

Wim Van Aken in interview with Kathimerini Cyprus

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Interview with Wim Van Aken, Country Team Coordinator for Cyprus

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Kathimerini Cyprus: Are we going to enter a deep recession after the pandemic and the war on Ukraine?

Wim Van Aken: We are facing a double shock. First, we had the Covid-19 shock and now the global and European economies are facing a new shock with the war in Ukraine. Both events are unprecedented for many of us.

The economic loss for the euro area stemming from the current energy price hikes already surpasses that of oil crises in the 1970s. So, for the euro area as an energy importer, the price increase is a transfer of income and wealth abroad to energy exporters. You cannot fully compensate this loss by fiscal measures. The war has also magnified inflation pressures, not only in energy prices, but also in other areas in the economy, particularly commodities.

This situation is quite challenging, not only for Europe. The IMF's latest economic projections do not expect a global or European recession next year, but the world is set for an economic slowdown.

What are your projections for Cyprus specifically?

The latest European Commission forecasts also do not foresee a recession in Cyprus. Neither does the IMF. The economic outlook is more favourable for Cyprus than for the euro area. The IMF expects 3.5% growth for 2022 and 2.5% growth for 2023. The European Commission's projections are economic growth of 3.2% and 2.1%, respectively.

One of the reasons why projections are better for Cyprus than other countries is because Cyprus does not directly depend on gas imports from Russia. A second reason is because the country has managed its fiscal situation quite well.

Finally, Cyprus has a very good recovery and resilience plan in place. It has all the right elements. It is not only key that Cyprus maintains its fiscal path, but also that it implements the plan until 2026. Cyprus needs the investments that will be generated by the plan to diversify its economy. So far implementation has been going well. There have been minor delays, but so far, the plan is on track.

Do you think that Cyprus has the firepower to support vulnerable groups through this crisis?

The current crisis is creating hardship, particularly for the most vulnerable, as citizens experience a loss of income. But it is important to understand what kind of crisis we are dealing with. As I mentioned before, EU countries, as energy importers, are transferring wealth to energy exporting countries. This loss cannot be fully compensated for. The government can only ensure that the burdens are fairly distributed. It can do this by using targeted instruments to help those in need and to preserve the substance of the economy.

Cyprus has been doing this. During the pandemic crisis, Cyprus gave timely and adequate support to the economy, which has been withdrawn in view of the improved pandemic situation. This timely withdrawal contributed to significantly improving Cyprus's fiscal position this year. During the current energy and cost-of-living crisis, Cyprus continued to extend support to the economy, while keeping its scope moderate. In this way, Cyprus has kept fiscal prudence, while expending targeted and temporary support to those in need. This will help mitigate the impact of the expected slowdown of the economy and help the country to be prepared for any future adverse shocks.

How do you compare Cyprus to other countries?

Cyprus is doing quite well. This is also due to the reform efforts that have been carried out by the country over the last years, as a result of the ESM programme. And these efforts have been noticed by rating agencies. Cyprus has a good track record over the last 5 years and ratings have systematically improved - with a pause during the pandemic - reflecting the efforts made. Achieving the recognition of investment grade from all main rating agencies would be beneficial. The key is to keep a good mix of temporary targeted support and a prudent and sustainable fiscal path. Achieving investment grade would in turn help Cyprus broaden and diversify its investor base in financial markets.

How do you assess the sustainability of the Cypriot public debt in the new economic environment, geopolitical crisis, increased inflation and energy insecurity?

Cyprus has shown a strong fiscal performance over the last few years with a declining trend in debt-to-GDP ratio. Last year, Cyprus's public debt to GDP ratio decreased to 103.6% from a peak of 115% of GDP in 2020. And this was while still facing the challenges from the pandemic. So despite the many external risks, domestic fiscal and economic policy choices have remained a key determinant of the debt path. This is a result of all the reforms done since the euro crisis. This year, we expect a further reduction in the debt ratio to around its 2019 pre-pandemic levels.

What is the ESM's opinion of Cyprus's decision to issue a green bond? Will this not increase public debt?

The ESM sees this ongoing development positively. Cyprus is in the process of setting up a sustainable bond framework, allowing it to issue both sustainable and

green bonds once the framework is in place. This allows the country to broaden and diversify its investor base to investors that are interested in investing in green or sustainable bonds. It does not mean that the debt is going to increase. If Cyprus rolls over a maturing bond by issuing a new bond, then the country is replacing existing debt with new debt. And this is a market that investors are very interested in. So, issuing a green or sustainable bond can be a major step for Cyprus.

Do you think that Cyprus is going to be affected more than other countries by the sanctions on Russia and why?

If you look at how the situation has developed, Cyprus has dealt with this impact quite well. In the financial sector for example, the process was smooth. The RCB Bank Ltd had an orderly wind-down which is close to completion. Regarding tourism, Cyprus accelerated its plan to diversify its tourism source markets and the results in 2022 are quite remarkable. Other areas of the economy are also diversifying, notably if you look at information and technology services. All this helps mitigate the risks stemming from the war in Ukraine and the sanctions imposed on Russia.

Are there new opportunities for the Cyprus economic growth model to make it more resilient to external pressures?

As I have said, so far Cyprus has dealt with these two shocks quite well, taking advantage of the implemented reforms and strong fiscal position. But being a small and open economy makes the country more vulnerable to external shocks.

In the medium to long term, the key for Cyprus is to diversify its economy and enhance productivity. One way of doing this is to modernise the economy through investment, for example in digital technologies and innovation. A strong growth in the ICT sector is one sign of important steps taken in this direction. Another element is to preserve future economic growth in view of climate risks. The transition to green energy will reinforce the economy's resilience by reducing dependence on external energy supplies. All European countries, including Cyprus, could accelerate this transition.

Cyprus should address frictions in the labour market, in particular a mismatch between the skills required by employers and those offered by job seekers. Specifically, education and training could be further strengthened in this regard.

Last but not least, an effective application of the insolvency and foreclosure frameworks is important to reduce the amount of non-performing loans. They will prove useful in supporting businesses in financial difficulty and provide clear rules both for lenders and borrowers. Cyprus's current foreclosure framework is sound and effective. The continuous suspensions and other challenges to the framework weaken its stability and that should be avoided.

How do you see the development of the Cyprus banking sector, which has an impact of course on Cyprus's economy?

The progress in the financial sector is evident. Non-performing loans of the Cypriot banking sector have decreased by close to 90% since 2015. And the financial sector has proven to be relatively robust during the recent crisis of the pandemic and the outbreak of the war in Ukraine.

Even with rising inflation and interest rates, we do not expect a significant increase in new non-performing loans. Of course, efforts to reduce the non-performing loans should continue. As I said before, an active use of insolvency and restructuring tools can prove useful in the future.

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