

The Cyprus Economy and the Financial Sector

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Introduction

- Macro Scenario
- Our Strategy
- Fiscal Consolidation
- Risks to Budgetary Outlook
- Challenges in the Banking Sector
- Conclusions



Introduction

- Cyprus enjoys sound economic fundamentals
- Challenges lay ahead
- Promising Prospects



Main Drivers of Growth

- International Business Services
- Tourism

International Business Services



- Cyprus has become an important international business center
- More than 200.000 international companies registered in Cyprus
- Significant Comparative Advantages:
 - Stable political and economical environment
 - Lowest tax rates in Europe
 - Double tax treaties
 - Treaty with Russia the best in the world
 - Advanced legal and accounting system
 - Efficient banking system
 - Good quality of life, etc.
- Registration of new companies in Cyprus still increasing



Macroeconomic Scenario

- Unfavourable external environment affects prospects for the Cyprus economy.
- Deleveraging anticipated from the banking industry, however still positive growth.
- Developments in Greece have an impact on Cyprus.
- Impact of fiscal consolidation on short term growth and prospects.
- Expected positive growth in tourism and services hydrocarbon oil discoveries increase interest for FDI in Cyprus.
- GDP Projections -0.5% in 2012, 0,5% in 2013 and 1% in 2014
- Unemployment expected to further rise in 2012 and stabilize in 2013 and fall there after.
- Headline inflation is expected to remain high at around 3% in 2012 due to discretionary tax increases, before slowing down to 2% in 2013-14.
- Fiscal Deficit Projection in 2012 2.7% of GDP
- Projections are in line with Commission forecasts.



Macroeconomic Scenario

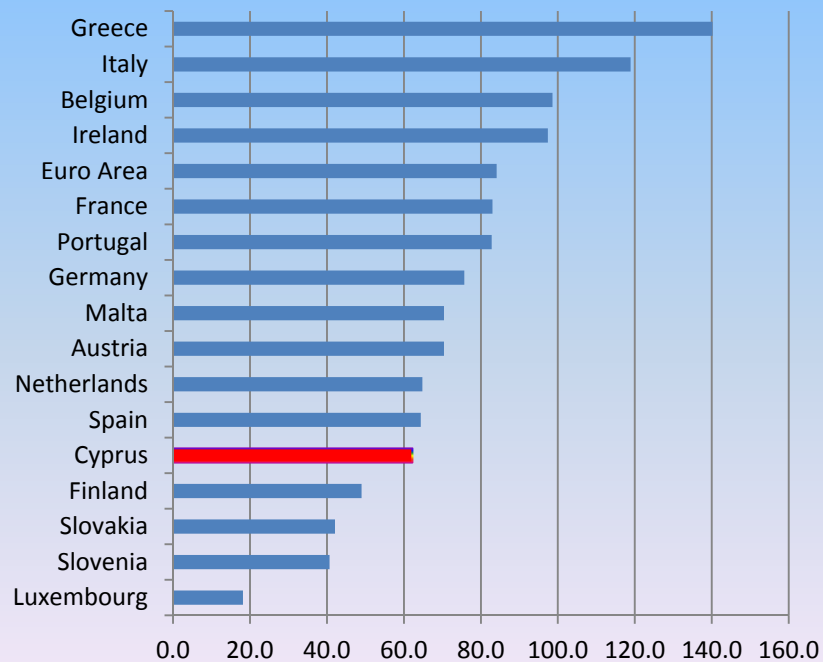
	2011	2012	2013	2014
Growth (%)	0,5	-0,5	0,5	1,0
Inflation (%)	3,5	3,0	2,2	2,0
Unemployment (%)	7,8	9,5	9,5	9,0
Current Account (% of GDP)	-8,5	-7,5	-6,5	-5,5
Deficit (% of GDP)	-6,4	-2,7	-0,5	0,0
Debt (% of GDP)	71,6	71,7	70,2	69,0

Public Debt

Debt as % GDP	Beginning 2008	End 2010
Cyprus	58.3%	60.8%
Euro-zone	69.7%	85.1%

Eurostat, April 2011

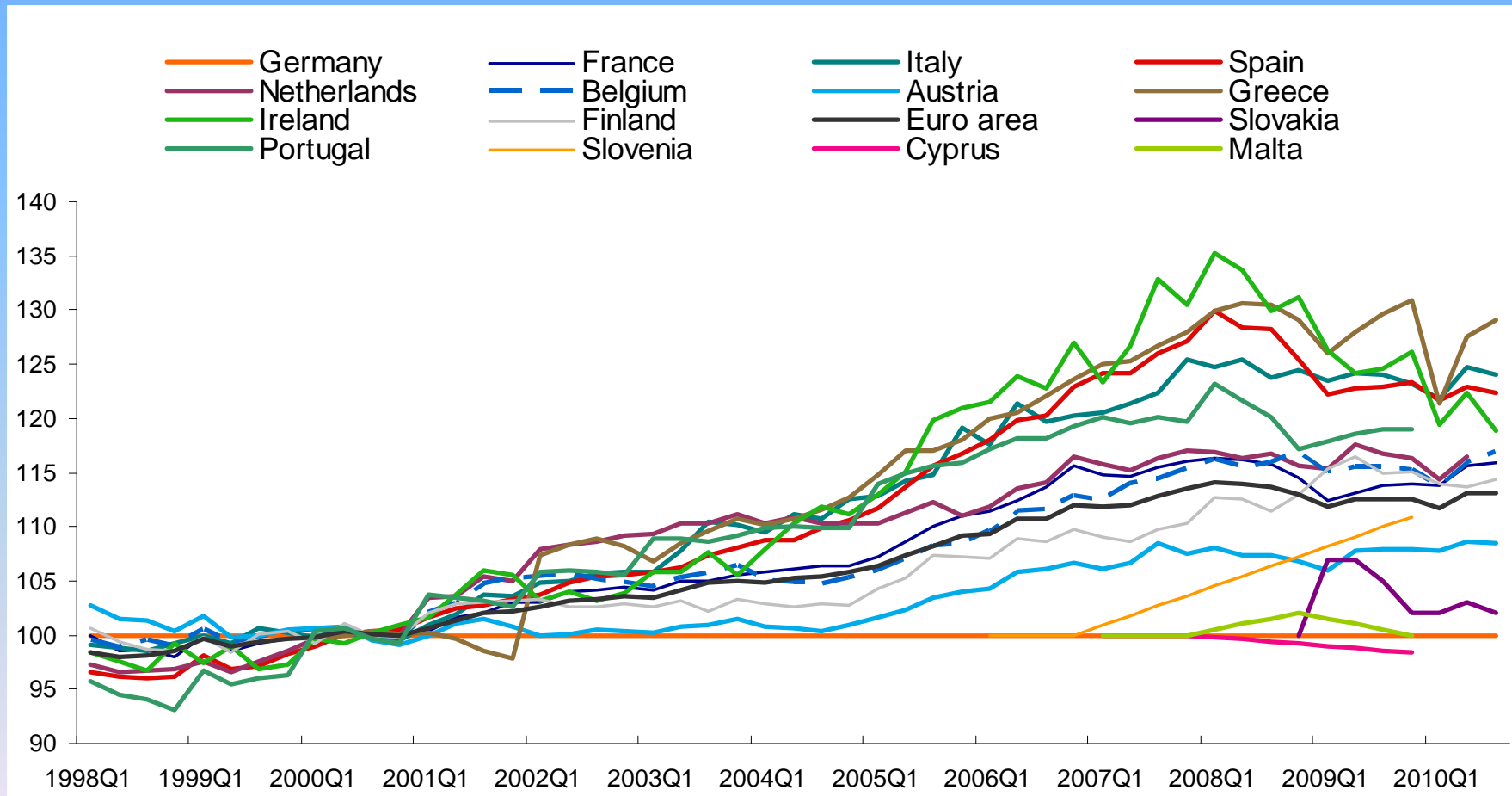
Public Debt to GDP, statistics for 2010



Source: Ministry of Finance, DIF, Eurostat

Competitiveness

UNIT LABOUR COST



Eurostat Data



Our Strategy

- Firm commitment to fiscal consolidation to address market concerns:
 - Ambitious fiscal commitments <3% of GDP in 2012 - Close to Balance Budget in 2013 - Balanced Budget by 2014.
 - Place debt-to-GDP ratio on a downward path in a medium term horizon.
 - Medium Term Budgetary Framework with binding fiscal rules to be introduced in primary legislation – Fiscal Compact.
- Long term fiscal sustainability
- Growth Stimulus package to boost employment, investment and enhance Cyprus position as a services centre
- Address weaknesses in the banking sector



Fiscal Consolidation

- Frontloaded adjustment - mainly on the expenditure side
- Based (mostly) on measures of permanent nature:
 - Freeze in public wages and pensions for 2 years.
 - Abolition of public pension scheme for newcomers.
 - Reduction of salary scales for new entrants.
 - Introduction of permanent contributions towards public pension entitlements as well as temporary ones.
 - Employment reduction in the public sector one recruitment to every four retirements – de-freezing appointments
 - Targeting of social spending as well as discretionary spending cuts
 - Increase of VAT rate and other discretionary tax increases – parliament efforts to reduce VAT on electricity



Risks to Budgetary Outlook

- Upside risks
 - Likely natural gas resources – spill overs to the economy
 - Private Investment Initiatives
- Downside Risks
 - Growth may be lower than forecast
 - Eurozone sovereign debt crisis – effects on public finances, banking system



Challenges in the Banking Sector

- Relatively large banking sector
- Relatively good capital adequacy (before haircuts) and good core profitability, however:
- Significant exposure to Greece via the holding of GGBs as well as a significant loan portfolio
- Currently banking sector under pressure –but confident that no risk to bank deposits
- Re-capitalisation efforts/ plans
- Our strategy – primacy of private sector solution
- Close co-operation with the Central Bank



Conclusions

- Low growth environment
- Nevertheless firm commitment to achieving a closed to balanced budget by 2014
- Close, systematic monitoring of the situation – additional fiscal measures if necessary
- Efforts to access the international capital markets – financing needs for 2012 almost covered
- Aware of challenges in the banking sector