

HOW DEPENDENT IS THE CYPRUS ECONOMY ON RUSSIA?

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The Cyprus economy has been undergoing a silent transformation over the past few years as the relative importance of the tourism sector declines and the relative importance of the business sector increases. In 2008, balance-of-payments income from travel (mainly tourism revenue) amounted EUR 1.9 billion or 11% of GDP, down from 18% of GDP in 1998. By contrast, income from "other business services", around half of which comprises accounting and legal services, reached EUR 1.4 billion, or 8.2% of GDP, up from 7% in 1998.

Much of the accounting and legal services business comes from Russian nationals. However, during this global financial crisis, questions have now been raised about how vulnerable Cyprus is to a downturn in the Russian economy. This is an important question, because real GDP growth in Russia contracted by 9.5% year on year in the first quarter; forecasts for the year range from a contraction of between 5% and 7.5%.

Unfortunately, obtaining hard data on Russian business is difficult. First, there is the matter of definitions. For example, balance-of-payments data show that Russian investment in real estate accounted for 7.3% of total inward direct investment in real estate in 2006 (much lower than the 76.0% recorded for the UK). However, these figures do not include real estate purchases made by a Russian national resident in Limassol, for example. It is possible, therefore, that the Russian market is rather larger.

Another approach might be to look at the nationality of depositors at the banks. Central Bank data show that bank deposits of non-EU non-residents amounted to EUR 16.4 billion in February 2009, equivalent to around 28% of total deposits. If we knew the nationality of those depositors, we could assess the vulnerability of Cyprus to specific markets such as Russia. Alas, although

the commercial banks gather this data, the Central Bank of Cyprus does not make it available.

One statistic that we do have is tourism. Russians are now the second largest tourism market after the UK, but come a distant second at 7.5% of all tourists in 2008 compared with 51.7% for the UK.

Thus, in order to arrive at an idea of the dependence of the Cyprus economy on the Russian market the economist must turn, with a heavy heart, to anecdotal evidence. Discussions with professionals from the banking, business services and real estate sectors suggest the following.

First, that Russian deposits account for as much as 66% of all non-resident deposits. Notwithstanding changes in residency definitions which led to some to report in error that the Russian deposit base was falling, it has in fact remained stable during the financial crisis. Russian deposits can therefore be estimated at around EUR 11 billion.

Second, Russian nationals account for around 20% of foreign real estate sales, which in turn are around 20% of the real estate market. Thus, Russians account for about 4% of the total real estate market. The real estate market was worth EUR 2.5 billion in 2007 in gross output terms, therefore the annual Russian real estate market might be valued at EUR 100 million.

Third, Russian business reportedly accounts for "the vast majority" of accounting and legal services business. On the assumption that this means around 80%, Russian accounting and legal services may amount to around EUR 560 million each year.

The same sources suggest that after a bumper 2008, the Russian market is in rapid retreat: the Russian market for real estate and accounting and legal services could be down by as much as 50% this year. Tourism arrivals also fell in April for the first time in over two years.

This suggests that for the first time in many years, the three major sectors in Cyprus—tourism, real estate and business services—may be contracting. It is hardly surprising therefore, that unemployment has risen more quickly in March-April than at any time in recent history.

But it also begs the question why the Cypriot economy still scraped a tiny growth rate of 0.01% compared with the previous quarter according to the flash estimate for January-March. The full figures are not yet out, but no doubt we shall see that the only reason why the economy has remained afloat these past two quarters is government spending.

Perhaps the best measure of the dependence of the economy on the Russian market, therefore, will be the size of this year's budget deficit.