

Fiscal Challenges

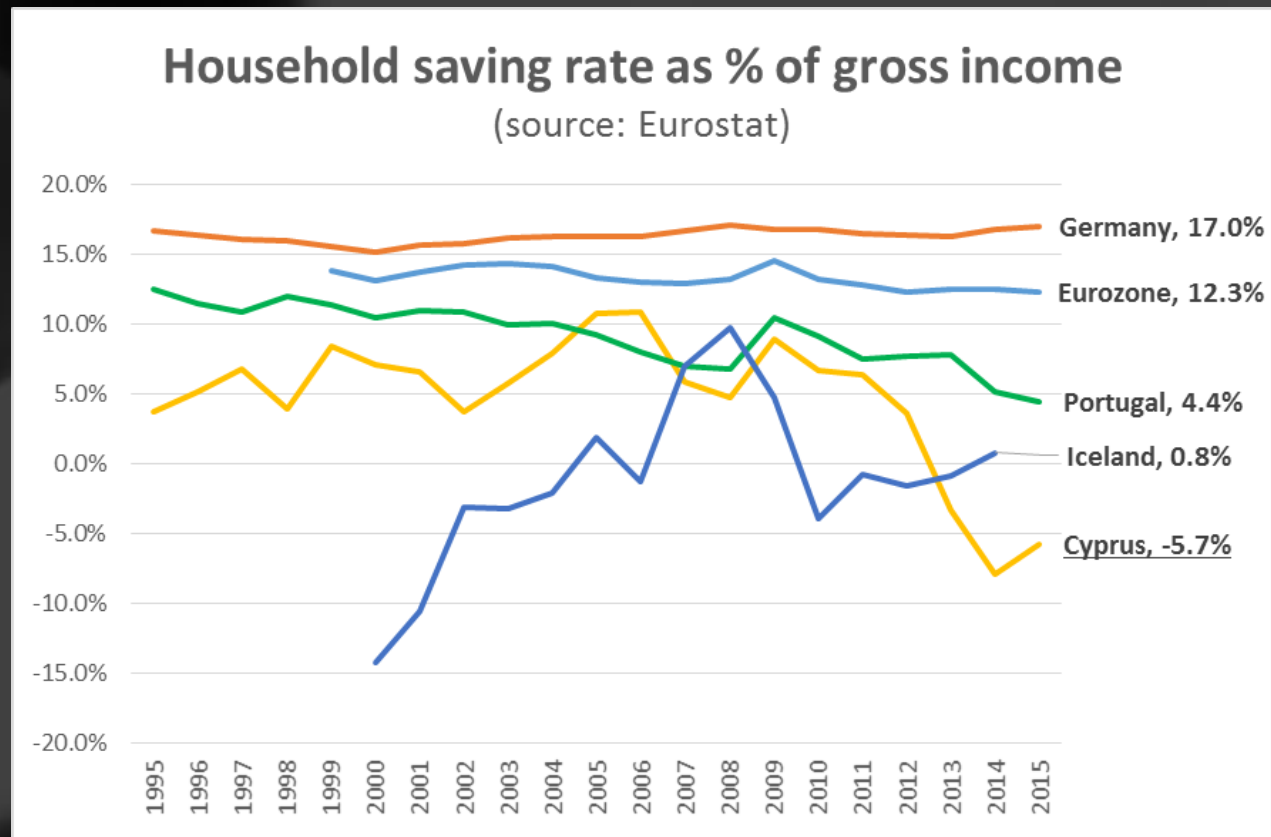
**The Cyprus Economy Panel: Outlook for
2017-2018 & the Economic Challenges
Going Forward**

The "top 10"

- 1) Failure to follow anticyclical fiscal policies.
 - a. Estimating potential output/ Output gap and weighing upside and downside risks.
 - b. Government payroll.
 - c. Other government expenditure.
- 2) External environment remains favorable, but for how long?
 - a. How long will low interest rates and accommodative QE policies be the norm?
 - b. Is the boost in tourism permanent or sustainable?
- 3) Temporary and not real competitive advantages:
 - a. Low income and corporation tax rates & "favorable" double tax treaties.
 - b. Cyprus (EU) citizenship for "investment" policies.
- 4) Not saving enough.
- 5) Step into the unknown: Cyprus solution.
- 6) Step into the known: National health system.
- 7) Extremely high public and private debt.
- 8) Persistently high NPL's.
- 9) Great and urgent need but no reforms
 - a. Private sector -Lack of competitiveness
 - b. Public sector - Lack of strong institutions, bureaucracy & lack of transparency.
- 10) The BLAME GAME leads to a lot of pain with very little gain. Failure to recognise past mistakes and reluctance to take corrective action and resist pressure from interest groups.

How much do we save?

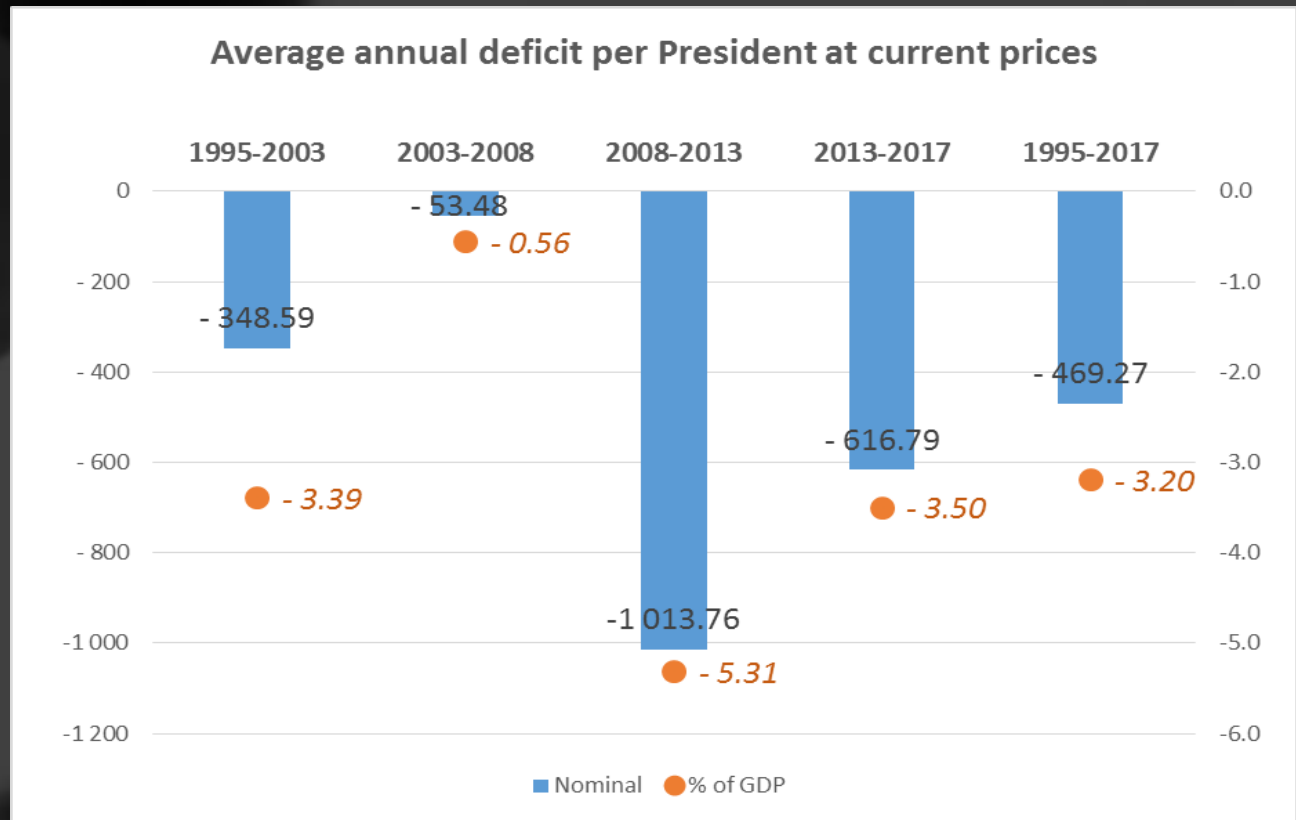
- We don't



Link: <http://ec.europa.eu/eurostat/tgm/table.do?tab=table&init=1&language=en&pcode=tsdec240&plugin=1>

Who is to blame

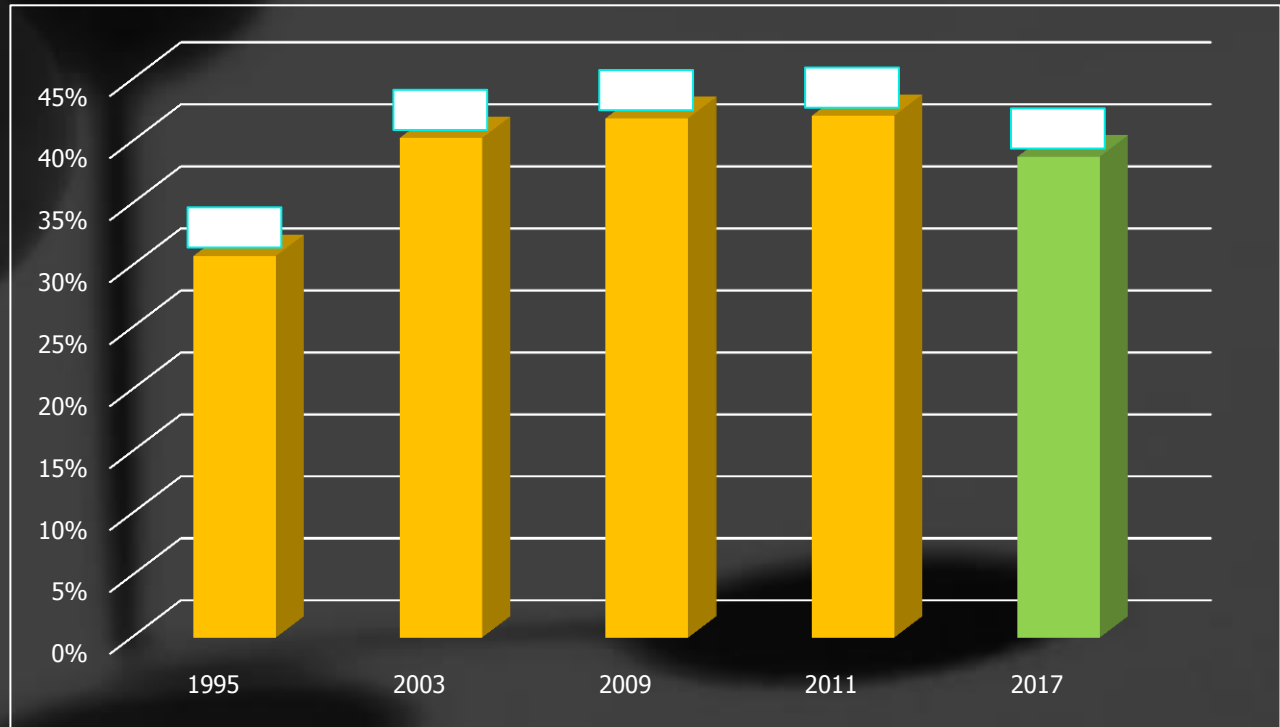
- ... the first impression.... and for most the last one.



- Sources: Eurostat and MoF DBP

THE FAST GDP growth & THE FURIOUS expenditure growth

Between 1995-2011 the economy was growing by an average rate >6% and at the same time the size of government* was growing as a % of GDP

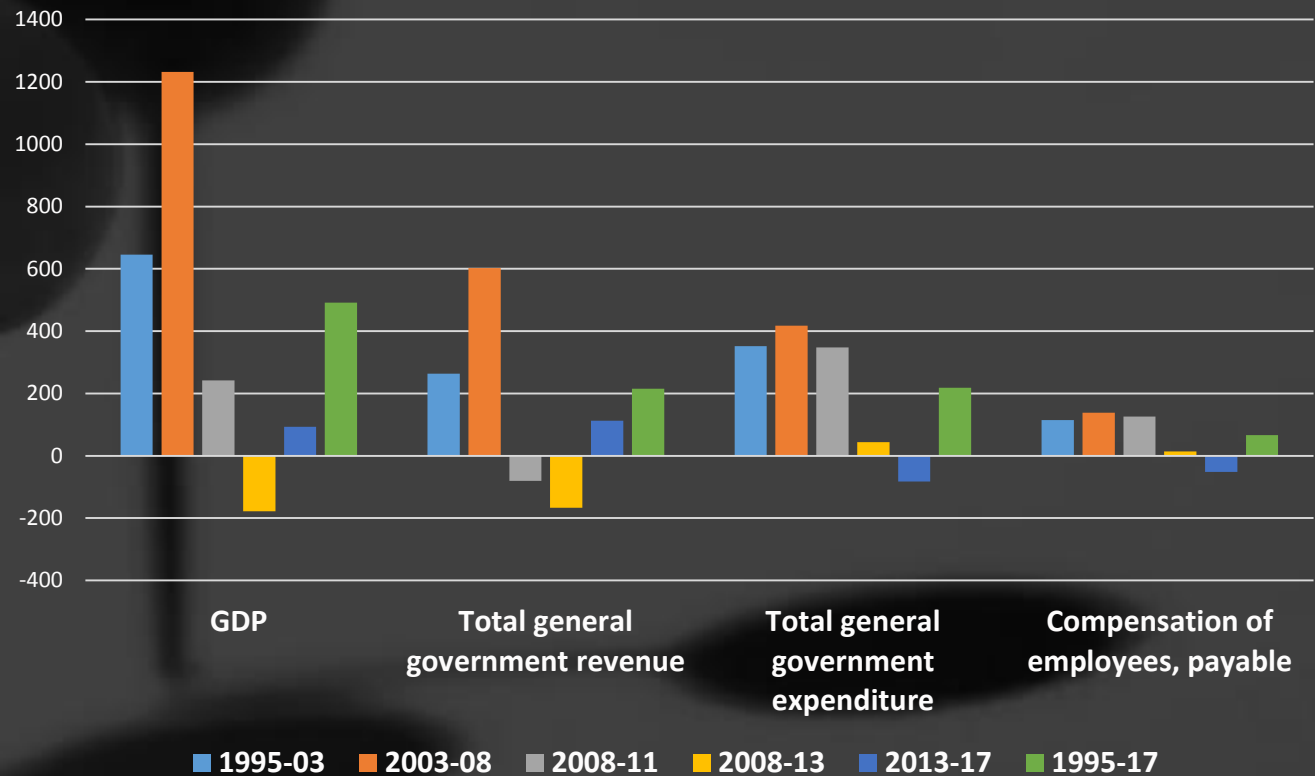


* General government expenditure / GDP
Sources: Eurostat and MoF DBP 2017-19

Saved by the boom ... temporarily

Change per year in presidency at current prices

Sources: Eurostat and MoF DBP



Potential output

- Rules exist but can be easily undermined or difficult to implement effectively
- December DOMBROVSKIS & MOSCOVICI Letter to:

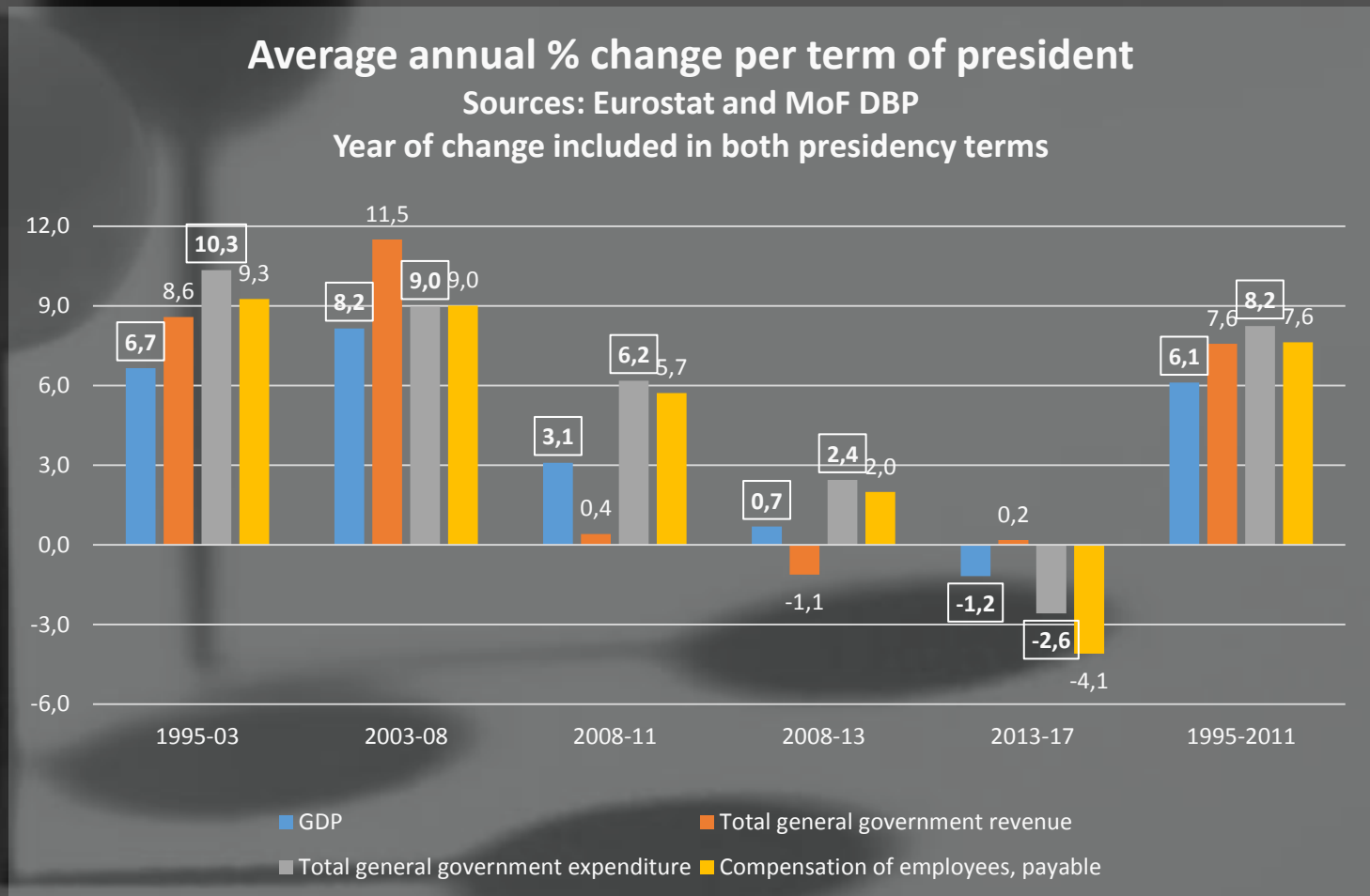
“Dear Minister, ... it is true that the output gap estimates derived from the commonly agreed methodology are **subject to uncertainty**...”

- A few weeks later the Conclusion for Cyprus:

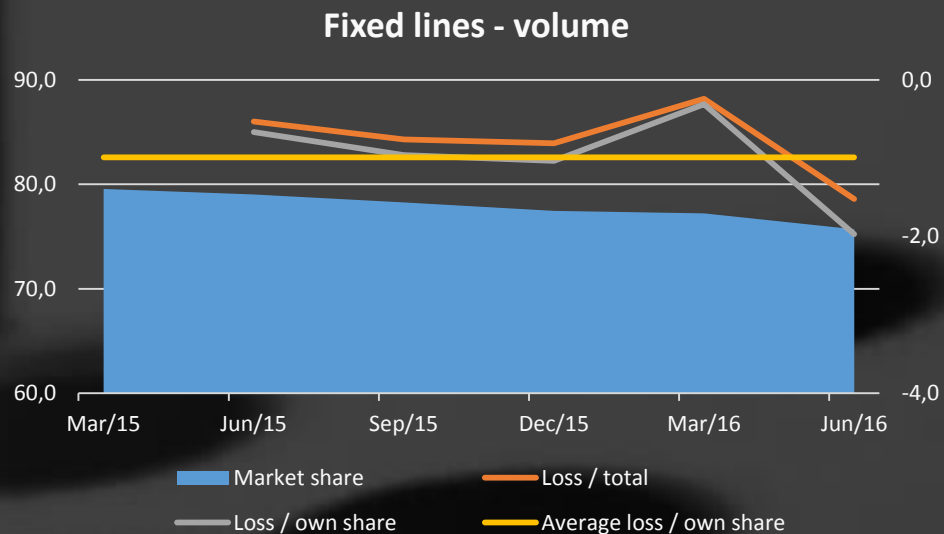
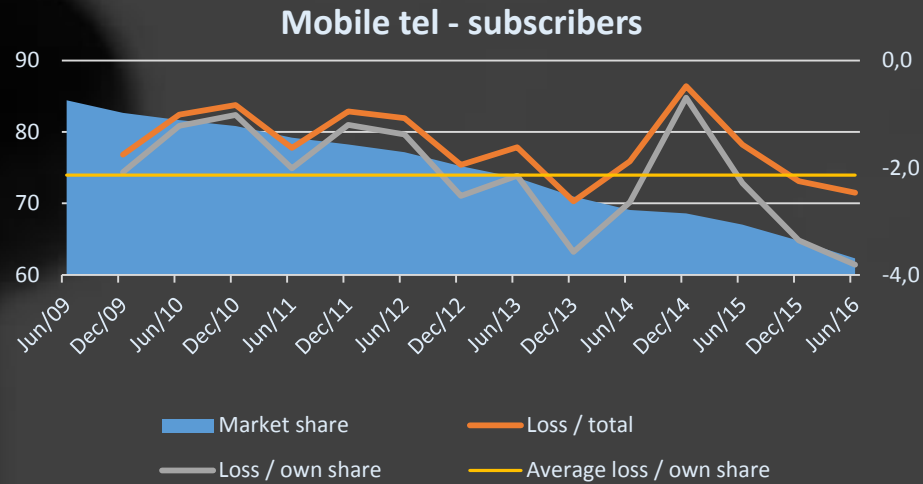
“We welcome the commitments of Cyprus, in such circumstances (deviation from the rule), to implement the measures necessary to ensure that the 2017 budget will be compliant with the rules of the preventive arm of the SGP”.

Fiscal Rules: Difficult to implement but catastrophic if ignored

- What if MTO and/ or Expenditure rules existed earlier?



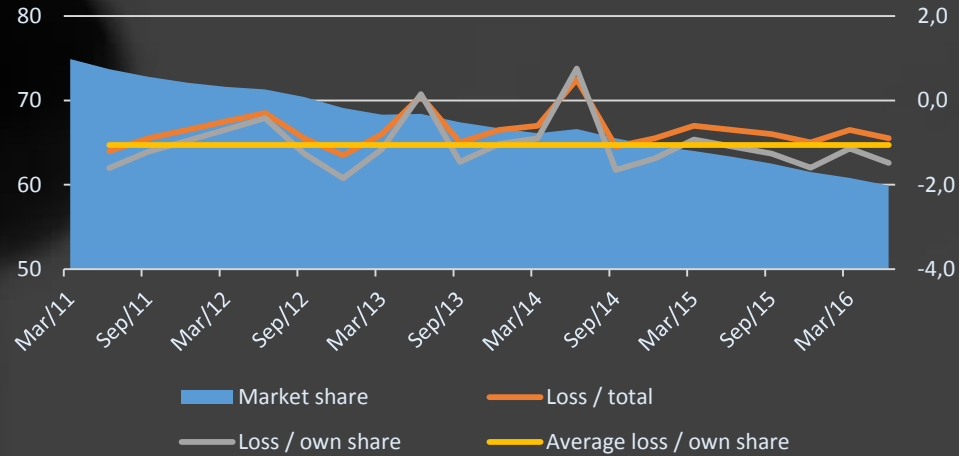
CYTA: Another Cyprus Airways?



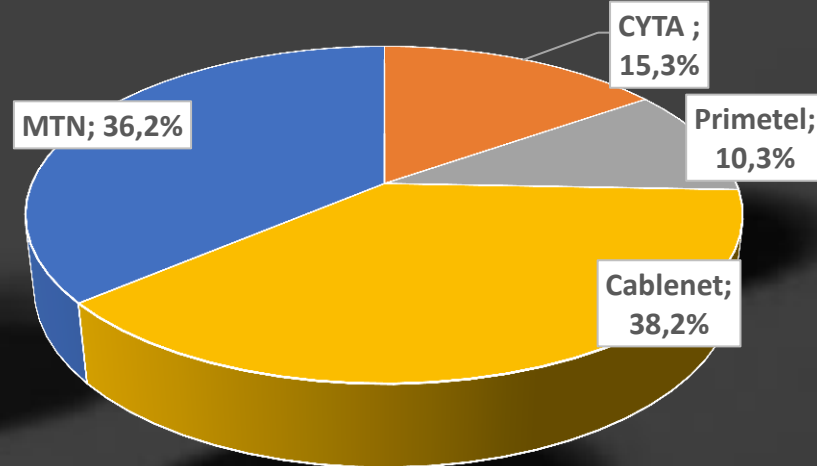
Source:
[www. Ocecpr.org.cy](http://www.Ocecpr.org.cy)
 (ΓΕΡΗΕΤ - telecom
 market regulator)

CYTA: Another Cyprus Airways?

Broadband subscribers



New broadband subscribers



Source:
[www. Ocecpr.org.cy](http://www.Ocecpr.org.cy)
 (ΓΕΡΗΕΤ - telecom
 market regulator)

Lack of competitiveness

Table 1.1: MIP Scoreboard 2015

Year 2015	External imbalances and competitiveness					Internal imbalances						Employment indicators ¹		
	Current account balance - % of GDP (3 year average)	Net international investment position (% of GDP)	Real effective exchange rate - 42 trading partners, HICP deflator (3 year % change)	Export market share - % of world exports (5 year % change)	Nominal unit labour cost index (2010=100) (3 year % change)	House price index (2010=100), deflated (1 year % change)	Private sector credit flow, consolidated (% of GDP)	Private sector debt, consolidated (% of GDP)	General government gross debt (% of GDP)	Unemployment rate (3 year average)	Total financial sector liabilities, non-consolidated (1 year % change)	Activity rate - % of total population aged 15-64 (3 year change in pp)	Long-term unemployment rate - % of active population aged 15-74 (3 year change in pp)	Youth unemployment rate - % of active population aged 15-24 (3 year change in pp)
Thresholds	-4/6%	-35%	±5% (EA) ±11% (Non-EA)	-6%	9% (EA) 12% (Non-EA)	6%	14%	133%	60%	10%	16.5%	-0.2 pp	0.5 pp	2 pp
BE	-0.2	61.3	-1.2	-11.3	1.5	1.3p	4.5	166.3	105.8	8.5	-1.0	0.7	1.0	2.3
BG	0.6	-60.0	-4.1	12.8	14.9p	1.6bp	-0.3	110.5	26.0	11.2	7.0	2.2	-1.2	-6.5
CZ	0.2	-30.7	-8.0	0.1	0.5	3.9p	0.9	68.6	40.3	6.1	7.7	2.4	-0.6	-6.9
DK	8.8	39.0	-1.5	-8.8	4.9	6.3	-3.3	212.8	40.4	6.6	-2.0	-0.1	-0.4	-3.3
DE	7.5	48.7	-1.4	-2.8	5.7	4.1	3.0	98.9	71.2	4.9	2.8	0.4	-0.4	-0.8
EE	0.9	-40.9	6.4	8.5	14.4	6.8	3.3	116.6	10.1	7.4	8.1	1.9	-3.1	-7.8
IE	4.7*	-208.0*	-5.9	38.3*	-18.1	8.3	-6.7	303.4	78.6	11.3	9.5	0.8	-3.7	-9.5
EL	-1.2	-134.6	-5.5	-20.6	-11.1p	-3.5e	-3.1	126.4	177.4	26.3	15.7	0.3	3.7	-5.5
ES	1.3	-89.9	-2.9	-3.5	-0.7p	3.8	-2.7	154.0	99.8	24.2	-2.1	0.0	0.4	-4.6
FR	-0.7	-16.4	-2.7	-5.4	2.5p	-1.3	4.4	144.3	96.2	10.3	1.8	0.8	0.6	0.3
HR	2.7	-77.7	0.1	-3.5	-5.0	-2.4	-1.3	115.0	86.7	17.0	2.1	2.9	0.1	0.9
IT	1.5	-23.6	-2.2	-8.9	1.5	-2.6p	-1.7	117.0	132.3	12.2	1.7	0.5	1.3	5.0
CY	-4.1	-130.3	-6.2	-16.8	-10.5p	2.9bp	4.4	353.7	107.5	15.7	2.8	0.4	3.2	5.1
LV	-1.8	-62.5	3.1	10.5	16.0	-2.7	0.7	88.8	36.3	10.9	12.2	1.3	-3.3	-12.2
LT	0.9	-44.7	4.0	15.5	11.6	4.6	2.2	55.0	42.7	10.5	6.7	2.3	-2.7	-10.4
LU	5.3	35.8	-0.5	22.9	0.6	6.1	24.2	343.1	22.1	6.1	15.5	1.5b	0.3	-1.4
HU	3.0	-60.8	-6.9	-8.0	3.9	11.6	-3.1	83.9	74.7	8.2	0.4	4.9	-1.9	-10.9
MT	4.3	48.5	-0.2	-8.8	3.9	2.8p	5.4	139.1	64.0	5.9	1.3	4.5	-0.7	-2.3
NL	9.1	63.9	-0.6	-8.3	0.2p	3.6	-1.6p	228.8p	65.1	7.2	3.2p	0.6	1.1	-0.4
AT	2.1	2.9	1.8	-9.6	6.1	3.5	2.1	126.4	85.5	5.6	0.6	0.4	0.5	1.2
PL	-1.3	-62.8	-1.0	9.7	-0.4p	2.8	3.2	79.0	51.1	8.9	2.4	1.6	-1.1	-5.7
PT	0.7	-109.3	-2.8	2.8	0.0e	2.3	-2.3	181.5	129.0	14.4	-1.6	0.0	-0.5	-6.0
RO	-1.0	-51.9	2.7	21.1	0.5p	1.7	0.2	59.1	37.9	6.9	4.1	1.3	0.0	-0.9
SI	5.4	-38.7	0.6	-3.6	-0.6	1.5	-5.1	87.3	83.1	9.6	-3.4	1.4	0.4	-4.3
SK	1.1	-61.0	-0.7	6.7	2.2	5.5	8.2	81.4	52.5	13.0	4.5	1.5	-1.8	-7.5
FI	-1.0	0.6	2.3	-20.5	3.6	-0.4	9.5	155.7	63.6	8.8	1.5	0.6	0.7	3.4
SE	5.0	4.1	-7.9	-9.3	3.6	12.0	6.5	188.6	43.9	7.8	2.3	1.4	0.0	-3.3
UK	-4.8	-14.4	11.3	1.0	1.7	5.7	2.5	157.8	89.1	6.3	-7.8	0.8	-1.1	-6.6

Debt Sustainability

European Commission Debt Sustainability Monitor 2016

- No country would be at high risk of fiscal stress in the short-term
- High risks to fiscal sustainability for 12 countries (including Cyprus) and medium risks for another 4 over the medium-term.
- Medium or high risks to fiscal sustainability for 14 countries over the long-term (Cyprus not included).
- **Why high medium term risk for Cyprus:**
 - Debt level
 - NPL's
 - Share of debt by non-residents
 - Other MIP indicators
 - **Sovereign debt yield**
 - **Probability of bank recap**

Fiscal risks cannot be eliminated but can be limited

- Implement fiscal rules and anticyclical fiscal policies
- Limit public and private debt ASAP
- Reform and improve competitiveness

In deciding whether to reform someone needs to focus in evaluating whether the proposal on the table will bring an improvement. A reform should not be rejected solely on the belief that there is room for further improvement... especially when the rejection is not accompanied with an improved proposal.

By aiming for the best and not implementing the better we remain stuck with the worse, because there will always be room for improvement.

- Thank you