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Cyprus: Selected Issues

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CYPRUS

Selected Issues

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Approved by European I Department

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Cyprus: Basic Data

Total area:	9,251 square kilometers
Population:	650,000 (1997) in government-controlled area
GDP per capita:	US\$12,933 (1997) in government-controlled area.
Life expectancy:	74 (male); 78 (female): (1992)
Infant mortality:	9 per thousand (1993)

	1991	1992	1993	1994	1995	1996	1997 Off. est.
National Accounts (percent changes in real terms)							
GDP	0.4	9.7	0.7	5.8	5.6	2.0	2.3
Total domestic demand	5.0	9.3	-9.6	6.6	9.2	3.7	0.8
Private consumption	9.9	3.2	-5.0	4.2	10.9	2.5	2.1
Investment	-5.2	22.7	-16.4	14.2	9.1	1.7	-4.4
(in percent of GDP)	26.0	28.7	24.1	25.5	26.4	26.5	24.8
Exports of goods & services	-8.4	19.8	-1.7	7.9	4.2	3.4	1.8
Imports of goods & services	1.5	18.2	-18.5	8.7	11.5	6.4	-1.0
Prices, Wages, and the Labor Market (percent changes)							
CPI	5.0	6.5	4.9	4.7	2.6	3.0	3.6
GDP deflator	4.0	6.0	4.8	5.3	3.2	2.1	2.6
Average earnings (economy-wide)	9.1	10.5	9.6	7.7	6.6	6.1	6.5
Productivity	0.3	3.1	1.2	3.2	2.4	1.1	2.8
Unit labor costs (economy-wide) nominal	8.7	7.1	8.3	4.4	4.1	4.9	3.6
Unemployment rate (in percent)	3.1	1.8	2.7	2.7	2.6	3.1	3.4
Balance of Payments, Exchange Rates							
Current account balance (in percent of GDP)	-7.5	-9.4	1.6	1.0	-2.3	-5.4	-4.5
Trade balance (in percent of GDP)	-29.4	-35.0	-24.2	-24.6	-24.9	-25.8	-25.3
Tourist arrivals (percent change)	-11.3	43.7	-7.5	12.4	1.5	-7.1	5.0
Gross official foreign exchange reserves (in US\$ millions, end of period)	1,364	993	1,062	1,427	1,079	1,505 1/	1,357
US\$/£C (period average)	2.16	2.22	2.01	2.03	2.21	2.14	1.95
ECU/£C (period average)	1.74	1.71	1.72	1.71	1.69	1.69	1.72
NEER (1990 = 100)	102.3	104.8	105.8	109.6	113.8	116.0	116.9
REER (1990 = 100)	100.0	102.6	103.1	105.6	106.7	107.0	106.8
Financial Indicators (end of period)							
Discount rate	6.5	6.5	6.5	6.5	6.5	7.5 4/	7.0 4/
Long-term bond yield (Development Stock)	8.0	8.0	8.0	7.0	7.0	7.0	6.9 5/
M1	5.0	9.3	8.8	4.8	6.8	7.8	7.8 6/
M2	13.0	13.9	16.4	12.5	11.5	11.0	11.0
Credit to public sector, net	20.6	47.9	24.5	2.4	6.6	11.0	12.2
Credit to private sector	13.1	17.5	12.7	13.5	17.0	12.2	11.0
Public Finances (Consolidated central government, in percent of GDP)							
Revenue	27.2	28.2	30.3	31.4	32.0	32.0	31.8
Expenditure	34.1	33.0	32.7	32.8	33.0	35.4	36.9
Balance	-6.9	-4.8	-2.4	-1.4	-1.0	-3.4	-5.1
Primary balance	-2.0	-0.1	2.6	3.7	4.1	1.9	0.2
Debt	56.6	55.9	58.4	53.5	51.8	53.1	55.6

Source: IMF, *International Financial Statistics* and data provided by the authorities.

1/ Including US\$547 million of gold revaluation and accounting changes.

2/ April.

3/ June 16, 1998.

4/ Lombard-type rate since 1996.

5/ May.

6/ January-March.

I. INTRODUCTION AND OVERVIEW

1. Since 1960, the time of its independence, Cyprus has exhibited an impressive economic performance. At that time, Cyprus was a rather poor and underdeveloped country, with a per capita income of US\$450. Now it is a developed, service-based economy with a per capita income of US\$12,900, higher than that of Greece and comparable to that of Portugal's—both established European Union members.
2. Over the past few years, Cyprus has embarked on an ambitious task, aiming to join the European Union (EU) as a full-fledged member. Despite certain political obstacles, Cyprus started official accession negotiations with the EU this March, and has committed itself to conform to a challenging structural reform agenda to achieve harmonization with the European *Acquis Communautaire*.
3. Looking ahead, difficult challenges remain. On the macroeconomic front, Cyprus' prudent past policies have resulted in low domestic and external debt stocks. However, a recent deterioration in the fiscal deficit will need to be reversed before Cyprus fully satisfies the Maastricht criteria. More challenging will be the structural reforms that will allow Cyprus to reap the benefits of EU accession fully. Two aspects of reform deserve special mention, and are covered in depth in this paper: external competitiveness and financial sector liberalization.
4. A recent deterioration in the current account balance despite generally weak cyclical conditions in Cyprus and strong cyclical positions in Cyprus' trading partners has raised the question whether Cyprus' goods and services exports remain competitive. A continuing appreciation in the real exchange rate (measured by relative unit labor costs), affected by Cyprus' labor relations system (which has strong trade unions and full wage indexation), further amplifies these concerns. Claudio Paiva adapts a methodology developed at the IMF for estimating equilibrium exchange rates to examine whether Cyprus' exports (and imports), including more specifically the key tourist sector, remain competitive. He finds that the current real exchange rate is close to equilibrium, but that, were current trends to continue, the situation could be reversed. On the macroeconomic front, further fiscal retrenchment and disinflation are required to safeguard competitiveness in the future. On the structural reform front, wage indexation remains a key obstacle to improving competitiveness.
5. Cyprus' formal financial sector has been heavily regulated since 1944, through the imposition of a ceiling on lending rates. EU accession will require the abolition of this ceiling and, together with capital account liberalization, will lead to a significant liberalization of a financial sector that is not used to pricing heterogeneous credit risk, controlling exchange rate risk, or managing potentially destabilizing external flows. There is also a less regulated, cooperative financial sector that if it is not strongly supervised could pose additional problems in the postliberalization environment. Benedikt Braumann presents an overview of Cyprus' financial sector. He then traces the financial liberalization experience of selected Scandinavian countries, and draws cautionary conclusions for the case of Cyprus. Although financial liberalization is desirable, careful sequencing and enhanced supervision will be necessary to safeguard banking system soundness while reaping the benefits of reform.

II. EXTERNAL COMPETITIVENESS IN CYPRUS¹

A. Introduction

6. The purpose of this paper is to examine the adequacy of Cyprus' economic competitiveness. Although Cyprus' current account balance has fluctuated widely in the past two decades (Figure 1), some elements associated with the sharp deterioration of the current account from 1993–95 to 1996–97 may justify a closer analysis of the country's competitiveness and current account sustainability. This paper looks at the recent behavior of conventional indicators of competitiveness, estimates Cyprus' equilibrium real exchange rate, and provides an econometric analysis of the main determinants of service exports. The overall conclusion is that the country's current level of the real effective exchange rate is in line with savings-investment fundamentals, but that the recent unfavorable trends in public savings and relative unit labor costs should be reversed to avoid problems in the medium term.

7. Cyprus' current account position has deteriorated significantly in the last few years, moving from an average balanced position in the period 1993–95 to an average deficit of 5 percent of GDP in 1996–97.² This deterioration stemmed solely from the balance in goods and nonfactor services, as net transfers and investment income as a percentage of GDP remained virtually unchanged in the period. The worsening in the balance of goods and nonfactor services can be partially explained by the negative shocks that occurred in 1996–97, namely the severe drought that affected agricultural exports in 1996 and 1997 and the escalation of tensions between the Greek and Turkish Cypriots, which significantly reduced the number of tourists visiting Cyprus in 1996.³

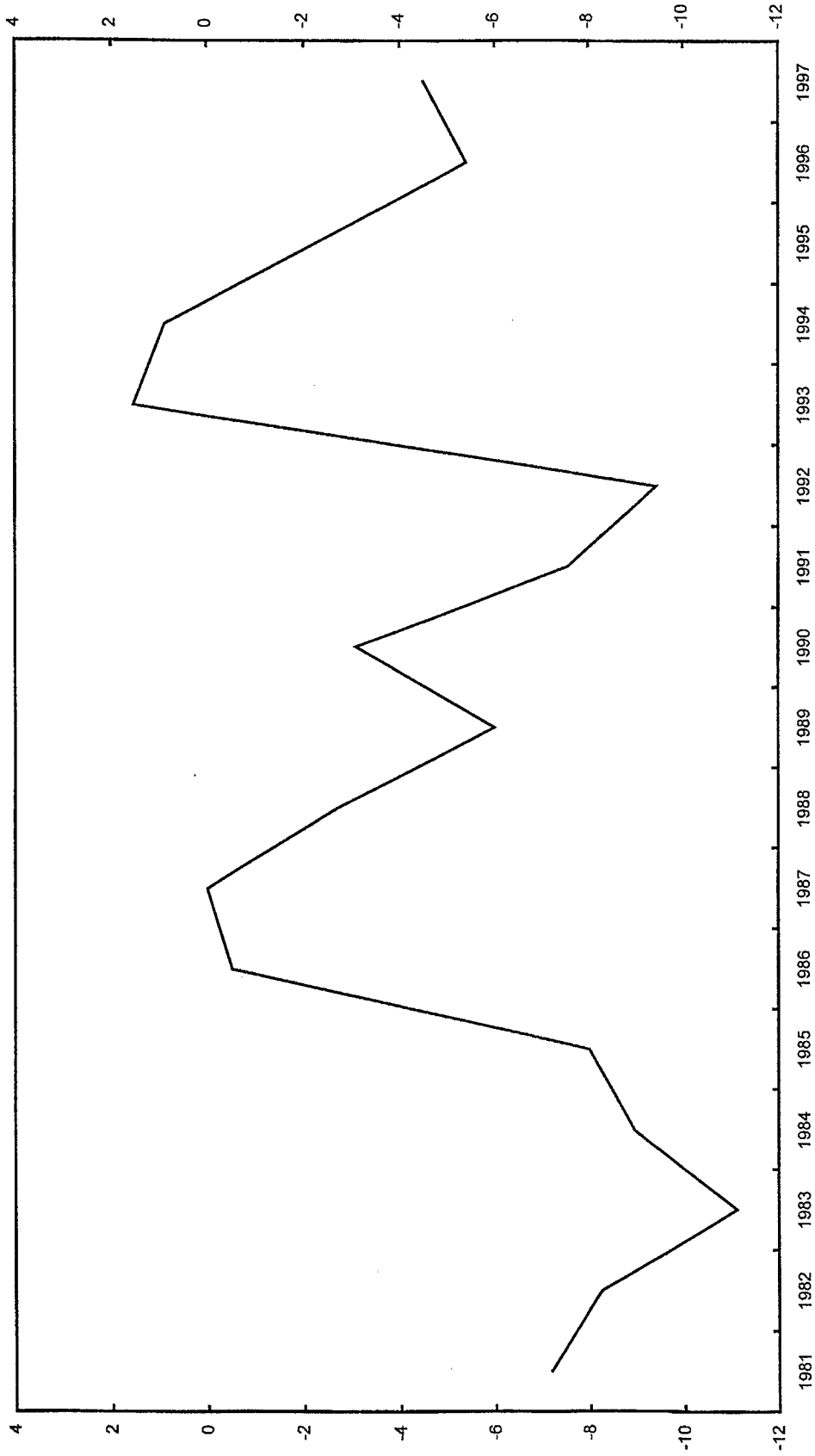
8. Looking ahead, the unwinding of the temporary shocks described above should contribute to an improvement in the external accounts in the near term. There are other favorable indicators of Cyprus' external position and current account sustainability as well:

¹Prepared by Claudio Paiva.

²The current account deficit declined from 5.4 percent of GDP in 1996 to 4½ percent of GDP in 1997. The cyclically adjusted current account deficit, however, continued to rise, as will be explained in paragraph 5.

³The direct impact of these shocks on the cumulative value of exports earnings is estimated at 3½ percent of GDP; the drop in tourism receipts from 1995 to 1996 was equivalent to 2¼ percentage points of GDP, and the drop in agriculture exports from 1995 to 1996–97 is estimated at 1.1 percentage points of GDP.

Figure 1. Cyprus: The Current Account Balance
(In percent of GDP)



Source: The Central Bank of Cyprus.

- the low **external debt** to GDP ratio, which decreased from 36 percent in 1990 to 25 percent in 1997. This path reflected mainly the government's choice to substitute domestic for foreign borrowing while private foreign debt remained fairly stable (Figure 2).⁴

- the low and declining level of **interest payments** on foreign debt, which dropped from 4.6 percent of GDP in 1993 to 2.8 percent in 1997. As a percentage of exports of goods and nonfactor services (GNFS), interest payments in 1997 were equivalent to about 6 percent (Figure 3).

- the level of **official reserves**, which in 1997 was equivalent to 18 percent of GDP or 5½ months of imports (Figure 4).

9. Despite these favorable elements, however, the deterioration in Cyprus' external accounts could be viewed as potentially worrisome in light of the relative cyclical positions of Cyprus and its main trading partners, and because (i) it has also been associated with negative trends in competitiveness and export market shares observed since the early 1990s and (ii) it has been underlined by a severe drop in public savings.

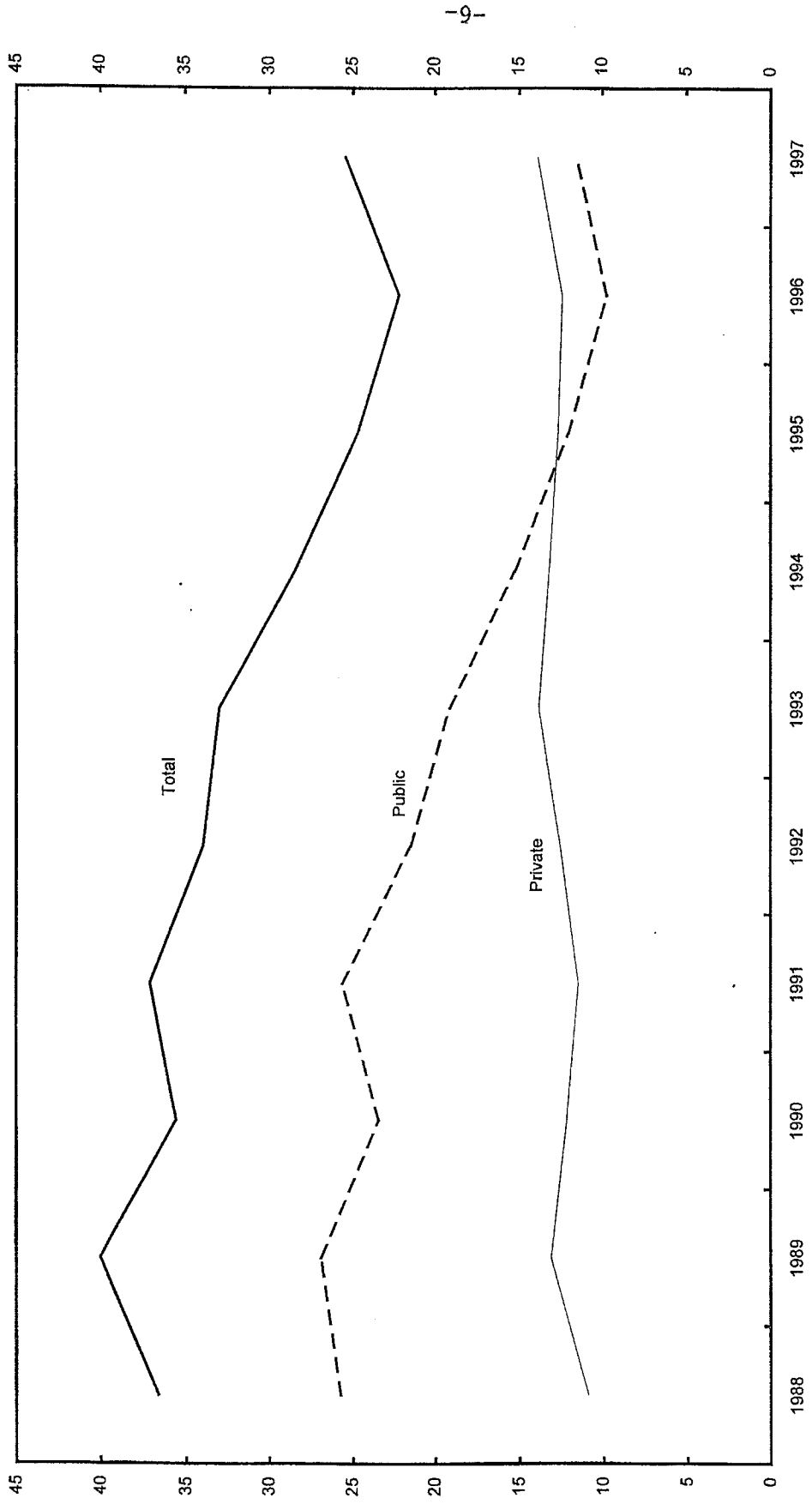
10. Output growth in Cyprus slowed from 1993–95 to 1996–97, creating a negative output gap, while the opposite trend occurred in its tourism and trade partner countries (Figure 5). One would expect these cyclical movements to lead to an improvement in the current account balance. Instead, the worsening of the current account balance took place despite the favorable impact of the relative cyclical positions, suggesting a strong structural deterioration that can only partially be attributed to the shocks. In fact, the estimated cyclically adjusted current account balance shifted from an average surplus of 3.8 percent of GDP in 1993–95 to an average deficit of 5 percent of GDP in 1996–97 (Figure 6).⁵ Furthermore, as opposed to the actual current account balance, the cyclically adjusted balance continued to worsen in 1997.

11. Contrary to the large current account deficits in the 1980s and early 1990s, which were associated with high investment rates, the recent current account deficits occurred in a context of declining investment that was more than offset by a sharp reduction in saving

⁴Notwithstanding the large issuance of public bonds in the European market in 1997, there was a marked decrease in the overall debt ratio. Public foreign debt as a percentage of GDP decreased from 23 percent in 1990 to 11½ percent in 1997.

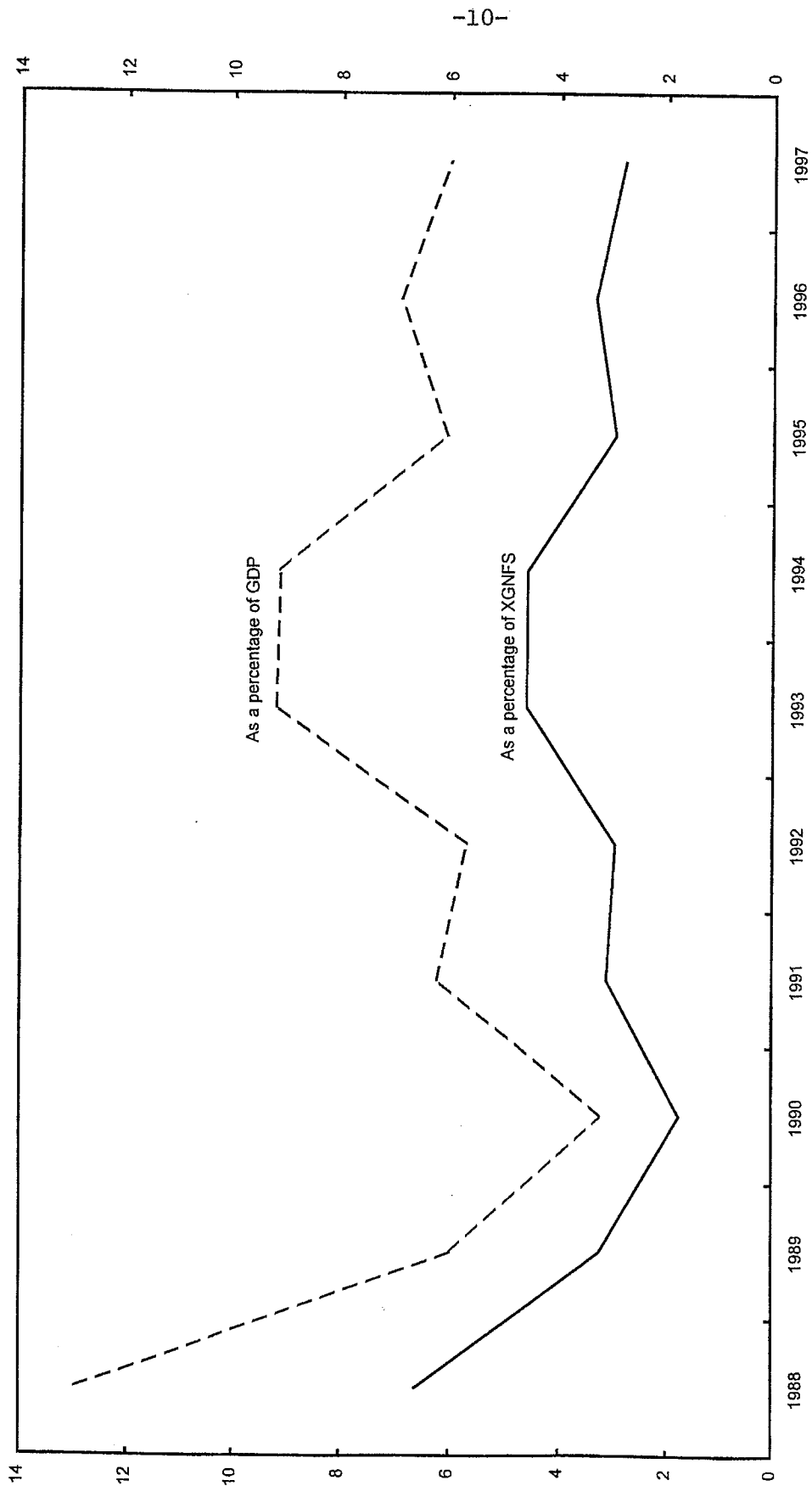
⁵The table on page 19 shows the income elasticities used to adjust the values of exports and imports of goods and services to the levels that would have prevailed were output to equal potential output for both Cyprus and its trading partners.

Figure 2. Cyprus: External Debt
(In percent of GDP)



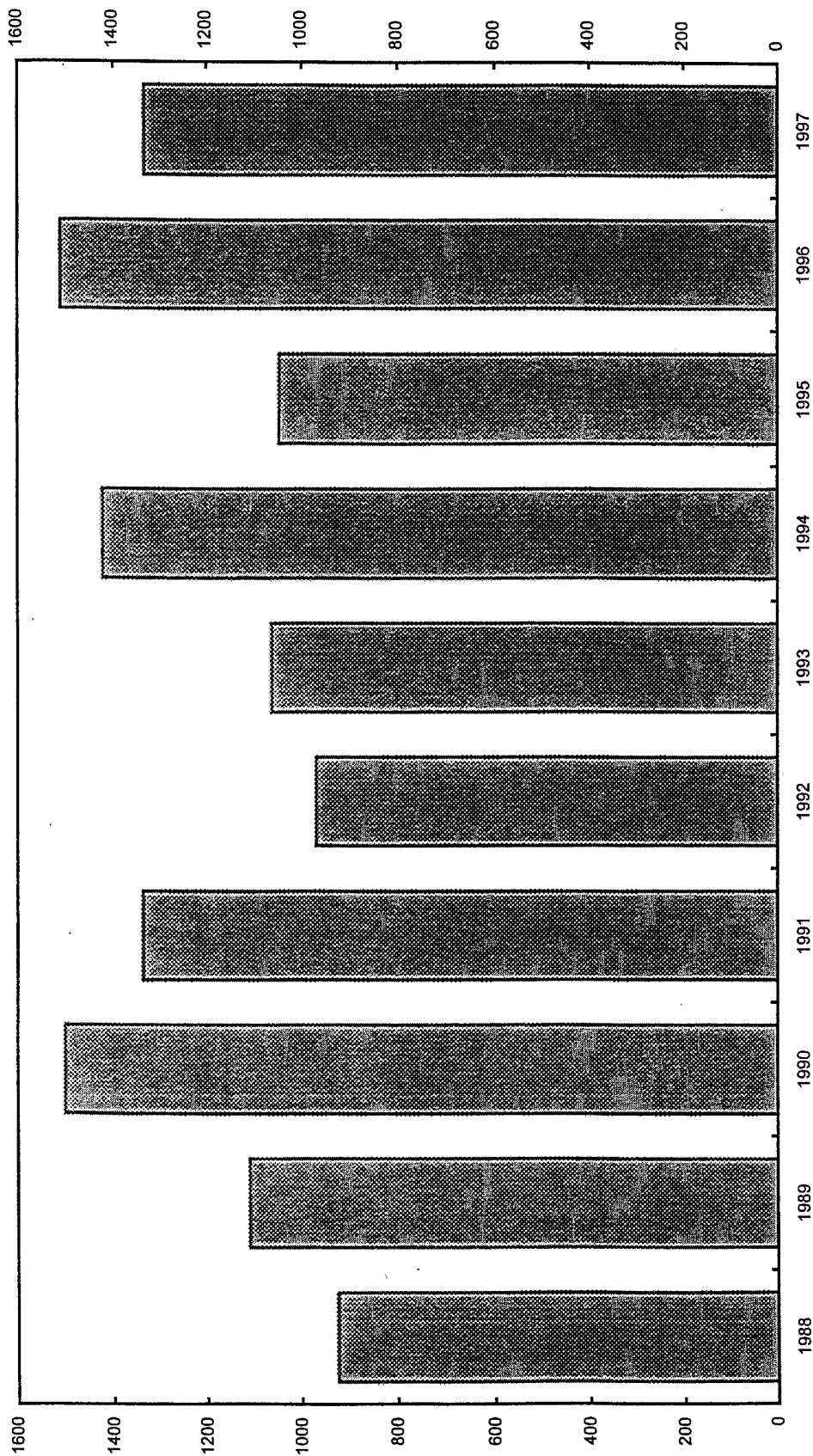
Source: The Central Bank of Cyprus.

Figure 3. Cyprus: Interest Payments on External Debt



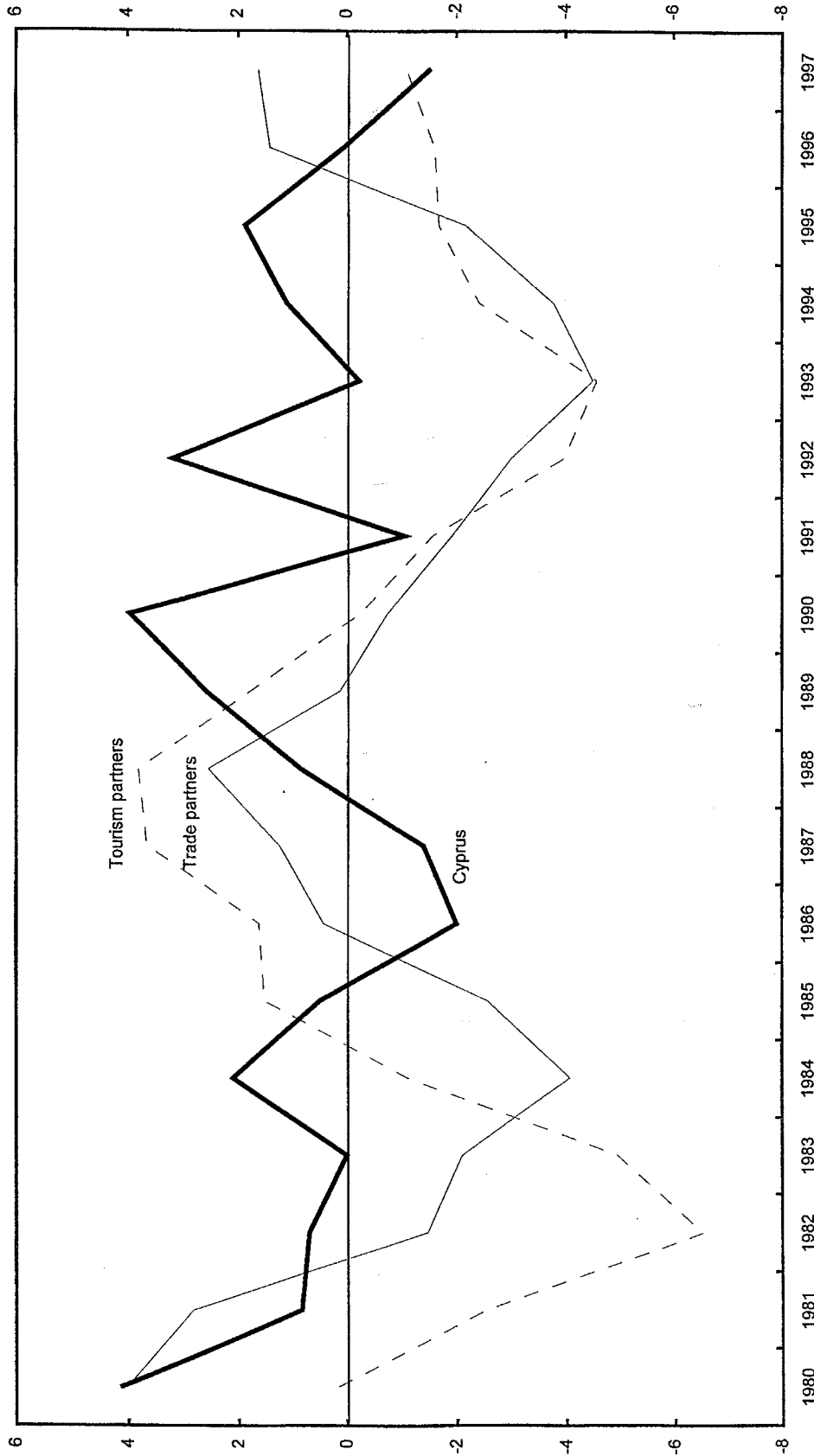
Source: The Central Bank of Cyprus.

Figure 4. Cyprus: Official Reserves
(In millions of US dollars)



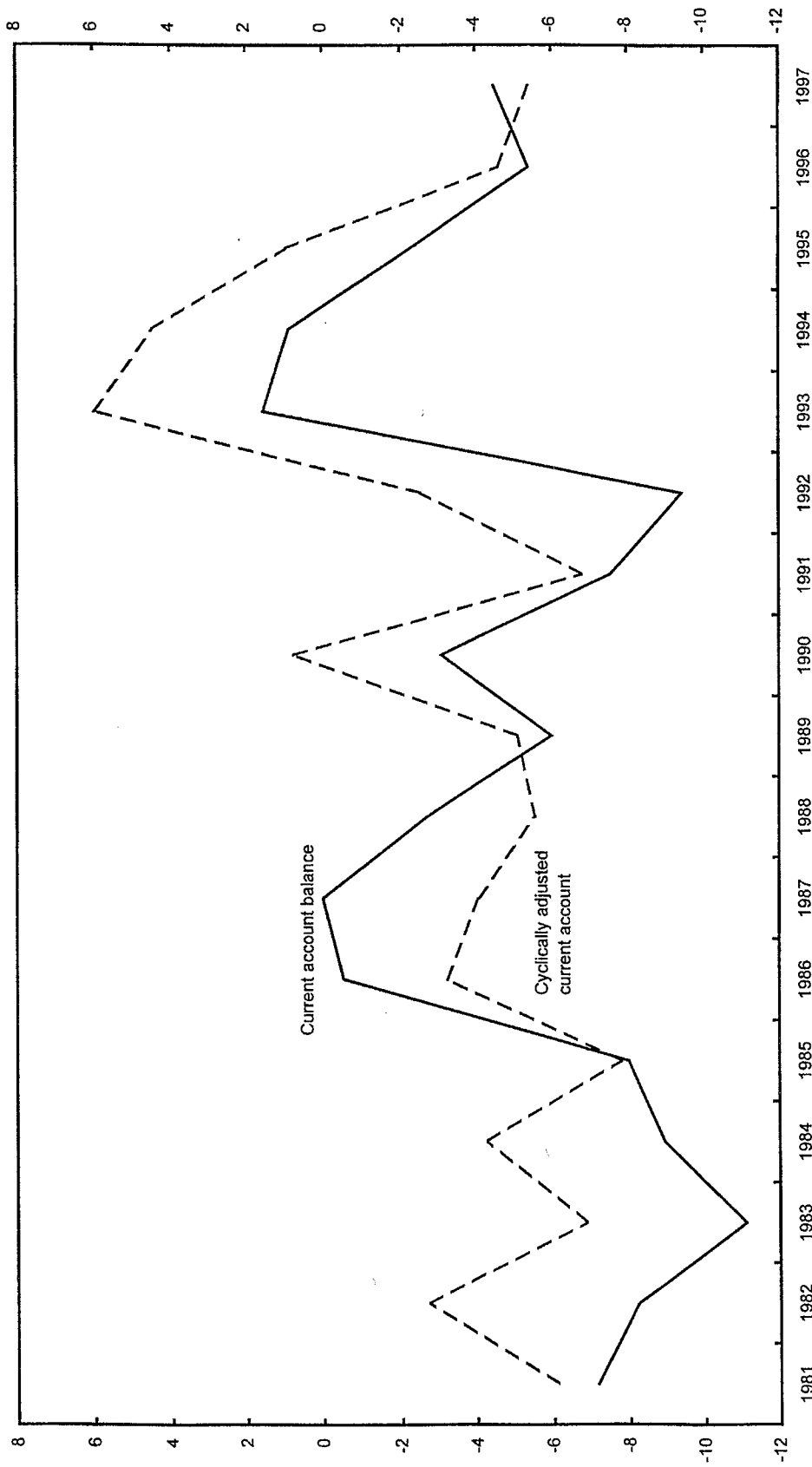
Source: The Central Bank of Cyprus.

Figure 5. Cyprus: Output Gap
(In percent of potential output)



Sources: IMF, World Economic Outlook; and staff estimates.

Figure 6. Cyprus: Current Account
(In percent of GDP)



Sources: Central Bank of Cyprus; IMF, World Economic Outlook; Direction of Trade Statistics; and staff estimates.

(Figure 7).⁶ The decline in investment is part of a long-term trend occurring since the early 1980s, which has been attributed to capital deepening and lower profitability.⁷ The decline in aggregate saving between 1993–95 and 1996–97, equivalent to about 7 percentage points of GDP, can be partially explained by private consumption smoothing and a decline in public savings of the order of 2¾ percentage points of GDP.

12. Notwithstanding the aforementioned shocks, some unfavorable trends in Cyprus' external position and competitiveness have also played an important role in the current account deterioration of the mid-1990s. Increases in labor costs have outpaced gains in productivity and export prices through most of the 1980s and 1990s, thus resulting in declining profitability in export activities (Figure 8). Relative unit labor costs (ULC) have increased steadily since the early 1990s, contributing to some loss in service export market share and an even sharper decline in the market share of domestic exports in world trade, especially in the EU (Figures 9 and 10).⁸ The lost dynamism of domestic exports of goods and services has been only partially offset by an increase in (lower value added) reexports, notably to Russia. As a result, total exports of GNFS trended downward, having averaged 53 percent of GDP in 1982–90 against 49 percent of GDP in 1990–97; combined with the recent rise in imports, this trend may raise questions about the adequacy of competitiveness of the economy as a whole. The next section looks further into this issue.

B. Estimating Cyprus' Equilibrium Real Effective Exchange Rate

13. This section estimates Cyprus' equilibrium real effective exchange rate based on a macroeconomic balance framework that focuses on the requirements for simultaneously achieving internal and external balance.⁹ This process involves estimating the current account that is likely to emerge in the medium term under prevailing exchange rates and with domestic and foreign outputs at their potential levels (the underlying current account) and comparing it with the "equilibrium" current account. The equilibrium current account here refers to the level of the current account that is compatible with the estimated savings/investment relation at full employment. When the underlying and equilibrium current account balances differ, it is assumed that the real exchange rate will adjust so as to move the underlying current account

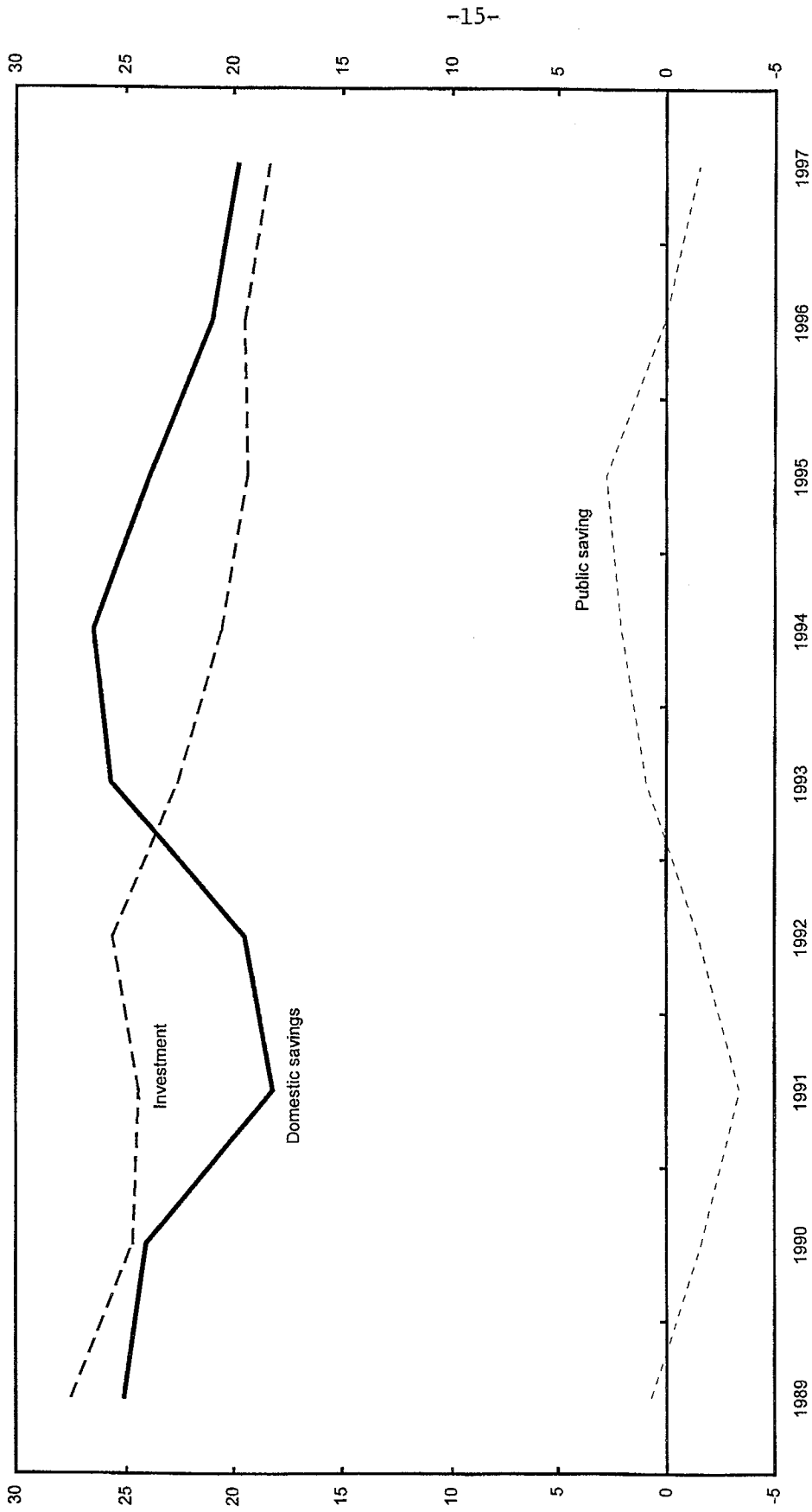
⁶The average investment to GDP ratio fell from 20.9 percent in 1993–95 to 18.8 percent in 1996–97. The average saving to GDP ratio dropped from 20.9 percent to only 12.9 percent.

⁷See Shirai (1996).

⁸Cyprus has however benefited greatly from the opening of the Eastern European economies, which have become an important market for Cypriot exports, especially reexports.

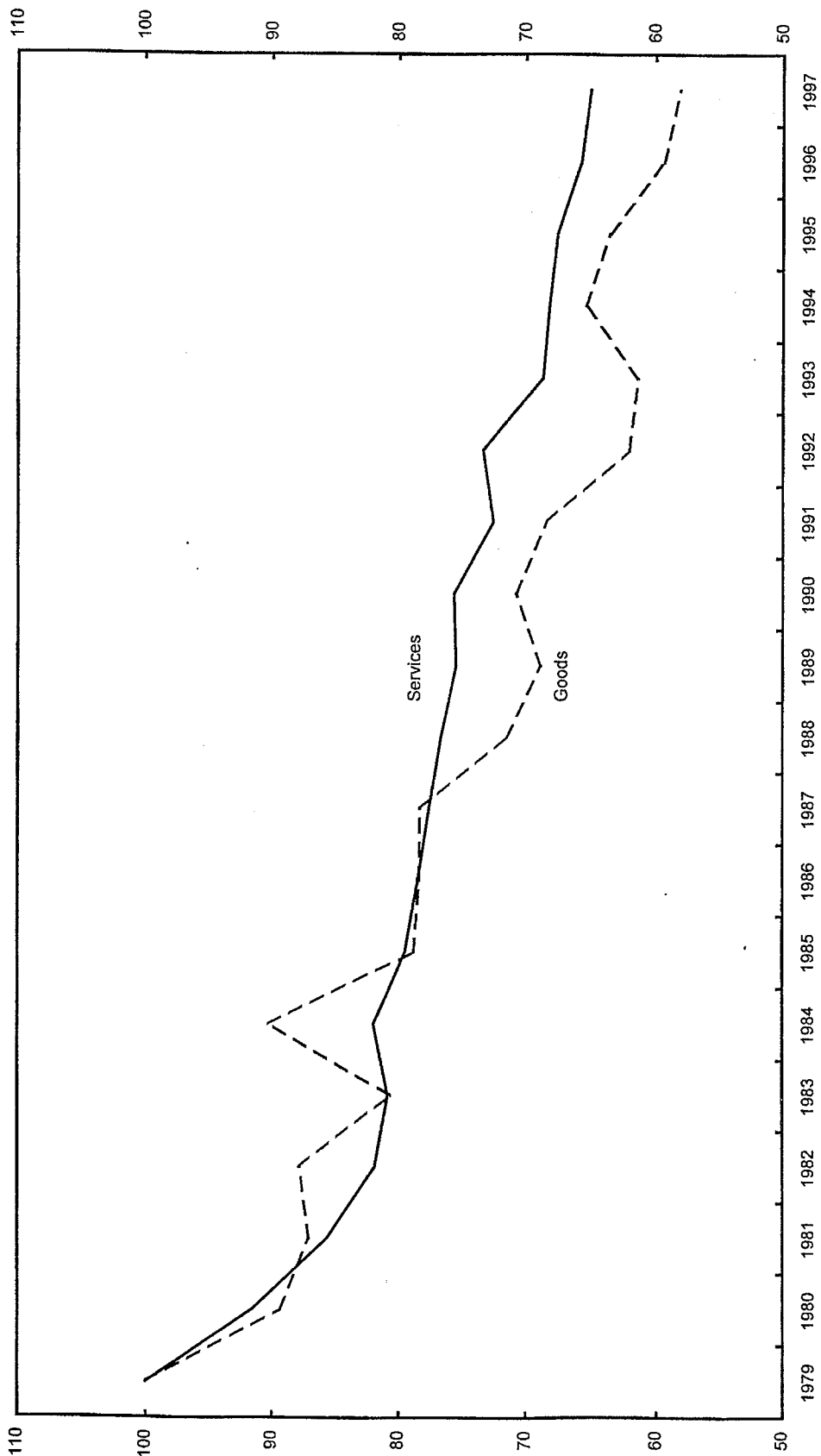
⁹This framework was developed by the IMF's Coordinating Group on Exchange Rate Issues (CGER) and is regularly used to estimate equilibrium exchange rates for industrialized countries. See International Monetary Fund (1997).

Figure 7. Cyprus: Savings and Investment
(In percent of GDP)



Sources: IMF, World Economic Outlook; and staff calculations

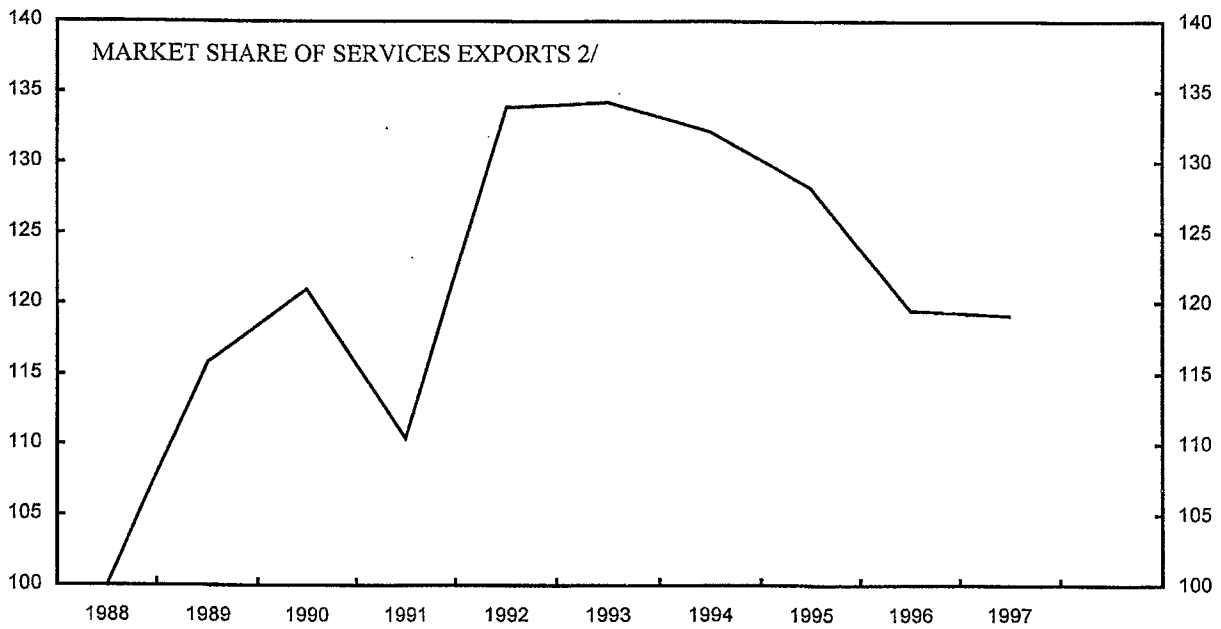
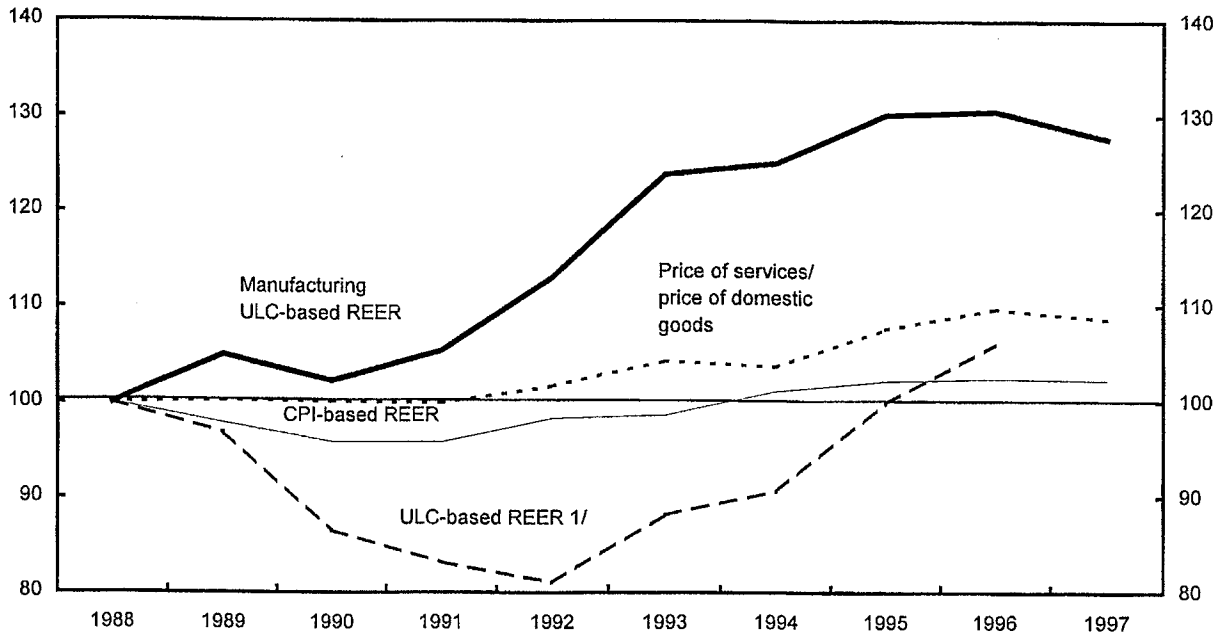
Figure 8. Cyprus: Export Profitability I/
(Index; 1979=100)



Sources: The Central Bank of Cyprus; and staff calculations.

I/ I/ Export Deflator/U/LC

Figure 9. Cyprus: Competitive Indicators
(Index; 1988=100)

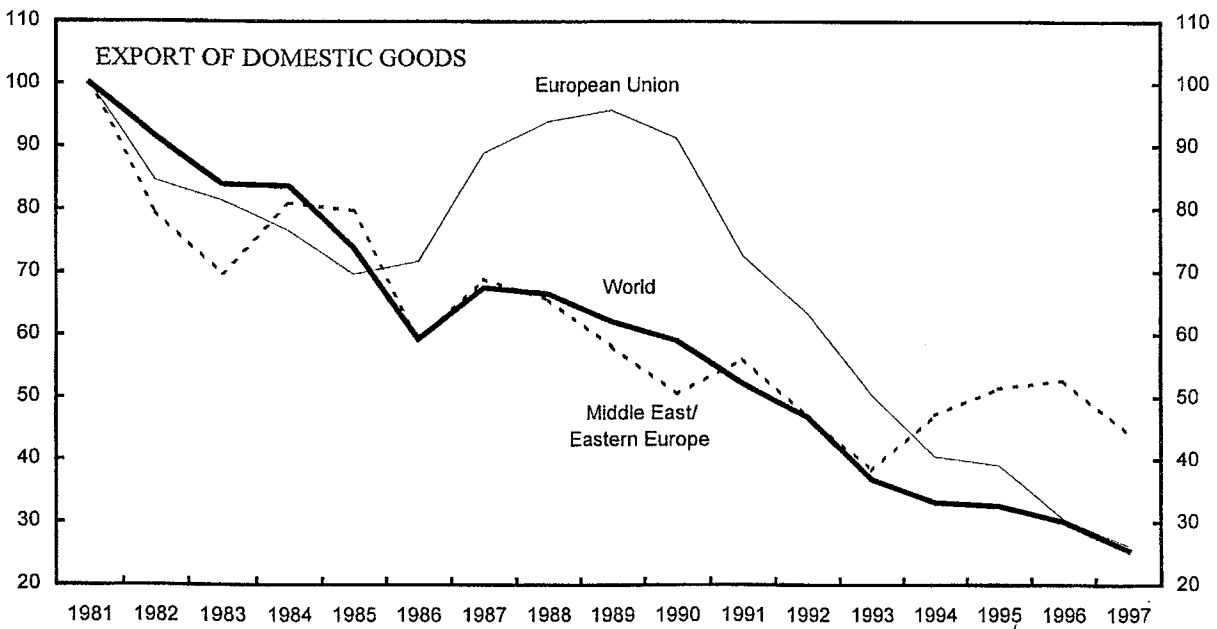
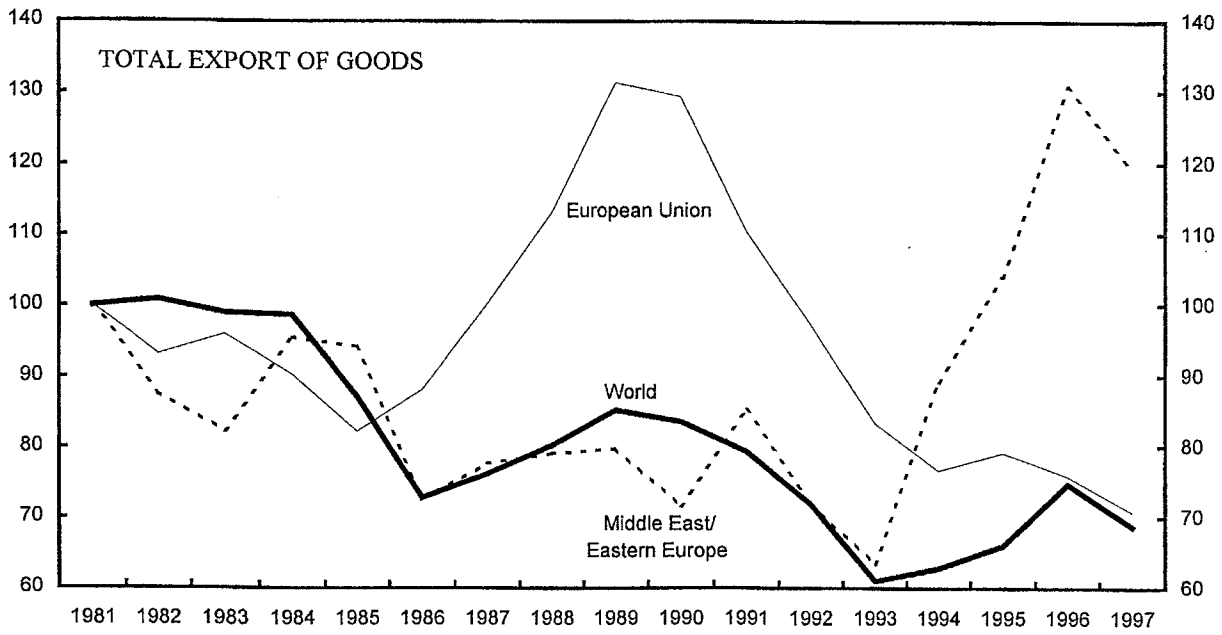


Sources: IMF, International Financial Statistics; Central Bank of Cyprus; OECD; and staff calculations.

1/ ULC in the whole economy vis-a-vis Cyprus' main industrial partner countries (tourism weights).

2/ Vis-a-vis Cyprus' main industrialized trade partners.

Figure 10. Cyprus: Export Market Share
(Index; 1981=100)



Sources: Central Bank of Cyprus; IMF, World Economic Outlook; and staff calculations

to the level of equilibrium. In the calculations reported below, it was assumed that the medium-term positions are reached over a three-year period.

14. The underlying current account is the cyclically adjusted current account that would result at current exchange rates if these rates were sustained for three years. It is calculated by adjusting the actual current account for existing output gaps in Cyprus and abroad and for the lagged effects of recent real exchange rate movements. The first step in performing this calculation was to estimate the long-run income and exchange rate elasticities of Cyprus' exports of goods, exports of services, imports of goods, and imports of services.¹⁰ A dummy variable accounting for the 1974 invasion was included in the export equations. Results are shown in the table below, and all coefficients are significant at the 1 percent significance level:

Long-Run Export and Import Elasticities

	Income elasticity	REER elasticity	R ²
Exports of goods	1.82	-0.69	0.97
Imports of goods	1.50	0.51	0.97
Exports of services	2.30	-1.49	0.83
Imports of services	1.55	0.81	0.89

Source: Cyprus authorities; and Fund staff estimates.

The estimated elasticities for traded goods are broadly in line with the elasticities estimated by Ito and others (1996) for APEC countries in a similar stage of development. The fact that the elasticities of services exports are much higher reflects the large share of tourism exports in total service exports, and the high sensitivity of the tourism activity to price and income fluctuations.

15. Once the long-run elasticities were estimated, the next step was to follow the CGER assumption that the full impact of an exchange rate change on trade (and service) volumes is spread over three years, with 60 percent of the long-run effect occurring during the first year, a further 25 percent during the second year, and the remaining 15 percent in the third year. It is also assumed that the price of each country's (aggregate) exports is unaffected by changes in its real exchange rate, while its import price immediately adjusts to reflect fully any changes in relative costs.

¹⁰The long-run elasticities were estimated using annual data for the period 1970–97. The estimation procedure utilized was suggested by Engle and Yoo and described in Cuthberston, Hall, and Taylor (1992). This same procedure was applied by Ito and others (1996) to estimate income and real exchange rate elasticities of trade for 15 countries of the APEC region.

16. The output gaps of industrialized countries are IMF estimates used for the World Economic Outlook exercise, whereas the output gaps for Cyprus and developing partners were estimated as deviations from trend GDP obtained through Hodrick-Prescott filtering. Weights used in the averaging of output gaps and exchange rate movements correspond to each country's share in Cyprus' exports of goods and exports of services. These estimates and assumptions, together with the observed current account deficit of 4½ percent of GDP, lead to **an estimated underlying current account deficit of 5 percent in 1997**. This means that at potential output (both domestic and foreign) and after factoring in the lagged effects of recent exchange rate fluctuations, the current account deficit in 1997 would be equivalent to 5 percent of GDP.

17. The equilibrium, or structural, current account balance is derived from a model of the equilibrium saving-investment balance which relates investment and saving flows (and thus the current account) to their medium-term structural determinants, notably country-specific and global fiscal variables, demographic variables, and relative country size.¹¹ The model was estimated with panel data from 21 OECD countries over the period 1971–93. Using the long-run coefficients obtained from this model, and a constant term that captures effects specific to Cyprus,¹² the structural current account balance for Cyprus can be derived as

$$CA = 0.65SUR - 0.20DEM + 0.09YPCAP - 1.6, \quad (1)$$

where:

- CA ≡ the structural current account as a percentage of GDP;
SUR ≡ the general structural government balance as a percentage of GDP;
DEM ≡ the dependency ratio, defined as the ratio of population 65 and older or 19 and younger to population aged 20–64; and
YPCAP ≡ the per capita potential GDP (PPP-adjusted) as a percentage of the U.S. level; and all three variables are measured as deviations from the 21-country average.

The equation captures the idea that high public savings and low population dependency ratio contribute to domestic savings and thus a higher current account balance, whereas low levels of income per capita tend to be associated with high returns to capital and thus high investment rates and a lower current account balance.

¹¹See Debelle and Faruqee (1996), and International Monetary Fund (1997).

¹²Since Cyprus was not among the countries considered in the panel-data estimations, the country-specific constant term (which corresponds to the general constant plus a fixed-effect dummy variable) for Cyprus was taken as the one that minimizes the squared errors between the observed current account deficits and the deficits predicted by the model coefficients.

18. According to these parameters, Cyprus' structural current account deficit in 1997 was equivalent to 4½ percent of GDP.¹³ This means that the model's structural determinants of savings (the fiscal balance and the dependency ratio) and investment (per capita income) in Cyprus currently predict a need for supplemental foreign saving of the order of 4½ percent of GDP. For the sake of comparison, Cyprus' actual current account deficit in 1985–95 averaged 3½ percent of GDP. Since the average fiscal deficit during that period was also lower than the current fiscal deficit, the estimated structural current account deficit in 1997 does not seem out of line with Cyprus' experience.

19. Counterposing the estimated underlying and structural current account deficits, and using the exchange rate elasticities reported in the table on page 19, it can be concluded that **the 1997 real effective exchange rate of the Cyprus pound is broadly in line with present savings and investment fundamentals.** It must be emphasized, however, that this result (i) is a function of the current state of the public finances, and (ii) does not involve any judgement or projection regarding the long run sustainability of the fiscal and external positions.

20. The present levels of fiscal and current account deficits imply a rising debt to GDP ratio, a situation that is undesirable in the medium term and unsustainable in the long run. Having this concern in mind, an alternative CGER simulation was carried out considering a scenario in which a three-year fiscal adjustment lowers the structural public deficit to 3 percent of GDP, a level compatible with a stable public debt-to-GDP ratio according to staff calculations. This improvement in public savings would imply an estimated structural current account deficit of 3½ percent of GDP which, in turn, would yield an estimated overvaluation of the pound of about 4 percent. **In other words, a real effective depreciation of 4 percent would be required to bring Cyprus' (underlying) current account to its equilibrium balance if the structural fiscal deficit were to be reduced to 3 percent of GDP.** This depreciation could take place without changes in the nominal exchange rate peg—for example, through a slowdown in wage and price inflation that would follow the envisaged contractionary fiscal policy. This adjustment path, however, is dependent on and reinforces the importance of reducing wage and price rigidities.

21. Another source of concern for the sustainability of Cyprus' current account is the decrease in investment and in export profitability of recent years, which may reduce the country's ability to generate foreign receipts in the near future. Cyprus' growing dependency on tourism for foreign exchange receipts (which are more sensitive to price and demand swings) also increases the country's external vulnerability and makes it even more important to address the factors hindering the sector's development. The next section presents an

¹³ The structural fiscal deficit in 1997 was estimated at 4.4 percent of GDP, against an average of 1½ percent in industrialized countries; Cyprus' dependency ratio was approximately 56 percent, against an industrial country average of 66 percent; and finally, Cyprus' potential GDP per capita was 50 percent of that of the United States, against an industrial-country average of 84½ percent.

analysis of the dynamism of service sector exports, with special emphasis on the extent to which labor costs affect the performance of exports of services.

C. Competitiveness in Exports of Services: A Vector Error Correction Analysis

22. Exports of services, notably tourism, have increased significantly since the late 1970s and have become Cyprus' main source of foreign exchange earnings and main economic activity. While in 1980 only about 19 percent of total exports of GNFS came from tourism receipts and 28½ percent from exports of manufactures, in 1997 tourism brought in 41 percent of Cyprus' exports of GNFS against only about 8½ percent obtained from exports of manufactures and 11½ percent from exports of domestic goods. Most of the decline in exports of domestic goods can actually be explained as a natural movement toward the exploitation of the island's comparative advantage in tourism, as investment in the sector has grown much faster than investment in manufacturing (export) activities. The importance of the service sector as a foreign exchange source in Cyprus warrants the analysis below.

23. The performance of Cyprus' exports of services is analyzed in this section based on the methodology used by Agénor (1995) to study the competitiveness of the French manufacturing industry. This methodology will provide an estimation of the relative importance of external demand, labor costs, and structural (nonprice) factors in the performance of Cyprus' services exports during the last 27 years. It is particularly important to evaluate the impact of labor costs on the export of services, since tourism activity is very price elastic. The preliminary assessment in this analysis indicates that the stagnation of Cyprus' tourism market shares may be related to the upturn in the island's relative unit labor costs vis-à-vis its main tourism (and service) partners. The methodology consists of two steps: (i) estimating a cointegrating relationship between service exports and foreign demand, relative ULC, and an indicator of nonprice competitiveness; and (ii) estimating a vector error correction model for the variables described above, which is then used to compute variance decompositions and impulse response functions. Variance decompositions can be used to estimate the share of the variance of each variable that is explained by the other variables in the system, while impulse response functions show how innovations to one variable affect the behavior of the other variables through time.

24. The principal variables of the analysis are defined as follows, where all variables are annual values in natural logarithms:

XSERV	≡	the volume of exports of services;
PCGDP	≡	an index of partner countries' real GDP; ¹⁴
RULCS	≡	an index of relative normalized unit labor costs;
TIS	≡	an index of the real investment in restaurants, hotels, transportation, storage, and communications; and

¹⁴The index is weighted by the countries' participation in Cyprus' total tourist arrivals.

INV74 ≡ a dummy variable that controls for the effect of the 1974 invasion.

The sample period is 1970–97. All series were tested for stationarity using augmented Dickey-Fuller tests. The results presented in the table below indicate that all series are nonstationary in levels but are stationary in first differences at the 5 percent significance level (for which the critical value is -2.98).

Augmented Dickey-Fuller Test Statistic

Series	Levels	First Differences
XSERV	-0.52	-3.16
PCGDP	-1.04	-3.25
ULCS	0.48	-4.69
TIS	-1.54	-4.77

25. The cointegrating model yielded the following long-run relationship:

$$XSERV_t = 1.92*PCGDP_t - 0.18RULCS_t + 0.61TIS_t - 5.1 + E_t, \quad (2)$$

where E_t is the error term and Johansen tests indicated that the series are cointegrated. The error correction formulation corresponding to this model is estimated as

$$DXSERV_t = 0.30*DXSERV_{t-1} + 0.64*DXSERV_{t-2} - 0.82*PCGDP_{t-1} - 0.77*PCGDP_{t-2} - 0.14RULCS_{t-1} - 0.21*RULCS_{t-2} - 0.18*TIS_{t-1} - 0.19*TIS_{t-2} + 0.26*D_t - 0.40 E_t, \quad (3)$$

where E_t is the residual in equation (2).¹⁵ The model estimation has a coefficient of determination (R -square) of 0.77. The coefficient of E_t is relatively large, indicating a rapid model convergence toward long-term values.

¹⁵ VEC models do not provide estimates of structural parameters but rather unconstrained estimates of the relationships among the variables in the system, so that individual coefficients should be interpreted with caution. For further details see Hamilton (1994) and Agénor (1995).

26. The model described in equations (2) and (3) yields the impulse response functions depicted in Figure 11 and the variance decomposition shown in the table below.¹⁶ As expected, external demand is the most powerful of the three explanatory variables in the short run (the current year), with relative ULC having little contemporaneous impact on the volume of services exported. After five years, however, the (negative) influence of increases in relative ULC peaks and explains about 20 percent of the variance of export volumes. In the long run, that is, after 10 years, external demand explains 31 percent and relative ULC are responsible for 18 percent of the variance in export volumes, while investment in the tourism sector explains about 12 percent.¹⁷ These results confirm the importance of cost factors in Cyprus' export performance. Looking ahead, measures to contain the sustained growth in labor costs will be key to the further development of services exports.

Variance Decomposition of XSERV

Year	XSERV	PCGDP	RULCS	TIS
1	68	26	6	0
2	64	21	13	2
5	50	20	20	10
10	39	31	18	12

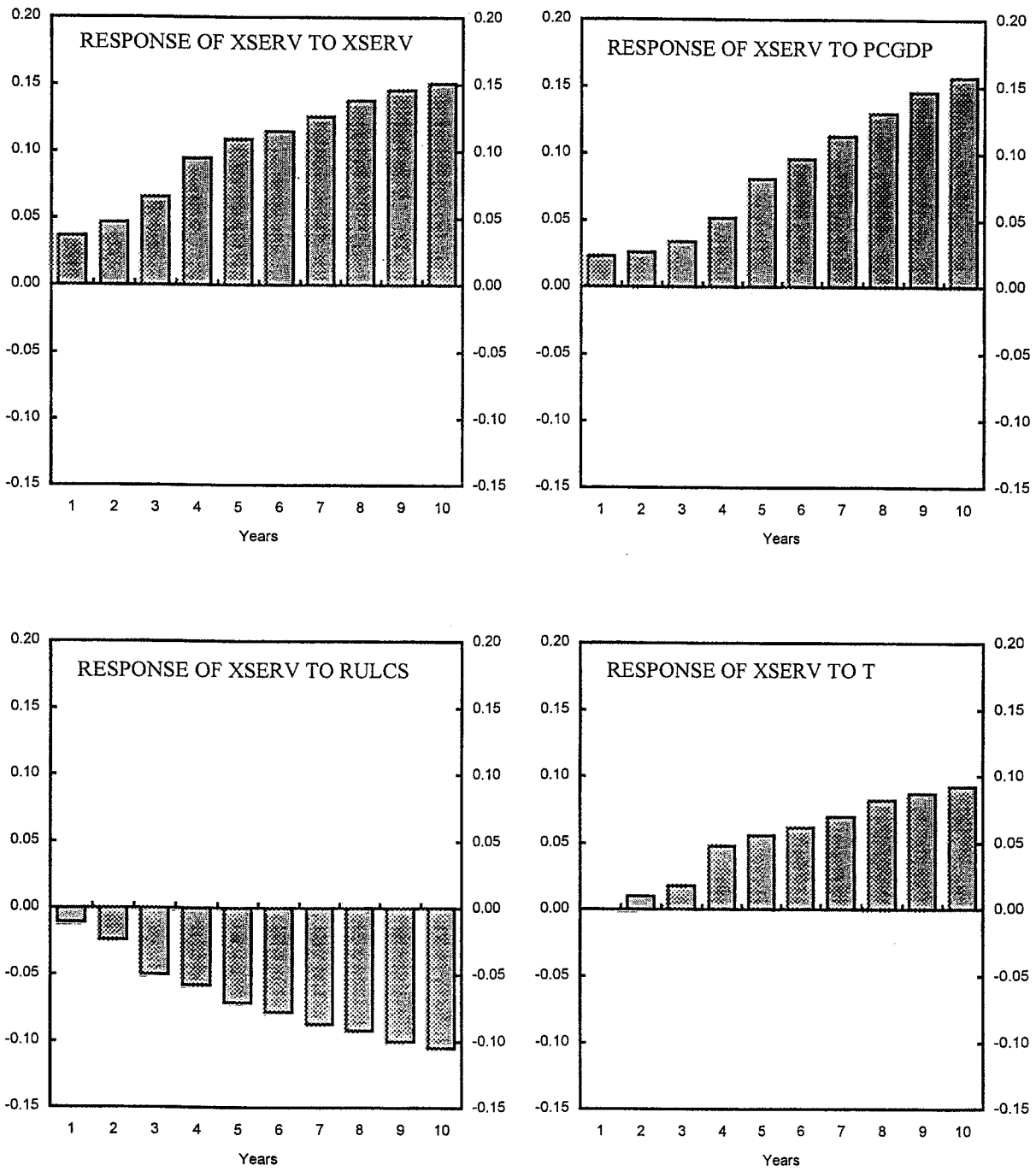
D. Concluding Remarks

27. The improvement in the current account in 1997 interrupted a three-year trend of deterioration and helped alleviate the concern over Cyprus' external position. CGER estimates indicate that Cyprus' real exchange rate is in line with present savings-investment fundamentals. These fundamentals indicate the need for a high inflow of foreign savings,

¹⁶When estimating impulse response functions and variance decompositions, the order in which the variables are entered into the system affects the outcome of the estimation. Such ordering must follow a progression of exogeneity of the variables, with the "most exogenous" (or those less affected by contemporaneous values of the other variables) being listed first and so on. In our case, exogeneity suggests the ordering PCGDP, RULCS, XSERV, TIS.

¹⁷The simplicity of the model, with only three exogenous variables, and the relatively small sample size are probably behind the fact that a significant share of the variance of XSERV is explained by its own lagged values. When the variables are entered into the system in a different order, with TIS being allowed to explain contemporary changes in export volumes, the variance decomposition shows a much lower degree of persistence in XSERV, and investments in the service sector become the main explanatory variable in the long run. Nonetheless, the relative importance of external demand and relative ULC is not affected by this different ordering.

Figure 11. Cyprus: Impulse Response Function for XSERV 1/



Source: Staff calculations.

1/ Response to one standard deviation innovations.

especially in view of the high fiscal deficit, and thus the appropriateness of the current exchange rate to generate such inflows (or such current account deficits). This analysis, therefore, suggests that the appropriate way to improve the current account to a position that is both sustainable in the long run and compatible with Cyprus' development needs is to improve the fiscal balance, thus reducing the need for foreign savings and allowing for a lower real exchange rate. The effectiveness of the fiscal adjustment in enhancing Cyprus' competitiveness within the prevailing exchange rate regime will in turn depend on the flexibility of domestic prices and wages, which highlights the importance of abolishing the existing wage indexation system.

28. The declines in investment and in the profitability of export activities may hinder the economy's ability to generate foreign exchange in the medium term. The recent decline in service export market share, the stagnation of exports as a percentage of GDP, and the appreciation of the real effective exchange rate (especially the ULC-based REER) simultaneously reflect and signal trends that, if left unchecked, may result in a worsening of Cyprus' external competitiveness. Together with expansionary fiscal and credit policies, these trends could not only increase the current account deficit but also reduce the flow of capital into the country, leading to a fast deterioration of Cyprus' ability to service its external obligations. The degree of dependency on tourism receipts adds to the vulnerability of the external accounts, owing to the sensitivity of this activity to price, costs, and external demand fluctuations. These findings lend further support to the recommendations that the fiscal deterioration be reversed and the upward trend in ULC be arrested to maintain the viability of the fixed exchange rate in the medium term.

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III. FINANCIAL REFORM IN CYPRUS—LESSONS FROM SCANDINAVIA¹⁸

29. Cyprus is on the verge of undertaking a comprehensive financial reform. The two cornerstones of the reform are (i) a liberalization of interest rates and (ii) an opening of the capital account. The reform is intended to prepare the country for a membership in the EU, and to tap new sources of economic growth which would result from a better allocation of savings.
30. In contrast to the liberalization of trade, financial reform is often regarded with some scepticism. Latin American countries experienced formidable crises in the late 1970s, which were preceded by financial reform. These crises have highlighted the need to establish a stable macroeconomic environment before financial markets are deregulated.¹⁹
31. However, sound macroeconomic policies are not a guarantee for success. At least equally important are the underlying microeconomic conditions of the financial system. Quite recently, a number of countries with excellent macroeconomic records saw their financial reforms turn into costly banking crises because of neglecting microeconomic fundamentals. The Asian crisis is a case in point. This paper first gives an outline of the present financial system in Cyprus, with special emphasis on microeconomic conditions. It then presents a case study of the financial reforms in Scandinavia during the mid-1980s, and the difficulties experienced there. Interestingly, the starting conditions of the Scandinavian reforms closely resemble the situation in Cyprus today. Therefore, these examples might contain some useful lessons.

A. The Present Financial System of Cyprus

32. The existing financial system of Cyprus can best be described as three-tiered: it comprises a formal, highly regulated domestic banking sector, an informal cooperative sector, and offshore banks. Measured in terms of assets, formal banks are slightly larger than offshore banks, and about three times as large as the informal cooperative sector (Figure 12).²⁰ The three tiers of the financial system operate under very different legal and regulatory conditions, which determine their microeconomics. Each sector shall be discussed briefly.

¹⁸Prepared by Benedikt Braumann.

¹⁹ Villanueva and Mirakhor (1990), *Review of Experiences with Financial Reform During the Last Two Decades*.

²⁰Measured by assets in percent of GDP; formal banks have 179 percent, offshore banks have 154 percent, and cooperatives have 49 percent (deposits only).

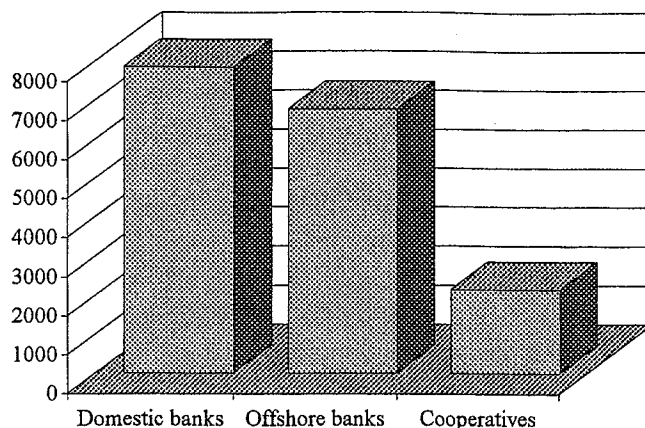


Figure 12. The Size of the Three Segments of the Financial System (In £C million) in 1997. Assets of domestic and offshore banks, total deposits of cooperatives. Source: Central Bank of Cyprus (CBC).

The formal domestic banking sector

The formal banking sector is highly regulated. By law, banks cannot charge more than 9 percent interest on loans. In addition, the CBC can prescribe maximum deposit and lending rates below the 9 percent ceiling. Figure 13 shows that nominal deposit and lending rates have been broadly unchanged over a long period of time. As a consequence, real interest rates were determined almost entirely by inflation (Figure 14). The law on the interest rate ceiling has been in place since 1944. It was drafted under British rule to protect farmers against widespread usury by money lenders. Another reaction to usury was the creation of agricultural cooperatives, which will be discussed shortly.

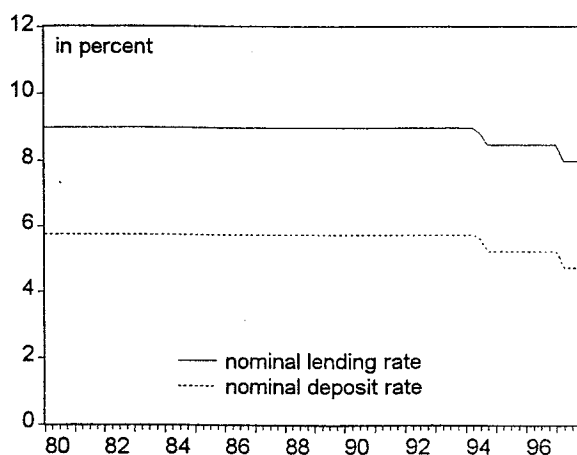


Figure 13. Nominal Interest Rates in Cyprus.

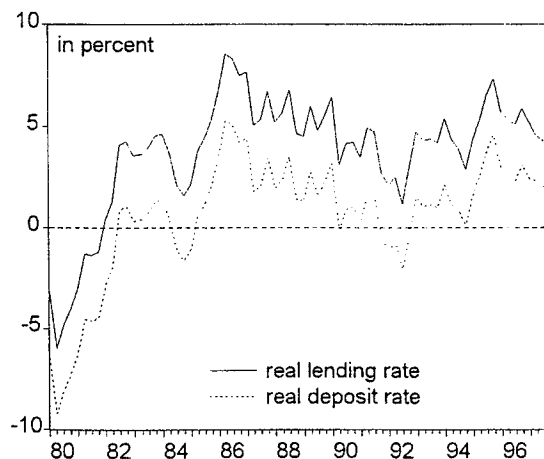


Figure 14. Real Interest Rates in Cyprus.

33. At a macroeconomic level, an interest rate ceiling can create procyclical output effects. When inflation is high, real interest rates are low. This increases aggregate demand, adding to the overheating pressures. Two examples are the years of 1984 and 1992, when inflation peaked at (the still modest level of) 6 and 6.5 percent, respectively. With real interest rates down to 2 percent, real GDP growth was unusually high, reaching 9 percent in 1984 and 10 percent in 1992. The opposite effect during recessions has been less pronounced. As long as inflation remains above zero, the ceiling sets an upper bound to real interest rates. During the past 20 years, real interest rates have never surpassed 7.5 percent. A decrease in inflation rarely resulted in a sharp slowdown of output.

34. To stabilize aggregate demand, the CBC had to rely on instruments other than the interest rate. In the monetary framework that was in place until December 1995, liquidity requirements were the most prominent tool, sometimes supplemented by direct credit controls. Liquidity requirements have traditionally been high in Cyprus, averaging 27 percent of deposits. The CBC increased them in periods of high inflation and decreased them during recessions. However, as their remuneration was below the lending rate, liquidity requirements were similar to a tax on banking, and created economic distortions. In 1996, the CBC started to lower liquidity requirements gradually and introduced open-market operations. As long as the interest ceiling remains in place, however, open-market operations will only function properly in periods of high liquidity, when interest rates are low.

35. Since 1992, Cyprus has pegged its exchange rate to the ECU. Nevertheless, tight capital controls have allowed the CBC to retain a certain degree of freedom in monetary policy. Domestic interest rates do not correlate closely to rates in Western Europe.

36. The rather closed capital account has limited banks to using domestic deposits for the funding of their loans. This holds despite the fact that Cypriot banks have accumulated a large amount of deposits in foreign currency. At the end of 1997, these deposits reached a volume of 47 percent of GDP. However, the CBC has made it difficult to channel foreign currency into the economy, as every loan needs the central bank's approval. In 1997, an equivalent of only 1.2 percent of GDP in foreign currency loans was allowed to leak through the capital account barrier. However, once the capital account is liberalized, deposits in foreign currency are apt to become an important source for the funding of loans.

37. On a microeconomic level, the interest rate ceiling has truncated the market for loans. As banks cannot charge more than 9 percent interest, they tend to select low-risk borrowers. Riskier projects are rarely funded, although their expected return might be higher. The interest rate ceiling denies banks a share in the extra returns. However, the extra risk would force them to increase their loan-loss provisions, which would raise costs. Credit demand is therefore rationed, making banking "relationship-oriented." Banks and their customers cultivate long-standing relations to overcome the information problem inherent in financial intermediation. As banks become more familiar with their clients, they attain an accurate knowledge of business and default risks. Long-standing relations substitute for comprehensive project assessments and for a close monitoring of loans. It is interesting to note that the sectoral distribution of loans in Cyprus has a strong bias toward low-risk borrowers (see

table below). The highest percentage goes to personal loans, whose rate of default is traditionally very low. The next largest items are trade, typically a low-risk business, and construction, which uses real estate as collateral. Tourism, the most important sector in terms of output in Cyprus, appears only in the fifth position.

Distribution of Loans, 1997

Sector	Loans in percent of total	Output in percent of GDP
Individuals	33.4	...
Trade	24.1	8.4
Construction	14.3	8.2
Manufacturing	10.8	11.0
Tourism	10.2	19.5

Sources: Central Bank of Cyprus and Ministry of Finance.

38. The interest rate ceiling favors debt financing of firms. With low real interest rates, borrowing is inexpensive, and corporations have an incentive to be highly leveraged. A proxy for the extent of leverage is the ratio of private sector credit to GDP, which is shown in Figure 15. Cyprus has a ratio of 1.25, significantly higher than other European and Mediterranean countries. Furthermore, this ratio has been increasing steadily over the last two decades (Figure 16).

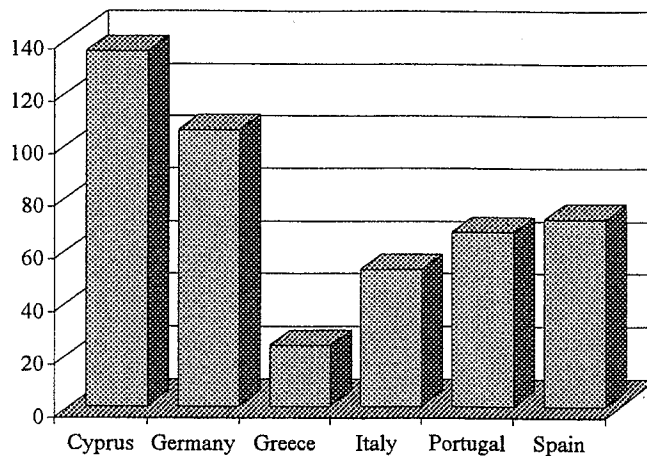


Figure 15. Credit to the Private Sector in Percent of GDP: A proxy for economy-wide leverage. Source: *International Financial Statistics*.

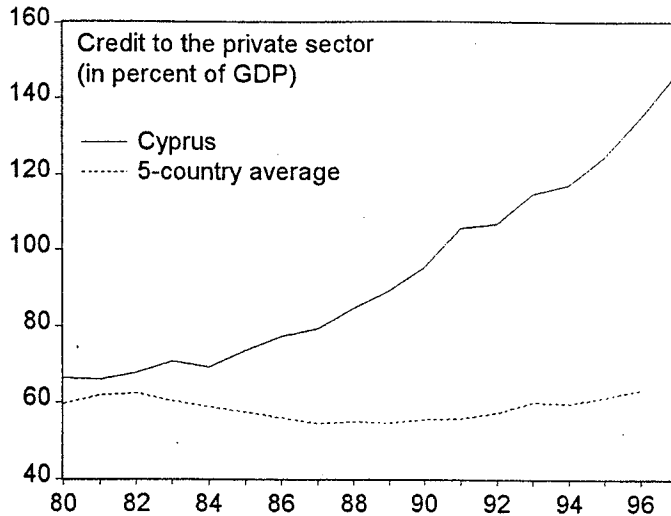


Figure 16. Credit to the Private Sector. Credit to the private sector has been increasing strongly in Cyprus, compared to an average of the five other countries in Figure 15. Source: *International Financial Statistics*.

39. According to estimates by the Bank of Cyprus, the aggregate debt-to-equity ratio of Cypriot firms may be as high as 6. Although these data may be particularly difficult to compare, the ratio in Cyprus would be substantially above the average for industrialized countries (0.25 in the United Kingdom and 0.2 in the United States), and even higher than the ratio of 4 measured in South Korea before the recent crisis (1996).

40. Banks too have an incentive to favor borrowing over equity. With few risks in their portfolio, they do not expect large loan losses. Therefore, a small amount of equity can easily fulfill the function of a shock absorber. A small equity position also allows banks to generate a larger return to shareholders from a given profit. Figure 17 shows that the risk-adjusted capital adequacy ratio of Cypriot banks is comparatively low, and it has been decreasing in recent years. For cooperatives, the ratio seems to be lower still.

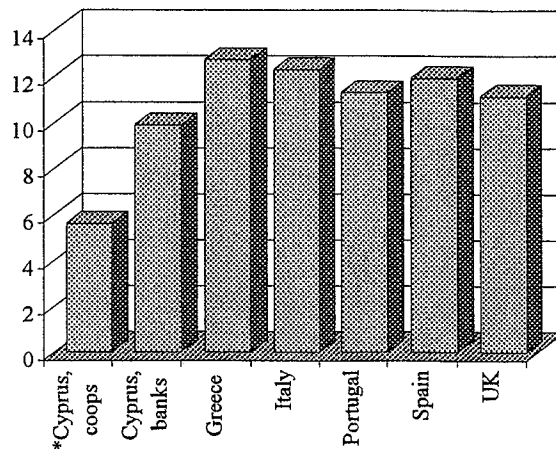


Figure 17. Risk-adjusted Capital Adequacy Ratios in Percent, Data for 1995, Cyprus Banks 1997, and Cooperatives 1996. (*) Ratio of accumulated reserves to deposits, for lack of comparable information. The risk-adjusted measure might be somewhat higher. Source: OECD (1997) and Moody's (1997).

41. The fact that interest rates are regulated, did not lead to a complete suppression of market forces. Instead, banks engaged in a vigorous nonprice competition for deposits. To be as close as possible to the source of funds, Cypriot banks have installed an extensive network of branches. Figure 18 shows the number of bank branches per 1,000 inhabitants in different countries. Cyprus indeed appears to be greatly “overbanked.” Also, the intense use of electronics, and the quality and range of products offered are not typical for a country with the income level of Cyprus. Similar observations have been made in highly regulated industries all around the world, such as utilities or air transport. Industries with a predictable rate of return tend to use a high proportion of capital. This tendency increases average costs and can create a competitive disadvantage if the regulations are removed.²¹

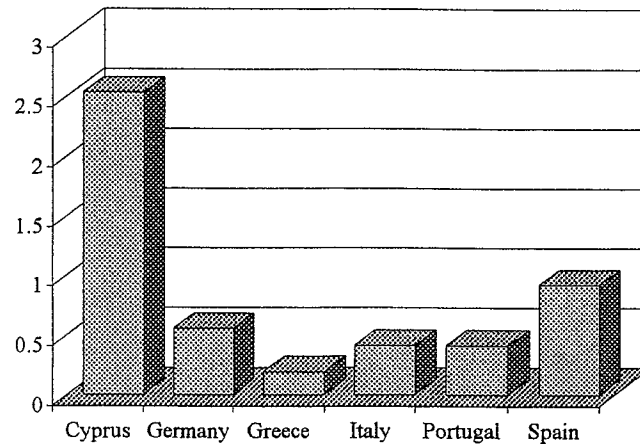


Figure 18. Bank Branch Density in Different Countries. Data for Cyprus include credit cooperatives. Sources: OECD (1997), Moody’s (1997), and Cypriot authorities.

42. The formal banking sector in Cyprus is highly concentrated. In total, there are nine competitors, four domestic and five foreign-owned banks. The domestic banks are larger and control about 85 percent of the market. Since 1974, there has been no entry, but two banks have disappeared in mergers. Concentration and an extensive branch network—the “overbanking” described above—deter new competitors, who have to incur large setup costs. The table below shows that the present, sheltered conditions allow Cypriot banks to earn high profits and a high return on capital. These profits strongly exceed the average in the other five countries and are unlikely to persist in a more competitive environment.

²¹The observation that regulated firms use high capital-labor ratios and do not minimize costs is known as the Averch-Johnson effect in the industrial organization literature. See Train (1991).

Profitability Indicators

Country	Return on assets	Return on capital
Cyprus	1.13	18.51
Germany	0.33	6.47
Greece	0.75	17.44
Italy	0.03	0.33
Portugal	0.52	6.34
Spain	0.57	6.63

Note: Capital includes equity, reserves, and subordinate capital. Data are for 1995, except for Cyprus: those refer to 1997 and are an average of the three largest commercial banks. Sources: CBC and OECD (1997), *Bank Profitability*.

43. The CBC is the central regulatory agency for commercial banks. It supervises them and controls entry into the banking market. The regulatory framework seems to have functioned well in the past, as no single bank has failed. However, prudential standards are not uniform throughout the financial system, and cooperatives follow distinctly different guidelines. This is a serious weakness that shall be discussed shortly.

The informal cooperative sector

44. The first cooperatives in Cyprus were founded around 1910, to take care of the financing needs of agriculture. At this time, farmers depended on unscrupulous money lenders, which charged interest rates of up to 30 percent in real terms.²² A "Central Cooperative Bank" was established to intermediate liquidity among local cooperative societies. The cooperative movement has grown rapidly over the years and commands strong popular support: 80 percent of all Cypriots belong to a cooperative.

45. Traditional cooperatives are owned and managed by their members. After the Turkish invasion of 1974, a new type of cooperative emerged, the so-called "secondary" or "industrial" cooperative. Members of an industrial cooperative are not individuals but other cooperatives which pool their funds to finance large projects. With this new type of organization, the character of the cooperative movement has changed. Industrial cooperatives financed large projects in industry and construction and were guided by a clear profit-maximizing motive. They aggressively entered the genuine banking business, and increasingly lost their association with agriculture.

²²*Phylaktis* (1995), p.27.

46. The rapid expansion of cooperatives was also a result of legal privileges (Figure 19). Cooperatives are not subject to the monetary directives of the CBC. They do not have to fulfill liquidity requirements, and do not have to pay income and corporate taxes. Cooperatives have their own supervisory body, which operates along prudential standards that are less stringent than the CBC's. This adds up to a sizeable competitive advantage over commercial banks.

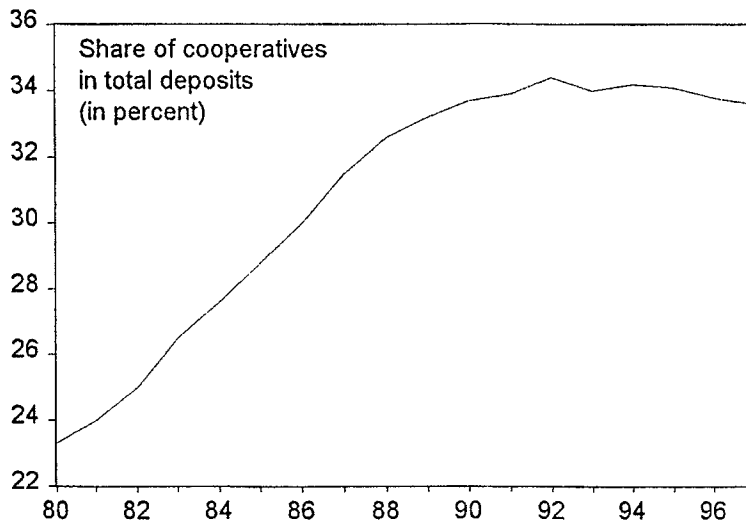


Figure 19. The Share of Cooperatives in Total Deposits in Percent. Source: CBC.

47. The Central Cooperative Bank was shaken by two episodes of financial crisis. The first one occurred around 1980. Cooperatives had been heavily involved in financing an investment boom in the late 1970s, a result of reconstruction efforts after the Turkish invasion. Loans were often granted without the necessary feasibility studies. Being new to the business, the cooperatives lacked knowledge about the risks in industrial investment. A large number of loans turned out to be nonperforming, and the Central Cooperative Bank slid into a full-fledged solvency crisis. The government recapitalized the Central Cooperative Bank, injecting more than £C 22 million over three years (3 percent of 1980 GDP). Public assistance was needed again in the late 1980s when the government provided £C 67 million to cover new loan losses (3 percent of 1989 GDP).

48. In reaction to the crises, the government placed the Central Cooperative Bank under the supervision of the CBC. However, all other cooperative societies were placed under a separate supervisory body, which reports to the Ministry of Commerce and Industry. This has created a split in banking supervision (mentioned above). The liquidity of cooperatives continued to deteriorate in recent years, as the ratio of loans to deposits increased from

85 percent in 1988 to 91 percent in 1997. By comparison, commercial banks record a ratio of around 65 percent (Figure 20).

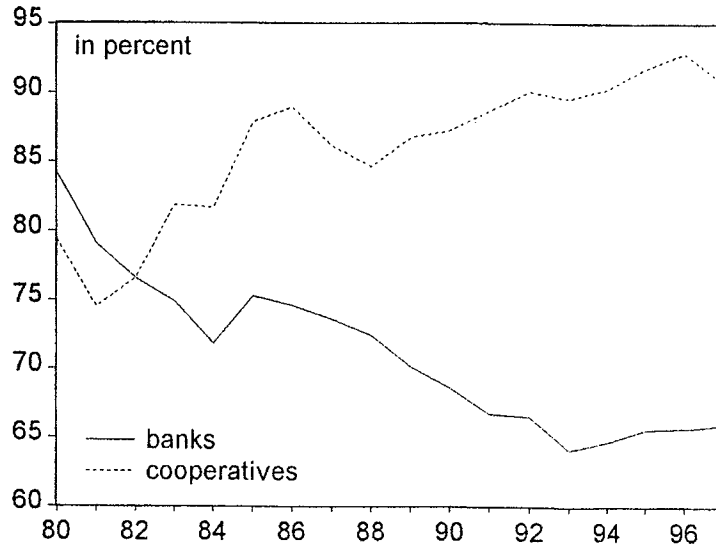


Figure 20. Ratio of Loans to Deposits as a Measure of Illiquidity. Source: CBC.

49. It could be argued that two characteristics of cooperatives provide for a certain safety in lending. First, cooperatives only lend to members, which are locally known individuals, especially in the case of smaller communities. And second, around 55 percent of all loans go into housing or construction, and are collateralized. Looking ahead, however, the commercial niche that cooperatives have exploited may disappear, since financial reform will lead to increased competition from banks. The small size of most institutions will then become a major disadvantage. There are currently 476 credit cooperatives, most of them tiny. More than half of the deposits are controlled by the two large cooperatives of Limassol and Strovolos (Nicosia). The fact that cooperatives are limited to doing business within their political district has so far impeded a process of consolidation.

50. The presence of a large cooperative sector complicated monetary policy. The CBC could not enforce its liquidity requirement on the cooperatives. If it wanted to restrict credit growth, it had to tighten liquidity more strongly in the formal banking sector. This put commercial banks at a disadvantage, and part of the demand for loans simply shifted into the cooperative sector. Controlling the monetary aggregates in this traditional way was thus very difficult. Figure 21 shows in fact a *positive*, not negative, correlation between liquidity requirements and money growth during 1983–95.²³ Indirect instruments that affect the interest rate are more likely to level the playing field. Credit demand is sensitive to interest rates in

²³When direct credit control instruments were in full use.

both sectors. Therefore, lifting the 9 percent ceiling would allow the CBC to improve its control over monetary aggregates.

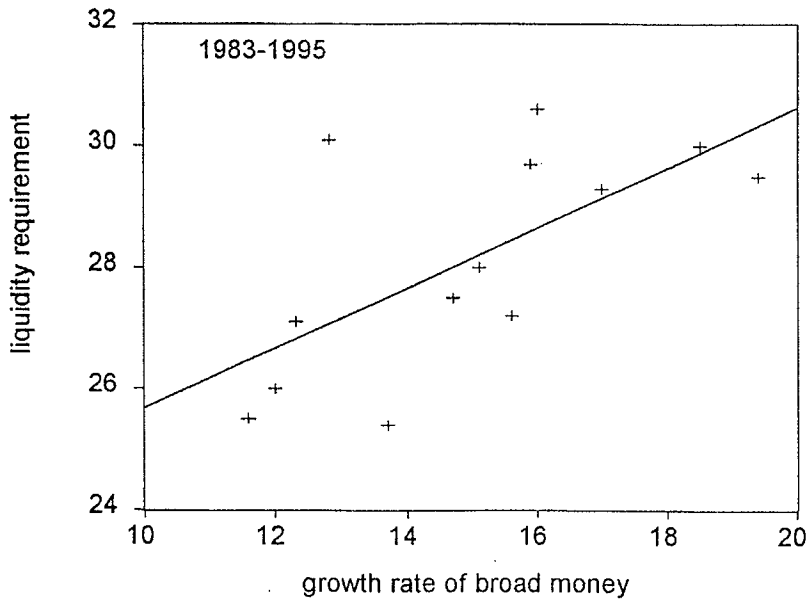


Figure 21. Correlation Between Liquidity Requirements and the Growth Rate of Broad Money (in percent). Source: CBC.

51. In recent years, the market share of cooperatives has stagnated at around 34 percent of domestic deposits (Figure 19). It seems that intermediation in the cooperative and formal banking sectors are not perceived as perfect substitutes. Most likely, this is the result of a certain product differentiation, as the two sectors do not completely overlap in their range of services.

The offshore sector

52. Cyprus has created a very attractive environment for offshore banking. Most importantly, there is no withholding tax on interest earnings and no capital gains tax. Offshore banks pay only a 4.25 percent profit tax. Their employees enjoy substantial privileges in income taxation compared to local workers. Finally, Cyprus has signed double taxation agreements with a large number of countries (25 at present), eliminating legal uncertainty for offshore banks and preserving their cost advantages.

53. Geography places Cyprus in a prime position to be an international financial center. It is close to the Middle East, the Gulf states, and Eastern and Western Europe. Cyprus can intermediate funds from Arab Gulf states and Western Europe into investments in transition

economies and less developed Middle Eastern countries. It has good diplomatic relations with all countries in the region (except Turkey), and a modern telecommunications infrastructure.

54. The CBC regulates entry into the offshore market. Its policy is to select only reputable foreign banks which are subject to stringent supervision in their home countries. Measured in terms of assets, the offshore sector has reached about the same size as the formal domestic banking sector. At present, there are 18 offshore banking units and 65 so-called offshore financial companies, which are predominantly small financial consulting firms.

55. Whereas formal domestic banks face direct competition from the cooperatives, they did not face much competition from offshore banks in the past. Cyprus' strict capital account regulations drew a sharp line between the domestic and the offshore banking sector. Offshore banks are allowed to deal with nonresidents only, and only in foreign currency. Domestic banks were in general not allowed to extend loans to foreigners, with the exception of export credits. The build-up of foreign currency deposits in recent years has so far not spilled over into the domestic market. Every foreign currency loan to a resident has to be approved by the CBC, and approvals have not been numerous.

B. Financial Liberalization in Scandinavia, 1983–92

56. Fifteen years ago, Scandinavian countries faced similar decisions to those facing Cyprus now. Sweden, Finland, and Norway saw the need to open up their financial sectors in order to align themselves more closely with the markets of the European Community, which they intended to eventually join. The cases of Sweden and Finland are especially illustrative, as the effects of financial liberalization can be studied in a very "pure" form, that is, almost in isolation from other shocks. As both countries started out with reasonably sound macro policies, the crucial role of microeconomics will become evident. The deregulations were completed in a brief period of time and hit the economies as a major shock. They triggered pronounced boom-and-bust cycles and expensive fiscal rescue operations. The mistakes that became apparent in hindsight may provide the most valuable lessons for Cyprus today.²⁴

Banking in Scandinavia until 1983

57. The financial system in Scandinavia in the early 1980s bears striking resemblance to the Cypriot system today. Before 1983, both lending and deposit rates were set by the central banks (Figure 22). Although nominal interest rates were changed more frequently than in Cyprus, real interest rates remained quite low. In addition, interest payments were tax deductible. Borrowing offered an attractive way of reducing the notoriously high

²⁴This section is based on a study by Drees and Pazarbaşıoğlu (1998). Norway has introduced similar measures of financial deregulation, but its effects are somewhat obscured by developments in the large oil sector.

Scandinavian tax burden. As Figure 23 shows, real interest rates after taxes were strongly negative, sometimes in the order of -6 to -8 percent per year.²⁵

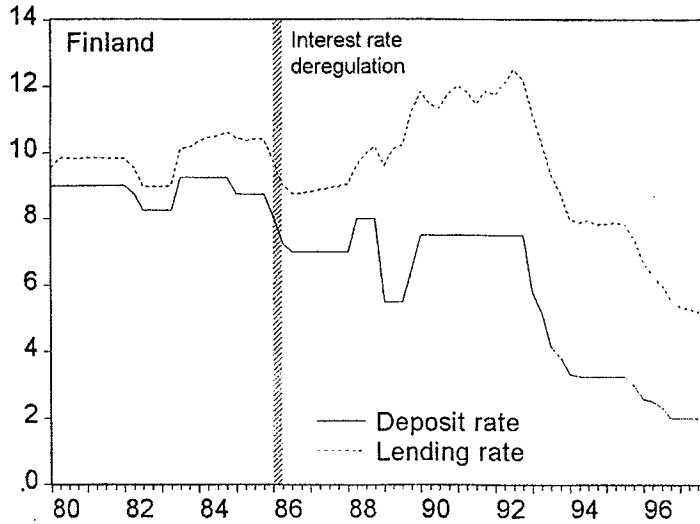


Figure 22. Nominal Interest Rates in Finland. Source: *International Financial Statistics*.

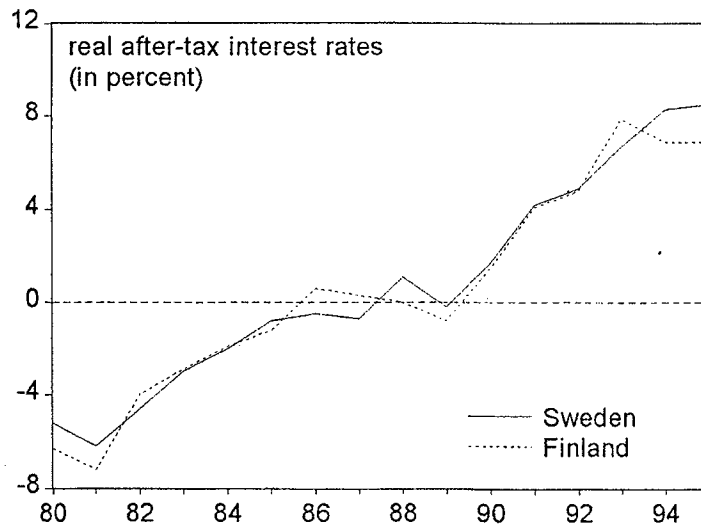


Figure 23. After-Tax Real Interest Rates in Scandinavia. Source: Drees and Pazarbaşıoğlu (1998).

²⁵Drees and Pazarbaşıoğlu (1998).

58. Both the administrative interest ceilings and the tax deductibility created a large excess demand for loans. The mechanism of rationing was the personal contact to banks and long-standing business relations were perceived as highly desirable. By knowing their borrowers intimately, banks did not need to devote a large amount of resources into risk assessment and monitoring. They were very conservative in granting loans, and selected low-risk projects, as the interest rate ceiling limited their potential return.

59. Entry into the banking business was regulated and difficult. In both countries the market was dominated by a small number of banks, by 14 banks in Sweden and by 7 banks in Finland. This stands in contrast to Denmark, which had more than 200 institutions in 1983 but about the same population as Finland. Banks competed for deposits by expanding their branch networks and offering a wider range of products.

60. Because of the small share of risky projects in banks' portfolios, the rate of nonperforming loans was low. Tight prudential supervision was not perceived as a priority by the authorities. Compared to other countries, loan loss provisions were minimal. In 1983, they amounted to only 0.05 percent of assets in Sweden and 0.02 percent in Finland, compared with 0.60 percent in Germany and 1.03 percent in Italy.

61. Also, low interest rates created an incentive for firms to be highly leveraged. The economy-wide debt to equity ratios in 1980 were 4 for Finland and 5.5 for Sweden.²⁶

62. During the early 1980s inflation accelerated, but the authorities were reluctant to adjust nominal interest rates. The ceilings became more and more binding, and accentuated the desire to bypass the regulations. An informal sector developed, with market-determined interest rates. Borrowers and lenders often interacted directly on this "grey market," without the help of banks. The "grey market" expanded rapidly and began to frustrate monetary policy. Liquidity requirements could not be enforced in this part of the financial system. To be effective, the liquidity requirements had to be raised extra high in the formal banking sector, a fact that was rightly perceived as unfair discrimination. The only way to overcome this dilemma was for monetary policy to switch to an active management of interest rates. Interest rate increases would be felt in both sectors, formal and informal. The central banks therefore started to press hard for financial reform and demanded the abolition of the interest rate ceiling.

Deregulation

63. Within the relatively short period of two–three years, both Finland and Sweden completely liberalized their domestic financial systems. The liquidity ratios were abandoned in 1983. In 1985, interest rate ceilings were removed. The central banks resorted to indirect instruments of credit control, such as open-market operations. Importantly, exchange rates

²⁶Drees and Pazarbaşıoğlu (1995), p. 17.

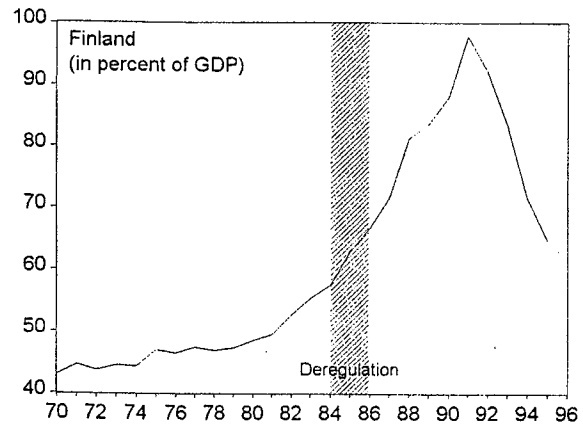
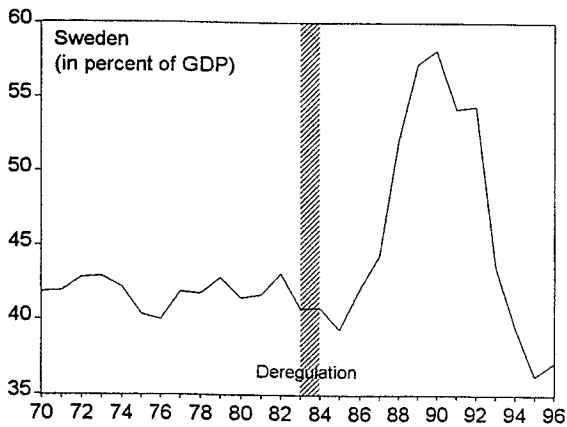
remained pegged in both countries. By 1989, the last foreign exchange restrictions were abolished.

The boom-and-bust cycle

64. After removing the interest rate ceiling, credit demand was no longer rationed. A large backlog of higher-risk projects flooded the market and promised ample profit opportunities. Banks responded to this stock adjustment in demand with an aggressive expansion of credit supply. They willingly incurred losses to attract as many depositors and borrowers as possible. Net interest income of banks declined during the liberalization period. In Finland, the competition for market shares was such that lending rates remained below the yield on public issues until the late 1980s.

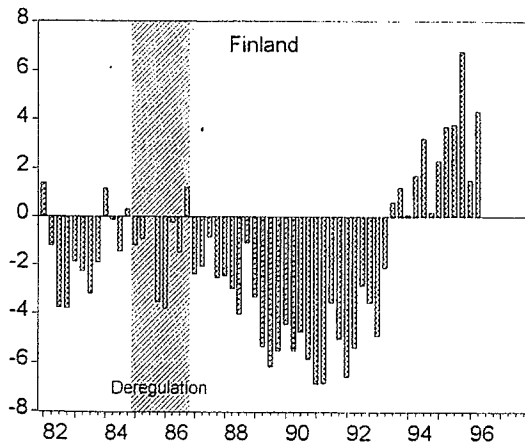
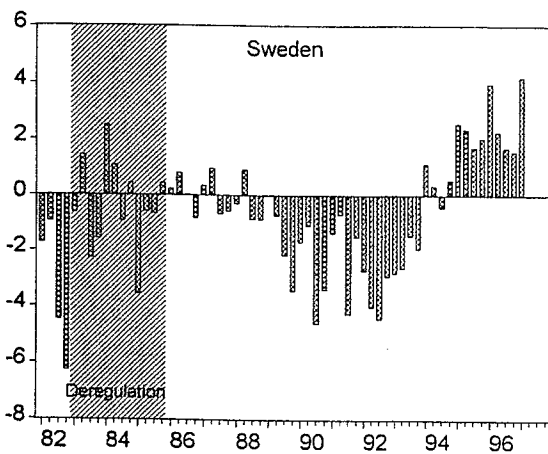
65. The response of the government was inadequate in many ways. In a new “laissez-faire” attitude, the authorities *reduced* rather than intensified their efforts at banking supervision. In addition, the government announced a “no-bank-will-fail” policy to soothe the public, which was worried about radical changes. This encouraged banks to minimize their screening and monitoring of loans and induced them to take more risks. The large branch network of Scandinavian banks also encouraged risk-taking behavior. Individual branches were poorly supervised by their headquarters and acted in an autonomous way. Small subsidiaries granted loans generously, including loans for very risky projects. The Finnish savings banks were most notorious in this respect: Their ownership structure was such that management was not monitored by shareholders. Moreover, an individual savings bank did not bear the entire default risk of its loans, since losses were shared with other banks through a system of mutual insurance.

66. Evidence from many countries suggests that after financial liberalization loans grow faster than deposits. The Scandinavian countries confirm this rule. Figures 24 and 25 show the expansion of private sector credit as a percentage of GDP for Sweden and Finland. As deposits became insufficient to finance the rapid expansion of loans, banks increasingly borrowed abroad. This introduced a large dose of exchange rate risk into the system. Borrowing in foreign currency was stimulated by an exchange rate peg, which was perceived as durable. Banks extended foreign currency loans to nontradable sectors, and increasingly to more cyclical parts of the economy.

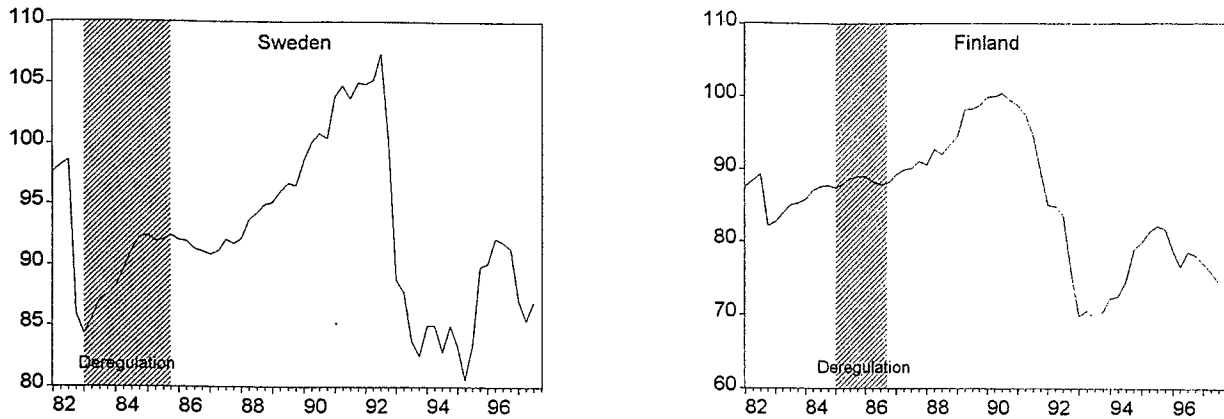


Figures 24 and 25. Private Sector Credit Relative to GDP. Source: *International Financial Statistics*.

67. A boom in asset prices reinforced the credit expansion. Sharp hikes in real estate prices increased the value of collateral, and booming share prices increased perceived wealth. This led to a fall in the savings rate. Both investment and consumption grew at a faster rate than output, and large current account deficits appeared in Sweden and Finland (Figures 26 and 27). Monetary policy initially accommodated the credit boom, perhaps in fear of an excessive increase in real interest rates. This fueled domestic inflation and led to a continuous real appreciation of the currency. The loss of external competitiveness was an early warning sign for the difficulties to come (Figures 28 and 29).



Figures 26 and 27. Current Account in Percent of GDP. Source: *International Financial Statistics*.



Figures 28 and 29. Real Effective Exchange Rates. Source: *International Financial Statistics*.

68. Around 1990, seemingly minor factors triggered a severe banking crisis in Finland and Sweden. A tax reform in Sweden reduced the financial incentive to borrow. Together with tighter monetary policy, it led to a sharp increase in real after-tax interest rates. Finland was hit by a drop in world paper prices, and, more severely, by the collapse of trade with the former socialist COMECON countries. Now the dangers of a highly leveraged economy became apparent. The increase in debt servicing costs in Sweden and the drop in revenues in Finland caused a wave of bankruptcies. This wave was reinforced, as both countries decided to devalue and float their currencies in order to contain the current account deficits. The devaluation led to a large increase in the value of foreign debt and to more bankruptcies.

69. Banks registered a surge in loan losses. Nonperforming loans increased to 11 percent of GDP in Sweden (1993) and 9 percent in Finland (1992). The largest default rates were registered in the construction sector, after the real estate bubble burst and land prices collapsed. As providers of nontradables, construction firms could not repay loans in foreign exchange after the devaluation.

70. Because banks themselves were highly leveraged, they were ill prepared for the increase in bad loans. Their small equity base was swiftly eroded, and several of the largest banks became insolvent. A full-fledged banking crisis threatened to pull the entire economy down into a depression. The government decided to intervene, taking over a number of large banks. Using tax money, the government conducted an expensive exercise in restructuring the financial system. This was the price for neglecting prudential supervision in the early stages of deregulation. The direct fiscal impact of the bank support operations amounted to 5.2 percent of GDP in Sweden and 10 percent of GDP in Finland.

C. Conclusions

71. Successful financial deregulation requires a delicate mix of conditions. The Scandinavian experience highlights the following points:

- First, stable and sound macroeconomic policies are needed to create basic confidence in the financial system. Scandinavia differed favorably from Latin American countries in this respect. Still, a serious crisis occurred. Macroeconomic stability alone is clearly not sufficient for a successful financial liberalization.
- Financial reform brings deep changes in microeconomic incentives and the behavior of firms. A history of smooth banking holds no guarantees for the future. The level of credit risk is likely to increase because new segments of demand enter the market. These market participants had previously been rationed. In Scandinavia, even banks with a record for conservatism turned into aggressive lenders after liberalization to protect their market shares.
- Banks need to recognize the importance of more thorough risk assessment and monitoring. As the examples of Sweden and Finland show, this might require a break with old habits and seemingly successful business practices. To have a buffer against higher risks, banks must increase their capital base.
- Prudential supervision must be intensified during liberalization. Furthermore, no bail-out guarantee should be given to banks because such guarantee might encourage excessive risk-taking. Scandinavian regulators failed on both accounts, with the consequence of costly rescue operations.
- Monetary policy faces the challenge of containing a possible credit boom. To avoid asset price bubbles and other inflationary phenomena, monetary policy should not be accommodating during the period of reforms.
- The opening of the capital account should proceed with caution. It is critical that supervision be extended to foreign exchange operations of banks. Borrowing from abroad introduces exchange rate risk into the system, in addition to the domestic default risk. By lending foreign currency to nontradable sectors, Scandinavian banks greatly increased the vulnerability of the economy to external shocks. As the credit bubble burst and the currencies were devalued, widespread bankruptcies occurred which intensified the downturn of the economy.

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Table 1. Cyprus: Aggregate Demand

(At constant 1990 prices)

	1992	1993	1994	1995	1996	1997 Est.
(In millions of Cyprus pounds)						
GDP at market prices	2,815.7	2,834.7	2,999.7	3,166.5	3,229.8	3,303.0
Consumption	2,268.6	2,105.7	2,193.4	2,396.0	2,501.1	2,567.1
Private	1,744.7	1,656.7	1,726.0	1,914.9	1,962.8	2,004.0
Government	523.9	449.0	467.4	481.1	538.3	563.1
Investment	817.4	683.0	780.2	851.0	865.3	827.6
Of which: change in stocks	83.7	43.3	157.5	237.6	238.7	224.4
Total domestic demand	3,086.0	2,788.7	2,973.6	3,247.0	3,366.4	3,394.7
Foreign balance	-332.3	-31.3	-44.9	-160.3	-217.8	-169.9
Exports of goods and NFS	1,426.9	1,403.0	1,514.5	1,578.2	1,632.1	1,661.5
Imports of goods and NFS	1,759.2	1,434.3	1,559.4	1,738.5	1,849.9	1,831.4
Statistical discrepancy	62.0	77.3	71.0	79.8	81.2	78.2
Net factor income from abroad	35.3	39.8	29.5	36.3	19.5	32.4
GNP at market prices	2,851.0	2,874.5	3,029.2	3,202.8	3,249.3	3,335.4
(Annual percentage changes)						
GDP at market prices	9.4	0.7	5.8	5.6	2.0	2.3
Consumption	5.4	-7.2	4.2	9.2	4.4	2.6
Private	3.1	-5.0	4.2	10.9	2.5	2.1
Government	13.8	-14.3	4.1	2.9	11.9	4.6
Investment	22.7	-16.4	14.2	9.1	1.7	-4.4
Total domestic demand	9.3	-9.6	6.6	9.2	3.7	0.8
Exports of goods and NFS	17.6	-1.7	7.9	4.2	3.4	1.8
Imports of good and NFS	18.9	-18.5	8.7	11.5	6.4	-1.0
(Contribution to growth of real GDP)						
GDP at market prices	9.4	0.7	5.8	5.6	2.0	2.3
Consumption	4.5	-5.8	3.1	6.8	3.3	2.0
Private	2.0	-3.1	2.4	6.3	1.5	1.3
Public	2.5	-2.7	0.6	0.5	1.8	0.8
Investment	6.1	-4.8	3.4	2.4	0.5	-1.2
Total domestic demand	10.7	-10.6	6.5	9.1	3.8	0.9
Foreign balance	-1.8	10.7	-0.5	-3.8	-1.8	1.5
Exports of goods and NFS	8.3	-0.8	3.9	2.1	1.7	0.9
Imports of good and NFS	-10.9	11.5	-4.4	-6.0	-3.5	0.6

Source: Ministry of Finance.

Table 2. Cyprus: Aggregate Demand

(At current prices)

	1992	1993	1994	1995	1996	<u>1997</u> Prov.
(In millions of Cyprus pounds)						
GDP at market prices	3,102.9	3,274.6	3,648.9	3,976.0	4,142.5	4,346.6
Consumption	2,527.7	2,482.5	2,706.1	3,033.2	3,267.0	3,478.4
Private	1,937.0	1,930.0	2,098.0	2,378.0	2,522.0	2,667.7
Government	590.7	552.5	608.1	655.2	745.0	810.7
Investment	890.5	788.8	930.1	1,049.7	1,097.2	1,076.6
Gross fixed capital formation	795.9	741.2	750.1	769.7	807.2	798.0
Change in stocks	94.6	47.6	180.0	280.0	290.0	278.6
Total domestic demand	3,418.2	3,271.3	3,636.2	4,082.9	4,364.2	4,555.0
Foreign balance	-347.0	-12.9	-20.9	-148.4	-286.7	-275.4
Exports of goods and NFS	1,534.6	1,549.1	1,734.6	1,851.3	1,922.2	1,990.1
Imports of goods and NFS	1,881.6	1,562.0	1,755.5	1,999.7	2,208.9	2,265.5
Statistical discrepancy	31.7	16.2	33.6	41.5	65.0	67.0
Net factor income from abroad	38.9	46.0	35.9	45.6	25.0	42.6
GNP at market prices	3,141.8	3,320.6	3,684.8	4,021.6	4,167.5	4,389.2
(In percent of GDP)						
Consumption	81.5	75.8	74.2	76.3	78.9	80.0
Private	62.4	58.9	57.5	59.8	60.9	61.4
Public	19.0	16.9	16.7	16.5	18.0	18.7
Investment	28.7	24.1	25.5	26.4	26.5	24.8
Gross fixed capital formation	25.7	22.6	20.6	19.4	19.5	18.4
Change in stocks	3.0	1.5	4.9	7.0	7.0	6.4
Total domestic demand	110.2	99.9	99.7	102.7	105.4	104.8
Foreign balance	-11.2	-0.4	-0.6	-3.7	-6.9	-6.3
Exports of goods and NFS	49.5	47.3	47.5	46.6	46.4	45.8
Imports of goods and NFS	60.6	47.7	48.1	50.3	53.3	52.1
Statistical discrepancy	1.0	0.5	0.9	1.0	1.6	1.5

Source: Ministry of Finance.

Table 3. Cyprus: Contributions to Growth of Real GDP 1/

(In percent)

	1992		1993		1994		1995		1996		1997	
	Incl bulk items	Excl. bulk items	Incl. bulk items	Excl. bulk items	Incl. bulk items	Excl. bulk items	Incl. bulk items	Excl. bulk items	Incl. bulk items	Excl. bulk items	Incl. bulk items	Excl. bulk items
Real GDP	9.4	9.4	0.7	0.7	5.8	5.8	5.6	5.6	2.0	2.0	2.3	2.3
Total Domestic Demand	10.7	10.7	-10.6	-5.8	6.5	6.9	9.1	9.5	3.8	2.5	0.9	1.2
Consumption	4.5	4.7	-3.6	-1.4	2.1	2.0	4.5	4.8	2.2	1.4	1.3	1.5
Private	2.0	2.2	-1.9	-2.0	1.7	1.7	4.2	4.3	1.0	1.0	0.8	0.8
Public	2.5	2.5	-1.7	0.7	0.4	0.3	0.3	0.5	1.2	0.4	0.5	0.6
Investment	6.1	4.0	-3.0	-2.4	2.3	2.7	1.6	1.6	0.3	0.3	-0.8	-0.8
GFCF	4.4	2.0	-2.1	-1.4	-0.4	0.0	-0.2	-0.2	0.3	0.3	-0.5	-0.5
Change in stocks	1.7	2.0	-0.9	-0.9	2.7	2.8	1.8	1.8	0.0	0.0	-0.3	-0.3
Foreign balance	-2.6	0.5	10.7	5.9	-0.5	0.8	-3.8	-4.2	-1.8	-0.5	1.5	0.3
Statistical discrepancy	0.6	0.6	0.5	0.5	-0.2	-0.2	0.3	0.3	0.0	0.0	-0.1	-0.1

Source: Ministry of Finance.

1/ Bulk items include aircraft purchases for Cyprus Airways valued at £C 48.4 million and £C 17.4 million in 1992 and 1993 respectively. Totals may not equal the sum of individual components due to rounding.

Table 4. Cyprus: Composition of Gross Fixed Capital Formation

	1992	1993	1994	1995	1996	1997 Est.
(In millions of Cyprus pounds, at constant 1990 prices)						
New buildings and works	462.0	439.8	441.9	435.6	436.6	421.4
Dwellings	232.8	224.9	225.8	226.8	242.5	230.4
Nonresidential buildings	144.9	105.3	99.8	93.8	100.2	95.7
Other construction works	84.3	109.6	116.3	115.0	93.9	95.3
Land improvement and plantation	0.8	0.8	1.2	1.6	1.1	1.1
Machinery and other equipment	183.6	146.0	145.5	141.3	150.3	144.3
Vehicles, ships and aircraft	87.3	52.3	32.0	33.1	37.7	35.4
Motor vehicles	37.5	29.1	29.5	36.7	34.7	32.3
Other	49.8	23.2	2.5	-3.6	3.0	3.1
Breeding stock, dairy cattle etc.	0.0	0.8	2.1	1.8	0.9	0.9
Total fixed capital formation	733.7	639.7	622.7	613.4	626.6	603.1
(Annual percentage changes at constant prices)						
New buildings and works	4.5	-4.8	0.5	-1.4	0.2	-3.5
Dwellings	-0.2	-3.4	0.4	0.4	6.9	-5.0
Nonresidential buildings	14.3	-27.3	-5.2	-6.0	6.8	-4.5
Other construction works	2.8	30.0	6.1	-1.1	-18.3	1.5
Land improvement and plantation	0.0	0.0	50.0	33.3	-31.3	0.0
Machinery and other equipment	40.2	-20.5	-0.3	-2.9	6.4	-4.0
Vehicles, ships and aircraft	172.8	-40.1	-38.8	3.4	13.9	-6.1
Motor vehicles	27.1	-22.4	1.4	24.4	-5.4	-6.9
Other	1,892.0	-53.4	-89.2	-244.0	-183.3	3.3
Breeding stock, dairy cattle etc.	0.0	1,718.2	162.5	-14.3	-50.0	0.0
Total fixed capital formation	16.2	-12.8	-2.7	-1.5	2.2	-3.8
(Percent of total, at constant prices)						
New buildings and works	63.0	68.8	71.0	71.0	69.7	69.9
Dwellings	31.7	35.2	36.3	37.0	38.7	38.2
Nonresidential buildings	19.7	16.5	16.0	15.3	16.0	15.9
Other construction works	11.5	17.1	18.7	18.7	15.0	15.8
Land improvement and plantation	0.1	0.1	0.2	0.3	0.2	0.2
Machinery and other equipment	25.0	22.8	23.4	23.0	24.0	23.9
Vehicles, ships and aircraft	11.9	8.2	5.1	5.4	6.0	5.9
Motor vehicles	5.1	4.5	4.7	6.0	5.5	5.4
Other	6.8	3.6	0.4	-0.6	0.5	0.5
Breeding stock, dairy cattle etc.	0.0	0.1	0.3	0.3	0.1	0.1

Source: Ministry of Finance.

Table 5. Cyprus: Origin of Gross Domestic Product

	1992	1993	1994	1995	1996	1997 Est.
(In millions of Cyprus pounds at constant 1990 prices)						
Primary sector	190.9	198.6	175.0	204.3	201.0	168.7
Agriculture	183.6	189.6	164.1	194.2	191.3	159.0
Mining	7.3	9.0	10.9	10.1	9.7	9.7
Industry	698.0	668.5	683.4	695.8	692.2	686.7
Manufacturing	372.3	350.6	362.7	366.9	358.7	358.7
Electricity, gas, and water	59.4	64.9	70.4	80.7	85.8	87.5
Construction	266.3	253.0	250.3	248.2	247.7	240.5
Services	1,473.6	1,494.3	1,646.7	1,746.7	1,801.1	1,891.5
Transport, storage and communications	242.6	263.7	297.4	304.2	313.7	324.4
Trade, restaurants, and hotels	607.3	584.6	649.5	690.7	684.0	704.0
Finance, insurance and real estate	455.2	460.9	502.2	541.2	573.3	613.4
Community, social and personal	168.5	185.1	197.6	210.6	230.1	249.7
Public administration	327.4	345.8	359.7	373.8	386.9	404.7
Other	18.8	20.2	20.9	24.3	25.9	27.7
Less imputed bank charges	87.7	78.5	86.6	91.5	94.3	97.9
Plus import duties & VAT (net)	194.7	185.8	200.6	213.1	217.0	221.6
GDP at constant 1990 prices	2,815.7	2,834.7	2,999.7	3,166.5	3,229.8	3,303.0
(Annual percentage changes at constant prices)						
Primary sector	19.5	4.0	-11.9	16.7	-1.6	-16.1
Agriculture	20.0	3.3	-13.4	18.3	-1.5	-16.9
Mining	9.0	23.3	21.1	-7.3	-4.0	0.0
Industry	3.8	-4.2	2.2	1.8	-0.5	-0.8
Manufacturing	1.8	-5.8	3.5	1.2	-2.2	0.0
Electricity, gas, and water	12.7	9.3	8.5	14.6	6.3	2.0
Construction	4.8	-5.0	-1.1	-0.8	-0.2	-2.9
Services	12.0	1.4	10.2	6.1	3.1	5.0
Transport, storage and communications	9.2	8.7	12.8	2.3	3.1	3.4
Trade, restaurants, and hotels	9.6	-3.7	11.1	6.3	-1.0	2.9
Finance, insurance and real estate	20.2	1.3	9.0	7.8	5.9	7.0
Community, social and personal	11.1	9.9	6.8	6.6	9.3	8.5
Public administration	5.6	5.6	4.0	3.9	3.5	4.6
Other	6.8	7.4	3.5	16.3	6.6	6.9
(Contribution to real GDP growth)						
Primary sector	1.2	0.3	-0.8	1.0	-0.1	-1.0
Agriculture	1.2	0.2	-0.9	1.0	-0.1	-1.0
Mining	0.0	0.1	0.1	0.0	0.0	0.0
Industry	1.0	-1.0	0.5	0.4	-0.1	-0.2
Manufacturing	0.3	-0.8	0.4	0.1	-0.3	0.0
Electricity, gas, and water	0.5	0.2	0.2	0.3	0.2	0.1
Construction	0.3	-0.5	-0.1	-0.1	0.0	-0.2
Services	6.1	0.7	5.4	3.3	1.7	2.8
Transport, storage and communications	0.8	0.7	1.2	0.2	0.3	0.3
Trade, restaurants, and hotels	1.1	-0.8	2.3	1.4	-0.2	0.6
Finance, insurance and real estate	1.8	0.2	1.5	1.3	1.0	1.2
Community, social and personal	0.6	0.6	0.4	0.4	0.6	0.6
Public administration	0.7	0.7	0.5	0.5	0.4	0.6
Other	0.0	0.0	0.0	0.1	0.1	0.1

Source: Ministry of Finance.

Table 6. Cyprus: Origin of Gross Domestic Product

(At current prices)

	1992	1993	1994	1995	1996	1997 Est.
(In millions of Cyprus pounds)						
Primary sector	186.0	194.1	190.2	210.7	199.5	181.5
Agriculture, forestry and fishing	177.6	183.8	177.8	199.5	189.0	171.1
Mining and quarrying	8.4	10.3	12.4	11.2	10.5	10.4
Secondary Sectors	784.7	795.9	842.1	884.9	914.4	935.1
Manufacturing	416.9	416.3	448.6	466.3	477.2	489.6
Electricity, gas, and water	61.0	67.1	70.9	84.2	88.8	93.3
Construction	306.8	312.5	322.6	334.4	348.4	352.2
Services	1,606.7	1,652.7	1,888.6	2,074.3	2,196.3	2,359.6
Transport, storage and communications	263.9	267.0	305.6	327.6	342.3	358.2
Trade, restaurants and hotels	652.0	638.3	732.2	805.4	811.5	851.5
Finance, insurance, estate, business	496.9	520.6	594.1	656.5	718.3	793.9
Community, social and personal services	193.9	226.8	256.7	284.8	324.2	356.0
Government Services	371.3	424.1	467.5	507.1	537.3	586.8
Other producers	21.3	24.5	26.8	32.9	36.5	40.9
Less imputed bank service charges	96.1	89.0	102.5	111.5	117.9	127.0
Plus import duties	192.5	160.0	167.6	186.0	178.4	163.5
Plus value added tax, net	36.5	112.3	168.6	191.6	198.0	206.3
GDP at current prices	3,102.9	3,274.6	3,648.9	3,976.0	4,142.5	4,346.7
(Percentage share of GDP)						
Primary sector	6.0	5.9	5.2	5.3	4.8	4.2
Agriculture, forestry and fishing	5.7	5.6	4.9	5.0	4.6	3.9
Mining and quarrying	0.3	0.3	0.3	0.3	0.3	0.2
Secondary sector	25.3	24.3	23.1	22.3	22.1	21.5
Manufacturing	13.4	12.7	12.3	11.7	11.5	11.3
Construction	2.0	2.0	1.9	2.1	2.1	2.1
Electricity, gas, and water	9.9	9.5	8.8	8.4	8.4	8.1
Services	51.8	50.5	51.8	52.2	53.0	54.3
Transport, storage and communications	8.5	8.2	8.4	8.2	8.3	8.2
Trade, restaurants and hotels	21.0	19.5	20.1	20.3	19.6	19.6
Finance, insurance, estate, business	16.0	15.9	16.3	16.5	17.3	18.3
Community, social and personal services	6.2	6.9	7.0	7.2	7.8	8.2
Government Services	12.0	13.0	12.8	12.8	13.0	13.5
Other producers	0.7	0.7	0.7	0.8	0.9	0.9

Source: Ministry of Finance.

Table 7. Cyprus: Gross Manufacturing Output by Major Industries

	1992	1993	1994	1995	1996	1997
(In millions of Cyprus pounds at current prices)						
Food, beverages, and tobacco	308.8	309.5	342.5	375.4	397.5	414.5
Textiles, clothing, and leather products	239.5	186.8	177.3	183.2	169.3	163.6
Wood products and furniture	91.6	93.4	100.8	109.6	109.9	111.6
Paper products, printing, and publishing	69.9	69.1	76.1	84.5	89.0	90.2
Chemicals, petroleum and plastic products	150.4	154.9	175.2	178.0	185.0	209.4
Nonmetallic mineral products	88.0	95.3	107.0	118.4	119.1	116.5
Metal products, machinery and equipment	131.8	135.3	142.7	151.7	154.1	160.3
Other manufacturing industries 1/	28.8	28.9	31.0	32.2	33.8	34.3
Total	1,108.8	1,073.2	1,152.6	1,233.0	1,257.7	1,300.4
(In percent of total)						
Food, beverages, and tobacco	27.8	28.8	29.7	30.4	31.6	31.9
Textiles, clothing, and leather products	21.6	17.4	15.4	14.9	13.5	12.6
Wood products and furniture	8.3	8.7	8.7	8.9	8.7	8.6
Paper products, printing, and publishing	6.3	6.4	6.6	6.9	7.1	6.9
Chemicals, petroleum and plastic products	13.6	14.4	15.2	14.4	14.7	16.1
Nonmetallic mineral products	7.9	8.9	9.3	9.6	9.5	9.0
Metal products, machinery and equipment	11.9	12.6	12.4	12.3	12.3	12.3
Other manufacturing industries 1/	2.6	2.7	2.7	2.6	2.7	2.6
(Annual percentage change, at current prices)						
Food, beverages, and tobacco	13.6	0.2	10.7	9.6	5.9	4.3
Textiles, clothing, and leather products	0.3	-22.0	-5.1	3.3	-7.6	-3.4
Wood products and furniture	9.4	2.0	7.9	8.7	0.3	1.5
Paper products, printing, and publishing	8.0	-1.1	10.1	11.0	5.3	1.3
Chemicals, petroleum and plastic products	-2.4	3.0	13.1	1.6	3.9	13.2
Nonmetallic mineral products	7.9	8.3	12.3	10.7	0.6	-2.2
Metal products, machinery and equipment	0.6	2.7	5.5	6.3	1.6	4.0
Other manufacturing industries 1/	1.6	0.3	7.3	3.9	5.0	1.5
Total	5.2	-3.2	7.4	7.0	2.0	3.4

Source: Central Bank of Cyprus.

1/ Including cottage industries.

Table 8. Cyprus: Tourist Arrivals and Receipts

	1992	1993	1994	1995	1996	1997 Est.
(In thousands)						
Total arrivals	1,991.0	1,841.0	2,069.0	2,100.0	1,950.0	2,080.0
European countries	1,764.8	1,583.6	1,853.0	1,807.0	1,699.5	1,909.0
Of which: United Kingdom	1,087.5	950.0	970.0	850.0	720.0	859.0
Middle Eastern countries 1/	114.2	105.0	111.0	105.0	105.0	53.0
Of which: Lebanon	50.3	35.0	35.0	32.0	...	...
Other countries	112.0	152.4	105.0	188.0	145.5	118.0
(Changes in percent)						
Total arrivals	43.7	-7.5	12.4	1.5	-7.1	6.7
European countries	47.0	-10.3	17.0	-2.5	-5.9	12.3
Of which: United Kingdom	60.4	-12.6	2.1	-12.4	-15.3	19.3
Middle Eastern countries 1/	16.8	-8.1	5.7	-5.4	0.0	-49.5
Of which: Lebanon	28.0	-30.4	0.0	-8.6	...	...
Other countries	28.7	36.1	-31.1	79.0	-22.6	-18.9
(In percent of total)						
European countries	88.6	86.0	89.6	86.0	87.2	91.8
Of which: United Kingdom	54.6	51.6	46.9	40.5	36.9	41.3
Middle Eastern countries 1/	5.7	5.7	5.4	5.0	5.4	2.5
Of which: Lebanon	2.5	1.9	1.7	1.5	...	...
Other countries	5.6	8.3	5.1	9.0	7.5	5.7
(In millions of Cyprus pounds at current prices)						
Foreign exchange receipts from tourism	696.0	698.3	812.5	812.9	783.1	838.5

Source: Cyprus Tourism Organization.

1/ Excluding Israel.

Table 9. Cyprus: Labor Force and Employment by Sector

	1992	1993	1994	1995	1996	1997 Est.
	(In thousands)					
Total labor force	285.6	286.7	294.3	303.1	307.3	306.7
Employed domestically	265.6	265.3	272.8	282.0	284.6	285.3
Primary sectors	33.0	32.2	30.8	31.3	30.7	29.1
Agriculture, forestry and fishing	32.3	31.5	30.1	30.5	29.9	28.5
Mining and quarrying	0.7	0.7	0.7	0.8	0.8	0.6
Industry	75.0	71.3	70.7	71.2	69.3	66.9
Manufacturing	48.1	44.8	44.4	44.0	42.5	40.6
Electricity, gas and water	1.4	1.5	1.5	1.5	1.5	1.5
Construction	25.5	25.0	24.8	25.7	25.3	24.8
Services	157.6	161.8	171.3	179.5	184.6	189.3
Trade, restaurants, hotels	66.6	67.4	70.8	74.6	76.3	77.3
Transport, communications	16.2	16.8	17.8	18.5	18.6	19.0
Finance, insurance, real estate	18.4	19.4	21.3	22.6	23.5	24.0
Other services	56.4	58.2	61.4	63.8	66.2	69.0
Employed abroad and other 1/	14.8	13.8	13.5	13.2	13.3	11.0
Unemployed	5.2	7.6	8.0	7.9	9.4	10.4
	(Percent of total)					
Employed domestically	93.0	92.5	92.7	93.0	92.6	93.0
Primary sector	11.6	11.2	10.5	10.3	10.0	9.5
Agriculture, forestry and fishing	11.3	11.0	10.2	10.1	9.7	9.3
Mining and quarrying	0.2	0.2	0.2	0.3	0.3	0.2
Industry	26.3	24.9	24.0	23.5	22.6	21.8
Manufacturing	16.8	15.6	15.1	14.5	13.8	13.2
Electricity, gas and water	0.5	0.5	0.5	0.5	0.5	0.5
Construction	8.9	8.7	8.4	8.5	8.2	8.1
Services	55.2	56.4	58.2	59.2	60.1	61.7
Trade, restaurants, hotels	23.3	23.5	24.1	24.6	24.8	25.2
Transport, storage and communications	5.7	5.9	6.0	6.1	6.1	6.2
Finance, insurance, real estate, business	6.4	6.8	7.2	7.5	7.6	7.8
Other services	19.7	20.3	20.9	21.0	21.5	22.5
Employed abroad and other 1/	5.2	4.8	4.6	4.4	4.3	3.6
Unemployed	1.8	2.7	2.7	2.6	3.1	3.4
Memorandum items:						
Percentage change in total labor force	2.6	0.4	2.7	3.0	1.4	-0.2
Percentage change in employment	4.5	-0.1	2.8	3.4	0.9	0.2
Participation rate 2/	72.6	71.5	72.3	72.9	73.4	...
Male	89.9	89.2	89.2	88.9	89.8	...
Female	55.3	53.8	55.7	56.7	57.0	...

Source: Ministry of Finance.

1/ Includes employees of British military authorities and the national guard.

2/ In percent of the population ages 15-64 in government-controlled area.

Table 10. Cyprus: Wage and Productivity Indicators

(Percentage change over previous year)

	1992	1993	1994	1995	1996	1997 Prov.
Average wage 1/	10.5	9.6	7.7	6.6	6.1	6.5
Of which:						
Agriculture	9.9	7.2	5.3	6.0	5.8	5.0
Manufacturing	10.3	9.8	7.1	6.4	5.8	5.6
Construction	10.8	10.7	7.3	6.6	6.0	6.6
Trade, restaurants and hotels	10.1	9.7	7.4	6.5	6.3	5.6
Government	11.2	9.3	8.6	6.2	5.8	8.1
Average earnings 2/	9.7	9.1	6.5	6.1	6.1	6.4
Of which:						
Agriculture	8.8	8.2	2.2	6.2	5.3	4.7
Manufacturing	9.3	8.4	5.3	5.9	6.0	5.6
Construction	7.8	10.1	5.4	6.3	6.3	6.4
Trade, restaurants and hotels	9.9	9.3	7.5	6.3	6.0	5.4
Government	10.6	9.5	6.1	5.7	5.8	8.4
Output per person employed	4.7	0.8	2.9	2.1	1.1	2.0
Of which:						
Agriculture	19.3	5.9	-9.4	16.8	0.5	-12.8
Manufacturing	1.5	1.2	4.3	2.1	1.2	4.7
Construction	0.7	-3.1	-0.3	-4.3	1.4	-0.9
Trade, restaurants and hotels	4.5	-4.9	5.8	0.9	-3.2	1.6
Memorandum items:						
Average real wage deflated by the CPI	3.8	4.4	2.9	3.9	3.1	2.8
Unit labor cost 3/	4.8	8.2	3.5	3.9	5.0	4.3
Unit labor cost in manufacturing 3/	7.7	7.0	0.9	3.7	4.7	0.9
Real unit labor cost 4/	-1.2	3.2	-1.7	0.7	2.8	1.7
Manufacturing sector 5/	-0.1	0.9	-3.2	0.9	0.0	-1.7

Source: Ministry of Finance.

1/ Including basic wages or salaries, cost of living and other allowances, bonuses, gratuities, and payments in kind. Data exclude overtime payments and are gross of income tax and social security deductions.

2/ Total gross weekly earnings, including overtime.

3/ Based on average earnings.

4/ Deflated by the GDP deflator.

5/ Deflated by the manufacturing deflator.

Table 11. Cyprus: Price Indices

	Weights	1993	1994	1995	1996	1997	1993	1994	1995	1996	1997
		(Annual percentage change)					Prov.	(Contribution to growth) 1/			
Food, beverages, and tobacco	28.8	3.2	6.3	1.3	3.1	5.2	0.9	1.2	0.4	0.9	1.5
Clothing and footwear	9.0	7.7	4.0	2.9	7.3	2.9	0.7	0.4	0.3	0.6	0.3
Rent, fuel, and power	17.0	5.6	5.2	5.7	5.0	5.2	1.0	0.8	1.0	0.9	0.9
Furnishings, household equipment, and supplies	7.6	5.7	2.5	2.2	0.6	2.9	0.4	0.2	0.2	0.1	0.2
Medical care	3.6	6.1	5.1	5.5	5.8	4.5	0.2	0.2	0.2	0.2	0.2
Transport and communication	23.9	4.4	4.3	0.7	-0.3	0.6	1.1	1.3	0.2	-0.1	0.1
Recreation, education, and entertainment	7.1	5.7	1.4	5.3	4.0	3.7	0.4	0.1	0.4	0.3	0.3
Miscellaneous	3.1	5.7	5.4	2.7	1.8	3.2	0.2	0.2	0.1	0.1	0.1
Total	100.0	4.9	4.7	2.6	3.0	3.6	4.9	4.4	2.6	3.0	4.0

Source: Ministry of Finance.

1/ Components may not sum to totals due to rounding.

Table 12. Cyprus: Implicit Deflators

(Annual percentage change)

	1992	1993	1994	1995	1996	<u>1997</u> Prov.
Consumption	6.7	5.8	4.6	2.6	3.2	3.7
Private	7.0	4.9	4.3	2.2	3.5	3.6
Public	5.1	9.1	5.7	4.7	1.6	4.0
Investment	5.0	6.0	3.2	3.5	2.8	2.6
Fixed capital	5.4	6.8	4.0	4.2	2.7	0.7
Stocks	8.2	-2.7	4.0	3.1	3.1	2.2
Total domestic demand	6.4	5.9	4.2	2.8	3.1	3.5
Exports	1.6	2.7	3.7	2.4	0.4	1.7
Aggregate demand	4.8	4.8	4.1	2.8	2.3	2.9
Imports	4.3	1.8	3.4	2.2	3.8	3.6
GDP at market prices	5.8	4.8	5.3	3.2	2.1	2.6

Source: Ministry of Finance.

Table 13. Cyprus: Consolidated Central Government Budget

(In millions of Cyprus pounds)

	1992	1993	1994	1995	1996	1997 Est.
Revenue	875.1	991.7	1,144.5	1,270.8	1,323.7	1,381.2
Current revenue	873.2	987.7	1,140.1	1,266.2	1,320.5	1,380.2
Tax revenue	693.4	790.7	928.4	1,022.4	1,058.3	1,070.7
Direct taxes	226.8	250.7	303.3	328.3	353.1	368.9
Indirect taxes	333.8	386.5	456.2	513.1	507.6	491.0
Social security contributions	132.8	153.5	168.9	181.0	197.5	210.8
Nontax	179.8	197.0	211.7	243.8	262.3	309.5
Capital revenue	0.8	0.3	0.5	0.8	0.8	0.6
Foreign grants	1.1	3.8	4.0	3.9	2.4	0.5
Expenditure	1,022.7	1,069.5	1,192.4	1,306.1	1,462.8	1,597.2
Current expenditure	906.4	945.5	1,064.1	1,152.9	1,318.2	1,442.9
Wages and salaries	278.6	306.5	354.3	374.7	396.8	432.6
Other goods and services	75.3	89.1	90.8	95.3	111.5	131.5
Subsidies	29.8	39.1	28.6	37.7	46.5	36.8
Interest payments	143.3	162.8	185.5	201.1	221.7	229.7
Social security payments	131.1	159.1	176.9	191.5	217.8	234.5
Other transfers	103.8	125.0	156.6	175.5	196.0	236.9
Other	144.6	64.0	71.4	69.2	113.3	125.4
Capital	101.0	108.3	128.3	150.2	144.6	154.4
Investment	84.6	90.0	99.7	96.6	96.9	103.6
Transfers	16.4	18.4	28.6	56.6	47.7	50.8
Net lending	15.3	15.7	4.0	4.6	3.0	6.4
Overall balance	-147.6	-77.8	-51.9	-39.9	-142.1	-222.4
Primary balance	-4.3	85.0	133.6	161.2	79.6	7.3
Financing	147.6	77.8	51.9	39.9	142.1	222.4
Domestic	207.0	168.9	116.9	117.4	203.9	121.8
Bank	169.2	122.5	38.5	67.3	146.9	111.4
Of which: Short-term borrowing from Central Bank	179.2	-6.9	3.0	226.9	-104.4	-32.9
Nonbank	37.8	46.4	78.5	50.1	57.0	10.4
Foreign, net	-59.5	-91.0	-65.1	-77.5	-61.8	100.6
Medium and long-term	-68.6	-65.0	-103.3	-61.1	-41.4	-57.4
Drawings	18.6	30.2	10.8	8.8	25.2	10.4
Amortization	-87.2	-95.1	-114.1	-70.0	-66.6	-67.7
Short-term foreign borrowing 1/	22.8	-14.2	45.4	-11.4	-17.2	4.7
Suppliers' credits	-8.9	-11.9	-7.2	-5.1	-3.3	-0.5
Receipts	3.6	0.9	0.9	0.2	0.0	0.0
Payments	-12.4	-12.8	-8.1	-5.2	-3.3	-0.5
Net IMF transactions	-4.8	0.0	0.0	0.0	0.0	0.0

Source: Ministry of Finance.

1/ Euro-commercial paper.

Table 14. Cyprus: Consolidated Central Government Budget

(In percent of GDP)

	1992	1993	1994	1995	1996	1997 Est.
Revenue	28.2	30.3	31.4	32.0	32.0	31.8
Current revenue	28.1	30.2	31.2	31.8	31.9	31.8
Tax revenue	22.3	24.1	25.4	25.7	25.6	24.6
Direct taxes	7.3	7.7	8.3	8.3	8.5	8.5
Indirect taxes	10.8	11.8	12.5	12.9	12.3	11.3
Social security contributions	4.3	4.7	4.6	4.6	4.8	4.9
Nontax	5.8	6.0	5.8	6.1	6.3	7.1
Capital revenue	0.0	0.0	0.0	0.0	0.0	0.0
Foreign grants	0.0	0.1	0.1	0.1	0.1	0.0
Expenditure	33.0	32.7	32.7	32.8	35.4	36.8
Current expenditure	29.2	28.9	29.2	29.0	31.9	33.2
Wages and salaries	9.0	9.4	9.7	9.4	9.6	10.0
Other goods and services	2.4	2.7	2.5	2.4	2.7	3.0
Subsidies	1.0	1.2	0.8	0.9	1.1	0.8
Interest payments	4.6	5.0	5.1	5.1	5.4	5.3
Social security payments	4.2	4.9	4.8	4.8	5.3	5.4
Other transfers	3.3	3.8	4.3	4.4	4.7	5.5
Other	4.7	2.0	2.0	1.7	2.7	2.9
Capital	3.3	3.3	3.5	3.8	3.5	3.6
Investment	2.7	2.7	2.7	2.4	2.3	2.4
Transfers	0.5	0.6	0.8	1.4	1.2	1.2
Net lending	0.5	0.5	0.1	0.1	0.1	0.1
Overall balance	-4.8	-2.4	-1.4	-1.0	-3.4	-5.1
Primary balance	-0.1	2.6	3.7	4.1	1.9	0.2

Source: Ministry of Finance.

Table 15. Cyprus: Consolidation of Central Government Budgets

(In millions of Cyprus pounds)

	1992	1993	1994	1995	1996	1997 Est.
Total revenue and grants	875.1	991.7	1,144.5	1,270.8	1,323.7	1,381.3
Ordinary budget	571.3	647.7	770.2	861.2	888.5	916.7
Special relief fund	38.4	28.2	26.9	23.7	18.6	11.0
Public loans fund	3.3	2.6	2.7	2.7	2.7	4.3
Social insurance funds	178.6	208.8	233.2	255.1	281.9	306.7
Sinking funds	13.3	19.4	18.0	24.4	24.0	26.0
Defence funds	70.3	85.1	93.6	103.9	108.0	116.6
Total expenditure and net lending	1,022.7	1,069.5	1,196.4	1,310.7	1,465.8	1,603.6
Ordinary budget	554.2	626.0	721.2	792.7	877.5	972.4
Development budget	104.8	115.0	126.1	146.3	136.0	153.4
Special relief fund	45.4	49.9	57.0	61.8	67.0	71.3
Public loans fund	1.9	2.8	1.3	0.3	0.3	1.5
Social insurance funds	133.6	163.5	182.3	198.6	228.0	245.7
Cyprus grain commission deficit	22.6	27.9	19.8	25.1	27.7	16.8
Defence fund	159.7	84.9	89.1	86.1	128.7	142.5
Adjustments to expenditure and net lending	0.5	-0.4	-0.3	-0.3	0.6	0.0
Overall balance	-147.6	-77.8	-51.9	-39.9	-142.1	-222.3

Source: Ministry of Finance.

Table 16. Cyprus: Central Government Ordinary Budget

(In millions of Cyprus pounds)

	1992	1993	1994	1995	1996	<u>1997</u> Est.
Total revenue and grants	571.3	647.7	770.2	861.2	888.5	916.7
Direct taxes	172.7	196.4	241.1	267.3	281.3	293.5
Income taxes	142.9	167.4	209.4	226.6	243.8	254.7
Companies	43.6	47.2	62.8	69.5	96.7	102.0
Individuals	99.3	120.2	146.6	157.1	147.1	152.7
Property taxes	9.7	9.0	10.0	13.9	11.4	12.4
Other	20.0	20.1	21.7	26.8	26.0	26.4
Indirect taxes	281.3	329.4	400.7	449.4	456.3	440.1
Selective excises	95.9	89.3	102.6	118.5	117.5	107.7
Import duties	99.6	83.2	81.2	86.2	84.4	69.4
VAT	36.5	112.3	168.5	191.9	198.0	206.3
Other	49.4	44.7	48.3	52.8	56.4	56.8
Nontax revenue	116.3	118.6	125.4	141.1	149.5	182.0
Of which:						
Central Bank profits	22.5	15.0	6.9	7.8	10.2	8.8
Capital revenue	0.7	0.2	0.4	0.7	0.7	0.6
Foreign grants	0.2	3.0	2.6	2.6	0.8	0.5
Total expenditure and net lending	554.2	626.0	721.2	792.7	877.5	972.4
Current expenditure	545.1	618.6	712.8	779.3	865.5	952.8
Wages and salaries	270.4	297.8	344.4	364.4	386.3	420.3
Goods and services	60.8	72.2	72.1	75.5	89.8	102.5
Interest payments	127.7	142.3	168.1	184.5	205.7	212.5
Subsidies	7.2	11.2	8.8	12.7	18.8	20.0
Transfers	79.0	95.1	119.5	142.2	165.0	197.5
Capital expenditure	8.4	6.4	8.8	11.8	10.9	17.4
Fixed capital formation	7.2	6.3	8.4	11.0	9.2	12.9
Transfers	1.2	0.1	0.4	0.8	1.6	4.5
Net lending	0.7	1.1	-0.5	1.7	1.1	2.2
Overall balance	17.1	21.7	49.0	68.4	11.0	-55.7

Source: Ministry of Finance.

Table 17. Cyprus: Central Government Development Budget

(In millions of Cyprus pounds)

	1992	1993	1994	1995	1996	<u>1997</u> Est.
Total expenditure and net lending	104.8	115.0	126.1	146.3	136.0	153.4
Expenditure	99.9	113.7	125.2	144.8	135.6	153.4
Current expenditure	24.0	27.9	28.9	33.2	35.7	47.2
Wages and salaries	4.4	4.8	5.5	5.6	5.7	6.6
Goods and services	11.7	13.4	14.1	15.1	15.8	18.4
Transfers	7.9	9.8	9.2	12.5	14.2	22.2
Capital expenditure	75.9	85.8	96.3	111.7	99.9	106.2
Fixed capital formation	65.4	73.3	80.6	72.4	73.0	79.3
Transfers	10.6	12.5	15.8	39.3	26.9	26.9
Net lending	4.9	1.3	0.9	1.5	0.4	0.0
Overall balance	-104.8	-115.0	-126.1	-146.3	-136.0	-153.4

Source: Ministry of Finance.

Table 18. Cyprus: Social Insurance Funds 1/

(In millions of Cyprus pounds)

	1992	1993	1994	1995	1996	1997 Est.
Receipts	178.6	208.8	233.2	255.1	281.9	306.7
Employees' contributions	53.6	62.5	70.5	76.2	82.3	89.4
Employers' contributions	63.8	72.3	80.3	87.3	96.7	103.6
Self-employed contributions	15.5	18.7	18.2	17.5	18.5	17.9
Nontax receipts	45.7	55.3	64.3	74.1	84.4	95.9
Expenditures	133.6	163.5	182.3	198.6	228.0	245.7
Current expenditures	134.1	162.7	181.5	198.8	226.8	245.7
Wages and salaries	2.6	2.7	3.2	3.2	3.2	4.0
Other goods and services	0.5	0.8	1.4	1.2	0.8	1.7
Transfers	131.1	159.1	176.9	196.5	222.8	240.0
Capital expenditure	0.0	0.0	0.3	0.0	0.0	0.0
Net lending	-0.5	0.8	0.6	-0.2	1.2	0.0
Overall balance	44.9	45.3	50.9	56.5	54.0	61.0

Source: Ministry of Finance.

1/ Includes the Social Insurance Fund, Unemployment Benefit Account, Central Holiday Fund, and the Redundancy Fund.

Table 19. Cyprus: Defence Fund

(In millions of Cyprus pounds)

	1992	1993	1994	1995	1996	<u>1997</u> Est.
Revenue	70.3	85.1	93.6	103.9	108.0	116.6
Tax revenue	70.1	85.0	93.3	103.5	107.5	116.3
Direct	41.6	46.8	54.4	55.3	67.7	72.9
Employees	21.5	23.3	25.9	28.3	30.2	30.3
Self-employed	4.2	3.2	3.3	2.9	10.7	9.5
Pensioners	1.2	1.3	1.8	1.9	2.2	1.8
Other	14.7	19.0	23.4	22.2	24.6	31.3
Indirect	28.5	38.1	38.9	48.2	39.8	43.4
Employers	14.7	16.5	18.1	20.0	21.4	22.1
Petroleum tax	4.6	12.3	11.0	17.7	7.5	10.2
Excise on tobacco	2.2	2.3	2.7	3.0	3.4	3.7
Excise on petrol	7.0	7.1	7.2	7.4	7.5	7.4
Nontax revenue	0.2	0.2	0.3	0.4	0.4	0.3
Expenditure	159.7	84.9	89.1	86.1	128.7	142.5
Overall balance	-89.5	0.3	4.5	17.8	-20.7	-25.9

Source: Ministry of Finance.

Table 20. Cyprus: Accounts of Relief Fund for Displaced Persons

(In millions of Cyprus pounds)

	1992	1993	1994	1995	1996	<u>1997</u> Est.
Receipts	38.4	28.2	26.9	23.7	18.6	11.0
Taxes on income and profits	12.6	7.4	7.8	5.6	4.2	2.4
Temporary import levy	23.6	18.7	16.2	15.2	11.1	7.1
Other indirect taxes	0.3	0.3	0.3	0.4	0.4	0.4
Nontax receipts	1.0	1.0	1.0	1.1	1.2	1.0
Capital revenue	0.0	0.0	0.0	0.1	0.1	0.0
Grants	0.9	0.8	1.4	1.4	1.7	0.0
Expenditures	45.4	49.9	57.0	61.8	67.0	71.3
Current expenditure	20.2	23.8	32.1	30.5	32.8	37.6
Wages and salaries	1.0	1.1	1.2	1.4	1.5	1.6
Other goods and services	2.3	2.7	3.1	3.4	5.0	8.8
Interest payments	0.0	0.0	0.0	0.0	0.0	0.0
Transfers	16.9	20.1	27.8	25.8	26.4	27.2
Capital expenditures	16.7	16.1	22.9	29.7	33.8	30.8
Fixed capital formation	12.0	10.4	10.5	13.2	14.7	11.4
Transfers	4.7	5.7	12.4	16.5	19.1	19.4
Net lending	8.5	10.0	2.0	1.6	0.4	2.9
Overall balance	-6.9	-21.8	-30.1	-38.2	-48.4	-60.4

Source: Ministry of Finance.

Table 21. Cyprus: Public Loans Fund

(In millions of Cyprus pounds)

	1992	1993	1994	1995	1996	1997 Est.
Total revenue and grants	3.3	2.6	2.7	2.7	2.7	4.3
Nontax revenue	3.3	2.6	2.7	2.7	2.7	4.3
Expenditure	1.9	2.8	1.3	0.3	0.3	1.5
Current expenditure	0.2	0.3	0.3	0.3	0.3	0.3
Wages and salaries	0.1	0.1	0.1	0.1	0.1	0.1
Goods and services	0.1	0.1	0.1	0.2	0.1	0.1
Interest	0.1	0.1	0.1	0.0	0.1	0.1
Net lending	1.7	2.5	1.1	0.0	0.0	1.2
Overall balance	1.3	-0.2	1.4	2.4	2.4	2.8

Source: Ministry of Finance.

Table 22. Cyprus: Government and Government-Guaranteed Net Debt 1/

	1992	1993	1994	1995	1996	1997 Est.
(In millions of Cyprus pounds; end of period)						
Total government debt	1,736.0	1,913.5	1,953.2	2,059.1	2,199.3	2,418.3
Domestic debt 1/	1,070.7	1,285.7	1,396.6	1,579.8	1,796.4	1,915.8
Short-term	769.1	939.6	991.8	1,134.8	1,312.7	1,237.6
Long-term	301.6	346.1	404.8	445.0	483.6	678.2
Foreign debt	665.3	627.8	556.7	479.3	402.9	502.5
Short-term 2/	108.7	108.3	149.9	136.5	120.1	124.8
Long-term	556.6	519.5	406.8	342.8	282.8	377.7
Government-guaranteed external debt	221.8	259.0	280.5	290.0	290.5	340.0
Total government and government- guaranteed debt	1,962.9	2,177.5	2,233.7	2,349.1	2,489.8	2,758.3
(In percent of GDP)						
Total government debt	55.9	58.4	53.5	51.8	53.2	55.7
Domestic debt 1/	34.5	39.3	38.3	39.7	43.4	44.1
Short-term	24.8	28.7	27.2	28.5	31.7	28.5
Long-term	9.7	10.6	11.1	11.2	11.7	15.6
Foreign debt	21.4	19.2	15.3	12.1	9.7	11.6
Short-term 2/	3.5	3.3	4.1	3.4	2.9	2.9
Long-term	17.9	15.9	11.1	8.6	6.8	8.7
Government-guaranteed external debt	7.1	7.9	7.7	7.3	7.0	7.8
Total government and government- guaranteed debt	63.3	66.5	61.2	59.1	60.2	63.5

Source: Ministry of Finance.

1/ Excludes intragovernmental debt.

2/ Excludes short-term liabilities of the central bank.

Table 23. Cyprus: Total Gross Public Debt by Instrument and Lender 1/

(In million of Cyprus pounds)

	1992	1993	1994	1995	1996	1997 Est.
Domestic	1,813.8	2,152.3	2,403.4	2,730.7	3,102.5	3,395.5
Long-term	302.2	346.6	405.3	445.5	484.1	678.6
Development stocks	276.8	320.3	377.3	415.2	454.0	644.7
Central bank	24.3	23.3	25.4	29.8	30.9	42.9
Deposit money banks	6.0	6.0	6.0	5.0	0.0	106.1
Private sector	246.3	290.8	345.4	379.9	422.7	495.2
Sinking funds 2/	0.0	0.0	0.0	0.0	0.0	0.0
Social security funds 2/	0.2	0.2	0.5	0.5	0.5	0.5
Savings bonds	16.5	17.3	18.3	21.0	21.0	23.5
Central bank	0.5	0.6	0.9	3.7	2.0	3.5
Private sector	16.0	16.7	17.4	17.3	19.0	20.0
Savings certificates	8.8	9.0	9.7	9.3	9.1	10.5
Private sector	8.8	9.0	9.7	9.3	9.1	10.5
Other	0.0	0.0	0.0	0.0	0.0	0.0
Deposit money banks	0.0	0.0	0.0	0.0	0.0	0.0
Short-term	1,511.6	1,805.8	1,998.1	2,285.2	2,618.4	2,716.9
Treasury bills	1,274.7	1,536.2	1,670.9	1,925.2	2,286.1	2,403.5
Central bank	182.4	142.9	88.3	282.4	205.8	191.8
Deposit money banks	336.5	513.9	560.5	458.7	722.1	741.4
Private sector	13.3	13.3	15.8	33.7	52.6	-8.9
Sinking funds 2/	0.0	0.0	0.0	0.0	0.0	0.0
Social security funds 2/	742.5	866.2	1,006.3	1,150.4	1,305.7	1,479.2
Central bank advances	236.9	269.5	327.2	360.0	332.3	313.4
Foreign	670.0	632.6	561.4	484.0	407.7	507.3
Short-term liabilities of the Central bank to the IMF	4.8	4.8	4.8	4.8	4.8	4.8
Long-term loans	556.6	519.5	406.8	342.8	282.9	224.0
Of which: Defence fund	88.2	52.7	26.0	10.7	3.6	2.3
Medium-term loans (E.M.T.N.)	0.0	0.0	0.0	0.0	0.0	153.8
Short-term loans (E.C.P.)	108.7	108.3	149.9	136.5	120.1	124.8
Total debt	2,483.8	2,784.9	2,964.8	3,214.7	3,510.2	3,902.8

Source: Ministry of Finance.

1/ Includes intragovernmental debt and short-term liabilities of the central bank.

2/ Intragovernmental debt.

Table 24. Cyprus: Targets and Outturns for Monetary and Credit Aggregates

	1992		1993		1994		1995		1996		1997	
	Prog.	Outturn	Prog.	Outturn	Prog.	Outturn	Prog.	Outturn	Prog.	Outturn	Prog.	Outturn
	(Rates of growth; in percent)											
Total liquidity (M2)	14.5	13.9	8.1	16.4	12.9	12.5	14.0	11.5	9.0	10.5	9.3	11.0
Domestic credit 2/	13.4	15.9	10.9	9.5	9.6	8.1	10.5	11.0	8.9	11.5	11.3	14.5
Credit to private sector	13.6	17.5	11.5	12.7	11.0	13.5	11.0	17.0	13.0	13.7	11.0	12.2
Gross domestic product	12.6	16.0	5.8	5.5	8.1	11.4	8.2	9.0	7.3	4.2	5.7	6.0
	(As a ratio to average M2)											
Memorandum items:												
Income velocity of M2	1.23	1.28	1.19	1.17	1.10	1.15	1.03	1.11	1.05	1.05	1.01	0.99
Rate of change, in percent	-9.6	2.4	-3.3	-8.6	-7.6	-1.7	-6.4	-3.5	1.9	-5.4	-3.8	-5.7

Source: Central Bank of Cyprus.

1/ In calculating growth rates and ratios from 1991, data for Lombard Natwest Bank Ltd. at the end of 1990 were included in the category of DMBs.

2/ Adjusted for government foreign borrowing.

Table 25. Cyprus: Liquidity of All Banks

	1992	1993	1994	1995	1996	1997
(In millions of Cyprus pounds, end of period)						
Total liquid assets, net	676.7	890.8	992.8	944.1	...	...
Domestic 1/	666.1	892.8	985.5	942.4	...	...
Foreign 2/	10.6	-2.0	7.3	1.7	...	...
Total bank deposits 3/	2,462.5	2,911.7	3,297.0	3,702.2	...	...
(In percent of domestic deposits)						
Liquidity ratio	27.5	30.6	30.1	25.5	...	...
Required liquidity ratio	28.8	27.0	27.0	25.5	...	...
Reserve requirement						

Source: Central Bank of Cyprus.

Note: The monetary framework changed in 1996 from one based on the liquidity ratio to an indirect framework. Consequently, the presentation in this table has been discontinued.

1/ Includes cash, central bank balances, and treasury bills.

2/ Includes foreign currency checks, bills, and net short-term balances with foreign banks.

3/ Excluding "special deposits."

Table 26. Cyprus: Financial Indicators

	1992	1993	1994	1995	1996	1997
	(In millions of U.S. dollars)					
Gross official reserves	504.3	578.1	705.6	518.2	805.2	802.7
Central bank short-term foreign liabilities 1/	258.9	195.4	218.7	135.5	156.8	163.8
Central bank foreign currency exposure 2/	258.9	195.4	218.7	135.5	156.8	163.8
Short-term foreign assets of the financial sector 3/	635.2	767.5	857.6	1343.2	1444.6	1805.4
Short-term foreign liabilities of the financial sector 3/	746.7	965.7	1089.5	1604.7	1877.8	2333.1
Foreign currency exposure of the financial sector 2/ 3/	39.8	19.8	22.9	38.3	37.7	53.4
	(In percent)					
Central bank lending to banks/GDP	1.1	0.4	0.3	0.6	0.2	0.0
Share of non-performing loans in total loans	...	...	...	4.0	3.8	4.8
Risk-based capital asset ratio (capital/ risk-weighted liabilities)	12.2	11.2	11.2	10.5	9.9	9.9
Share of foreign exchange loans in total lending to domestic residents	2.0	2.7	2.5	2.8	4.3	4.8
Share of foreign deposits in total deposits	25.7	24.8	24.6	26.9	28.1	28.4
Average maturity of lending	...	...	...	...	...	...
Average maturity of deposits (in days)	...	218.0	...	233.0	229.0	233.0
Share of private credit collateralized by real estate	...	...	...	...	...	...
Share prices (indices, 1995 = 100)						
Financial sector	65.9	59.2	66.5	100	...	...
Banking	...	...	...	100	125.7	122

1/ Short term defined as one year and under. The use of remaining maturity, rather than original maturity is preferred.

2/ This position includes off-balance sheet foreign currency liabilities, such as short-forward positions.

3/ Excluding the central bank.

Table 27. Cyprus: Credit by Deposit Money Banks to the Private Sector

	1992	1993	1994	1995	1996	1997
(End-of-period stocks, millions of Cyprus pounds)						
Personal loans	572.8	669.3	764.3	944.6	1,153.1	1,397.0
Foreign and domestic trade	587.9	631.6	715.3	840.5	926.8	1,006.4
Manufacturing	325.9	347.5	372.7	405.6	439.0	451.2
Building and construction	310.6	377.9	431.5	489.2	538.0	595.9
Tourism	214.7	245.1	302.4	358.6	416.0	445.0
Other	172.2	189.8	211.1	230.2	245.3	277.1
Total	2,184.2	2,461.2	2,797.3	3,268.7	3,718.2	4,172.6
(As a percentage of end-of-period stocks)						
Personal loans	26.2	27.2	27.3	28.9	31.0	33.5
Foreign and domestic trade	26.9	25.7	25.6	25.7	24.9	24.1
Manufacturing	14.9	14.1	13.3	12.4	11.8	10.8
Building and construction	14.2	15.4	15.4	15.0	14.5	14.3
Tourism	9.8	10.0	10.8	11.0	11.2	10.7
Other	7.9	7.7	7.5	7.0	6.6	6.6
Total	100.0	100.0	100.0	100.0	100.0	100.0
(Flows of new credit, millions of Cyprus pounds)						
Personal loans	124.0	96.5	95.0	180.3	208.5	243.9
Foreign and domestic trade	97.6	43.7	83.8	125.2	86.3	79.6
Manufacturing	9.6	21.6	25.2	32.9	33.4	12.2
Building and construction	44.4	67.3	53.6	57.7	48.8	57.9
Tourism	30.0	30.4	57.3	56.2	57.4	29.0
Other	20.1	17.7	21.3	19.1	15.1	31.8
Total	325.7	277.1	336.1	471.4	449.5	454.4
(As a percentage of total flow of new credit)						
Personal loans	38.1	34.8	28.3	38.2	46.4	53.7
Foreign and domestic trade	30.0	15.8	24.9	26.6	19.2	17.5
Manufacturing	3.0	7.8	7.5	7.0	7.4	2.7
Building and construction	13.6	24.3	15.9	12.2	10.9	12.7
Tourism	9.2	11.0	17.0	11.9	12.8	6.4
Other	6.2	6.4	6.3	4.1	3.4	7.0
Total	100.0	100.0	100.0	100.0	100.0	100.0

Source: Central Bank of Cyprus, *Annual Report*, various issues.

Table 28. Cyprus: Monetary Survey

	1992	1993	1994	1995	1996	1997
(In millions of Cyprus pounds, end-of-period stocks)						
Foreign assets, net	168.1	220.8	306.6	178.3	286.3	183.7
Official reserves 2/	467.1	550.4	679.2	477.5	778.8	764.2
Deposit money banks	-298.9	-329.3	-372.5	-299.1	-492.3	-580.4
Payments agreements	-0.2	-0.2	-0.1	-0.1	-0.1	0.0
Domestic credit, net	2,799.7	3,225.8	3,579.3	4,108.1	4,670.7	5,228.5
Public sector	589.6	734.2	751.5	800.9	908.9	1,008.6
Central government	604.2	747.2	764.8	819.3	920.7	1,023.0
Advances	221.8	252.5	296.1	308.7	342.7	332.3
Treasury bills and securities	549.3	686.7	681.2	776.7	960.7	1,072.7
Deposits	-166.9	-192.0	-212.5	-266.1	-382.7	-382.0
Government agencies	2.3	5.2	4.4	-1.1	5.4	3.7
Other	-16.9	-18.2	-17.7	-17.3	-17.2	-18.2
Private sector	2,210.1	2,491.6	2,827.8	3,307.2	3,761.8	4,219.9
Other items, net	-391.6	-447.3	-513.1	-526.3	-800.7	-798.2
Broad money (M2)	2,576.2	2,999.3	3,372.8	3,760.1	4,156.4	4,614.0
Money supply (M1)	504.0	548.4	574.7	613.7	653.2	704.1
Currency in circulation	215.0	229.4	246.6	257.1	265.8	276.3
Demand deposits	289.0	319.0	328.1	356.6	387.4	427.8
Quasi-money	2,072.2	2,450.9	2,798.1	3,146.4	3,503.2	3,909.9
Savings deposits	147.0	152.6	163.8	167.2	168.2	180.9
Time deposits	1,901.9	2,271.3	2,598.7	2,927.4	3,265.0	3,652.2
Residents' foreign currency	23.3	27.0	35.6	51.8	70.0	76.8
(Absolute change over preceding 12 months)						
Foreign assets, net	-137.1	52.7	85.8	-128.3	108.0	-102.6
Official reserves 2/	-117.4	83.3	128.8	-201.7	301.3	-14.6
Deposit money banks	-19.8	-30.4	-43.2	73.4	-193.2	-88.1
Payments agreements	0.0	0.0	0.1	0.0	0.0	0.1
Domestic credit, net	520.1	426.1	353.5	528.8	562.6	557.8
Public sector	190.9	144.6	17.3	49.4	108.0	99.7
Central government	193.0	143.0	17.6	54.5	101.4	102.3
Advances	136.3	30.7	43.6	12.6	34.0	-10.4
Treasury bills and securities	73.3	137.4	-5.5	95.5	184.0	112.0
Deposits	-16.6	-25.1	-20.5	-53.6	-116.6	0.7
Government agencies	3.5	2.9	-0.8	-5.5	6.5	-1.7
Other	-5.6	-1.3	0.5	0.4	0.1	-1.0
Private sector	329.2	281.5	336.2	479.4	454.6	458.1
Other items, net	-68.8	-55.7	-65.8	-13.2	-274.4	2.5
Broad money (M2)	314.2	423.1	373.5	387.3	396.3	457.6
Money supply (M1)	42.8	44.4	26.3	39.0	39.5	50.9
Currency in circulation	19.5	14.4	17.2	10.5	8.7	10.5
Demand deposits	23.3	30.0	9.1	28.5	30.8	40.4
Quasi-money	271.4	378.7	347.2	348.3	356.8	406.7
Savings deposits	6.9	5.6	11.2	3.4	1.0	12.7
Time deposits	259.2	369.4	327.4	328.7	337.6	387.2
Residents' foreign currency	5.3	3.7	8.6	16.2	18.2	6.8
Memorandum items:						
Income velocity of M2 3/	1.3	1.2	1.1	1.1	1.0	1.0
Income velocity of M1 3/	6.4	6.2	6.7	6.5	6.3	6.2
Deposits with cooperatives 4/	1,230.3	1,417.3	1,608.4	1,800.4	1,976.9	2,200.0
Loans by cooperatives 4/	1,108.0	1,270.3	1,452.2	1,652.9	1,836.4	2,000.0

Source: Central Bank of Cyprus.

1/ As from 1991 Lombard Natwest Bank Ltd. is classified as a D.M.B.

2/ Includes holdings of SDRs, government holdings of foreign exchange, and reserve position in the IMF.

3/ Nominal GDP/average of money stock at beginning and end of year.

4/ Data exclude the operations of the Cooperative Central Bank, which is included in the monetary survey.
Data for 1997 are preliminary.

Table 29. Cyprus: Balance Sheet of the Central Bank

	1992	1993	1994	1995	1996	1997
(In millions of Cyprus pounds, end-of-period stocks)						
Total assets	982.2	1,030.8	1,151.3	1,186.8	1,421.4	1,398.7
International reserves 1/	486.9	559.2	687.2	500.2	787.3	783.9
Loans to banks	34.2	13.4	12.4	22.4	6.5	0.1
Loans to government	225.4	258.6	301.6	311.5	349.1	338.3
Government securities	209.3	169.4	117.2	313.4	239.0	238.6
other assets	26.4	30.2	32.9	39.3	39.5	37.8
Total liabilities	982.2	1,030.8	1,151.3	1,186.8	1,421.4	1,398.7
Currency	236.7	252.1	269.9	282.4	294.1	305.9
Deposits by banks	567.3	554.6	632.7	599.1	494.6	488.6
Deposits by government, others	137.5	161.2	183.0	235.0	352.3	350.9
Capital and other liabilities 1/	40.7	62.9	65.7	70.3	280.4	253.3
Monetary base	804.0	806.7	902.6	881.5	788.7	794.5
Currency	236.7	252.1	269.9	282.4	294.1	305.9
Deposits by banks	567.3	554.6	632.7	599.1	494.6	488.6
(Percentage change)						
Monetary base	6.9	0.3	11.9	-2.3	-10.5	0.7
International reserves 2/	-15.9	9.0	15.9	-20.7	32.6	-0.4
Domestic assets 3/	22.7	-8.7	-4.0	18.4	-43.1	1.2
Currency 4/	2.5	1.9	2.2	1.4	1.3	1.5
Deposits by banks 4/	4.3	-1.6	9.7	-3.7	-11.9	-0.8
Memorandum items:						
M1 multiplier	0.6	0.7	0.6	0.7	0.8	0.9
M2 multiplier	3.2	3.7	3.7	4.3	5.3	5.8
International reserves (in months of imports of goods and nfs.)	3.1	4.3	4.7	3.0	4.3	4.2

Source: Central Bank of Cyprus.

1/ Revaluation of assets in 1996 corresponds to an increase by £C 288.4 million.

2/ Contribution to growth of monetary base, excludes the effect of the revaluation.

3/ Monetary base minus international reserves, contribution to growth in monetary base.

4/ Contribution to growth in monetary base.

Table 30. Cyprus: Selected Interest Rates

(In percent per annum)

	1991	1992	1993	1994	1995	1996	1997
Central bank rates							
Discount rate	6.5	6.5	6.5	6.5	6.5	...	...
Loans to government agencies	6.0	6.0	6.0	6.0	6.0	6.0	6.0
Overdraft facility	4.5	4.5	4.5	4.5	4.5	...	...
Lombard facility	...	...	...	...	...	7.5	7.5
Deposits							
Minimum reserves 1/	6.0	6.0	6.0	6.0	6.0	6.0	6.0
Overnight	...	...	...	...	...	5.0	4.0
Seven days	4.5	4.5	4.5	4.5	4.5	...	...
One month	5.0	5.0	5.0	5.0	5.0	...	...
Interbank money market rate	7.5-8.0	7.5-8.0	7.5-8.0	7.25-8.0 2/	7.25-7.5	6.9 8/	4.8 8/
Commercial bank rates							
Demand deposits							
Up to £C 1,000	0.0	0.0	0.0	0.0	0.0	0.0	0.0 10/
Over £C 1,000 3/	2.0	2.0	2.0	2.0	2.0	2.0	2.0 10/
Savings deposits	4.0	4.0	4.0	4.0	4.0	4.0	4.0 10/
Time deposits							
Minimum 4/	4.5	4.5	4.5	4.5	4.5	4.5	4.5 10/
Maximum 5/	7.0	7.0	7.0	7.0	7.0	7.0	6.5 10/
Advances and loans	Up to 9.0	Up to 9.0	Up to 9.0	8.5 6/	8.5	8.5	8.0 10/
Rates on government paper							
Treasury bills	6.0	6.0	6.0	6.0	6.0	6.1 9/	5.4 9/
Long-term bond yield	8.0	8.0	8.0	7.0	7.0	7.0	6.9 11/

Source: Central Bank of Cyprus.

1/ Beginning in April 1992 a rate of 8 percent is paid on the top 2 percent of the minimum reserve requirements.

2/ 7.5-8.0 percent during January-May; 7.25-7.5 percent during June-December.

3/ Applies to balances of up to £C 15,000.

4/ Applies to balances of up to £C 5,000 which require seven days' notice for withdrawal.

5/ Applies to balances over £C 50,000 deposited for one year or more.

6/ As from September 1, 1994.

7/ As from May 1, 1994.

8/ Period average, overnight rate.

9/ Period average.

10/ As from March 18, 1997.

11/ From 1997 on: 10-year bond.

Table 31. Cyprus: Nominal and Real Exchange Rate Indices

(1990 = 100)

	Nominal Exchange Rate Indices			Nominal Effective Exchange Rate 1/	Relative Consumer Price Index 1/	Real Effective Exchange Rate 1/
	U.S. dollar/ Cyprus pound	ECU/ Cyprus pound	Pound sterling/ Cyprus pound			
1992	101.5	99.7	102.7	104.8	98.0	102.7
1993	92.0	99.9	109.3	105.8	97.6	103.3
1994	93.0	99.6	108.4	109.6	96.5	105.8
1995	101.1	98.4	114.3	113.8	93.9	106.8
1996	97.9	98.6	112.1	116.0	92.2	107.0
1997	88.8	99.1	96.9	116.9	91.4	106.8
1996						
I	98.3	97.3	114.4	114.7	92.9	106.5
II	96.9	98.3	113.3	115.3	92.6	106.8
III	98.7	98.9	113.1	116.8	92.2	107.6
IV	98.3	99.1	106.9	117.4	91.2	107.1
1997						
I	92.1	99.5	100.6	116.6	91.8	107.0
II	89.6	99.7	97.6	116.5	91.8	106.9
III	85.9	100.1	94.1	115.5	91.2	105.4
IV	88.5	99.9	94.9	119.1	90.4	107.7

Source: IMF, *International Financial Statistics*.

1/ INS trade weights, excluding Brazil.

Table 32. Cyprus: Balance of Payments Summary

(In millions of Cyprus pounds)

	1992	1993	1994	1995	1996	1997 Prov.
Exports, f.o.b. 1/	396.6	387.1	432.9	510.2	597.1	605.7
Imports, f.o.b. (including bulk items) 2/	-1,483.8	-1,181.1	-1,330.5	-1,499.4	-1,667.4	-1,704.7
Trade balance (excluding bulk items)	-1,087.2 -1,044.0	-794.0 -778.4	-897.6 -897.6	-989.2	-1,070.3	-1,099.0
Invisible receipts	1,301.4	1,326.4	1,467.6	1,514.2	1,508.1	1,588.7
Invisible payments	-505.1	-481.2	-533.7	-614.7	-660.7	-686.2
Invisible balance	796.3	845.2	933.9	899.5	847.4	902.5
Current account balance	-290.9	51.2	36.3	-89.7	-222.9	-196.5
Short-term (net)	45.9	-31.6	63.2	6.7	4.4	-22.5
Long-term loans (net)	26.0	-26.2	-60.5	-40.8	-47.2	134.2
Other long-term capital	30.7	22.3	8.2	18.8	37.6	-1.6
Capital account balance	102.6	-35.5	10.9	-15.3	-5.2	110.1
Net errors and omissions	54.8	35.1	18.8	-5.9	8.6	-32.1
Overall balance	-133.5	50.8	66.0	-110.9	-219.5	-118.5
Financing items						
Use of IMF credit	0.0	0.0	0.0	0.0	0.0	0.0
Change in gross official reserves (increase -)	100.9	-72.3	-121.3	164.3	28.0	24.1
Change in bank reserves (gross)	-184.9	-132.7	-88.4	-482.4	-101.7	-359.7
Allocation of SDRs	0.0	0.0	0.0	0.0	0.0	0.0
Changes in valuation of official gold	0.0	0.0	0.0	0.0	0.0	0.0
Central bank	4.4	-11.5	0.2	13.2	-16.9	10.6
Foreign assets (excluding reserves)	0.0	0.0	0.0	0.0	0.0	0.0
Foreign liabilities	4.4	-11.5	0.2	13.2	-16.9	10.6
Deposit money banks and other financial institutions	213.1	165.7	143.6	415.8	310.1	443.5
Foreign assets (excluding reserves)	4.8	0.9	-4.8	-1.9	1.4	-2.2
Foreign liabilities	208.3	164.8	148.4	417.7	308.7	445.7
Nonresident deposits	202.9	148.5	138.9	288.6	290.4	269.7
Other foreign liabilities	5.4	16.3	9.5	129.1	18.3	176.0

Source: Central Bank of Cyprus.

1/ Excluding ship-stores.

2/ Bulk items include aircraft purchases for Cyprus Airways valued at £C 16.3 million, £C 48.4, and £C 17.4 million in 1990, 1992, and 1993, respectively.

Table 33. Cyprus: Composition of Imports

	1992	1993	1994	1995	1996	1997 Prov.
(In million of Cyprus pounds)						
Total imports (c.i.f.)	1,653	1,316	1,482	1,670	1,858	1,899
Military equipment	163	55	64	54	103	96
Aircraft	48	17	0	0	0	0
Transport (excluding aircraft)	186	141	156	200	189	174
Imports for re-export	267	194	271	328	392	417
Other	989	909	991	1,089	1,173	1,212
Domestic demand	3,418	3,271	3,636	4,083	4,364	4,555
(Percent of domestic demand)						
Total imports (c.i.f.)	48.4	40.2	40.8	40.9	42.6	41.7
Military equipment	4.8	1.7	1.8	1.3	2.4	2.1
Aircraft	1.4	0.5	0.0	0.0	0.0	0.0
Transport (excluding aircraft)	5.4	4.3	4.3	4.9	4.3	3.8
Imports for re-export	7.8	5.9	7.5	8.0	9.0	9.2
Other	28.9	27.8	27.3	26.7	26.9	26.6

Source: Staff calculations based on data provided by the Central Bank of Cyprus.

Table 34. Cyprus: Merchandise Trade 1/

	Exports, f.o.b. 2/		Re-exports 3/ In millions of £C	Total Exports, f.o.b.		Imports, c.i.f. 4/		Trade Deficit In millions of £C
	In millions of £C	Percentage Change 5/		In millions of £C	Percentage Change 5/	In millions of £C	Percentage Change 5/	
1992	220.4	-11.2	222.6	443.1	2.6	1,653.4 7/	25.2 7/	-1,210.3 7/
I	54.3	-12.0	48.0	102.3	3.8	392.9	26.6	-290.6
II	60.3	-21.2	54.0	114.3	2.0	481.8	48.8	-367.5
III	51.6	0.2	53.6	105.4	1.8	384.3	14.9	-279.1
IV	54.2	-7.5	67.0	121.3	3.0	394.4	11.9	-273.1
1993	206.6	-6.3	224.9	431.5	-2.6	1,316.1 8/	-20.2 8/	-884.7 8/
I	47.0	-13.4	45.4	92.4	-9.7	331.4	-15.7	-239.0
II	61.6	2.2	52.2	113.8	-0.4	335.9	-30.3	-222.1
III	44.9	-13.0	66.1	111.0	5.5	315.0	-18.0	-204.0
IV	53.1	-2.2	61.1	114.2	-6.0	333.8	-15.4	-219.6
1994	219.5	6.2	256.5	476.0	10.3	1,482.2	12.6	-1,006.2
I	50.9	8.3	58.0	108.9	17.9	348.0	5.0	-239.1
II	73.4	19.2	57.7	131.1	15.2	382.5	13.9	-251.4
III	45.1	0.4	74.3	119.4	7.6	349.3	10.9	-229.9
IV	50.1	-5.6	66.5	116.6	2.1	402.4	20.6	-285.8
1995								
I	53.8	5.7	57.4	111.2	2.1	405.1	16.4	-293.9
II	86.3	16.6	70.4	156.7	19.5	436.9	14.2	-280.2
III	44.4	-1.6	84.7	129.1	8.1	399.8	14.5	-270.7
IV	54.1	8.0	104.4	158.5	35.9	428.7	6.5	-270.2
1996								
I	56.0	4.1	100.9	156.9	41.1	459.8	13.5	-302.9
II	75.1	-13.0	109.8	184.9	18.0	479.5	9.8	-294.6
III	48.8	9.9	91.3	140.1	8.5	419.6	5.0	-279.5
IV	52.6	-2.8	118.7	171.3	8.1	498.6	16.3	-327.3
1997								
I	57.5	2.7	88.8	146.3	-6.8	423.1	-8.0	-276.8
II	54.0	-28.1	107.3	161.3	-12.8	515.5	7.5	-354.2
III	52.7	8.0	125.3	178.0	27.1	480.7	14.6	-302.7
IV	55.6	5.7	98.8	154.4	-9.9	479.9	-3.8	-325.5

Source: Central Bank of Cyprus.

1/ Based on customs data. Quarterly figures do not necessarily add up to annual figures because valuation adjustments are only made at end of the year.

2/ Includes sales of domestic shipstores.

3/ Includes sales of foreign shipstores.

4/ Includes imports of between £C 2-4 million per year by foreign embassies and military bases.

5/ Over preceding year, or over the same period in the previous year.

6/ Includes aircraft valued at £C 16.3 million.

7/ Includes aircraft valued at £C 48.4 million.

8/ Includes aircraft valued at £C 17.4 million.

Table 35. Cyprus: Direction of Trade 1/

(In percent of total trade)

	Exports (fob) 2/						Imports (cif)					
	1992	1993	1994	1995	1996	1997	1992	1993	1994	1995	1996	1997
EU countries:	44.2	41.7	39.5	37.8	30.9	28.6	52.8	54.2	52.5	53.4	51.4	50.1
Of which:												
Germany 3/	4.4	5.8	6.5	5.8	4.8	3.4	9.0	8.1	8.6	8.4	7.5	6.3
France	2.1	1.8	1.7	1.5	1.4	1.1	7.9 4/	5.8	4.0 4/	4.2	4.2	4.4
Greece	9.5	8.6	8.3	6.6	6.3	7.6	6.8	8.3	7.1	7.4	7.6	7.5
Italy	1.9	1.4	1.2	1.4	1.7	1.4	9.7	10.4	10.3	10.1	9.7	8.7
United Kingdom	20.8	17.5	16.3	14.5	11.3	10.0	11.3	12.6	11.9	12.2	11.9	12.0
Middle Eastern countries	38.5	36.7	28.9	22.2	21.3	25.0	4.4	4.9	4.7	4.5	6.3	5.4
Of which:												
Algeria	0.0	0.0	0.0	0.0	0.0	0.0	0.7	0.4	0.6	0.1	0.0	0.0
Egypt	7.4	3.4	3.0	2.5	2.7	2.8	0.4	0.3	0.3	0.4	1.8	0.4
Iraq	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.4
Lebanon	13.8	14.3	9.5	4.7	4.3	5.8	0.3	0.4	0.2	0.3	0.2	0.2
Libya	1.5	2.2	1.9	1.2	0.7	1.1	0.0	0.0	0.0	0.0	0.2	0.2
Saudi Arabia	3.3	3.5	2.2	1.2	3.1	1.6	0.3	0.4	0.4	0.3	0.2	0.3
Eastern European countries	8.5	11.4	22.3	32.1	39.4	32.5	8.3	8.5	6.8	6.9	5.6	7.0
Other countries	8.8	10.2	9.3	7.9	8.4	13.9	34.5	32.4	36.0	35.2	36.7	37.5
Of which:												
Japan	0.3	0.3	0.2	0.2	0.1	0.1	10.5	8.1	7.1	6.9	6.3	5.6
United States	1.7	2.2	1.7	1.4	0.8	1.2	8.4	9.3	10.8	13.4	17.8	20.0

Source: Central Bank of Cyprus.

1/ Data on a customs basis. Do not include imports of military equipment.

2/ Includes re-exports.

3/ For the years prior to 1992, data are for the territory of the former Federal Republic of Germany.

4/ Imports from France in 1990, 1992, and 1993 include bulk imports of aircraft.

Table 36. Cyprus: Exports by Commodity 1/

	1992	1993	1994	1995	1996	1997 Prov.
(In millions of Cyprus pounds)						
Total domestic exports, f.o.b.	213.4	199.8	211.5	231.8	221.1	213.3
Agricultural products	39.2	43.3	47.2	70.1	55.5	38.5
Of which:						
Potatoes	11.4	20.1	23.7	43.1	27.7	8.4
Citrus fruit	16.1	13.5	13.8	16.8	18.1	17.3
Fresh vegetables	2.9	2.5	3.2	2.7	2.9	2.8
Manufactured goods	172.1	154.3	161.7	159.1	163.0	165.2
Of which:						
Clothing	64.5	51.0	44.5	44.3	37.5	29.9
Footwear	10.3	8.3	6.3	4.9	5.3	6.2
Cement	6.2	5.8	11.2	7.8	8.8	12.5
Wine and alcoholic beverages	7.3	5.3	8.5	9.6	10.4	8.6
Paper products	3.7	3.7	5.2	6.1	6.2	5.9
Machinery and transport equipment	9.1	9.9	10.6	10.7	11.3	14.1
Minerals 2/	2.1	2.2	2.6	2.6	2.6	9.6
Re-exports	182.9	187.0	221.2	277.9	375.5	391.9
Shipstores	46.7	44.6	43.2	45.7	52.2	34.6
Total exports	443.0	431.4	475.9	555.4	648.8	639.8
(In percent of total)						
Total domestic exports, f.o.b.	48.2	46.3	44.4	41.7	34.1	33.3
Agricultural products	8.8	10.0	9.9	12.6	8.6	6.0
Of which:						
Potatoes	2.6	4.7	5.0	7.8	4.3	1.3
Citrus fruit	3.6	3.1	2.9	3.0	2.8	2.7
Fresh vegetables	0.7	0.6	0.7	0.5	0.4	0.4
Manufactured goods	38.8	35.8	34.0	28.6	25.1	25.8
Of which:						
Clothing	14.6	11.8	9.4	8.0	5.8	4.7
Footwear	2.3	1.9	1.3	0.9	0.8	1.0
Cement	1.4	1.3	2.4	1.4	1.4	2.0
Wine and alcoholic beverages	1.6	1.2	1.8	1.7	1.6	1.3
Paper products	0.8	0.9	1.1	1.1	1.0	0.9
Machinery and transport equipment	2.1	2.3	2.2	1.9	1.7	2.2
Minerals 2/	0.5	0.5	0.5	0.5	0.4	1.5
Re-exports	41.3	43.3	46.5	50.0	57.9	61.3
Shipstores	10.5	10.3	9.1	8.2	8.0	5.4
Total exports	100.0	100.0	100.0	100.0	100.0	100.0

Source: Central Bank of Cyprus.

1/ Data on a customs basis.

2/ Includes quarrying materials.

Table 37. Cyprus: Imports by Commodity 1/

	1992	1993	1994	1995	1996	<u>1997</u> Prov.
(In millions of Cyprus pounds)						
Total imports, c.i.f.	1,653.2	1,316.1	1,482.2	1,670.4	1,896.0	1,899.3
Consumer goods	382.0	347.5	402.9	496.7	614.2	704.4
Intermediate inputs	579.4	508.2	563.5	612.6	662.3	603.8
Capital goods	168.1	136.6	171.7	179.5	170.9	164.4
Transportation equipment	234.1 2/	141.2 3/	155.8	199.6	188.8	173.7
Fuel and lubricants	127.0	127.5	123.8	128.4	156.8	157.3
Military equipment	162.6	55.1	64.5	53.6	103.0	95.7
(In percent of total)						
Consumer goods	23.1	26.4	27.2	29.7	32.4	37.1
Intermediate inputs	35.0	38.6	38.0	36.7	34.9	31.8
Capital goods	10.2	10.4	11.6	10.7	9.0	8.7
Transportation equipment	14.2	10.7	10.5	11.9	10.0	9.1
Fuel and lubricants	7.7	9.7	8.4	7.7	8.3	8.3
Military equipment	9.8	4.2	4.4	3.2	5.4	5.0

Source: Central Bank of Cyprus.

1/ Data on a customs basis; excluding imports of foreign embassies and military bases.

2/ Including aircraft imports of £C 48.4 million.

3/ Including aircraft imports of £C 17.4 million.

Table 38. Cyprus: Invisible Transactions

(In millions of Cyprus pounds)

	1992	1993	1994	1995	1996	1997 Prov.
Net invisible receipts	796.3	845.2	933.8	899.5	847.3	902.5
Freight and insurance, net	-157.6	-123.7	-140.3	-159.1	-177.7	-180.6
Receipts	7.3	7.5	7.5	7.5	7.6	8.8
Payments	-164.9	-131.2	-147.8	-166.6	-185.3	-189.4
Other transportation, net	97.0	95.2	104.2	92.3	110.4	99.1
Tourism, net	595.3	590.3	691.3	663.8	612.8	640.4
Receipts	696.0	698.3	812.5	812.9	783.1	838.5
Payments 1/	-100.7	-108.0	-121.2	-149.1	-170.3	-198.1
Investment income, net 2/	-23.7	-19.5	-22.8	-11.7	-16.1	-3.2
Profit remittances, net	-7.4	-6.3	-8.8	-8.0	-10.2	-9.7
Interest income	70.5	65.9	64.4	73.0	67.2	78.5
Interest payments	-86.8	-79.1	-78.4	-76.7	-73.1	-72.0
Other services, net	268.9	286.2	284.9	301.2	302.5	333.5
Military transactions	110.9	115.6	91.8	93.2	89.9	112.8
Other official transactions	20.4	22.5	23.5	23.4	24.5	22.8
Workers' remittances	25.8	27.3	23.4	18.3	8.1	4.0
Expenditures by offshore companies	92.0	112.0	140.0	160.0	164.9	168.7
Other	19.8	8.8	6.2	6.3	15.1	25.2
Transfers, net	16.4	16.7	16.5	13.0	15.4	13.3
Private remittances	9.9	9.3	9.0	4.0	7.4	4.3
Official transfers	6.5	7.4	7.5	9.0	8.0	9.0
Memorandum item:						
Tourism receipts/GDP	22.5	21.5	22.6	20.6	18.9	19.0

Source: Central Bank of Cyprus.

1/ Includes expenditures of Cypriot students abroad.

2/ Includes net profit remittances.

Table 39. Cyprus: Balance of Payments Capital Account

(In millions of Cyprus pounds; end of period)

	1992	1993	1994	1995	1996	1997 Prov.
Long-term Capital Movement	56.7	-3.9	-52.3	-22.0	-9.6	132.6
Loans/Credits received (net)	-7.5	-33.9	-60.9	-34.4	-42.8	-6.7
Drawings	134.4	127.8	108.7	86.9	115.3	128.9
Government	22.7	31.4	10.3	8.3	25.0	10.4
Official Credits	19.2	30.5	10.3	8.3	25.0	10.4
Private Creditors	3.5	0.9	0.0	0.0	0.0	0.0
Public Corporations	83.7	61.4	59.4	45.6	62.4	91.5
Official Creditors	7.6	29.2	36.3	9.8	13.8	53.4
Private Creditors	76.1	32.2	23.1	35.8	48.6	38.1
Private Sector	28.0	35.0	39.0	33.0	28.0	27.0
Repayments	-141.9	-161.6	-169.6	-121.3	-158.1	-135.5
Government	-98.0	-107.7	-122.0	-74.9	-69.5	-68.4
Public Corporations	-30.4	-38.9	-30.1	-26.4	-65.6	-42.1
Private	-13.5	-15.0	-17.5	-20.0	-23.0	-25.0
Medium-term Notes (MTN)	0.0	0.0	0.0	0.0	0.0	153.8
Loans/Credit extended (net)	33.5	7.7	0.4	-6.4	-4.4	-12.9
Government (net)	25.9	5.3	0.4	-6.4	-4.4	-12.9
Drawings (-)	-16.6	-3.0	-1.3	-9.9	-24.2	-24.0
Repayments (+)	42.5	8.3	1.7	3.5	19.8	11.1
Public Corporations	7.6	2.4	0.0	0.0	0.0	0.0
Drawings (-)	0.0	0.0	0.0	0.0	0.0	0.0
Repayments (+)	7.6	2.4	0.0	0.0	0.0	0.0
Other private long-term capital (net)	31.4	23.1	9.0	19.7	38.6	-0.5
Foreign Investments in Cyprus	50.3	44.0	39.8	56.9	94.2	52.2
Investments by Cypriots abroad	-8.6	-9.3	-15.4	-19.0	-25.5	-34.7
Other private long-term capital n.i.e.	-10.3	-11.6	-15.4	-18.2	-30.1	-18.0
Other official long-term capital (net)	-0.7	-0.8	-0.8	-0.9	-1.0	-1.1
Short-term Capital Movement (net)	45.9	-31.6	63.2	6.7	4.4	-22.5
Government (net)	25.9	-16.6	41.6	-13.3	-7.6	-17.5
Public Corporations and Private Sector (net)	20.0	-15.0	21.6	20.0	12.0	-5.0
Net Capital Movements	102.6	-35.5	10.9	-15.3	-5.2	110.1

Source: Cypriot authorities.

Table 40. Cyprus: Outstanding External Debt and Debt Service 1/

	1992	1993	1994	1995	1996	1997 Est.
(In millions of Cyprus pounds; end of period)						
Total outstanding external debt	1,213.5	1,231.4	1,199.7	1,161.5	1,127.5	1,307.4
Public sector	918.5	916.4	853.7	785.5	735.5	897.4
Medium- and long-term	790.3	792.0	694.7	639.5	582.7	753.8
Government	551.7	516.4	404.1	340.1	280.8	388.8
Public enterprises	238.6	275.6	290.6	299.4	301.9	365.0
<i>Of which: publicly-guaranteed</i>	221.8	263.8	280.5	290.0	290.5	340.0
Short-term 2/	128.2	124.4	159.0	146.0	152.8	143.6
Government	114.2	111.4	149.4	137.3	137.8	128.6
Public enterprises	14.0	13.0	9.6	8.7	15.0	15.0
Private sector	295.0	315.0	346.0	376.0	392.0	410.0
Medium- and long-term	150.0	177.0	191.0	204.0	212.0	220.0
Suppliers' credits	16.0	19.0	21.0	22.0	26.0	28.0
Other	134.0	158.0	170.0	182.0	186.0	192.0
Short-term 2/	145.0	130.0	155.0	172.0	180.0	190.0
Suppliers' credits	135.0	128.0	143.0	157.0	162.0	170.0
Other	10.0	10.0	12.0	13.0	18.0	20.0
Service payments of external debt 3/	201.0	219.6	224.4	173.4	203.2	177.3
Public sector	182.2	199.7	200.9	146.7	173.7	145.5
Amortization	128.4	146.6	152.0	101.0	135.1	110.5
Interest	53.8	53.1	48.9	44.8	38.6	35.0
Private sector	18.8	19.9	23.5	26.7	29.5	31.8
Amortization	13.5	15.0	17.5	20.0	23.0	25.0
Interest	5.3	4.9	6.0	6.5	6.5	6.8
(In percent of GDP)						
Outstanding external debt	39.1	37.6	32.9	29.2	27.2	30.1
Public sector	29.6	28.0	23.4	19.8	17.8	20.6
Medium- and long-term debt	25.5	24.2	19.0	16.1	14.1	17.3
Short-term debt	4.1	3.8	4.4	3.7	3.7	3.3
Private sector	9.5	9.6	9.5	9.5	9.5	9.4
Medium- and long-term debt	4.8	5.4	5.2	5.1	5.1	5.1
Short-term debt	4.7	4.0	4.2	4.3	4.3	4.4
(In percent of exports of goods and nonfactor services)						
Service payments	11.8	12.8	11.8	8.6	9.7	8.1
Public sector	10.7	11.7	10.6	7.2	8.3	6.6
Private sector	1.1	1.2	1.2	1.3	1.4	1.4

Source: Central Bank of Cyprus.

1/ Changes in the level of outstanding external debt as recorded in the external debt statistics tables differ from capital flows as recorded in the balance of payments table because of valuation adjustments not recorded in the balance of payments table, and as a result of timing differences in the registration of operations in both sets of data.

2/ Excludes short-term liabilities of the banking system.

3/ Medium- and long-term.

Table 41. Cyprus: Long-Term Foreign Debt by Creditor 1/

(In millions of Cyprus pounds; end of period)

	1992	1993	1994	1995	1996	1997 Est.
Public sector debt	790.3	792.1	694.7	639.5	582.7	600.0
Government	551.7	516.5	404.1	340.1	280.8	235.0
Official creditors	406.5	426.2	364.0	332.5	279.7	234.9
Multilateral	383.1	401.6	340.3	309.6	257.8	212.6
IBRD	11.1	15.2	16.6	17.5	16.8	15.7
RFCE 2/	351.6	365.6	304.7	274.0	221.6	172.2
Other	20.4	20.8	19.0	18.1	19.4	24.7
Bilateral	23.4	24.6	23.7	22.9	21.9	22.3
Private creditors	145.2	90.3	40.1	7.6	1.1	0.1
Suppliers' credits	29.0	17.0	8.9	3.0	0.0	0.0
Financial markets	116.2	73.3	31.2	4.6	1.1	0.1
Public enterprises	238.6	275.6	290.6	299.4	301.9	365.0
Official creditors	47.5	76.4	107.8	111.0	118.2	170.1
Multilateral	36.4	66.2	98.4	101.9	110.3	163.3
IBRD	7.9	11.8	13.7	15.4	13.6	14.4
RFCE 2/	20.3	43.6	73.2	72.6	71.8	106.1
Other	8.2	10.8	11.5	13.9	24.9	42.8
Bilateral	11.1	10.2	9.4	9.1	7.9	6.8
Private creditors	191.1	199.2	182.8	188.4	183.7	194.9
Suppliers' credits	7.4	9.1	8.7	8.3	2.3	1.0
Financial markets	183.7	190.1	174.1	180.1	181.4	193.9
Private sector debt	150.0	177.0	191.0	204.0	21.0	220.0
Suppliers' credits	17.0	20.0	21.0	23.0	25.0	25.0
Financial markets	133.0	157.0	170.0	181.0	187.0	195.0
Total long-term foreign debt	940.3	969.1	885.7	843.5	603.7	820.0
of which:						
International organizations	419.5	467.8	438.7	441.5	368.1	375.9
Foreign governments 3/	34.5	34.8	33.1	32.0	29.8	29.1
Financial markets	432.9	420.3	375.3	365.7	369.5	389.0
Suppliers' credits	53.4	46.1	38.6	34.3	27.3	26.0

Source: Central Bank of Cyprus.

1/ Excludes medium-term notes.

2/ Resettlement Fund of the Council of Europe.

3/ Among the most important creditors are the governments of Germany, France, Kuwait, and the United Kingdom.

Table 42. Cyprus: Net International Reserves

(In millions of SDRs, end of period)

	1992	1993	1994	1995	1996	1997
Central bank	707.8	775.6	981.3	707.4	1,049.3	987.5
Assets	763.7	814.5	1,019.3	767.5	1,088.4	1,047.5
Gold 1/	16.1	16.1	16.1	16.1	16.1	16.2
SDRs	0.1	0.1	0.1	0.0	0.0	0.2
Reserve position in the Fund	25.5	25.5	25.5	25.5	25.5	25.5
Foreign exchange	722.0	772.8	977.6	725.9	1,046.8	1,005.6
Liabilities	-55.9	-38.9	-38.0	-60.1	-39.1	-60.0
Commerical banks	-501.8	-512.4	-610.1	-524.9	-834.0	-914.2
Assets	956.4	1,074.9	1,233.5	1,979.2	2,138.0	2,545.0
Liabilities	-1,458.2	-1,587.3	-1,843.6	-2,504.1	-2,972.0	-3,459.2
Total net international reserves	206.0	263.2	371.2	182.5	215.3	73.3
Memorandum item: SDR/Cyprus pound	1.50	1.40	1.43	1.47	1.48	1.41

Source: Central Bank of Cyprus.

1/ Gold valued at SDR 35 per ounce.

