

# Cyprus

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## IN A NUTSHELL

- Economic recovery continued to strengthen driven by services and construction activity.
- Residential property prices started to rise in 2017 driven by rising economic activity.
- New home sales started to rise in 2014 and accelerated sharply in 2016/2017.
- The mortgage market remains large with mortgage loans at 57.9% of GDP in 2017.
- Funding conditions in the banking sector have improved substantially allowing banks to increase their mortgage lending.

## MACROECONOMIC OVERVIEW

Economic recovery continued to strengthen with real GDP rising by 3.9% in 2017 and by 4% in Q1 2018, seasonally adjusted. Growth was driven by construction, tourism and professional services and by domestic demand on the expenditure side. Fixed investment made a significant contribution reflecting rising construction activity. Despite a significant increase in exports of goods and services a steep increase in imports resulted in net-exports having a net negative contribution to growth in 2017.

The outlook remains positive and downside risks are mainly related to the external environment and geopolitical risks. Upside risks include the broader economic impact of a large casino-resort project under construction and other large building projects.

In public finances, strong economic activity aided revenue collection leading to a sizable budget surplus in 2017 and a significant drop in the public debt-to-GDP ratio. Public debt will rise significantly in 2018 following the restructuring of the Cyprus Cooperative Bank but this will not affect the downward trend in the debt-to-GDP ratio.

In the banking sector non-performing loans continued to decline. The recent amendments to the foreclosure and insolvency framework and the sale of the good loans portfolio of the Cyprus Cooperative Bank are expected to aid substantially in the resolution of remaining non-performing loans.

After four consecutive years of decline, consumer prices turned marginally positive in 2017 rising by 0.7%. Consumer prices remained almost unchanged in the first five months of 2018 but rose sharply in June driven by food, housing and electricity prices.

The unemployment rate dropped to a yearly average of 11.1% in 2017 compared with 13% the year before. On a seasonally adjusted basis, the unemployment rate dropped to 10.3% in Q4 2017 and to 9.4% in Q1 2018. The unemployment rate is expected to drop further in coming quarters as the economy continues to expand.

## HOUSING AND MORTGAGE MARKETS

### HOUSING MARKET

There is a high tendency for home ownership in Cyprus. According to Eurostat, the

ratio of owner-occupied homes in Cyprus was 72.5% in 2016. This was marginally down from 73% the previous year and from a peak of 74% in 2013, reflecting the impact of the recession of 2011-2014. However, in Cyprus there are still more people living under their own roof with respect to the averages of the EU and the Euro area, which were respectively around 69.2% and 66.4%.

In terms of real gross value added the construction sector peaked in 2008 on an annual basis and declined steeply to 2015. The cumulative decline in the period was 62.8%. The ratio to total economy real gross value added dropped from 10.4% to 4.2% in the same period. The construction sector started to recover in 2016 and 2017 rising respectively by 9% and 25%, and reaching 5.3% of real total economy gross value added in 2017.

According to the Cyprus Statistical Service, the production value of the construction sector at current prices increased by 2.4% in 2015 and by 11% in 2016 after six consecutive years of decline, reaching EUR 2.0 bn or 10.7% of GDP. This compares with a corresponding ratio to total economy gross value added at market prices of 25.9% in 2008 when construction activity peaked.

The number of completed new dwellings in 2015, the last available data, was 2,390 compared with 2,718 the year before and a peak of 18,195 in 2008.

Based on the Central Bank's residential property index, prices peaked in the third quarter of 2008 in Cyprus as a whole as well as in each of the provinces except for Limassol, where prices peaked in the fourth quarter of the same year. Since then, residential property prices were declining through to the end of 2016 but they started to recover in 2017. In this period residential prices dropped by a cumulative 30.6% on an economy-wide basis. Correspondingly prices dropped by 29.1% in Nicosia, 26.7% in Limassol, 34.2% in Larnaca, 25.8% in Paphos and 36.5% in Famagusta. Residential property prices rose by 1.1% on average in 2017. This was driven by price increases in Nicosia and Limassol with prices in the remaining provinces still registering small declines.

Property prices exhibit strong correlation with overall economic activity and GDP growth. With the recovery that started in 2015, property prices might be expected to continue to rise at a higher pace in coming quarters. Regional differences in price developments reflect differences in the composition of demand. There is a high proportion of vacation and second homes in the Larnaca, Paphos and Famagusta regions where prices have been weaker in both the contraction and the recovery phases.

New sales as reflected in sales contracts registered are still considerably below their peak levels from 2007, but have been rising sharply since 2014, they went up a steep 42.6% in 2016 and 23.7% in 2017.

### MORTGAGE MARKETS

#### Market dynamics

The mortgage market is relatively large in relation to GDP. Total housing loans outstanding at the end of 2017 were EUR 11.1 bn, which correspond to 56% of total household loans outstanding and to 26.3% of total loans to residents excluding the government. The ratio of mortgage loans to GDP at the end of 2017 was

57.9% compared with 66.3% in 2014. Total mortgage loans outstanding declined by 1.3% in 2016 from the prior year and by 3.1% in 2017. Compared with their peak in 2012, mortgage loans outstanding at the end of 2017 were 12.3% lower. The decline in total mortgage loans outstanding is the result of loan restructuring and deleveraging. New mortgage loans in 2017 amounted to EUR 857 mn of which EUR 136 mn were renegotiated amounts. This is less than half of new mortgage loans in 2011.

Mortgage lending rates have been declining in recent years. The floating rate for up to one year for house purchase dropped from an average of 6.47% in 2008 to 2.53% in 2017. Mortgage lending rates continued to drop in the first half of 2018.

Loan performance of households and non-financial corporations deteriorated markedly in the aftermath of the bail-in strategy for recapitalising banks in 2013 and the deep recession that started in the second half of 2011 and ended in 2014. Non-performing exposures, as defined by the European Banking Authority, rose sharply in the period. Whilst there are no separate statistics for the performance of mortgages themselves, the performance of household loans, more than half of which are mortgages, is indicative of the performance of mortgages as well.

Total household loans at the end of 2017 were EUR 21 bn or approximately 109.3% of GDP. Non-performing exposures of the household sector were EUR 11 bn or 57.1% of GDP in 2017 compared with EUR 12 bn or 66.1% of GDP in the prior year. The non-performing exposure ratio dropped to 52.4% of gross loans in 2017 from 54.6% in the prior year. It is noted that continued deleveraging causes the non-performing exposure ratio to drop only slowly. Mitigating this large ratio of non-performing exposure, is a high provisioning ratio of 43.3% at the end of 2017 and a high ratio of restructured facilities in of 36.6% of the non-performing exposures of the household sector.

### Non-Market led initiatives

The property market in Cyprus is being affected by changes in various tax related alterations and other legislative measures. The property tax payable to the Tax Department was reduced in 2016 and abolished in 2017.

A new amendment law that came into force on 2 January 2018 introduces a 19% VAT on building land and on the leasing of commercial property for business purposes.

As part of its policies aiming to attract foreign investors in Cyprus through the 'Scheme for Naturalisation of Investors in Cyprus by Exception', the Council of Ministers in March 2014 established relevant new financial criteria. This led to a substantial increase in foreign demand for property in 2016 and 2017.

## MORTGAGE FUNDING

Bank funding in Cyprus is dependent primarily on customer deposits. Funding conditions are comfortable as reflected in the net-loans (net of provisions) to deposits ratio at 83.9% at the end of 2017. There is one covered bond outstanding with a total size of EUR 650 mn. No new issuances of covered bonds occurred in 2017. The securitisation legislation has been enacted in July 2018 providing an additional tool for utilising banks' mortgage books to obtain funding. Moreover, in May 2016, new funding from the ECB was raised using as collateral a pool of housing loans that satisfy the criteria of the Additional Credit Claims as set out in accordance with the Implementation of the Eurosystem Monetary Policy Framework Directives of 2015 and 2016.

	CYPRUS 2016	CYPRUS 2017	EU 28 2017
Real GDP growth (%) (1)	3.4	3.9	2.4
Unemployment Rate (LSF), annual average (%) (1)	13.0	11.1	7.6
HICP inflation (%) (1)	-1.2	0.7	1.7
Outstanding Residential Loans (mn EUR) (2)	11,515	11,123	7,013,738
Outstanding Residential Loans per capita over 18 (EUR) (2)	16,949	16,196	16,872
Outstanding Residential Loans to disposable income ratio (%) (2)	94.7	88.7	73.8*
Gross residential lending, annual growth (%) (2)	34.5	-1.0	3.5
Typical mortgage rate, annual average (%) (2)	3.0	2.5	2.4**
Owner occupation rate (%) (1)	72.5	n/a	66.4*
Nominal house price growth (%) (2)	-1.8	0.4	6.0

\* The aggregate EU figure is from 2016.

\*\* Please note that this value is the simple average of the typical interest rate of the EU 28 countries.

### Sources:

(1) Eurostat

(2) European Mortgage Federation - Hypostat 2018, Statistical Tables.

## CYPRUS FACT TABLE

Entities which can issue mortgage loans:	Financial institutions (banks and cooperative credit institutions)
The market share of the mortgage issuances:	100%
Proportion of outstanding mortgage loans of the mortgage issuances:	Banks: 70% and coops: 30%
Typical LTV ratio on residential mortgage loans:	80%
Any distinction made between residential and non-residential loans:	Loan purpose & property use
Most common mortgage product(s):	Euro-denominated loans with bank base rate + spread
Typical maturity of a mortgage:	Average 25 years
Most common way to fund mortgage lending:	Customer deposits
Level of costs associated with a house purchase:	<ul style="list-style-type: none"> <li>• Transfer Tax</li> <li>• Title Deeds</li> <li>• Stamp Duty</li> <li>• Mortgage Fee</li> <li>• Land Tax</li> </ul>
The level (if any) of government subsidies for house purchases:	None