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Key points

- **The economy expanded in Q1-2017 by 3.3% on an annual basis, the fastest pace in the post-Lehman period**
- **The economy's solid performance continued into the second quarter of 2017 with encouraging signs across most sectors, including the real estate sector**
- **Cyprus tapped the international markets for the second time since graduation from its Economic Adjustment Programme at the lowest yield in the history of the Republic**
- **Both Moody's and DBRS upgraded the long-term sovereign rating of Cyprus Republic, Moody's in late July by one notch and DBRS in early June by two notches, both now placing Cyprus three notches away from investment grade**

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1. The second GDP estimate of Q1-2017 confirmed that the economy has switched to a faster than previously envisaged growth path

The second and latest estimate of CYPSTAT about the seasonally adjusted Q1 GDP reading confirmed the flash estimate of +0.6% QoQ/+3.3% YoY. This strong reading compares to +0.7% QoQ/+2.9% YoY in Q4-2016 and +0.7% QoQ / +2.9% YoY in Q3-2016, up from +0.3% QoQ/+2.8% YoY in Q1-2016. Real GDP growth marked the 8th consecutive positive reading on a both quarterly and annual basis after a three-year recession. The GDP growth rate of Q1 is among the highest in EA-19 and EU-28, both on a quarterly and an annual basis (Figure 2 & 3) and, for a sixth consecutive quarter in a row, above that of EA-19 (Figure 1). More importantly, the output performance of the first quarter is the highest in the post-Lehman period, marking a very strong start in the New Year and surpassing analysts' expectations and international organizations full year forecasts. In our view, the reading signals that the economy has embarked on a faster than previously envisaged growth path.

From a demand point of view, the consumption rebound continued into Q1-2017. Final consumption expanded by +0.3% QoQ/+2.1% YoY in Q1-2017 compared to +0.3% QoQ/+2.4% YoY in Q4-2016, little down from +0.3% QoQ / +2.5% YoY in Q3-2016 vs. +0.6% QoQ/+1.1% YoY in Q1-2016, making a +1.8ppts contribution to growth. The consumption rebound is underpinned by a number of factors, namely the strong sentiment improvement mirroring the 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.

A second force behind the GDP rebound is gross fixed capital formation, which was four times higher on an annual basis in Q1-2017, a trend also repeated in Q2 and Q4-2016, driven entirely by transportation equipment purchases, which are likely due to ship and airplane imports. In turn, investments made a hefty contribution of 17.2ppts in Q1-2017, which was broadly offset by the negative contribution of net exports. The latter mirrors not only the rise of imports but also the contraction of exports. Imports accelerated by +15.6% YoY in Q1-2017, up from +12.0% YoY in Q4-2016, compared to -0.4% YoY in Q3-2016 vs. +0.3% YoY in Q4-2015. On the other hand, exports contracted by -10.2% YoY, down from +0.8% YoY in Q4-2016 vs. +8.2% YoY in Q3-2016, compared to +10.5% YoY in Q1-2015.

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 +3.6% YoY in Q1-2017, down from +4.7% YoY in Q4-2016, +4.9% YoY in Q3-2016 and +4.2% YoY in Q1-2016. 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 +13.5% YoY in Jan-Mar2017. Similarly, tourism-revenues expanded by +22.9% YoY in Jan-Feb2017.

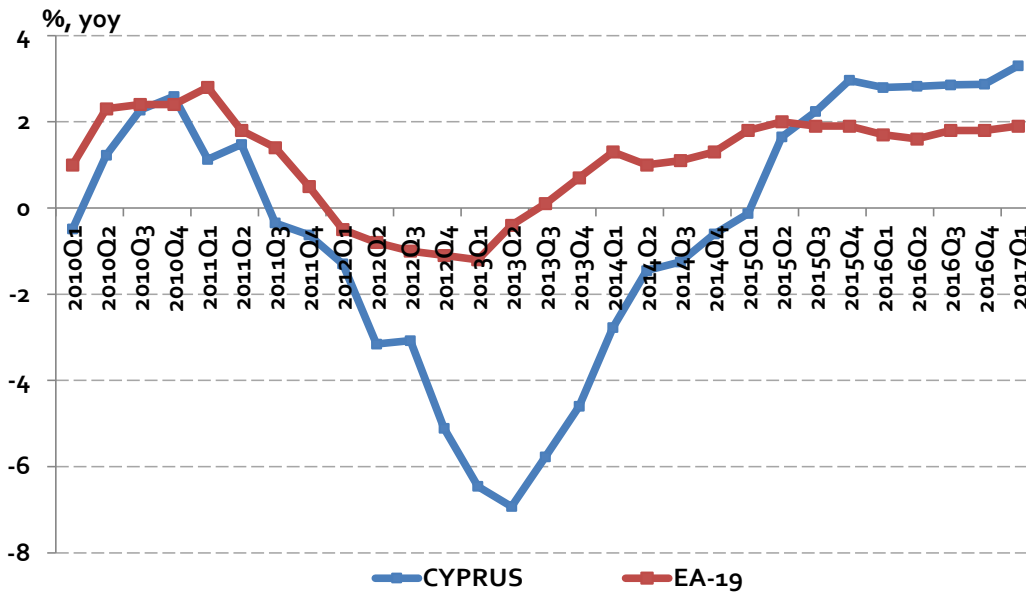
Manufacturing and professional services increased by +5.8% YoY in Q1-2017 (up from +5.1% YoY in Q4-2016, +4.8% YoY in Q3-2016 and down from +9.3% YoY in Q1-2016) and +3.7% YoY (down from +5.3% YoY in Q4-2016, +5.7% YoY in Q3-2016 and +6.4% YoY in Q1-2016) respectively. Furthermore, construction accelerated its dynamic double-digit recovery, expanding by +21.0% YoY in Q1-2017, up from +10.0% YoY in Q4-2016 compared to 10.3% YoY in Q3-2016 and 10.4% YoY in Q4-2015.

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 -3.9% YoY in Q1-2017, less than the -5.6% YoY in Q4-2016, -6.3% YoY in Q3-2016, compared to -2.7% YoY in Q1-2016. The negative contribution to GDP growth by the financial sector reflects largely the restructuring activities (debt to asset swaps), write-offs and the ongoing deleveraging.

Economic activity continued its upward trend in Q2-2017. High frequency and leading indicators, particularly the consumer related, were performing very well. More specifically:

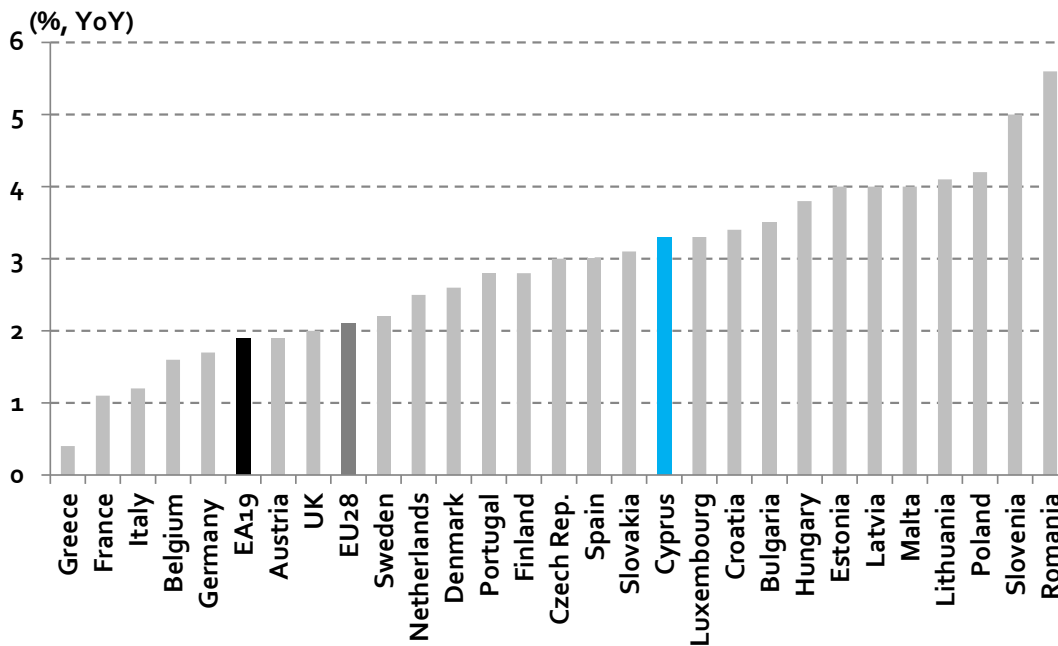
- **Sentiment:** The Economic Sentiment Index (ESI) climbed further in July 2017, an inch below the levels prior to the Lehman Brothers international crisis. The improvement mirrors the lasting progress within the economic adjustment program, as well as general optimism for the short-term prospects of the Cypriot economy.
- **Retail Trade:** Retail sales, except 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% YoY and 22% YoY respectively in 1H2017 (JCC Payments Ltd)
- **Tourism:** The positive momentum of the tourism industry continued in 1H-2017. Tourist arrivals increased by +16.6% YoY in 1H1-2017, up from +13.5% YoY in Q1-2017. Similarly, tourism revenues expanded by 22.4% YoY in Jan-May2017.
- **Industrial sector:** After expanding by 8.6% YoY in Q1-2017, industrial production on a calendar - not seasonally adjusted - terms, slowed down to 2.5% YoY in April and 4.5% YoY in May. This slight slow down is also evidenced in industrial confidence. Having climbed in last March to its highest pre-crisis level of June 2008 – the highest since April 2013, industrial confidence retreated to lower levels in April-May.
- **Property-market:** The number of real-estate market sale contracts has risen by 20% YoY in 1H-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 a stabilizing/increasing path in Q4-2016 and Q1-2017. The Residential Property Price Index (RPPI) recorded its second quarterly increase and the lowest annual decrease in Q4-2016 since 2009 (Central Bank of Cyprus). The House Price Index, another index prepared and announced by Eurostat, increased by -1.4% QoQ /+4.1% YoY in Q1-2017, up from +0.8% QoQ /+3.3% YoY in Q4-2016.
- **Labor market:** Unemployment continued its downward trend in Q2-2017. The unemployment rate in seasonally adjusted terms declined further to 11.0% in May 2017, down from 13.3% in March 2016 and 12.8% in May 2016.
- **Deposits:** Deposits growth continued accelerating on an annual basis in Q1-2017. The annual rate of expansion climbed to 7.1% YoY in March, up from +6.2% YoY in February and 6.0% YoY in January.

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



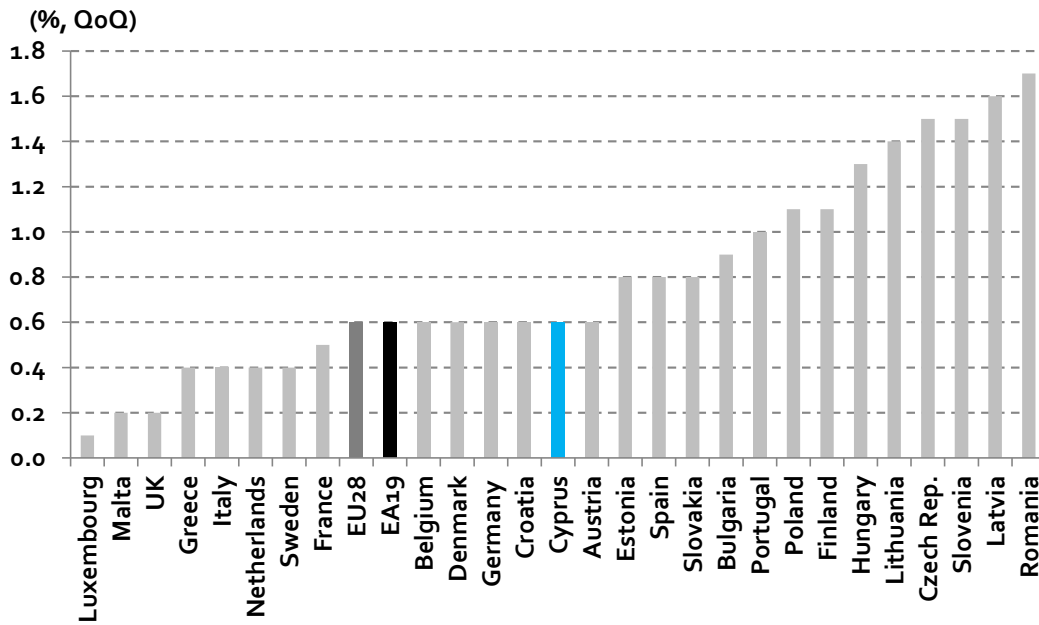
Source: Eurostat, CYSTAT, Eurobank Research

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



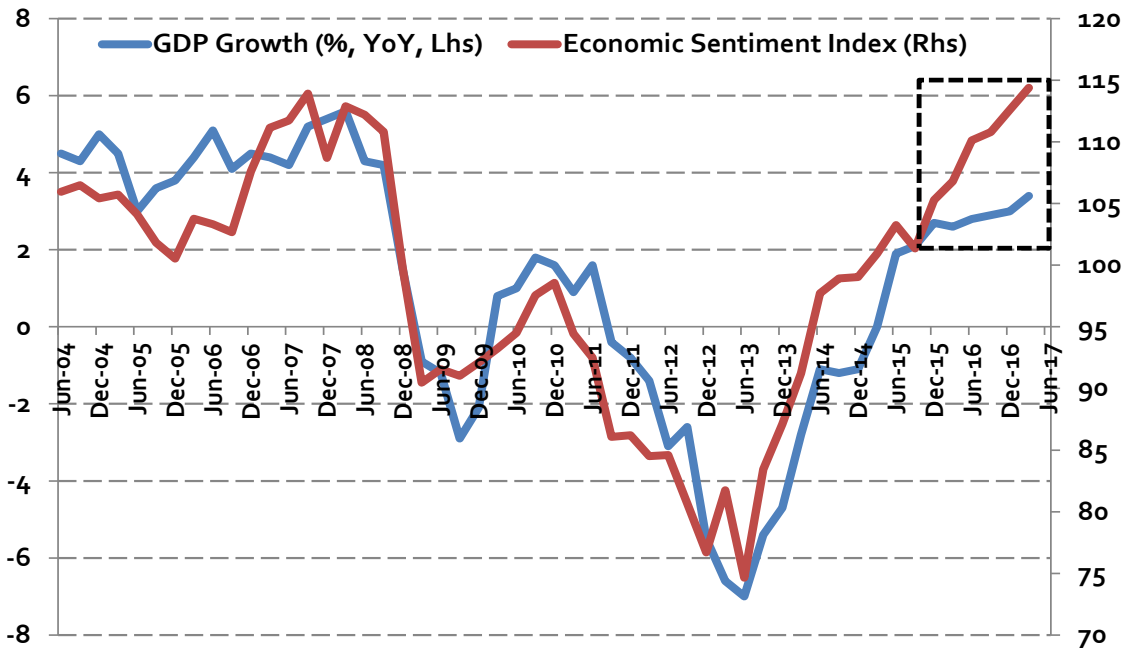
Source: Eurostat, CYSTAT, Eurobank Research

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



Source: Eurostat, CYSTAT, Eurobank Research

Figure 4: Economic Sentiment & Economic Growth in Cyprus



Source: Eurostat, CYSTAT, Eurobank Research

2. Cyprus tapped international markets with a new 7-Year bond at the lowest cost ever achieved in a benchmark bond issuance

On June 21, 2017 Cyprus tapped international markets with a new 7Y-Eurobond for the second time after exiting from the Economic Adjustment Programme in March 2016. In the latest tender, the Public Debt Management Office (PDMO) sold an offered amount of €850mn of 7-year government bonds as part of its €9bn Euro Medium Term Note (EMTN) programme. Citigroup, Goldman Sachs and HSBC were appointed by the Cypriot government as lead managers. The issue was more than four times over-subscribed with total bids amounting to €3.7bn. Following the competitive bids, the average accepted price was at 99.686 and the corresponding yield at 2.80%. The latter yield compares with an initial target of 3.0% and a guidance of 2.9%. The issue matures on June 27, 2024 and bears a 2.75% fixed annual coupon.

From a historical point of view, this is the lowest yield the Republic ever achieved in a benchmark bond debt issuance and reflects strong investor confidence towards the country's improving macroeconomic fundamentals. The previous 7-Year offer in July 2016 amounted to €1bn and was priced at 3.8% with a 3.75% coupon. Earlier, and within the first year of its MoU program, Cyprus was already a credible borrower and had made the fastest come-back to international markets among other Euro Area program countries. Cyprus had issued bonds three times in the international markets, once in June 2014 and then again in April 2015 and in October 2015.¹

The improving state of the economy is reflected on the borrowing rates of the Cypriot government. Since mid-2016, Cypriot government bond yields are on declining trend (Figure 6A), at a time when Periphery bond yields were rising. The five-year Cypriot bond yields are on a declining trend since mid-2016, yet they are outperformed by five-year Portuguese bonds since last February (Figure 6B).

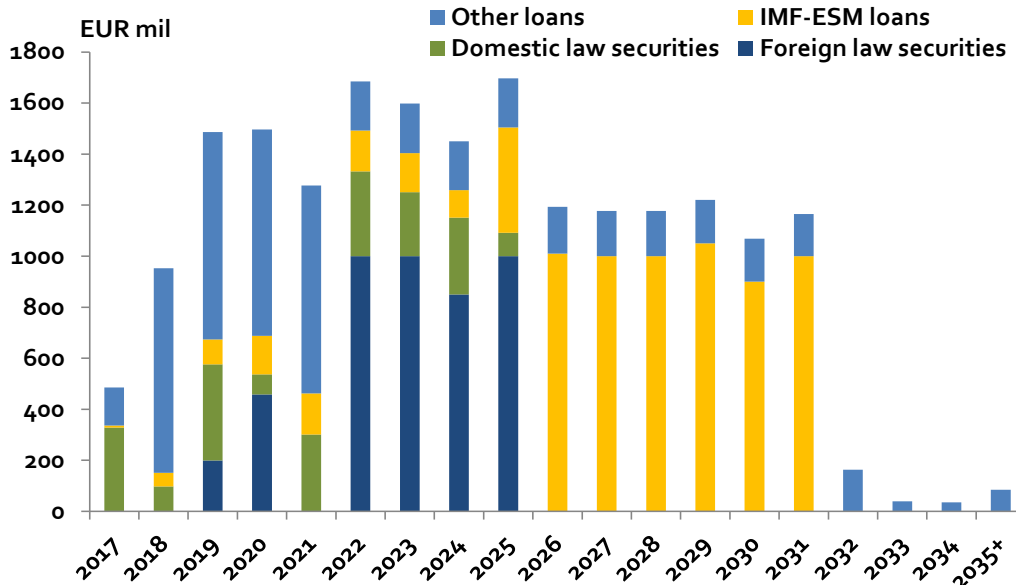
New bond issuance allows for a streamlining of the debt repayments of 2019-2020. The proceeds from the latest tender are being used to repay more expensive debt outstanding, including the buyback of three outstanding securities with a combined face value of €1.4bn and higher coupons. In this context, the government simultaneously promoted switch offers for the 4.75% June 2019 notes, the 4.625% February 2020 paper and the 6.5% May 2020 bonds. The total aggregate amount accepted for the purchase of these securities by the Republic of Cyprus came to €514.906mn, with the breakdown at €336.558mn, €101.994mn and €76.354mn, respectively.

Figure 5 shows Cyprus does not face any significant repayment obligations prior to 2019. As of the end of June 2017, the amounts to be repaid in 2017 and 2018 stand at €485mn and €953mn respectively. Moreover, most of the maturing bonds in the rest of 2017 are held by domestic financial institutions. For the years 2019 and 2020, the recent buy-back

¹ Specifically, on June 25, 2014, Cyprus raised €750mn by selling a new 5Y bond at a yield of 4.85%. Then on April 28, 2015, it raised €1bn by selling a new 7Y bond at a yield of 4%. Subsequently, on October 27, 2015, it raised €1bn by selling a new 10Y bond at a yield of 4.25%.

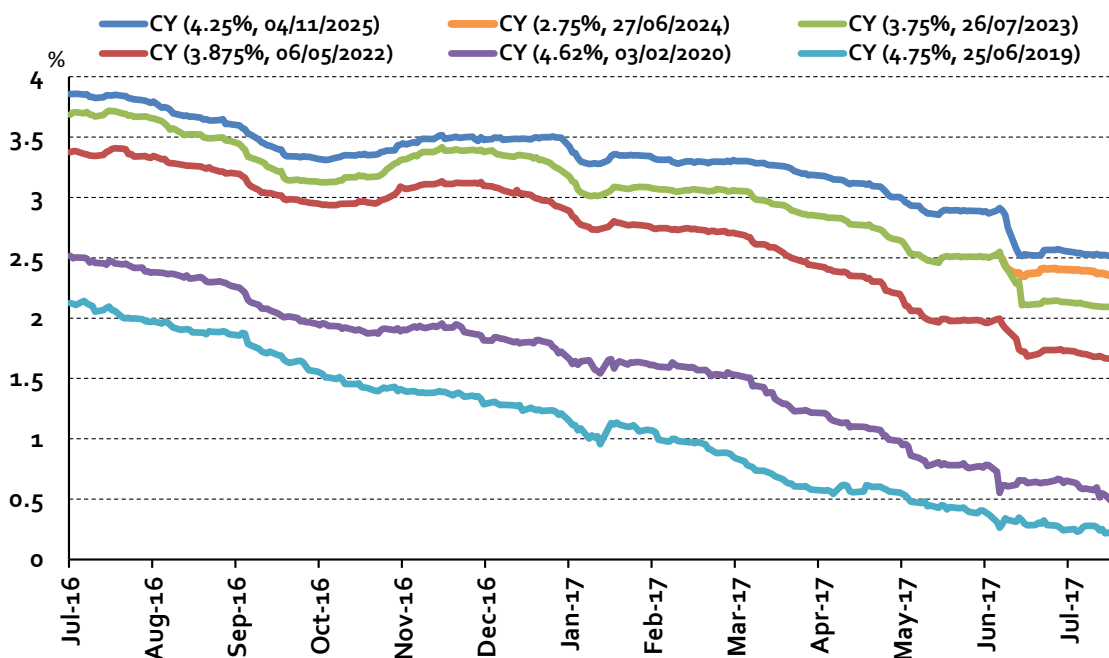
plus the one that took place in July 2016 have reduced the need for future issuance. As of June 2016, the need was €4bn, then as of March 2017 it was reduced to €3.5bn, and now it is down to around €3bn.

Figure 5: Maturity profile of public debt 2017-2035 as of June 30, 2017



Source: Ministry of Finance, Public Debt Management Office

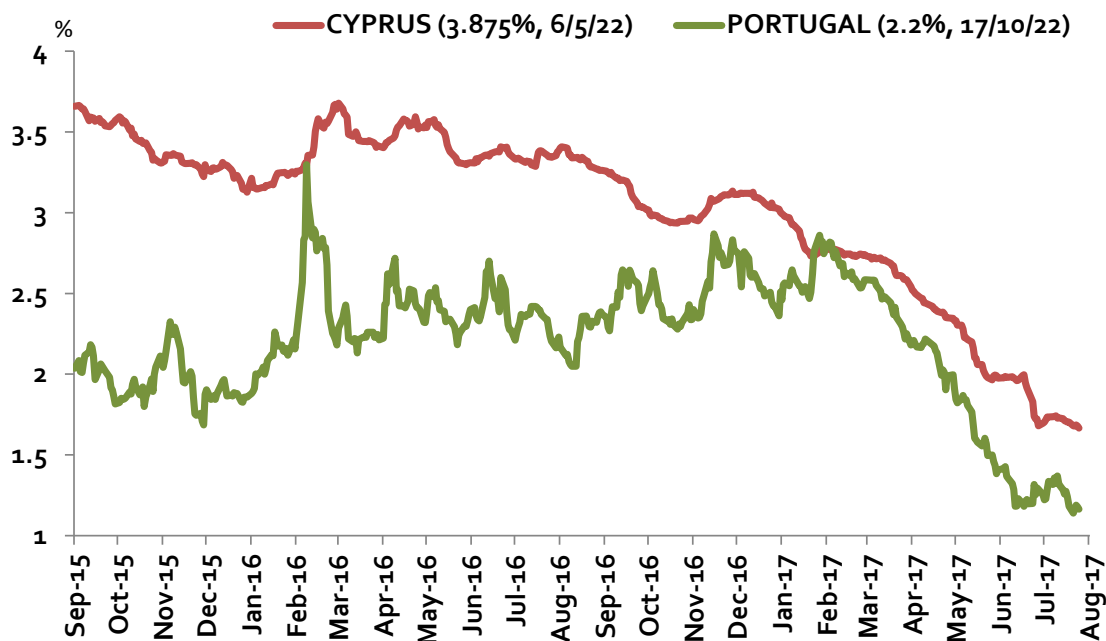
Figure 6A: Annualized Yields to Maturity of outstanding Cypriot Government Bonds



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 August 2, 2017. On that date, the longest 04/11/2025 bond had a maturity of 8 years and 3 months. At the other end, the shortest 25/06/2019 bond had a maturity of 11 months.

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 August 2, 2017 the Cypriot bond had an approximate maturity of 4 years and 9 months and the Portuguese 5 years and 3 months.

3. Both Moody's and DBRS upgraded the long-term sovereign rating of Cyprus Republic, now placing it three notches away from investment grade

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 upgrade reflects Cyprus' strong fiscal results over the past two years and declining imbalances in the private sector. According to DBRS, the adopted fiscal reforms in recent years should help maintain a sound budget position. At the same time, DBRS acknowledged that both household and non-financial corporate debt, have declined and there has been progress in the resolution of non-performing loans. The stable outlook reflects the substantial challenges still ahead despite the economic recovery, namely the high level of non-performing loans and the still high private sector debt. Finally, DBRS reiterated its earlier view that a future upward rating action will depend on Cyprus' ability to sustain economic growth and primary fiscal surpluses over the medium term. In addition, a material reduction of non-performing loans or strong progress on the privatization plan could also put further upward pressure on the rating.

More recently, on July 28, 2017, Moody's upgraded the long term sovereign rating of Cyprus by one notch to Ba3 from B1. Moreover, Moody's assigned a positive outlook.

According to Moody's, the decision reflects two main drivers: First, improvements in economic resilience that have occurred over the past two years, which seem likely to continue in the medium term. Second, a consistent fiscal outperformance and a continuing favorable fiscal outlook. The decision to maintain a positive outlook on the new rating of Cyprus reflects Moody's view that improvements in economic resilience and continuing fiscal outperformance are likely to be sustained, together with a reduction in the debt-to-GDP ratio as well as a fall in the stock of non-performing loans held by the banks.

Overall, DBRS and Moody's were the last rating agencies to upgrade the sovereign rating of Cyprus in the current round of reviews. The DBRS rating decision-an upgrade by two notches-was more aggressive than anticipated. As a result, DBRS is no longer the rating agency that assigns the lowest rating. Earlier on, during the last round of individual country assessments of spring 2017, out of the three main rating agencies (Fitch, Moody's and Standard & Poors) only Standard & Poors (S&P) had changed the long-term sovereign rating of Cyprus. This occurred on March 17, when S&P upgraded the sovereign rating of Cyprus by one notch (from BB to BB+) with a stable outlook. Yet, a week after the S&P upgrade, on March 24, Moody's deferred its scheduled assessment of Cyprus, thus retaining the sovereign rating of B1. Similarly, a month later on April 21, Fitch also affirmed the long-term sovereign rating of Cyprus at BB- with a positive outlook.

Following the last round of assessments, the divergence of views between the rating agencies on the sovereign rating of Cyprus, remains. The distance from government bond investment grade status is one notch for S&P (currently at BB+), and three notches for Moody's (currently at Ba3), Fitch (currently at BB-) and DBRS (currently at BB Low). 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.

The next round of reviews by the rating agencies is scheduled for autumn-winter of 2017: S&P (September 15, 2017), Fitch (October 20, 2017), Moody's (November 17, 2017), DBRS (December 1, 2017).

Table 1
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)

4. Interpreting the latest Cypriot Economic News (April-July 2017)

The real economy continues to surprise positively

Economic Sentiment Index (ESI Index)

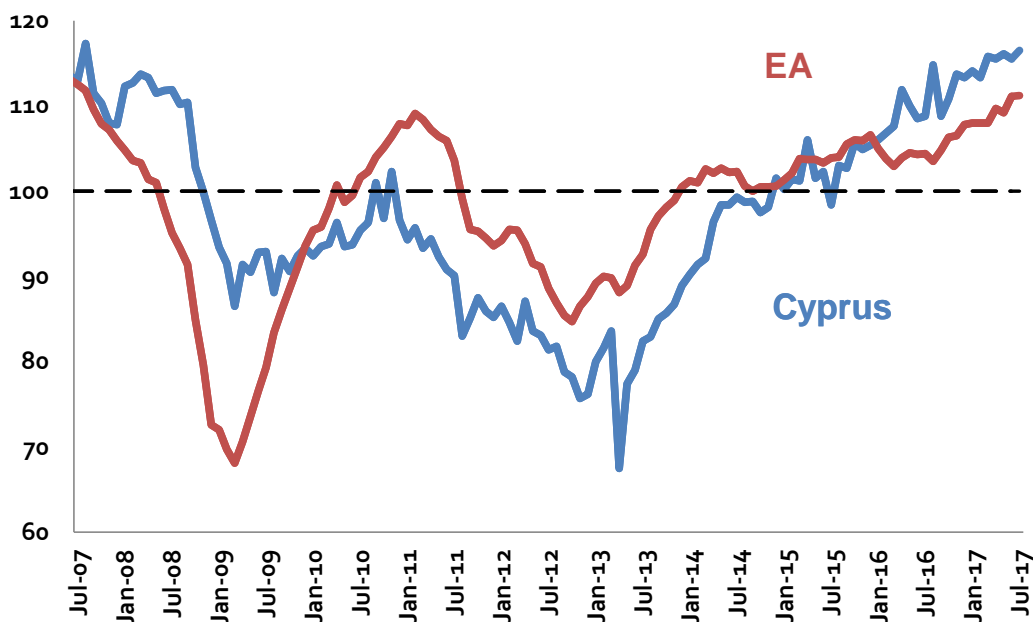
Confidence on an upward trend in recent months, an inch from its pre-Lehman peak

The ESI Index expanded by 1 point to 116.5 in July, up from 115.5 in June and 115.8 in last March, reaching a new multi-month high. The more pronounced improvement in expectations came from industry (by 3.9 points), and construction (by 3.0 points). On the other hand, consumer sentiment edged down by 0.4 points and services declined by 2.2 points. Including the latest reading, the ESI index stands an inch below its pre-Lehman peak at 117.3, which was recorded in August 2007 and has surpassed the previous multi month high at 114.8 recorded in August 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 49 points since April 2013 – is 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.

Figure 7: Index of Economic Sentiment



Source: Eurostat, Eurobank Research

Consumer prices (HICP)

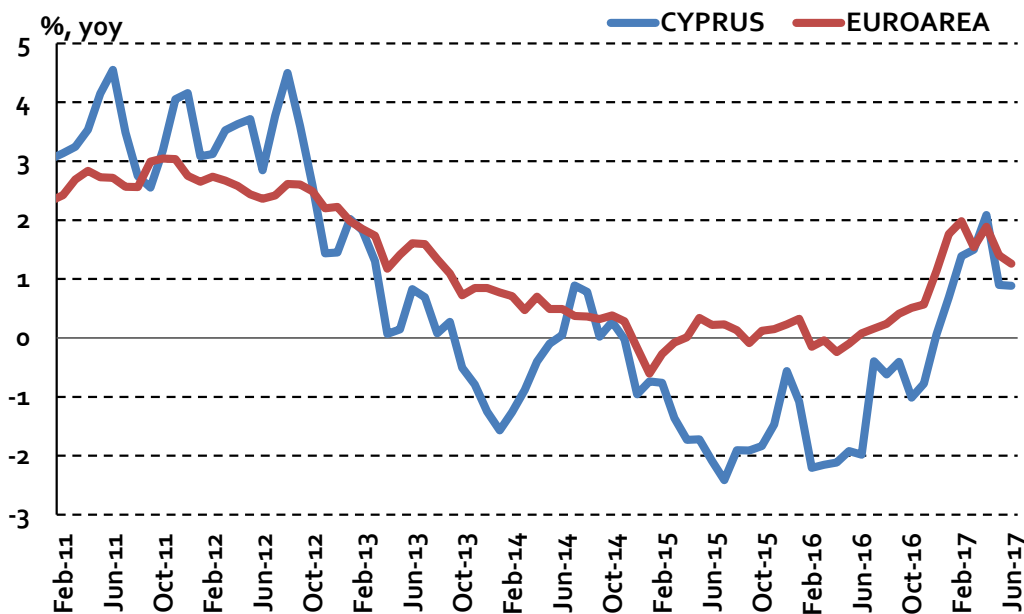
Inflation moderation in May & June

Consumer prices, measured by HICP, entered positive territory since December, marking the end of the prolonged-four-year- period of deflation, and started accelerating in the first quarter. Having jumped to +1.0% MoM/+2.1% YoY in April, compared to only +0.3% MoM/+0.1% YoY in last December, HICP moderated in May and June. In turn, HICP came at +0.3% MoM/+0.9% YoY in June, flat on an annual basis from +0.1% MoM/+0.9% YoY in May.

The biggest increases on an annual basis were observed in the categories of “Utilities” (+0.0% MoM/+10.4% YoY in June vs. -1.3% MoM/+10.1% YoY in May) and “Restaurants & Hotels” (+4.1% MoM/+3.4% YoY in June vs. +3.8% MoM/+1.9% YoY in May). 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. The rise in “restaurants & hotels” most probably reflects the increased demand for catering and accommodation services stemming from the flourishing tourist arrivals.

As of June, the rise of energy prices and prices of services accounted for 0.7 ppts and 0.5ppts respectively while volatile food (fruit and vegetables) and non-energy industrial goods subtracted another 0.2 ppts from the headline respectively. Overall, the average annual HICP edged up to +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

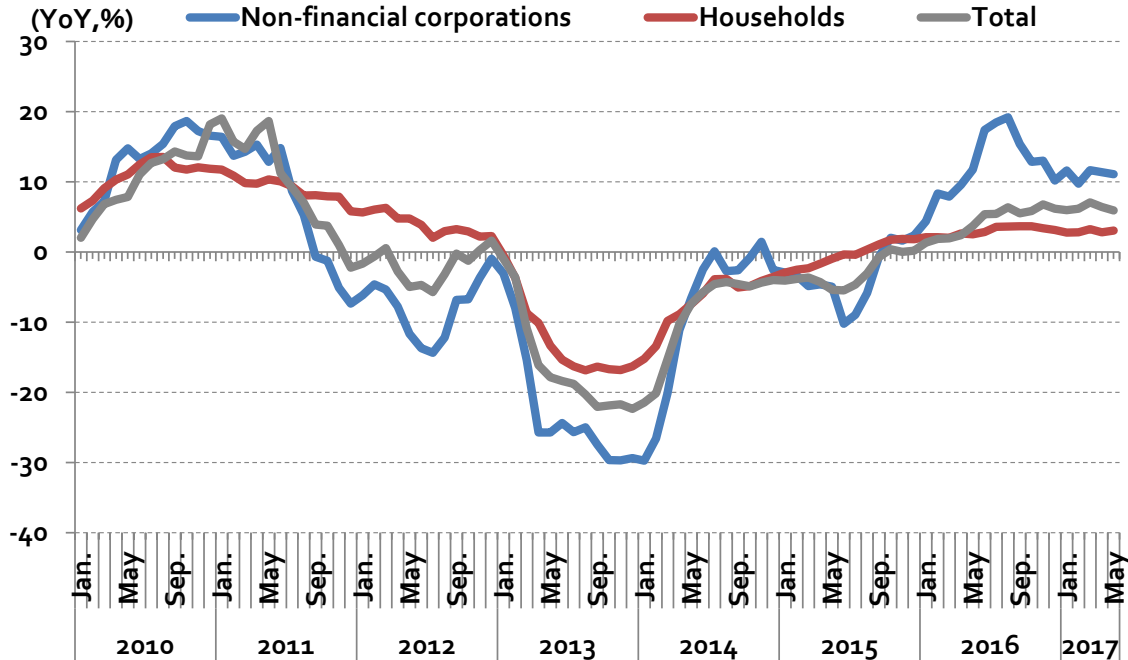
Deposit growth remained in positive territory on an annual basis in the first five months of 2017

The Central Bank of Cyprus published on July 5th the Monetary and Financial Statistics (MFS) of May.² From a flow point of view, total deposits recorded a net increase of €168.8mn in May up from a temporary decline of €3155.4 in April, compared to €332mn in March, €174.9mn in February and €3148.9mn in January, up from €377.2mn in May 2016.

The annual rate of expansion-*which has been in positive territory since October 2015*- came at 5.9% YoY in May down from 6.4% YoY in April, 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 May, €49.2bn in April, €49.6bn in March, compared to €49.0bn in December 2016 and €45.97bn in December 2015.³

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 -1.6% YoY in May, *the lowest reading since April 2013*- down from -5.0% YoY in April and 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 €54.1bn in May down from €54.6bn in April 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

² https://www.centralbank.cy/images/media/xls_el/2nd%20MFSJune2017gr.xls

³ The Central Bank is using ECB methodology to calculate the annual growth with a special formula taking into account the monthly transactions

Non Performing Exposures (NPEs)

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

According to the data released by the Central Bank of Cyprus, the stock of non-performing exposures (NPEs) declined further by €638mn in Q1-2017 on top of €452mn in Q4-2016 and €578mn in Q3-2016. The decline in NPEs reflects three main factors: increased repayments, the migration of successful restructurings to performing facilities after the completion of the observance period plus write-offs and settlements through immovable property exchange. At the same time, total loans declined by €39mn in Q1-2017 after expanding by €768mn in Q4-2016 compared to a €477mn decrease in Q3-2016, resulting in the small decline in the NPEs ratio from 48.6% in September 2016 to 47.2% in December 2016 –and to 46.0% in March 2017.

Overall, the stock of NPEs was down by €4.1bn, from €27.3bn to €23.7bn, or 15.1% cumulatively over the period December 2014 to March 2017. This decrease in the volume of NPEs is not showing up in the ratio statistics because during the same period total loans decreased by a much larger amount, €6.7bn. The net effect was a negligible decline in the ratio of NPEs to total loans, from 47.8% in December 2014 to 45.8% in December 2015 and remained almost flat to 46.0% in March 2017.

Recall that based on EBA's conservative definition, a restructured loan is still classified as an NPE for a probation period of at least 12 months, even if it is serviced without incurring new arrears. As a result, a very large fraction of the restructured loans are still classified as NPEs (€9.2bn out of €13.0bn in March 2017). Thus, when examining the traditional NPL (90+ past due) ratio, the improvement in the statistic is more striking. The NPL ratio declined from 38.5% in 2014 to 36.1% in 2015, further to 34.5% in 2016 and in Q1-2017.

Overall, the NPE ratio remains extremely high, and in December 2016 the second 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 NPEs.

Residential Property Price Index (RPPI)-Q4-2016

The RPPI Index recorded in Q4-2016 the lowest decrease on annual basis since 2009

The Central Bank of Cyprus published in mid-June the residential property price index (RPPI) for Q4-2016. On a quarterly basis, the RPPI increased by +0.1% QoQ, recording the quarterly first 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 +0.1% QoQ. On an annual basis, the RPPI declined by a further -1.3% YoY in Q3-2016 further down from -1.7% YoY in Q2-2016, almost unchanged compared to -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.

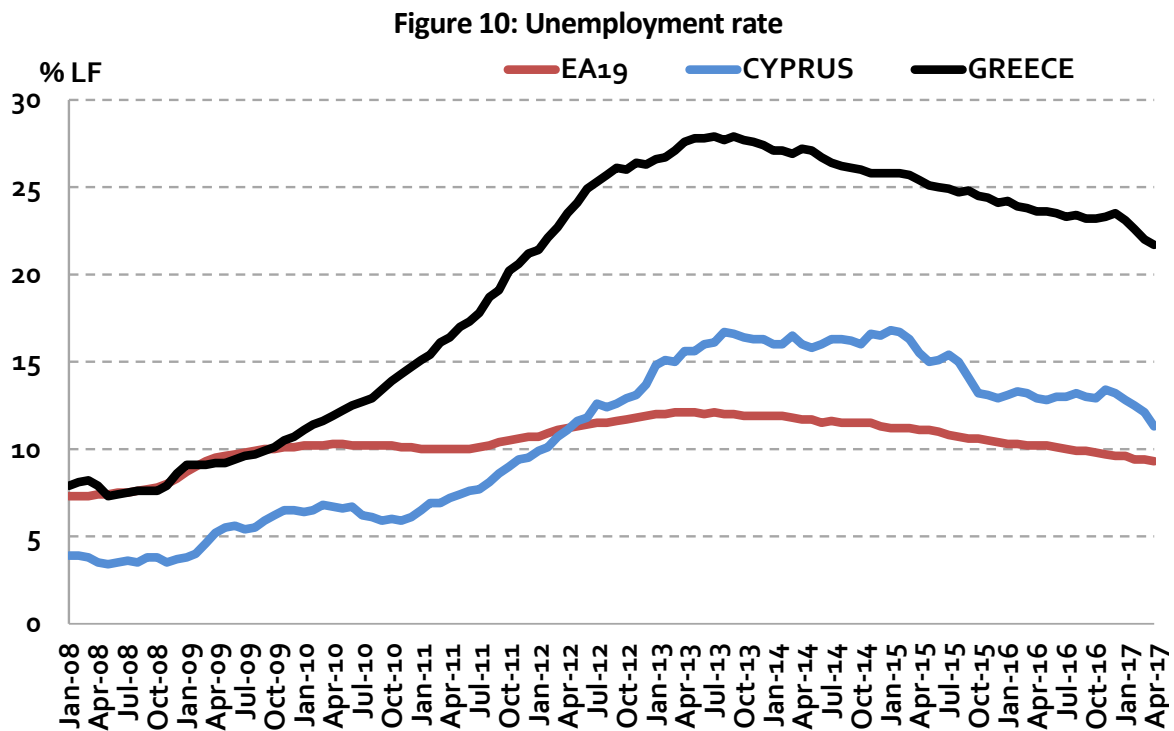
Overall, the RPPI trajectory in the past quarters, in combination with other high frequency data from the construction industry and real estate transactions, point to a further stabilization of the real estate sector. According to CYSTAT, the construction output index has accelerated further by 17.9% 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.

Unemployment

Unemployment’s declining trend continued in Q2-2017

According to the latest Labor Force Survey (LFS), unemployment on a seasonally adjusted basis declined further to 11.0% in May 2017, down from 11.3% in April 2017, 12.1% in March 2017, 13.2% in December 2016, 13.3% in March 2016, and 17% at its peak in October 2013. Overall, Cyprus recorded the highest unemployment decline in EU-28 in the first five months of 2017. In the previous year 2016, Cyprus had recorded the third highest decrease in unemployment in EU-28, behind Croatia and Spain.

The declining trend of unemployment in Cyprus and Greece was temporarily discontinued in Q4-2016, in contrast the rest of the Euro Area. Nevertheless it resumed in the first months of 2017 (See Figure 8). Despite the improving trend, unemployment in Cyprus is still the fourth largest in EU-28. Youth & Long-term unemployment are a source of concern and necessitate more attention.



Source: Eurostat, Eurobank Research

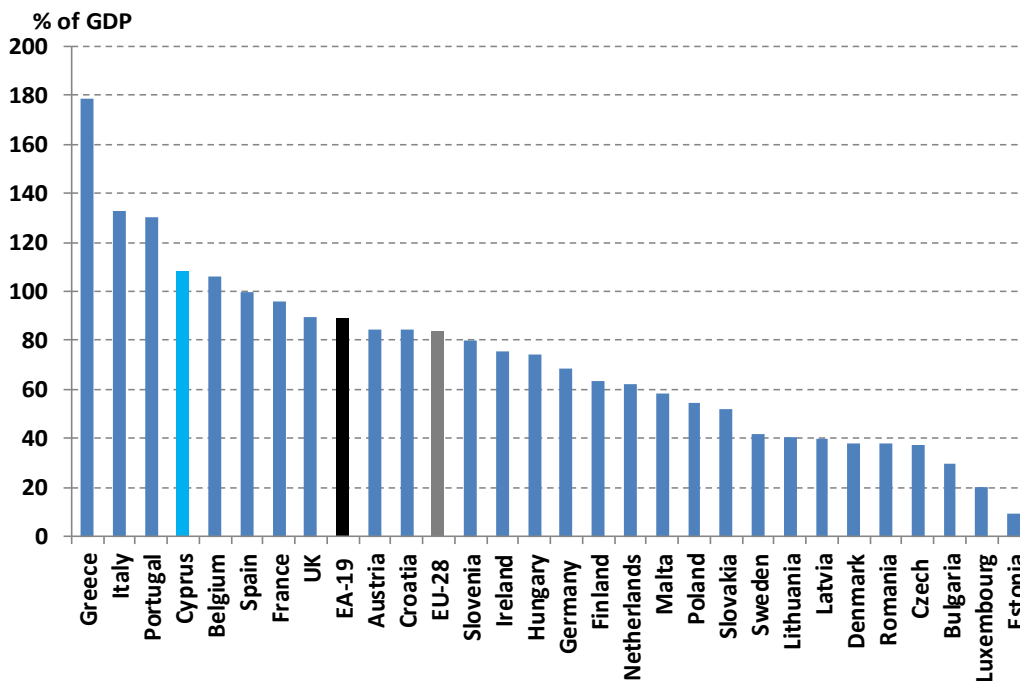
2016 General Government Deficit and Public Debt (ESA2010 terms)

Eurostat confirms the fiscal performance of 2016

On April 24th, Eurostat announced the provisional data for the fiscal deficit and debt in the context of the first notification by EU member states as part of the Excessive Deficit Procedure. In ESA2010 terms, Cyprus recorded a €64mn general government surplus in 2016, which is equivalent of 0.4% of GDP, switching from an earlier deficit of €209mn, equivalent of -1.2% of GDP, in 2015. This 2016 surplus occurred for the first time since 2008. Cyprus is now among those seven EU members who registered a general government surplus (compared to a Euro Area and EU-28 deficit of 1.5% and 1.7% respectively).

Accordingly, the general government debt climbed to €19.3bn or 107.8% of GDP in 2016, up from €19.0bn or 107.5% of GDP in 2015. The government debt as a percentage of GDP is the fourth highest in Cyprus behind that of Greece (179%), Italy (132.6%), and Portugal (130.4%). On another note, Eurostat withdrew its reservations on the quality of the data reported by Cyprus in relation to a series of technical issues which had not been clarified in a satisfactory manner during the October 2016 assessment.

Figure 11: General Government Debt across EU-28 members in 2016



Source: Eurostat, Eurobank Research

January-June 2017 Budget execution

The budget was in surplus in the first half of 2017

The budget was in surplus during the first six months of 2017. The consolidated government surplus increased to €62.5mn in 1H-2017, up from a deficit of €42.4mn in 1H-2016. As a percentage of GDP, the consolidated government surplus came at +0.3% in 1H-2017 compared to a deficit of -0.2% of GDP in 1H-2016. The primary surplus stood at +1.5% of GDP in 1H-2017 compared to +1.0% of GDP during the same period a year ago. Total revenues improved by +8.2% YoY, driven by higher indirect tax and social contributions. On the other hand, total expenditure expanded by +3.8% YoY driven by higher spending on procurement (+24.4% YoY), pensions (+4.0% YoY) and public wages (+2.9% YoY). On the other hand, spending items such as social security payments (+0.3% YoY) and current transfers (+2.0% YoY) remained relatively contained while spending on subsidies (-44.4% YoY) decreased.

Table 2: General Government Budget Execution

General Government Adjusted Budget Balance on cash basis (January-June 2017)		
in % GDP	January-June 2016	January-June 2017
I. Government Budget and SSF		
Total Revenue	16.8%	17.4%
Current revenue	16.7%	17.3%
Direct Taxes	4.8%	4.4%
Indirect Taxes	6.7%	7.3%
of which, VAT	3.9%	4.3%
Social security contributions	2.9%	3.0%
Non-tax revenue	2.3%	2.6%
Capital Revenue	0.0%	0.0%
Grants	0.1%	0.1%
Total Expenditure	17.2%	17.1%
Current expenditure	16.7%	16.6%
Wages and Salaries	4.4%	4.3%
Goods and services	0.9%	1.0%
Subsidies	0.4%	0.2%
Social Security payments	4.3%	4.2%
Pensions	1.5%	1.5%
Social Pensions	0.2%	0.2%
Current transfers	3.8%	3.7%
Non-allocated	0.0%	0.1%
Interest payments	1.3%	1.5%
Capital expenditure	0.4%	0.5%
Balance (I)	-0.1%	0.3%
II. Other General Government Bodies		
including		
Local Authorities	0.0%	0.0%
Semi-public Entities	0.0%	0.0%
Other Entities	0.0%	0.0%
Balance (II)	0.0%	0.1%
III. ESA 2010 adjustments		
Balance (III)	0.2%	0.0%
III. General Government Balance		
Budget Balance (I+II+III)	-0.2%	0.3%
Primary Balance (excl. interest)	1.0%	1.5%
Cyprus GDP (Mrd EURO-CYP)	17,901.4	18,646.0

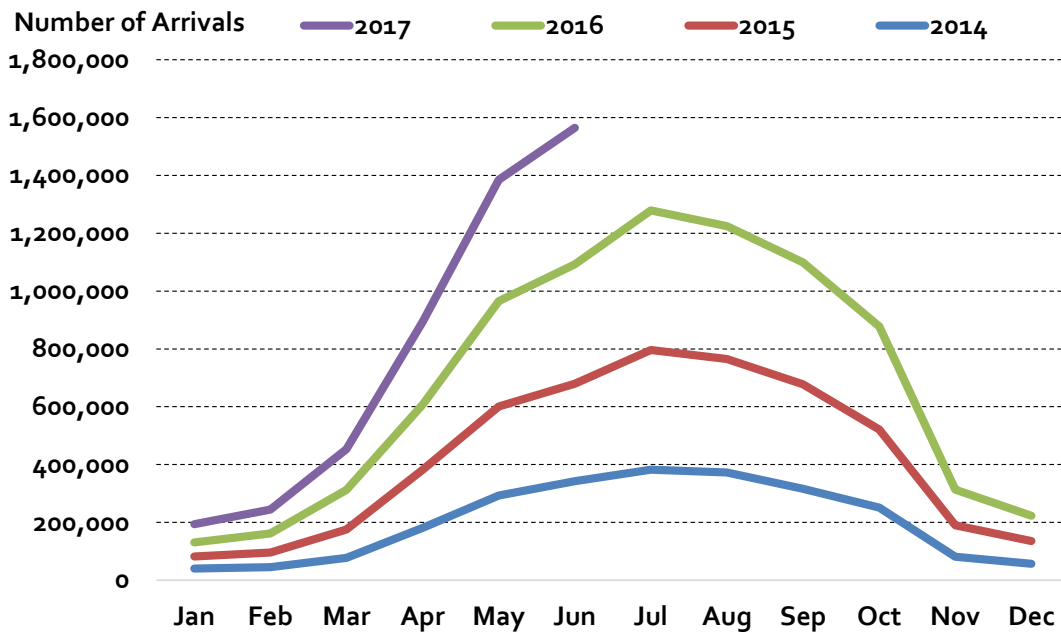
Source: Ministry of Finance, Eurobank Research

Tourism arrivals (January-June 2017) & revenues (January-April 2017)

Poised for another year of records in tourism arrivals

The positive momentum in the tourism sector continued into H1-2017. Tourist arrivals increased by +16.6% YoY in H1-2017 (1,463,206 vs. 1,255,240 see Figure 12a). The highest increase was recorded in tourist arrivals from Israel (+81.1% YoY, 91,147), Germany (+53.2% YoY, 77,753) and Austria (+38.9% YoY, 15,880). Tourist arrivals from traditional and more sizeable markets such as Russia (+11.3% YoY, 332,982) and UK (+9.7% YoY, 511,344) fared relatively well. In a similar vein, tourism revenues expanded also robustly by +25.3% YoY in January-April 2017 to €357.7mn, up from €285.5mn compared to the same period last year. This expansion is much larger than a year earlier.

Figure 12: 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	-3.2	-6.0	-1.5	1.7	2.8
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	1.9	2.9
General Government Final Consumption Expenditure (YoY%)	Constant Prices	Eurostat	1.2	2.8	7	3.3	5.7	6.4	1.2	2.1	-2.3	-8.2	-7.9	-0.6	-1.4
Gross Fixed Capital Formation (YoY%)	Constant Prices	Eurostat	4.7	6.9	21	7.8	8.8	-13.6	-2.6	-12.1	-20.5	-12.9	-17.5	12.0	25.9
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	0.0	3.6
Imports of Goods and Services (YoY%)	Constant Prices	Eurostat	6.9	1.6	5.7	10.5	12.5	-15	8	-3	-4.4	-4.8	4.6	2.1	5.3
GDP	Current Prices, SA ,mil	Cyprus Statistical Service	13856.3	14822.3	15999.9	17511.6	19006.0	18673.5	19299.5	19731.1	19467.0	18118.2	17567.4	17637.2	17901.4
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	-1.3	-6.9	-3.0	0.4	1.5
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	12,772	11,943	11,407	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