

Cyprus at the Crossroads

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In January 2021, Cyprus finds itself once again at a crossroads. The end of the Citizenship by Investment Programme, the COVID Pandemic and increasingly heavy regulation on company ownership across the European Union mean that Cyprus' basic economic model is being called into question.

This model, a mix of foreign direct investment, low tax / light touch regulation, and service exports, have been hit by the perfect storm of higher regulation, the pandemic and continuing loss of international reputation.

As long as this model functioned, the deeper problems of Cypriot competitiveness and governance could function unhindered: the politicised state, patron-client relations, regulatory capture, and a fragmented legal and educational system.

This article will review the impact of three major hits to the economy and discuss forecasts and options for the next few years.

1. The COVID-19 Pandemic

The severity of the COVID-19 Pandemic, and more correctly the effects of the national and international lockdowns, have brought the Cypriot economy to its knees. This is reflected in four economic areas: Tourism Arrivals; GDP; Public Finance; and Unemployment.

1.1 Tourism Arrivals

The Cyprus economy remains dominated by tourism. In 2019, tourist arrivals amounted to 3.98 mln and tourism revenue accounted for approximately 20% of GDP. In 2020, following the fear unleashed by the Pandemic as well as the lockdown measures, arrivals fell to just 16% of 2019 arrivals, or 0.63 mln.

	2019	2020	2021	2022	2023
Tourism Arrivals (pax)	3,976,777	631,609	1,590,711	2,386,066	3,181,422
Tourism Arrivals (% 2019)		16%	40%	60%	80%

[Cystat Services > Tourism](#)

In 2021, we believe that achieving 45% of 2019 arrivals, or 1.59 mln arrivals, will be a stretch goal. This is due to continuing problems with access, pricing and quality of the Cyprus tourism product; source market difficulties; and strong competition.

We also see a challenge in regaining the 2019 high in arrivals. This record was achieved at a time when Turkey and Egypt were both out of bounds to Russian tourists. Both countries have

since re-opened with a strong domestic currency, pricing and visa issuance advantage, as well as a competitive flight schedule.

1.2 Gross Domestic Product

In 2019, GDP rose to € 22.3 billion, the highest yet recorded in Cypriot history. In 2020, the provisional estimates are that GDP fell to € 20.8 billion, a decline of 6.5%. This is despite billions in government support for the COVID Pandemic.

	2019	2020	2021	2022	2023
Cyprus GDP (€ mln mkt price)	22,287	20,838	21,672	22,322	22,992
GDP Change (%)	4.0%	-6.5%	4%	3%	3%

[Cystat: Economy & Finance > National Accounts](#)

Our forecast for 2021 is a GDP increase of 4% (over 2020), raising GDP to € 21.67 bln. This forecast is dependent on a number of factors, not least of which the absorption of EU funds and additional government spending.

1.3 Public Finance

In 2019, Cyprus saw a significant surplus in government operations, causing public debt to decline to € 20.8 billion, or 93% of GDP. In 2020, that debt grew by nearly 30% of GDP, to € 25.2 bln, as the government ramped up spending to manage the impact of the coronavirus crisis.

	2019	2020	2021	2022	2023
Cyprus GDP (€ mln mkt price)	22,287	20,838	21,672	22,322	22,992
Cyprus Public Debt (€ mln)*	20,756	25,165	26,665	26,465	26,165
Debt : GDP Ratio	93%	121%	123%	119%	114%

[Cyprus Public Debt Management Office](#) & Cystat

In 2021, our base case forecast sees the government deficit reaching a further € 1.5 bln, despite the increase in GDP. This is due to continuing coronavirus measures; cash flow impacts of EU funds; and the fact that to date, nearly no structural measures have been taken to reduce government expenditure.

We do expect a fiscal improvement in 2022 and 2023, brought about by a recovering GDP, a recovering tourism sector and other impacts. This positive scenario, however, is at high risk of endogenous events as well as exogenous risks.

1.4 Unemployment

Unemployment closed in 2020 at 8.1% for the full year average. This number, however, does not include the staff currently employed by companies but registered for “furlough” benefits at about 60% of their salary. While no precise numbers are reporting, press reports indicate that

the number fluctuated between 70,000 and 180,000 per month over 2020, depending on the month and the lockdown phase.

	2019	2020	2021	2022	2023
Registered Unemployed**	31,703	33,382	40,000	34,000	30,000
Labour Force (15+)	448,181	452,154	458,654	466,654	476,654
Unemployment Rate (LFS)***	7.1%	8.1%	8.7%	7.3%	6.3%

[Cystat: Labour > Unemployment](#)

The real picture of unemployment is therefore concealed (as a policy choice) but the furlough scheme. In 2021, we expect unemployment to rise to the end of the year. We believe 2022 and 2023 will see declines in unemployment as the economic situation improves.

The Termination of Citizenship by Investment

In October 2020, shaken by a sensationalist undercover video by Al Jazeera purporting to show corruption in the Citizenship by Investment Programme (CIP), [the Anastasiades government decided to terminate it](#).

The Government was already under pressure from the European Commission and European Parliament on the CIP. It was placed under further pressure when rumours circulated that Al Jazeera had at least two more videos of alleged corruption to release.

The CIP is acknowledged by the government to have brought € 8 billion in investment to Cyprus between 2013 and 2020. This is a large amount for an economy of approximately € 20 billion even taking into account its dispersal over 7 years.

The impact has been particularly present in the property sector, where literally thousands of companies, subcontractors and independent professionals depend on the commission income and direct income that the CIP brought.

While it is still early to tell what the impact of ending the CIP is, in the past 2 months the number of finished or semi-finished properties on the market has been increasing, while their prices have been decreasing.

There is a backlog of application from 2019 and 2020 that is currently being processed. We assume that following this backlog, any property decline will accelerate.

In the meantime, work on several tower projects has idled or stopped completely. Several of the large developers and property agents have been laying off staff, including senior staff.

Regulation and Transparency

In 2021, the [Ultimate Beneficial Owner \(UBO\) registry for companies and trusts is coming into effect](#). Together with the Common Reporting Standards (CRS) and Automated Exchange of

Information between banks and governments, this means that many of the benefits of having a Cypriot company as a non-domiciled owner are now in doubt.

Cyprus already passed a [Cyprus Substance requirement](#) several years ago, requiring Cypriot companies to have a real physical presence. The effect of the 2021 changes means that a citizen of the European Union who is resident in another Member State can no longer conceal or conveniently ignore income he or she may be getting from a company in Cyprus.

Last year, Russia also [amended the Russia-Cyprus Double Tax Treaty](#), imposing a 15% withholding tax on profits repatriated from Russia to Cyprus. Exceptions to this include CySEC regulated or listed entities in Cyprus, or certain categories of income from Russia.

The withholding tax is currently higher than the baseline Russian corporate income tax rate, and the exemptions are narrow enough that the large majority of Russian companies are affected by this change.

These changes mean is that it is becoming more expensive in maintaining a company in Cyprus, and the traditional benefits of this structure are even more in doubt for a large number of company owners, including Russians and EU citizens.

Forecast for 2021

We believe that 2021 will be a year of transition:

1. The total number of people vaccinated in 2021 will most likely not be sufficient for Cyprus and many other countries to reach the required population immunity levels. This insufficiency is a factor of the number of vaccines available; the difficulty in applying them; the unwillingness of many people to get one; and the genetic mutability of the virus itself. We believe Cyprus will be lucky to have 30% of its population immunised by June 2021 and 50-55% by December 2021.
2. As a result, we will be living through a series of lockdowns through May 2021 and will have to continue social distancing into the fall and winter of 2021.
3. The recovery of tourism in 2021 is likely to be limited. While there is a huge, pent-up demand for travel, household financial difficulties and the continued presence of COVID means that Cyprus will be lucky to get 40-45% of 2019 tourist arrivals.
4. Household disposable income has fallen and entire economic sectors have been destroyed. As a result, there is a significant debt overhand across the entire economy, and many households have exhausted their savings and disposable income.
5. In Cyprus, the political system is now increasingly focussed on Parliamentary elections in May, and rational decision-making and crisis management are suffering as a result. Even more than usual, politicians are taking decisions to avoid political cost and maximise their

media exposure. Much of what we see in the headlines today has little to do with managing the real crisis and everything to do with perceived election benefits.

Some of the key impacts that take place in the first half of this year are:

1. Cyprus holds Parliamentary elections in May 2021. Campaigning is already underway. Numerous new personalities have been drawn into the campaign, outraged by the corruption seen in the current Parliament and government. From now until May, any substantive government work will freeze.
2. Turkey has committed to negotiations with Greece, and appears to have scaled down its provocations in the Eastern Mediterranean, in no small part due to its own isolation and economic damage. This will offer a period of calm, but the geopolitical issue of how hydrocarbon resources can be extracted in the Eastern Mediterranean remain unsolved.
3. Parliament has extended, delayed or crawled back crucial legislation on mortgage and loan repayment and restructuring of non-performing loans. While this removes a short-term pressure, it does not solve the problem.
4. The first tranches of EU subsidies under the Next Generation EU Programme will be disbursed in the spring. A series of new subsidies will hit the economy, with collateral political benefits.

After the elections, we expect three developments in the remainder of 2021:

1. **Restarting the Reunification Negotiations.** International patience and support for a settlement to the Cyprus question is rapidly fading. We expect President Anastasiades to relaunch negotiations later in 2021. As there is no consensus between the political parties or among the society on what a final settlement might look like, we do not have high hopes of a useful process. It is likely to be the last one undertaken with extensive international support.
2. **Restart of Tourism:** Cyprus has [very correctly changed its flight and admission criteria, focusing on individual risk rather than country risk](#). From 1 February and 1 March, the entry criteria for 56 countries are changing. This should be a positive impact on tourism, and we anticipate arrivals in 2021 reaching some 1.5 million, assuming the public and private sectors work effectively. There are a number of risks here, not least the fact that international competitors have opened much earlier (Turkey, Egypt); the Cyprus tourism product remains expensive and undifferentiated; and that foreign tourists have real problems with their income.
3. **Restart of COVID:** We fully expect a flare up of COVID in the fall, including likely mutations. The immunisation process appears to have stalled in Europe, and unless significant new supplies of vaccines can be located and distributed, progress will be slow.

Cyprus: January 2021 Forecast

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* 2019: Q4 2019; 2020: Q3 2020

Sources: Cystat, Cyprus Public Debt Management Office; European Commission

** 2019: Average full year; 2020: Q3; number reported is for 15+

*** 2020 unemployment is full year average

Moving forward into 2022 and beyond, Cyprus needs to urgently develop policies and a national consensus on a few critical points:

1. Role and efficiency of the public sector;
2. Role of the political parties and their role in state operations;
3. Economic competitiveness in the public and private sectors;
4. Improvement of key sectors such as banking, energy generation and other utilities;
5. Wider economic model, which is currently dependent on external investment or service exports.

None of these five points is likely to be decided favourably at any time in the immediate future.

As a result, our longer-term base case is that, absent a real political consensus and renewal, Cyprus will increasingly lose its attractiveness as an investment destination for most companies, except possibly those seeking a haven from more repressive and controlled systems.

Philip Ammerman is an investment advisor and angel investor based in Limassol, Cyprus. Philip founded [Navigator Consulting](#), [NavInvest Cyprus](#), the [Centre for Innovation & Entrepreneurship](#) and a number of other start-ups and companies. He has supported investment transactions with a total investment value of over € 6 billion since 1995.