up from 12.0% YoY in Q3-2016 bringing the FY2016 reading at 12.9% YoY, yet still remaining 47.0% below the 2010 average.

Figure 10A: RPPI Index (2010Q1=100)



Figure 10B: RPPI Index (% YoY)

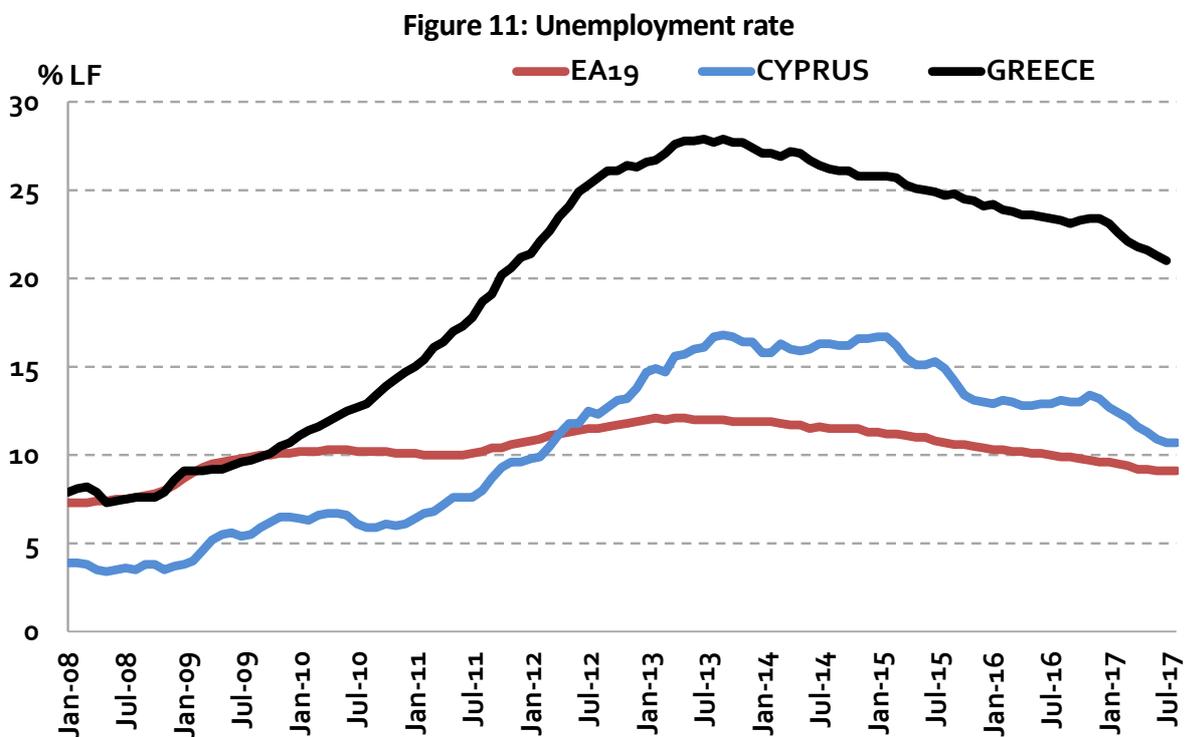


Source: Central Bank of Cyprus, Eurobank Research

Unemployment

Unemployment’s declining trend accelerated in the summer months

According to the latest Labor Force Survey (LFS), unemployment on a seasonally adjusted basis declined further to 10.7% in August down from 11.3% in May 2017, 12.1% in March 2017, 13.2% in December 2016, 12.8% in May 2016, and 17% at its peak in October 2013. (See Figure 11). Overall, Cyprus recorded the highest unemployment decline in EU-28 in the first eight months of 2017, so that unemployment now stands close to that of Euroarea. In the previous year 2016, Cyprus had recorded the third highest decrease in unemployment in EU-28, behind Croatia and Spain. Despite the improving trend, unemployment in Cyprus is still the fifth largest in EU-28. Youth & Long-term unemployment are a source of concern and require more attention.



Source: Eurostat, Eurobank Research

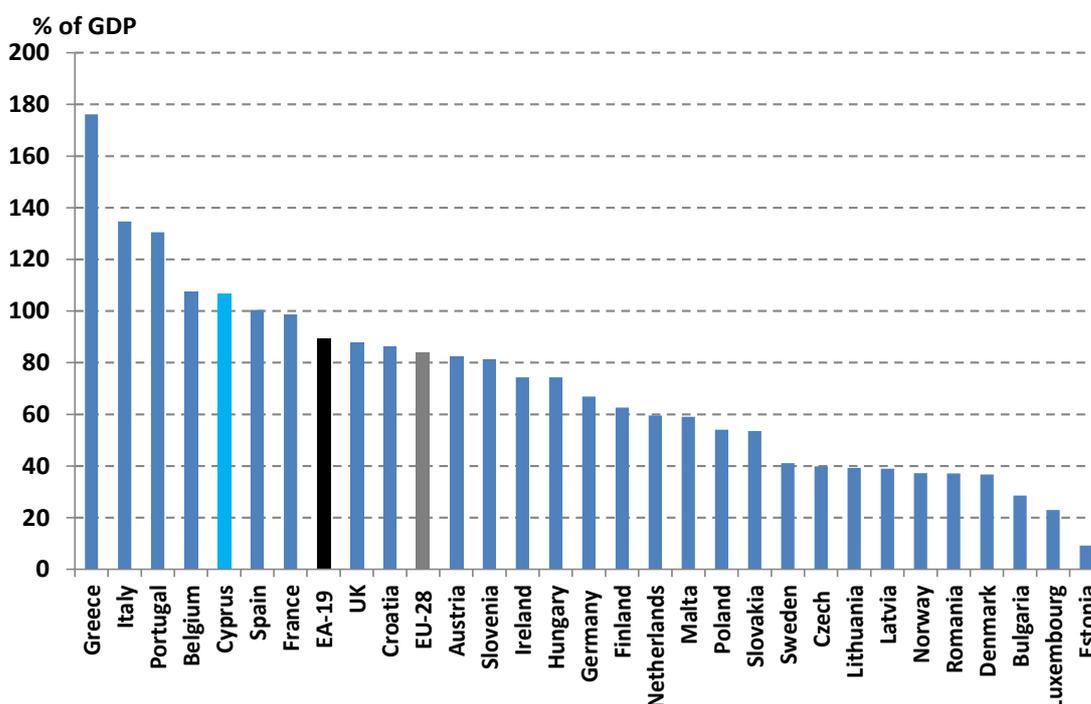
Q1-2017 General Government Deficit and Public Debt (ESA2010 terms)

Cyprus improves in the public indebtedness ratio in Eurostat ranking

On July 22, Eurostat announced⁶ the provisional data for the fiscal deficit and public debt in the first quarter of 2017. In ESA2010 terms, Cyprus recorded a €200.9mn general government surplus in Q1-2017, which is approximately 4.5% of the *GDP in the same quarter*, switching from an earlier deficit of €79mn, equivalent of -1.7% of *Quarterly GDP* in Q4-2016. Cyprus is now among those ten EU-28 members which registered a general government surplus (compared to a Euro Area and EU-28 deficit of 2.3% and 1.3% respectively) in Q1. According to the latest Ministry of Finance data, the general government surplus in ESA2010 terms had reached €431.5mn or 2.3% of projected GDP in 8M-2017.

Given the on-going fiscal surplus, the general government debt declined by 0.8 ppts of GDP to €19.4bn or 107.0% of GDP in Q1-2017, down from €19.3bn or 107.8% in Q4-2016, compared to €19.1bn or 107.5% of GDP in Q1-2016. More importantly, Cyprus' ranking among EU-28 members has improved: The Cypriot government debt as a percentage of GDP is now the fifth highest. Cyprus behind that of Greece (176.2%), Italy (134.7%), and Portugal (130.5%) and Belgium (107.7%). The public debt of Cyprus is in the form of loans (33.2% of total) and debt securities (66.8% of total).

Figure 12: General Government Debt across EU-28 members in Q1-2017



Source: Eurostat, Eurobank Research

⁶ <http://ec.europa.eu/eurostat/documents/2995521/8118661/2-20072017-AP-EN.pdf/83147478-c193-40e9-8a0a-b76e56a5cebc>

January-August 2017 Budget execution

The budget was in surplus in the first eight months of 2017

The budget was in surplus during the first eight months of 2017. The consolidated government surplus increased to €431.5mn in 8M-2017, up from €12.4mn in 8M-2016. As a percentage of GDP, the consolidated government surplus came at +2.3% in 8M-2017, compared to +0.1% of GDP in 8M-2016. The primary surplus stood at +4.1% of GDP in 8M-2017 compared to +1.9% of GDP during the same period a year ago. Total revenues improved by +13.3% YoY, driven by double digit growth in both direct and indirect taxes. On the other hand, total expenditure remained relatively contained in an election year, expanding by +2.5% YoY driven by higher spending on procurement (+17.2% YoY), pensions (+3.4% YoY) and public wages (+4.2% YoY). On the other hand, spending items such as social security payments (+0.9% YoY) remained at low levels and while spending on current transfers (-1.9% YoY) and subsidies (-42.8% YoY) decreased.

Table 4: General Government Budget Execution

General Government Adjusted Budget Balance on cash basis (January-August 2017)		
in % GDP	January-August 2016	January-August 2017
I. Government Budget and SSF		
Total Revenue	22.7%	24.9%
Current revenue	22.6%	24.8%
Direct Taxes	6.9%	7.6%
Indirect Taxes	9.1%	10.0%
of which, VAT	5.3%	6.0%
Social security contributions	3.8%	4.0%
Non-tax revenue	2.8%	3.2%
Capital Revenue	0.0%	0.0%
Grants	0.1%	0.2%
Total Expenditure	22.9%	22.8%
Current expenditure	22.2%	22.0%
Wages and Salaries	5.8%	5.8%
Goods and services	1.3%	1.4%
Subsidies	0.4%	0.2%
Social Security payments	5.5%	5.4%
Pensions	1.9%	1.9%
Social Pensions	0.2%	0.2%
Current transfers	5.1%	4.9%
Non-allocated	0.1%	0.0%
Interest payments	1.8%	2.1%
Capital expenditure	0.8%	0.7%
Balance (I)	-0.2%	2.2%
II. Other General Government Bodies		
including		
Local Authorities	0.0%	0.1%
Semi-public Entities	0.1%	0.0%
Other Entities	0.0%	0.1%
Balance (II)	0.1%	0.1%
III. ESA 2010 adjustments		
Balance (III)	0.2%	0.0%
III. General Government Balance		
Budget Balance (I+II+III)	0.1%	2.3%
Primary Balance (excl. interest)	1.9%	4.1%
Cyprus GDP (Mrd EURO-CYP)	17,901.4	18,717.0

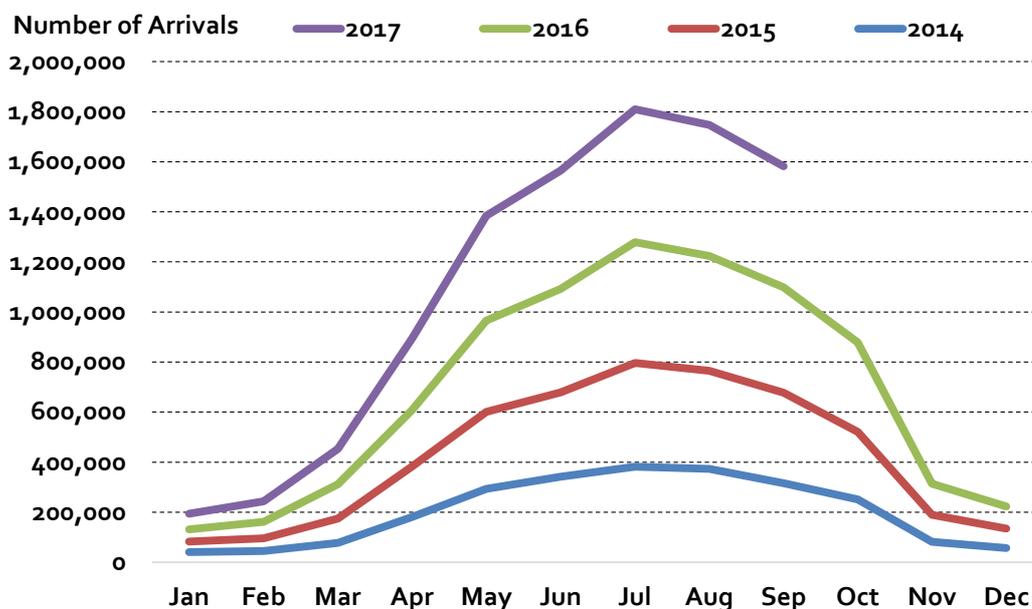
Source: Ministry of Finance, Eurobank Research

Tourism arrivals (January-September 2017) & revenues (January-July 2017)

Poised for another year of records in tourism arrivals

The positive momentum in the tourism sector continued into 9M-2017. Tourist arrivals increased by +14.7% YoY in 9M-2017 (3,001,603 vs. 2,617,218 see Figure 13). The highest increase was recorded in tourist arrivals from Israel (+84.2% YoY, 218,157), Germany (+57.3% YoY, 139,362) and Austria (+40.9% YoY, 32,041). Tourist arrivals from traditional and more sizeable markets such as Russia (+5.0% YoY, 703,446) and UK (+8.3% YoY, 1,039,783) fared relatively well. In a similar vein, tourism revenues expanded also robustly by +15.3% YoY in January-July 2017 to €1,4bn, up from €1,2bn compared to the same period last year. The expenditure per person for the month of July 2017 only reached €801.6, compared to €834.2 in the corresponding month of the previous year, recording a decrease of -3.9%. The expenditure per person/per day for July 2017 compared to July 2016 also recorded a decrease of -5.9%. This percentage decrease was smaller the corresponding percentage increase in tourist arrivals, hence revenues expanded.

Figure 13: Tourism Arrivals



Source: CYSTAT, Eurobank Research

Eurobank Cyprus Research

Economic Indicators	Description	Source	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
National Accounts															
Population	Number	Eurostat	722,893	733,067	744,013	757,916	776,333	796,930	819,140	839,751	862,011	865,878	858,000	847,008	848,319
GDP (%YoY)	Constant Prices	Eurostat	4.6	3.7	4.5	4.8	3.9	-1.8	1.3	0.3	-3.1	-5.9	-1.4	2.0	3.0
Households and NPISHs Final Consumption Expenditure (YoY%)	Constant Prices	Eurostat	7.2	3.5	4.4	10.2	7.9	-6.4	3.3	-0.7	-1.3	-5.9	0.7	2.6	3.3
General Government Final Consumption Expenditure (YoY%)	Constant Prices	Eurostat	1.2	2.8	7.0	3.3	5.7	6.4	1.2	2.1	-1.8	-8.1	-7.2	-2.8	-0.4
Gross Fixed Capital Formation (YoY%)	Constant Prices	Eurostat	4.7	6.9	21.0	7.8	8.8	-13.6	-2.6	-12.1	-20.5	-12.9	-17.5	13.6	35.0
Exports of Goods and Services (YoY%)	Constant Prices	Eurostat	2.3	2.1	1.3	5.3	-0.7	-4.1	4.5	5.6	-2.7	2.1	4.2	6.3	3.9
Imports of Goods and Services (YoY%)	Constant Prices	Eurostat	6.9	1.6	5.7	10.5	12.5	-15.0	8.0	-3.0	-4.4	-4.8	4.6	8.1	6.6
GDP	Current Prices, SA ,mil	Cyprus Statistical Service	13856.3	14822.3	15999.9	17511.6	19006.0	18673.5	19299.5	19731.1	19489.7	18140.5	17605.9	17742.0	18122.5
GDP (%YoY)	Current Prices, SA ,mil	Cyprus Statistical Service	7.9	7.0	8.0	9.5	8.5	-1.8	3.4	2.2	-1.2	-6.9	-3.0	0.8	2.1
Labour Market															
Unemployment Rate	% active population	Eurostat	4.6	5.3	4.6	3.9	3.7	5.4	6.3	7.9	11.9	15.9	16.1	15.0	13.0
Labor Productivity	Real, Per employee, % Change	Eurostat	0.6	0.1	2.6	0.4	0.3	-1.8	0.8	0.3	0.0	0.0	0.2	-0.2	0.1
Unit Labor Costs	Index, 2010=100	Eurostat	82.3	87.7	89.1	90.4	93.0	100.2	100.0	101.8	103.3	97.7	93.8	92.9	92.3
Unit Labour Cost Growth Total Economy	YoY%	Eurostat	1.6	6.5	1.6	1.5	2.9	7.7	-0.2	1.8	1.5	-5.4	-4.0	-0.9	-0.7
Short-term business statistics															
Economic Sentiment Index (ESI)	EoP, SA	EU Commission	106.3	99.8	108.1	108.4	97	93.8	97.1	85.7	76.6	89.6	102.7	106.7	113.3
Industry	EoP, SA	EU Commission	-36.4	-26.2	-31.8	-40.8	-39.2	-40.5	-46.7	-61.3	-43.9	-20.2	-10.0	-4.0	-0.4
Construction	EoP, SA	EU Commission	-4.4	-32.7	2.7	-7.9	-27.5	-38.8	-44	-51.5	-56.5	-54.5	-49.8	-30.3	-27.4
Retail trade	EoP, SA	EU Commission	3.3	5.2	0.7	11.2	-12.8	-22.5	-22.6	-29.0	-31.8	-19.1	-10.6	-1.6	8.5
European Commission Services Confidence Indicator Cyprus	EoP, SA	EU Commission	14.4	6.1	15	8.7	1.8	-3.6	3.6	-25.2	-40.7	-24.2	11.4	8.2	28.4
Industrial Production General Index	NSA	Cyprus Statistical Service	103.2	102.7	103.5	111.0	109.9	102.8	100.3	92.5	75.2	69.9	72.8	77.3	84.5
Industrial Production General (YoY)	NSA	Cyprus Statistical Service	3.7	-0.5	0.8	7.2	-1.0	-6.5	-2.4	-7.8	-18.7	-7.0	-9.6	7.8	8.7
European Commission Capacity Utilization Cyprus SA	SA	Cyprus Statistical Service	70.0	72.6	66.8	71.3	69.4	63.0	63.9	58.1	53.7	50.8	54.5	61.1	59.6
Housing and Real Estate															
Building Permits	Number	Cyprus Statistical Service	8252.0	9098.0	9794.0	9521.0	8896.0	8950.0	8777.0	7506.0	7172.0	5341.0	4933.0	5014.0	5354.0
Value of permits	mil €	Cyprus Statistical Service	1994.6	2288.9	2473.4	2782.3	2904.6	2815.8	2639.5	2065.1	1632.3	1141.0	859.5	1071.4	1157.6
Area of permits	(Thousand Sqm)	Cyprus Statistical Service	3015.7	3417.0	3507.5	3612.8	3689.1	3136.5	2917.9	2253.0	1499.9	1044.8	784.9	881.1	1047.1
Dwelling Units	Number	Cyprus Statistical Service	15743.0	18770.0	18915.0	20486.0	20082.0	16688.0	14312.0	8839.0	5879.0	4141.0	2855.0	3197.0	2348.0
Personal/Household Sector															
Credit for Consumption	mil €	ECB MFIs Statistics		2,577	2,848	3,118	4,261	4,770	3,390	3,371	3,341	3,039	2,794	2,792	2,583
Lending for House Purchase	mil €	ECB MFIs Statistics		4,140	5,450	6,989	8,584	10,492	12,033	12,658	12,772	11,943	11,747	11,735	11,587
Other Lending Cyprus	mil €	ECB MFIs Statistics		5,645	5,676	6,111	6,366	5,600	7,381	7,855	8,025	7,558	7,433	7,099	6,736
Total MFI Loans to Non-MFIs Domestic Residents	Monetary & Financial Statistics	Central Bank of Cyprus		25,005	27,511	33,995	43,452	45,681	49,403	52,870	53,936	50,082	49,583	51,201	45,310
Gross Household Saving Rate	% of Gross Disposable Income	Eurostat	7.9	10.7	10.8	5.9	4.8	8.9	6.7	6.4	3.6	-3.3	-7.9	-5.7	N/A
International Trade & Balance of payments															
Current account balance (%GDP)	BMP6	Eurostat					-15.5	-7.7	-11.3	-4.1	-6.0	-4.9	-4.3	-2.9	-5.3
Current Account, Goods & Services Net Balance (%GDP)	BMP6	Eurostat					-12.8	-5.4	-7.3	-2.9	-1.5	1.8	2.1	0.3	0.0
Current Account, Primary Income Net Balance (%GDP)	BMP6	Eurostat					-2.5	-1.3	-3	0	-3	-4.7	-3.6	-0.3	-2.7
Current Account, Secondary Income Net Balance (%GDP)	BMP6	Eurostat					-0.3	-1.0	-1.0	-1.1	-1.4	-2.1	-2.8	-2.9	-2.6
Imports of Goods (%GDP)	BMP6	Eurostat					42.2	34.7	36.8	35.5	33.7	31.2	32	32	35.1
Exports of Goods (%GDP)	BMP6	Eurostat					12.0	13.1	13.9	15.3	15.6	15.0	16.0	14.1	13.6
Imports of Services (%GDP)	BMP6	Eurostat					20.7	19.4	20.7	20.4	21.3	25.7	28.1	28.9	28.0
Exports of Services (%GDP)	BMP6	Eurostat					38.1	35.7	36.3	37.6	37.9	43.7	46.2	47.2	49.5
Financial Account (%GDP)	BMP6	Eurostat					-18.5	-8.4	-8.6	-1.2	-2.1	-1.9	-7.1	2.0	-5.9
Government Finance & Debt															
General Government Deficit (-) or Surplus (+) (% GDP)	including Coops banks' recap	Cyprus Statistical Service	-3.7	-2.2	-1.0	3.2	0.9	-5.4	-4.7	-5.7	-5.6	-5.1	-8.8	-1.2	0.4
General Government Debt EDP Procedure (% GDP)		Cyprus Statistical Service	64.1	62.8	58.7	53.5	44.7	53.4	55.8	65.2	79.3	102.2	107.1	107.5	107.8
Prices															
CPI (%YoY)	Annual Average	Cyprus Statistical Service	2.3	2.6	2.5	2.4	4.7	0.3	2.4	3.3	2.4	-0.4	-1.4	-2.1	-1.4
Cyprus HICP All Items (YoY)	Annual Average	Eurostat	1.9	2.0	2.2	2.2	4.4	0.2	2.6	3.5	3.1	0.4	-0.3	-1.5	-1.2
Tourism															
Tourist & Excursionist Arrivals	Number	Cyprus Statistical Service	2,349,007	2,470,057	2,400,919	2,416,075	2,403,744	2,141,187	2,172,993	2,392,223	2,464,903	2,405,387	2,441,231	2,659,400	3,186,531
Revenue From Tourism	mil €	Cyprus Statistical Service	1,678,419	1,718,302	1,755,252	1,858,106	1,792,787	1,493,246	1,549,801	1,749,306	1,927,600	2,082,400	2,023,400	2,112,100	2,363,400
Market Indicators															
10Y Gov Bond Yield Rate	%, EMU criterion series	Eurostat	6.3	4.1	4.3	4.6	4.6	4.6	4.6	7.0	7.0	6.0	6.0	3.9	3.6
Cyprus Stock Exchange Index	EoP, Composite Index		1012.27	1704.76	3900.39	4820.72	1101.42	1597.23	1055.21	295.94	114.86	103.31	85.70	67.75	66.40