

ECONOMIC OUTLOOK 2003

1. All figures concerning the Cyprus economy for 2004 are preliminary estimates of the Planning Bureau and were based mainly on data of the period January-February 2004. Figures concerning the international economy and the European Union are based on estimates of international organizations published during April 2004.

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FOREWORD

The publications “**Economic Outlook**” and “**Economic and Social Indicators**” aim at offering an objective overview of the course of the Cyprus and the international economy. These publications are issued by the Planning Bureau for the fifteenth consecutive year and it is with satisfaction that the Bureau notes the increasing interest exhibited by both the public and the private sector.

Part One of the “Economic Outlook” includes an analysis of the developments of the international economy during 2003 and the prospects for 2004. The increasing trend towards globalisation and interdependence of the economies worldwide enhances the need to follow closely and analyse international economic developments, especially for small countries such as Cyprus whose economy is open and vulnerable to external factors. Part Two covers the Cyprus economy. The Tables in Part Three contain statistical data used for the analysis of the current situation and short-term prospects of the international and Cyprus economy. More detailed data for the international and Cyprus economy can be found in the accompanying publication “Economic and Social Indicators”, covering the period 1950-2004.

In 2003, the Cyprus economy continued to exhibit for the second consecutive year deceleration of its rate of growth, owing to the unfavourable external environment, which Cyprus had to face, as a result of the war in Iraq as well as the delay in the course of recovery of our main trading partners.

The rate of growth of the Cyprus economy reached 2% in real terms, following the same increase in 2002. The rate of unemployment increased to 3,5% of the economically active population from 3,2% in 2002. The inflation rate rose to 4,1%, as against 2,8% in 2002. The fiscal deficit increased to 6,3% of GDP in 2003, deviating from the relevant Maastricht convergence criterion. In contrast, the current account deficit of the Balance of Payments exhibited an improvement and decreased to 4,4% of the GDP from 5,4% in 2002.

The prospects of the Cyprus economy for 2004 are more favourable, as compared to 2003. The economic activity of our major tourist markets is expected to accelerate in 2004. Assuming a containment of tourist revenues to the levels of the previous year, which is the combined result of an increase in tourist arrivals by 5% and a similar decrease in the per capita expenditure of tourists, the Cyprus economy is estimated to reach a rate of economic growth around 3,5%, in real terms in 2004, whereas it is estimated that conditions of full employment will continue to prevail with a small decrease in the unemployment rate. The rate of inflation is estimated to be contained to around 2%. The current account deficit in the Balance of Payments as a percentage of GDP is expected to fluctuate at the same levels of 2003, whereas a small improvement of public finances is expected.

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Panicos Poulos
Permanent Secretary, Planning Bureau

Contents

FOREWORD

PART ONE

INTERNATIONAL ECONOMY.....	1
General Assessment.....	1
Rate of Economic Growth.....	3
Advanced Countries.....	3
European Union.....	5
Developing Countries and Other Emerging Markets.....	7
Unemployment.....	11
Inflation Rate.....	12
Trade and External Transactions.....	15
External Debt	15
Public Finances.....	17
Prospects for 2003.....	20
Effects on the Cyprus Economy.....	28
Growth in the Export Markets of Cyprus.....	28
Competitiveness of the Cyprus Economy.....	29
Domestic Market.....	29
External Market	31
Conclusions	34

PART TWO

CYPRUS ECONOMY.....	36
Structure of the Economy	36
Developments During 2003	44
General Assessment.....	44
Demand.....	52
Domestic Demand.....	52
Consumption.	52
Investment.....	54
External Demand.....	57
Domestic Production.....	59
Labour Market.....	80
Inflation Rate.....	84
Balance of Payments.....	85
Public Finances.....	92
Monetary-Credit.....	95
Stock Market.....	97
Developments in the European Union.....	100
Cyprus's Accession Course.....	103
Progress in the Implementation of the Strategic Development Plan, 1999-2003	138
Prospects for 2004.....	144

PART THREE

TABLES.....	156
International Economy.....	157
Cyprus Economy.....	164
Structure of the Planning Bureau	

TABLES

A. INTERNATIONAL ECONOMY

Table	1: Output and Investment, 1999-2004	157
Table	2: Labour Market and Inflation Rate, 1999-2004.....	158
Table	3: International Trade and Commodity Prices, 1999-2004	159
Table	4: Current Account Balance and External Debt, 1999-2004	160
Table	5: Monetary- Public Finances, 1999-2004	161
Table	6: Economic Indicators of Cyprus Trading Partners And Competitors, 1999-2004	162
Table	7: Medium-Term Forecasts	163

B. CYPRUS ECONOMY

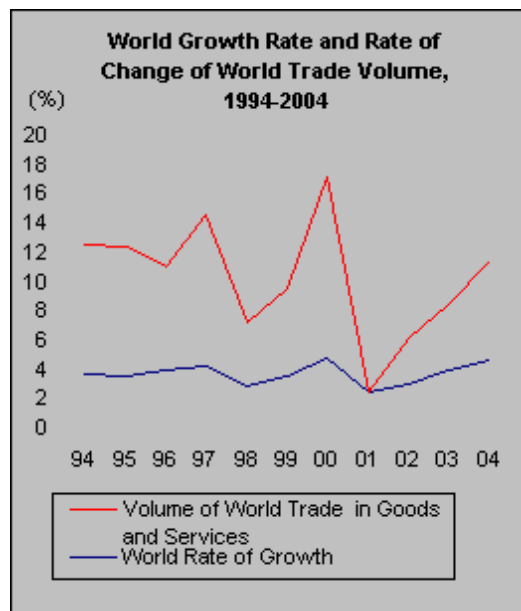
Table	1: GDP by Economic Sector, 1999-2004 (constant market prices of 1995)	164
Table	2: Percentage Distribution of GDP by Economic Sector, 1999-2004 (current market prices)	166
Table	3: GDP by Category of Expenditure, 1999-2004 (current market prices)	167
Table	4: GDP by Category of Expenditure, 1999-2004 (constant market prices of 1995)	169
Table	5: Gross Fixed Capital Formation by Capital Asset, 1999-2004 (current market prices)	171
Table	6: Gross Fixed Capital Formation by Capital Asset, 1999-2004 (constant market prices of 1995)	173
Table	7: Manpower Balance, Productivity and Prices, 1999-2004	175
Table	8: Balance of Payments Summary, 1999-2004	177
Table	9: Analysis of Current Account Balance, 1999-2004	179
Table	10: Net Capital Movements, 1999-2004.....	181
Table	11: Fiscal Deficit of the Broad Public Sector 1999-2004.....	183
Table	12: Public Debt, 1999-2004	187
Table	13: Monetary Indicators, 1999-2004	189
Table	14: Long-term Foreign Debt, 1999-2004	191

PART ONE

INTERNATIONAL ECONOMY¹

General Assessment

The war in Iraq and the SARS virus that affected the Asian countries marked international economic developments during 2003. The relatively short duration of the war in Iraq, the implementation of expansionary monetary and fiscal policies in a significant number of countries, and the progress in the implementation of structural reforms in a large number of countries, led to the restoration of the confidence climate among economic agents, resulting in the recovery of the world economic activity in the second half of the year. More specifically, world output is estimated to have expanded at a rate of 3,9% in real terms, in 2003, as against 3% in 2002, reflecting an acceleration of the rate of economic growth both in advanced and developing countries and other emerging economies.



Despite the acceleration of the rate of economic growth in advanced countries, the unemployment rate in these countries rose from 6,4% in 2002 to 6,6% in 2003. In the USA the unemployment rate recorded a small increase and reached 6% in 2003, from 5,8% in 2002, while in Japan, the unemployment rate decreased marginally from 5,4% in 2002 to 5,3% in 2003, despite the relatively

¹ Data for the international economy was derived from the IMF "World Economic Outlook" Issue of April 2004. For EU member states the data used are derived from the European Commission Publication, European Economy No.2/2004, Economic Forecasts, Spring 2004.

satisfactory expansion of the volume of production. In the EU member states, the unemployment rate reached 8% of the economically active population, as against 7,7% in 2002, as a result of the further slowdown of the rate of expansion of economic activity.

The inflation rate in the advanced countries accelerated from 1,5% in 2002 to 1,8% in 2003, while in developing countries and other emerging markets the rate of inflation increased marginally from 6% in 2002 to 6,1% in 2003.

The rate of expansion of the volume of world trade of goods and services registered a partial acceleration from 3,1% in 2002 to 4,5% in 2003, reflecting the recovery of the world output observed during the last six months of the year.

The implementation of expansionary fiscal policies in a substantial number of countries led to a deterioration in the fiscal stance of advanced countries in 2003. In contrast, in developing countries and other emerging markets the fiscal situation improved.

Another important development during 2003 constituted the increase in the price of oil in international markets. More specifically, the price of oil in US dollars, according to the IMF estimates of April 2004 increased by 15,8% in 2003 as against a small increase of 2,5% in 2002 and fluctuated on average at \$28,9 per barrel. The rise in the price of oil is owed, from the supply side, to the reduction in the production of oil from Iraq due to the war, and the delay in restoring supply to the pre-war levels, and from the demand side, to the increase in international demand for oil, as a result of the acceleration of the international economy.

An additional characteristic of developments in 2003 constituted the recovery of equity prices in the stock markets of advanced countries and emerging markets, following their downward course in 2002, reflecting the improvement in business profitability, as a result of the strengthened

economic activity, but also the excess liquidity, due to the expansionary monetary policy followed.

In exchange rate markets, a worth-mentioning development in 2003 constituted the further weakening of the US dollar vis-à-vis the euro and the yen, a development attributed mainly to the large deficit of the US current account and the low level of US interest rates.

Rate of Economic Growth

-Advanced Countries

The rate of expansion of economic activity in advanced countries accelerated from 1,7% in 2002 to 2,1% in 2003. This development reflects the substantial recovery of economic activity in Japan and the strengthening of economic growth in the USA. In contrast, the rate of economic growth in the EU countries, Canada and Australia, as well as to the Newly Industrialised Asian economies registered a deceleration.

More analytically, the rate of economic growth in the USA, accelerated from 2,2% in 2002 to 3,1% in 2003. The war in Iraq, in conjunction with the continued negative effects of the fall in equity prices during 2002 and the overall uncertainty climate that prevailed, had a negative impact on the US economy during the first six months of the year. The termination of the war in Iraq in April 2003, the restoration of the confidence climate among economic agents and the implementation of expansionary fiscal and monetary policy, allowed the recovery of economic activity in the USA during the second half of the year. The acceleration of the rate of expansion of economic activity in the USA, during the second half of the year reflects, from the demand side, the expansion of domestic demand and more specifically the increase of fixed investment following a fall in 2002, and public consumption, combined with the maintenance of the rate of growth of private consumption at high levels. In relation to this, it is mentioned that in an effort to boost economic activity, the US Federal Reserve proceeded with further reductions in interest rates in June 2003, while at the same time, the expansionary fiscal policy adopted by

the US Government continued also in 2003, and included further tax reliefs and increased public expenditure, mainly defence expenditure related to the war in Iraq. External demand exhibited a small increase following a decline over the past two years, benefiting from the depreciation of the US dollar vis-à-vis the euro and the expansion of the volume of world trade. However, the higher increase in import demand in 2003, resulted in a negative contribution of the external transactions of the country to GDP growth.

Japan exhibited a recovery in 2003 following a period of recession in the previous years, with output increasing by 2,7%, as against a marginal decline of 0,3% in 2002. The recovery of economic activity in Japan is owed mostly to the strengthened domestic demand, reflecting mainly the expansion of fixed investments, and to the increased external demand, due to the improved external environment, and particularly the further acceleration of the Chinese economy. In contrast, the slow implementation of the necessary business and banking reforms, as well as the continued deflation constitute restraining factors to the further growth of the Japanese economy.

The economic activity in the Newly Industrialised countries of Asia² recorded a deceleration from 5,1% in 2002 to 3% in 2003. The slowdown of economic activity in these countries is attributed to the containment of the rate of growth of domestic demand and in particular of private consumption. The SARS virus affected to a large extent tourist demand and private consumption in Hong Kong and Singapore. The main engine of growth in these countries constituted their net external transactions, as a result, on the one hand, of the greater expansion of the external demand for goods, and on the other, of the slowdown of import demand. The external demand for goods benefited from the higher rate of economic growth in the main export markets of these countries as well as from the enhancement of the competitiveness of their exports, as their national currencies are pegged to the US dollar.

² Hong Kong, Korea, Singapore and Taiwan

-European Union

In the EU member states the rate of increase of GDP registered a further deceleration from 1,1% in 2002 to 0,8% in 2003, reflecting mainly the economic recession in Germany, the largest economy of the EU. This development is attributed mainly to the subdued external demand which was adversely affected by the erosion of competitiveness of the goods and services of the eurozone, due to the appreciation of the euro. Economic growth in the EU countries was based on private and public consumption, while investment demand recorded a further small decline, following a larger fall in the previous year. The negative confidence climate that prevailed among consumers and investors, during the first half of 2003, due to the geopolitical tensions and particularly the war in Iraq, constituted an additional restraining factor to economic growth. The gradual but slow recovery of economic activity in the EU countries which became apparent in the second half of the year and was primarily based on investment and external demand, constituted a positive development. The gradual reversal of the negative confidence climate prevailing among consumers and investors, the acceleration of the rate of growth of the world economy, as well as the further reduction in interest rates by the European Central Bank in June 2003 by half a percentage point, contributed towards this direction. The more positive course of the EU member states economies during the second half of the year, proved insufficient to reverse substantially the negative fundamentals of the first half of the year.

In the UK the rate of economic growth accelerated from 1,6% in 2002 to 2,2% in 2003. Domestic demand constituted the main engine of growth. Fixed investments and private consumption, notwithstanding its slowdown compared to 2002, constituted the main promoting factors of economic growth, from the demand side. The improvement of the confidence climate among consumers and investors in the second half of the year and the positive repercussions of the low interest rates on investment and consumption demand contributed positively towards this direction. In relation to this, it is mentioned that the Central Bank of England proceeded to a

reduction of interest rates by 0,25 percentage points in July 2003. The external balance of the country continued to contribute negatively to economic growth. It is noted that the UK exhibited in 2003, as it did in 2002, one of the best economic performances, among EU member states.

In contrast, the economic recession in Germany continued throughout 2003, with output declining marginally as against a marginal increase of production in 2002. The marginal decline of economic activity in Germany reflects mainly the fall of domestic demand and particularly investments in construction and equipment. A positive development constituted the reversal of the downward trend of the volume of production in the second half of the year, as a result of the recovery of external demand and the expansion of investment demand; it was, however, not sufficient to reverse the negative picture of the first half of the year.

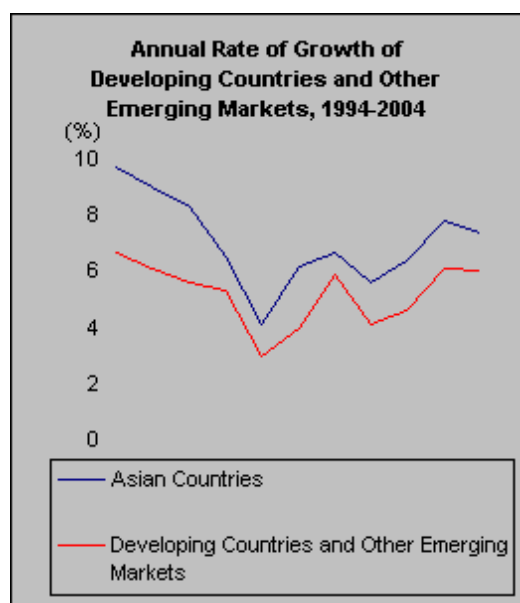
The Greek economy continued its course of satisfactory growth with economic activity expanding by 4,2% in 2003 compared to 3,9% in 2002, remaining above the EU average for the eighth consecutive year. Domestic demand constituted the main engine of growth and particularly the substantial expansion of fixed investment in construction works owing to the implementation of infrastructural projects within the context of preparation for the 2004 Olympic games. The high salary increases and tax reliefs granted within the framework of the recent tax reform resulted in the acceleration of private consumption, while public consumption also exhibited a higher expansion. In contrast, external transactions had a negative contribution to the rate of increase of GDP given that the partial recovery of external demand was accompanied by a greater increase of import demand, reflecting the strong rebound of domestic demand.

The most dynamic EU economy during the past fifteen years, the Irish economy exhibited a substantial slowdown with the rate of economic growth decelerating to 1,2% in 2003 from 6,9% in 2002. The deceleration of the Irish economy reflects both the containment of the rate of growth of domestic demand as well as the slowdown of external demand. Concerning domestic demand, fixed investment in equipment recorded a substantial decline, a

development partly attributed to the purchase of aircrafts during 2002. Economic growth in Ireland was based on the satisfactory expansion of private and public consumption, despite the slowdown compared to 2002. External demand registered a decline, which, however was accompanied by a larger fall in import demand, and as a result the contribution of the country's external balance to GDP growth remained positive, albeit significantly lower than in 2002.

- Developing Countries and Other Emerging Markets

The rate of economic growth of developing countries and other emerging markets recorded an acceleration and reached 6,1% in 2003 compared to 4,6% in 2002, reflecting, the higher rate of expansion of economic activity in all the geographical groups of these countries.



Analytically, in the developing countries of Asia economic activity strengthened and expanded by 7,8% compared to 6,4% in 2002 and constituted the fastest growing geographical area in the world in 2003, reflecting mainly the continued very satisfactory rate of economic growth of China. Economic activity in these countries accelerated in the second half of the year, as a result of both the

recovery of domestic, and particularly investment demand, as well as external demand. The recovery of external demand is owed to the acceleration of the world economic activity and world trade, the depreciation of the national currencies of a number of countries in the region that are pegged either directly or indirectly to the US dollar as well as to the recovery of external demand for technological products. Domestic demand and mainly private consumption strengthened in the second half of the year particularly in the countries affected by the SARS virus, benefiting from the adoption of expansionary monetary policy and increased credits granted to the private

sector. The promotion of corporate governance reforms including the strengthening of accounting and auditing standards, restructuring of businesses, privatising banks etc remain serious challenges for these countries.

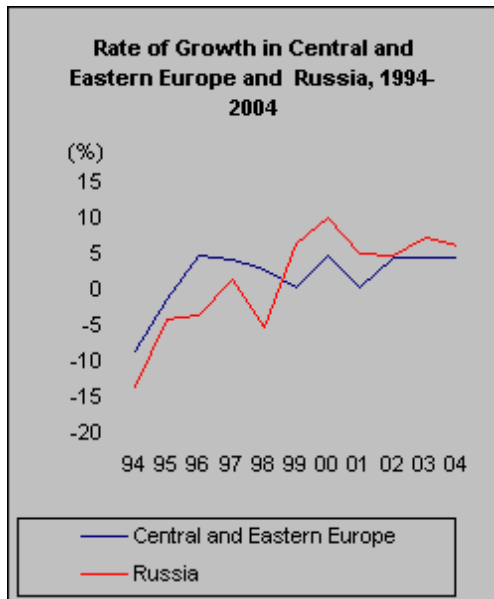
In the Middle East countries, the rate of economic growth accelerated from 4,2% in 2002 to 5,4% in 2003, a development that reflects mainly the expansion of economic activity in the oil producing countries of the region, that benefited from the higher oil prices that prevailed during the year and the increase in oil production, so as to cover the shortage created in oil production from Iraq, as well as the implementation of economic reforms in countries like Iran. In countries with close economic ties to Iraq such as Jordan and Syria, economic activity was adversely affected by the war in Iraq and the overall insecurity climate that prevailed in the region, while Egypt was negatively affected by the fall in tourist demand.

Economic activity in Central and South American countries registered a recovery following the economic recession observed during the period 2001-02, and expanded at a rate of the order of 1,7% as against a marginal decline in absolute terms by 0,1% in 2002. The recovery of economic activity is owed mainly to the expansion of external demand, which benefited from the strengthening world economy and particularly the US economy. During the past few months of the year domestic demand also exhibited a recovery benefiting from the reduced interest rates and the restoration of the confidence climate among economic agents. However, economic growth remains fragile, due, inter alia, to the political instability that prevails in a number of countries in the region. The implementation of supportive macroeconomic policies in Argentina led to a substantial recovery of economic activity in 2003 following the sharp drop in output observed in 2002. Economic growth was based on private consumption and investment in construction. In contrast, economic activity in Venezuela recorded a further decline in absolute terms, while a marginal fall in production was also observed in Brazil in 2003. A positive development in Brazil constituted the recovery of economic activity in the last quarter of the year, thus containing

the fall in production for the year as a whole to very low levels. This development reflects the positive effects of the implementation of prudent macroeconomic policies and the progress in the implementation of structural reforms. In contrast, countries like Mexico and Chile were not significantly affected by the crisis in the region, mainly due to the adoption of a policy aiming at establishing macroeconomic stability conditions and also due to their close economic relations with the USA.

In Africa, the rate of economic growth registered a slight acceleration from 3,5% in 2002 to 4,1% in 2003. The acceleration of economic activity in these countries is attributed to the strengthening of domestic demand and the increased non oil primary products' prices, that constitute the main export items of these countries. The implementation of macroeconomic policies aiming at improving the conditions of macroeconomic stability in a substantial number of African countries and the reduction of the debt stock of the heavily indebted poor countries in the region, also contributed towards this direction. In the oil producing countries of the region such as Nigeria, the expansion of economic activity resulted from the higher oil prices and volume of oil production. In contrast, the political instability and the HIV virus that affects a large number of African countries, constituted restraining factors to the growth prospects of certain countries in the region.

The rate of increase of GDP in the Commonwealth of Independent States accelerated from 5,1% in 2002 to 7,6% in 2003. This development reflects the expansion of economic activity both in Russia as well as in the majority of the remaining countries of the region. Analytically, in Russia output expanded at a rate of 7,3% in 2003 compared to 4,7% in 2002. The expansion of economic activity in Russia is attributed to the positive effects from the increased revenue from oil production, due to the higher oil prices that prevailed in 2003. In addition, the increase in real wages, the favourable liquidity conditions in the domestic market and the increased access to international capital markets contributed towards the same direction. In Ukraine, the rate of growth of GDP accelerated, based on the increased external and domestic demand.



In the Central and Eastern European countries, economic activity, registered a marginal acceleration, from 4,4% in 2002 to 4,5% in 2003. Economic activity in these countries was based on external and private consumption, which benefited from the expansion of the disposable income of households, due also to the falling inflation rate. The implementation of policies aiming at establishing conditions of

macroeconomic stability in the Baltic countries, in view of their accession to the EU, combined with increase direct investments inflows, contributed positively to the economic growth of these countries. The expansion of economic activity in Poland was based on fixed investments and external demand, which benefited from the depreciation of its national currency during the past 18 months and the expansionary fiscal policy followed. In the Czech Republic, the main engines of growth constituted investment and external demand, despite the harsh external environment the country had to face. In Bulgaria and Romania, the main engine of growth constituted domestic demand, which benefited from the expansion of bank credit to the private sector and the increases in wages. In Turkey³, the rate of economic growth slowed down, it remained however at satisfactory levels. Economic activity was based on private investments and to a lesser extent on private consumption. The satisfactory growth of the Turkish economy is attributed to the significant progress observed in the implementation of economic reforms and policies aiming at improving macroeconomic stability conditions, within the context of Turkey's efforts for candidacy for EU accession, with positive repercussions on the confidence climate in the financial markets. The further fall of the inflation rate owing to the appreciation of the Turkish lira contributed positively to the recovery course of the Turkish economy.

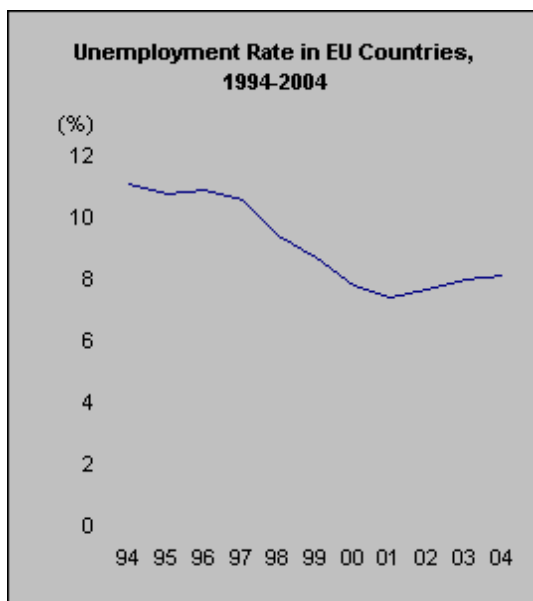
³ Based on the new classification of the IMF, Turkey has been classified in the Central and Eastern European countries.

Unemployment

Despite the partial acceleration of economic activity in the advanced countries, the unemployment rate for this group of countries increased from 6,4% in 2002 to 6,6% in 2003.

In the USA, the unemployment rate increased further from 5,8% in 2002 to 6% in 2003. This development is attributed to the negative effects of the subdued economic activity observed in the previous years in the labour market.

In Japan, the unemployment rate remained at high levels despite its marginal fall from 5,4% in 2002 to 5,3% in 2003. The restrained marginal fall of the unemployment rate in Japan is attributed to the negative labour productivity observed in the previous five years, which implies that there is room for expanding production without hiring additional labour.



The deceleration of economic activity in EU member states, was translated to a small increase of the unemployment rate from 7,7% in 2002, to 8% in 2003. In relation to this, employment in the EU countries rose by 0,1% in 2003 as against 0,6% in 2002. From a sectoral perspective, employment fell in the sectors of manufacturing and construction, while in the services sectors employment increased, mainly due to the fact that these sectors were influenced to a relatively lesser extent by the slowdown of economic activity, but also attributed to their limited exposure to international competition. The problem of unemployment remains particularly acute in Spain with the unemployment rate fluctuating at 11,3%, Greece and Germany 9,3% and Finland 9%. From a medium-term perspective, the unemployment problem in the EU is attributed,

partially, to the technological progress that leads to a substitution of the labour factor of production, mostly unskilled and low-skilled, with capital, as well as to the rigidity that characterises the wage setting mechanism, in conjunction with the high tax burden on labour. It is noted however, that during the past few years significant progress has been made in the adoption of structural changes in the labour market aiming at ameliorating the above problems through the introduction of more flexible forms of employment, the reduction in the labour tax burden and the promotion of active labour market policies.

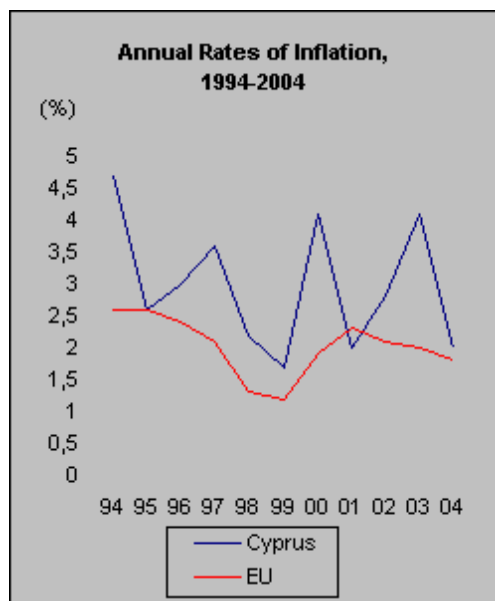
Unemployment in the Central and Eastern European countries remained at high levels, reflecting the problems these countries face in their process of transition to free market economies. Indicatively, in Poland the unemployment rate fluctuated at 19,8% in 2003, in Slovakia at 17,1%, in Bulgaria at 13,9%, in Lithuania at 12,7% and in Latvia at 10,5%, whereas in the remaining EU acceding countries, the unemployment rate fluctuates at lower levels.

[Inflation Rate](#)

In advanced countries the rate of inflation accelerated from 1,5% in 2002 to 1,8% in 2003. Specifically, the rate of inflation in the USA accelerated from 1,6% in 2002 to 2,3% in 2003. The increase of the inflation rate in the USA is attributed to the depreciation of the dollar in the exchange rate markets, which implies the increase of the prices of the imported goods and services and to the expansionary fiscal policy adopted. However, the rate of inflation in the USA, notwithstanding its increase, remains at comparatively low levels, a development attributed to the high rate of productivity growth observed in the USA as from the mid 1990s, in conjunction with the restrained wage increases granted during the same period, which led to a containment of unit labour costs and a fall in the inflation rate.

In Japan, the general price index continued its decline by 0,2% in 2003 following a fall of 0,9% in 2002, a development attributed to the economic recession the country has been undergoing during the past few years. The

course of recovery of economic activity observed in 2003 in Japan was not sufficient to halt the falling trend of the general price index.



In the EU countries, the harmonised rate of inflation declined slightly from 2,1% in 2002 to 2% in 2003. The rigidity of the inflation rate, despite the slowdown of economic activity in these countries, is attributed to the increase in oil prices and in the prices of fresh food, due to the adverse weather conditions observed during the year and the increase in indirect taxation in a number of EU countries.

In developing countries and other emerging markets, the rate of inflation registered a marginal acceleration from 6% in 2002 to 6,1% in 2003, reflecting an acceleration in the rate of inflation in the African countries, the developing countries of Asia, the Middle East countries and in the Central and South American countries, which was largely offset, by the containment in the rate of inflation in the countries of the Commonwealth of Independent States and the Central and Eastern European countries.

The acceleration of the inflation rate in African countries, to 10,3% in 2003 from 9,6% in 2002, is attributed mainly to the increase in the prices of oil and of primary goods.

In the developing countries of Asia, the inflation rate remained at low levels, despite its rise from 2% in 2002 to 2,7% in 2003. The rise of the inflation rate in these countries is owed mostly to the increased oil prices, the expansionary monetary policy adopted in a large number of countries in the region, the depreciation of the national currencies of a number of countries in the area whose national currency is pegged to the dollar, as well as to the high levels of production capacity utilization in these countries.

The increase in the inflation rate in the Central and South American countries from 8,9% in 2002 to 10,6% in 2003 reflects the higher inflation rate in countries such as Brazil, Venezuela, Uruguay and Paraguay, as a result of the macroeconomic imbalances reflected in high fiscal deficits, the absence of a prudent monetary policy aiming at price stability in most countries of the region, as well as the depreciation of their national currencies in 2002. In contrast, in Argentina the inflation rate decelerated, as a result of the appreciation of the peso and the implementation of policies aiming at improving macroeconomic stability conditions.

The rate of inflation in the Middle East countries increased from 7,5% in 2002 to 8,6% in 2003. A significant acceleration of the inflation rate was exhibited in Iran, as a result of the excess liquidity conditions prevailing in the country.

The inflation rate in the Commonwealth of Independent States recorded a small decline from 13,8% in 2002 to 12,1% in 2003. In Russia, the fall in the inflation rate continued throughout 2003, albeit at a lower rate, from 16% in 2002 to 14,4% in 2003. Despite its containment during 2003, the rate of inflation in the Commonwealth of Independent States remains at two digit levels, reflecting overall, the lax monetary and fiscal policy followed, as well as the delay in implementing the necessary structural reforms.

The inflation rate in the Central and Eastern European countries including Turkey was contained from 14,8% in 2002 to 9,2% in 2003, reflecting the deceleration of the inflation rate in the majority of the new EU member states but also the sharp fall in the inflation rate in Turkey from 45% in 2002 to 25,3% in 2003. The substantial containment of the inflation rate in Turkey is attributed to the appreciation of the Turkish lira and the implementation of policies aiming at improving macroeconomic stability conditions.

Trade and External Transactions

The volume of the world trade in goods and services increased at a rate of 4,5% in 2003 as against a smaller increase of 3,1% in 2002, owing to the acceleration of the course of recovery of the world economy during the second half of the year.

With regard to the external transactions of the main industrial countries, a widening, in relative terms, of the current account deficit of the USA, a small increase of the current account surplus of Japan and a small decline in the current account surplus of Germany, was observed. The widening of the current account deficit of the USA from 4,6% of GDP in 2002 to 4,9% in 2003, is attributed mainly to the strengthened domestic demand and consequently import demand, while the depreciation of the US dollar had an increasing, although limited impact on exports, given also the time lag empirically observed in the responsiveness of external and import demand to exchange rate changes. In the case of Japan, the increase in the current account surplus, from 2,8% in 2002 to 3,2% in 2003, is owed to the greater increase in the volume of exports as compared to the rate of expansion of imports. In the case of Germany, the current account surplus fell from 3,1% of GDP in 2002 to 2,6% in 2003, a development attributed to the greater expansion of the import volume, as compared to the respective increase of the export volume which exhibited a deceleration vis-à-vis 2002. This development is attributed also to the appreciation of the euro, which rendered imported goods and services cheaper in the German market, and the German products more expensive in international markets.

The current account surplus of developing countries and other emerging markets widened, in absolute terms, in 2003. This development reflects the increased surpluses of Middle East countries and the countries of the Commonwealth of Independent States, the conversion of the deficit of the Central and South American countries into a surplus, and the decline of the deficit of the African countries. In contrast, the surplus in the current account of the developing countries of Asia registered a small decline, while the deficit

in the current account deficit of the Central and Eastern European countries widened.

The small decline in the current account surplus of the developing countries of Asia, in absolute terms, is owed to the fall of tourism revenue due to the negative effects of the SARS virus on tourist demand, the higher oil prices that prevailed in 2003 but also to the robust domestic and consequently import demand. The recovery of the world economy in the second half of the year and of export demand for technology goods, in conjunction with the depreciation of the national currencies in a number of countries in the region, prevented a larger decline of the current account surplus in these countries, in absolute terms. It is noted, however, that in relative terms, the current account surplus remained at the levels of the previous year, a development attributed to the fact that the currencies of a number of countries in the area are pegged to the US dollar.

The widening of the current account surplus of the Middle East countries reflects the expansion of the surpluses of the oil producing countries in the region, due to the increase in the price of oil in 2003 combined with the increased oil production particularly in countries such as Saudi Arabia, United Arab Emirates and Kuwait.

The containment of the current account deficit of the African countries reflects the sharp fall of the deficit in Nigeria and the increase in the surplus of Algeria, which benefited from the rise in the price of oil in 2003, and the containment of the deficit in other countries of the region, as a result of the higher prices of primary products that constitute their main exports. However, in a significant number of African countries the current account deficit widened reflecting, inter alia, the fall in tourist arrivals due to the political instability conditions prevailing in these countries and the fear of terrorist attacks.

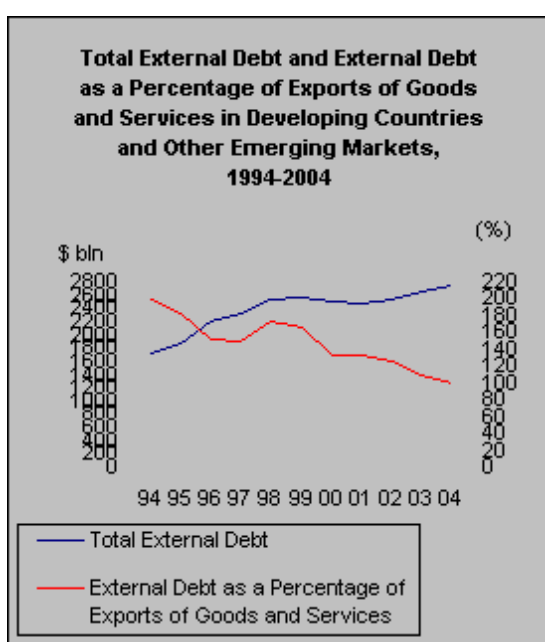
The conversion of the current account deficit of the Central and South American countries into a surplus, is owed to the significant recovery of their exports, while the widening of the surplus of Venezuela is attributed to the

increased oil production, following the termination of the February strike and to the higher oil prices that prevailed in 2003.

The small increase of the surplus of the Commonwealth of Independent States, in absolute terms, reflects the expansion of the current account surplus of Russia, which is owed to the increase in the price of oil during 2003 having a positive effect on revenue from the country's oil exports. The appreciation of the ruble in international exchange markets and the expansion of import demand, as a result of the increase of domestic demand, prevented a larger increase of the surplus, which as a percentage to GDP remained at its 2002 levels.

The widening of the current account deficit of the Central and Eastern European countries, is attributed to the expansion of domestic demand resulting from the rise in the credit extended to the private sector in a number of countries in the region, and consequently of import demand. In addition, the slowdown of economic activity in the EU and the appreciation of the euro in 2003 affected negatively the exports of countries in the region with close economic ties to the EU and particularly countries whose currency is pegged to the euro.

External Debt



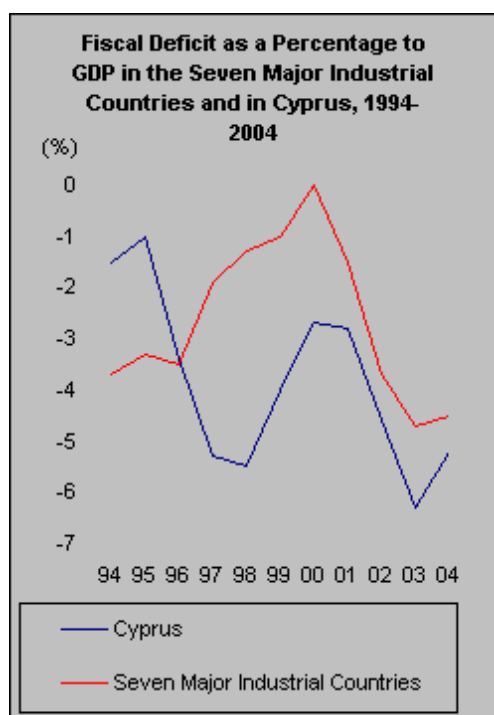
The total external debt of developing countries and other emerging markets reached \$2644,2 bln and represented 109,9% of the value of exports of goods and services in 2003 as against \$2526,6 bln or 124,6% in 2002, reflecting the containment of external debt, in relative terms, in all geographical areas of the category of developing countries and other emerging markets. The debt service ratio declined from 19,7% in 2002 to

18,1% in 2003, a development attributed to the reduction in interest rates worldwide.

In countries classified by the IMF as heavily indebted poor countries, external debt continues to remain at high levels and therefore acts as a constraining factor to the growth prospects of these countries and particularly of the less developed countries of Africa.

Regarding the sources of financing of external debt of developing countries, a small decline in the share of financing from official sources (Governments, International Organisations) was observed, while the share of financing from other private organisations, and from commercial banks recorded a small increase.

Public Finances



The fiscal deficit in advanced countries widened from 3,1% of GDP in 2002 to 4% in 2003, reflecting mainly the expansion of the fiscal deficit in the USA and the EU member states. The widening of fiscal deficits in advanced countries is attributed mainly to the implementation of expansionary fiscal policies mainly in the USA and Japan, aiming at reviving economic activity, while in the case of EU member states the widening of the fiscal deficit is owed mainly to the deceleration of the rate of economic growth that had an adverse effect on public revenue and an increasing impact on public expenditure.

Analytically, in the USA the fiscal deficit of 3,3% of GDP in 2002 widened substantially to 4,9% of GDP in 2003, while the structural deficit⁴, which is the most adequate indicator used to determine the kind of fiscal policy followed (expansionary or contractionary), expanded from 2,5% of GDP in 2002 to 3,9% in 2003. The expansionary fiscal policy reflects mainly the increased defence expenditure related to the war in Iraq but also the tax reliefs granted, aiming at reviving the American economy.

In the EU countries the fiscal deficit of 2% of GDP observed in 2002 expanded to 2,6% of GDP in 2003. This development is attributed mainly to the slowdown of economic activity in the EU member states, which had an adverse effect on public revenue and an increasing impact on public expenditure, such as increased expenditure on unemployment benefits as a result of the rise in unemployment. It is noted that the structural deficit of the EU member states fluctuated at marginally lower levels in 2003 as against 2002, implying the adoption of a slightly tighter fiscal policy in 2003.

The fiscal deficit in Japan remained at relatively very high levels, 8,2% of GDP in 2003, as against 7,9% in 2002, despite the recovery of the Japanese economy. The expansion of the fiscal deficit is attributed to the expansionary fiscal policy followed during the past years, within the context of efforts to revive the Japanese economy. The conclusion that the Japanese government has been implementing an expansionary fiscal policy is also supported by the fact that the structural fiscal deficit increased from 6,4% in 2002 to 7,2% in 2003.

In developing countries and other emerging markets, as a whole, the fiscal deficit was contained from 4,4% of GDP in 2002 to 3,6% in 2003. This development reflects the improvement of the fiscal situation in all geographical regions of this group of countries, mainly due to the greater growth of economic activity, which had a positive effect on public revenue. In the Middle

⁴ The structural fiscal deficit is defined as the fiscal deficit which would emerge if the economy of a country grew at its potential rate of growth. In simple words, the structural fiscal deficit excludes the impact on the fiscal balance that results from the cyclical position of the economy, and therefore a change in the size of the structural deficit reflects the policy adopted by the Government, whether expansionary or contractionary.

East countries the improvement of the fiscal situation in 2003 reflects the increased Government revenue from the higher oil prices, as well as the adoption of a tighter fiscal policy in a number of countries in the region such as Saudi Arabia and Jordan, through higher taxation. The containment of the fiscal deficit in African countries and Latin American countries reflects the adoption of policies aiming at the improvement of macroeconomic stability conditions in a number of countries in these regions.

In the Commonwealth of Independent States the fiscal surplus of the Central Government of the order of 1% of GDP observed in 2002 increased slightly to 1,2% in 2003. This development is attributed mainly to the greater expansion of economic activity in these countries in 2003 with positive effects on public revenue.

The fiscal deficit in the Central and Eastern European countries, which include Turkey, was contained reflecting mostly the fall in the fiscal deficit in Turkey. In contrast, in the remaining countries of the region, and particularly in the EU acceding countries, the fiscal deficit widened reflecting, on the one hand, the deceleration of the rate of economic growth which adversely affected public revenue and had an increasing impact on public expenditure, and on the other, the increased public expenditure associated with the harmonisation with the *acquis communautaire*, including expenditures for the creation of the necessary structures for the effective implementation of the *acquis communautaire*.

Prospects for 2004

The projections regarding the course of the international economy for 2004 are positive. Promoting factors constitute, according to the IMF April 2004 estimates, the reduction of geopolitical tensions, the continued expansionary fiscal and monetary policy followed in a number of countries, although a gradual implementation of a stricter monetary and fiscal policy is expected, given the high fiscal deficits observed in a number of countries and the historically low interest rates, the improvement of the confidence climate

among economic agents, as well as the recovery of international trade and the rebound of the information technology sector.

Analytically, the international economy is projected to expand at a rate of 4,6% in 2004, compared to 3,9% in 2003, as a result of the anticipated acceleration of the rate of growth of GDP in the advanced countries and the maintenance of the rate of expansion of economic activity in the developing countries and other emerging markets at the satisfactory levels of the previous year.

Analytically, the rate of economic growth in advanced countries is projected to accelerate marginally from 2,1% in 2003 to 3,5% in 2004, as a result of the anticipated expansion of economic activity in almost all countries that comprise this category of countries and particularly in the USA, the EU member states, Japan, the Newly Industrialised Asian countries and Australia.

In the USA the rate of economic growth is anticipated to accelerate from 3,1% in 2003 to 4,6% in 2004, reflecting the expected substantially higher expansion of external demand, as well as the greater increase of domestic demand and particularly fixed investments and private consumption. Promoting factors to the greater expansion of external demand constitute the depreciation of the US dollar, which implies an improvement of the competitiveness of US products in international markets, as well as the acceleration of the rate of growth of the world economy and the rate of expansion of the volume of world trade. The large increase of fixed investments indicates the need to expand the production capacity of the US economy in order to meet the increased domestic and external demand. Private consumption is expected to increase at a higher rate, reflecting the satisfactory increase in the disposable income of households, explained by the increase in employment and earnings. In contrast, the rate of increase of public consumption is projected to be contained in 2004 vis-à-vis 2003.

In Japan GDP is expected to expand at a rate of 3,4% in 2004 as against 2,7% in 2003. From the demand side, the acceleration of economic activity in Japan is expected to be the result of the strengthened domestic

demand and in particular of fixed investments, and to a lesser extent, private consumption. The maintenance of the rate of expansion of external demand at the very satisfactory levels of the previous year also contributed positively to economic growth. Despite the recovery of the Japanese economy, the need for implementing structural reforms in Japan both in the vulnerable banking sector and in businesses still remains imperative.

According to the European Commission projections of April 2004, the rate of economic growth in the 15 EU member states is anticipated to accelerate from 0,8% in 2003 to 2% in 2004. From the demand side, both domestic demand, and particularly private consumption and fixed investments, as well as external demand, are expected to constitute the main engines of growth. Analytically, private consumption is anticipated to benefit from the historically low interest rates, the improvement of the confidence climate among investors and consumers and the expansion of the real disposable income of households, due to the expected further containment of the inflation rate, the rise in earnings and the small increase in employment as well as from the increased wealth of households resulting from the recovery of the equity prices in European stock markets. Fixed investments are expected to expand following their contraction in the previous two years, reflecting the need to increase the production capacity of the economy to meet the expanding private consumption and external demand. External demand is also expected to have a positive contribution to the acceleration of economic growth, reflecting the improvement of the external environment and the rate of growth of the world trade, despite the negative effects of the erosion of the competitiveness of the goods and services of the eurozone due to the appreciation of the euro. The progress in the implementation of structural reforms, the supportive macroeconomic policies adopted in EU member states, the falling trend of the inflation rate and the accommodative financing conditions constitute promoting factors to the recovery course of the EU – 15 economies. An important development in 2004 constitutes the enlargement of the European Union with the accession of 10 new member state, including Cyprus as from May 1st 2004.

In Britain, economic activity is projected to accelerate from 2,2% in 2003 to 3% in 2004. The acceleration of the rate of growth of the economy will be based on domestic demand and will result mainly from the recovery of fixed investments and particularly investments in equipment, as a result of the improvement of the business climate and the increased private consumption and external demand, in conjunction with the improved economic situation of firms. Private consumption is expected to register a small acceleration, as a result of the improved consumer expectations, the satisfactory expansion of the real disposable income of households, reflecting the further increase in employment and nominal earnings, as well as the positive effects of the low interest rates on the cost of financing durable consumer goods. Exports of goods and services are projected to exhibit a substantial expansion, benefiting from the recovery of the international economy and the improvement of the competitiveness of British products from the depreciation of the sterling pound. However, the anticipated higher rate of increase of imports of goods and services, as a result of the stronger domestic demand, will maintain the negative contribution of external transactions to GDP growth.

In Germany, economic activity is projected to recover and expand at a rate of 1,5% in 2004 as against a marginal fall of 0,1% in 2003. The acceleration of economic activity in Germany is projected to result mainly from the recovery of investment in equipment and to a lesser extent from the expansion of the rate of growth of private consumption benefiting from the anticipated improvement of the confidence climate. Exports of goods and services are estimated to register a substantial acceleration, resulting from the higher rate of growth of the world economy and the volume of world trade, and in conjunction with the relatively smaller expansion of imports, will lead to a positive contribution of the external balance to GDP growth.

The rate of economic growth in developing countries and other emerging markets is expected to fluctuate at approximately the 2003 levels, 6% in 2004 as against 6,1% in 2003. The maintenance of a very satisfactory rate of economic growth in the specific category of countries, reflects, on the one hand, the acceleration of economic activity in Central and South America,

and on the other, the deceleration of economic activity in the developing countries of Asia, the Middle East countries and the countries of the Commonwealth of Independent States, as well as the maintenance of a similar rate of growth as in the previous year, in the Central and Eastern European and African countries.

Analytically, economic activity in the countries of Central and South America is expected to expand at a rate of 3,9% in 2004 as against 1,7% in 2003, mainly as a result of the anticipated small economic recovery in Brazil, Venezuela and Uruguay, following the fall in output recorded in 2003, as well as the acceleration of the rate of increase of GDP in countries such as Mexico and Chile, due to their closer economic ties with the USA. Promoting factors towards the economic recovery of the countries in the region constitute the enhancement of domestic demand, the higher prices of primary goods and the more favourable overall external environment.

In African countries the rate of economic growth is projected to fluctuate at the satisfactory levels of the previous year, 4,2% in 2004 compared to 4,1% in 2003. The maintenance of a relatively satisfactory growth rate in the African countries, is estimated to result from the improvement of the macroeconomic stability conditions in a number of countries in the region, the further increase in the prices of primary goods and the increase in oil production in a number of countries of the region. In contrast, the political instability observed in a number of other countries of the same region constitutes a restraining factor to the further growth of the African countries as a whole.

The rate of economic growth in the Central and Eastern European countries, including Turkey, is expected to remain at satisfactory levels and to expand at a rate of 4,5%, as in 2003. The maintenance of economic growth in these countries at satisfactory levels reflects, on the one hand, mainly the anticipated partial strengthening of economic activity in the EU acceding countries of the region, and on the other, the slowdown of the rate of economic growth in Turkey from 5,8% in 2003 to 5% in 2004. The acceleration of economic activity in the EU acceding countries, is owed to the

positive climate created by their accession to the EU as from May 1st 2004 as well as to the strengthening of their external demand, that will result from the anticipated economic recovery of the EU member states during 2004, which constitute their basic trading partner.

Despite the small deceleration in their rate of economic growth from 7,8% in 2003 to 7,4% in 2004, the developing countries of Asia will remain the fastest growing geographical region in the world in 2004. The implementation of supportive macroeconomic policies, the competitive national currencies of a number of countries in the region and the recovery of the information technology sector are expected to have a positive effect on economic activity in these countries. In addition, the continued satisfactory economic growth of China will be supportive to the further growth of other countries in the region.

In contrast, the rate of economic growth in the Middle East countries, is projected to decelerate from 5,4% in 2003 to 4,1% in 2004, mainly as a result of the lower expansion of oil production anticipated during 2004.

In the Commonwealth of Independent States, the increase in the volume of production is estimated to decelerate from 7,6% in 2003 to 6% in 2004, remaining, however, at satisfactory levels, reflecting the slowdown of economic activity both in Russia as well as in the remaining countries of this region. The anticipated deceleration of economic activity in these countries is estimated to result from the restoration of the rate of increase of consumption and investments to smoother levels as well as from the gradual decrease of the high oil prices projected for the remaining months of 2004.

The stronger economic activity in advanced countries foreseen in 2004 is expected to lead to a marginal decrease in the unemployment rate from 6,6% in 2003 to 6,4% in 2004. The unemployment rate is projected to decline in the USA, Japan and the newly Industrialised Asian countries. Specifically in the USA, the unemployment rate is anticipated to fall from 6% in 2003 to 5,5% in 2004, in Japan from 5,3% in 2003 to 4,9% in 2004, and in the newly industrialised Asian countries from 4,3% to 4,1%. In contrast, in the EU member states the unemployment rate is expected to increase marginally,

from 8% in 2003 to 8,1% in 2004, reflecting the negative effects of the subdued economic activity of the previous years.

The rate of inflation in advanced countries is projected to decelerate marginally from 1,8% in 2003 to 1,7% in 2004, mainly as a result of the anticipated containment in the inflation rate in the EU 15 member states and the continued deflation in Japan. In the USA, the rate of inflation is projected to remain at the 2003 levels, 2,3%. In the EU-15 member states the rate of inflation in 2004 is expected to decelerate marginally to 1,8% in 2004 from 2% in 2003, due to the appreciation of the euro and the lower prices of imported goods and services. In the medium term, the appreciation of the euro observed since 2002 combined with the containment in unit labour costs, reflecting both the expected improvement in productivity as well as the containment of nominal earnings, is expected to lead to a further deceleration of the inflation rate in these countries.

In developing countries and other emerging markets, the inflation rate is expected to fall from 6,1% in 2003 to 5,7% in 2004, due to the anticipated containment of the inflation rate in the Central and South American countries, African countries, the countries of Central and Eastern Europe including Turkey and the countries of the Commonwealth of Independent States. The containment of the inflation rate in the Central and Eastern European countries, reflects to a large extent, the sharp fall of the inflation rate in Turkey, while in contrast, in the majority of the EU acceding countries of the region, the inflation rate is anticipated to increase due to the expected increases in indirect taxation, within the framework of the completion of the harmonisation with the minimum levels prescribed by the *acquis communautaire*. The fall in the inflation rate in the countries of the Commonwealth of Independent States is attributed to the efforts for fiscal consolidation. The further anticipated fall in the inflation rate in the Central and South American and African countries reflects their efforts for fiscal consolidation and in general the adoption of policies aiming at improving macroeconomic stability conditions. In contrast, in the developing countries of Asia and in the Middle East countries, the inflation rate is projected to

increase, mainly as a result of the fiscal imbalances in a number of countries in these regions, as well as of the high level of production capacity utilisation in the Asian countries.

The strengthened world economic activity projected for 2004 is expected to lead to a larger expansion of the rate of increase of the world trade volume in goods and services from 4,5% in 2003 to 6,8% in 2004.

As regards the external transactions of the major industrial countries in 2004, a decline, in relative terms, of the current account deficit of the USA, an increase in the current account surplus of Germany is anticipated, while the current account surplus of Japan is expected to remain at its 2003 levels. The current account deficit of the USA will fall, in relative terms, from 4,9% in 2003 to 4,2% in 2004, due to the anticipated substantially higher expansion of export demand as compared to that of import demand. In Germany, the anticipated increase of the current account surplus reflects the projected greater increase of export demand as compared to the expansion of import demand, resulting from the improved external environment. In Japan the current account surplus is estimated to remain approximately at the levels of the previous year.

In developing countries and other emerging markets a containment in their current account surplus is projected for 2004, both in absolute and relative terms, reflecting the fall in the current account surplus of the developing countries of Asia, the Middle East countries and the countries of the Commonwealth of Independent States, in conjunction with the conversion of the current account surplus of the Central and South American countries observed in 2003 into a deficit and the increase of the current account deficit of the African and Central and Eastern European countries. The reduction of the surplus of the Middle East countries and the Commonwealth of Independent States projected in 2004 is attributed to the anticipated smaller increase of the volume of oil production in 2004, while in the Central and Eastern European countries, the anticipated widening of the current account deficit, reflects the continued implementation of expansionary monetary and fiscal policy that feeds import demand. The stronger domestic demand and

consequently import demand in the developing countries of Asia, Africa and Central and South America projected for 2004, is expected to lead to a fall in the current account surplus of the former and to an expansion of the deficit in the other two categories of countries.

With regard to public finances a containment of the fiscal deficit of advanced countries from 4% in 2003 to 3,8% in 2004 is projected, reflecting a marginal reduction of the fiscal deficit mainly in the USA and Japan. The anticipated containment of the fiscal deficit in these countries is estimated to come from the acceleration of economic activity, which will have a positive effect on public revenue. In the EU-15 countries the fiscal deficit is expected to remain at its 2003 levels, 2,6% of GDP. In developing countries and other emerging markets, the fiscal deficit is projected to decline from 3,6% in 2003 to 3,2% in 2004.

Effects on the Cyprus Economy

Developments in the international economy affect to a significant extent the Cyprus economy, given its open character. Determining factors constitute the rates of growth of GDP and volume of imports of Cyprus' economic partners, the evolution of labour and other costs of production and the evolution of prices of goods and services in international markets, compared to the respective magnitudes in Cyprus.

Growth in Cyprus Export Markets

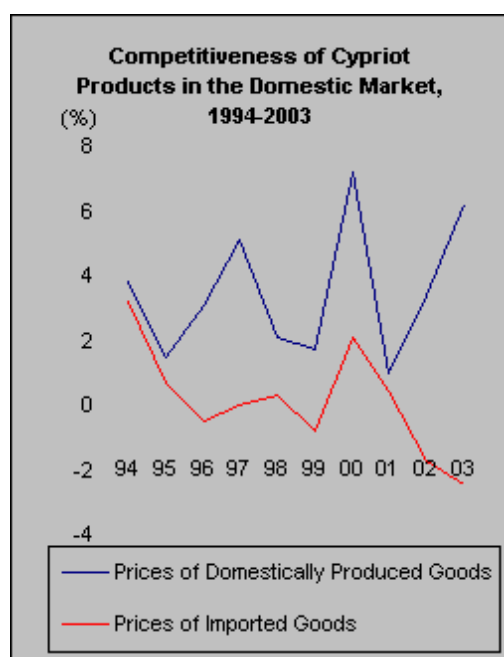
The course of Cyprus's main economic partners during 2003 was mixed. Specifically, economic growth in the UK, which constitutes Cyprus' main economic partner exhibited a partial acceleration in 2003. In contrast, in the remaining EU member states, which also constitute a significant economic partner for Cyprus, economic activity slowed down in 2003. In the Middle East countries, an acceleration of economic activity was observed mainly due to the increase in the oil price observed in 2003. However, in the main Arab export markets of Cyprus, that is, Lebanon, the United Arab Emirates, Syria, Egypt, Jordan and Iraq, the rate of economic growth exhibited a deceleration,

the only exception being the United Arab Emirates. The partial expansion of the rate of economic growth in the Central and Eastern European countries and Russia, which constitute an economic partner of growing importance for Cyprus constituted a positive development.

The overall mixed situation as regards the rate of economic growth of Cyprus' main economic partners, with the partial acceleration of economic activity in the UK and in the Central and Eastern European countries and the slowdown of the rate of economic growth in our main Arab export markets and the remaining EU member states (excluding the UK), was shadowed by the war in Iraq, the insecurity climate that prevailed in the region, as well as from the exchange rate developments that led to an increase in the value of the Cyprus pound vis-à-vis the dollar, the sterling pound and a number of other currencies, pegged to the dollar, having an adverse effect on the expansion of external demand for Cypriot goods and services. As a consequence, external demand for Cypriot goods and services exhibited only a marginal increase, of the order of about 0,5%, in real terms in 2003 following a decline of 5,1% in 2002.

Competitiveness of the Cyprus economy

-Domestic Market



The retail prices of the domestically produced goods increased by 6,2% in 2003 compared to a decline of 2,46% of the retail prices of imported goods. The increase in the retail prices of domestic products is owed to the significant increase of the prices of industrial goods and the price of electricity during 2003.

Analytically, the retail prices of domestic agricultural goods increased by 4,5% in 2003 as against an increase

of 1,8% in 2002. The prices of imported agricultural products recorded a higher increase of the order of 6,9% in 2003. The retail prices of domestic industrial products (excluding petroleum products) exhibited a substantial increase of 6,7% in 2003 reflecting the increase of the VAT rate from 10% to 13% as from 1.7.2002 and from 13% to 15% as from 1.1.2003 as well as the increases imposed on excise duties and mainly tobacco products, within the framework of harmonisation with the minimum levels prescribed by the *acquis communautaire*. In contrast, the retail prices of imported industrial products exhibited a decline of 2,8%, a development attributed to the increase in the value of the Cyprus pound against the sterling, the dollar and the yen, while the fall in the excise duty on saloon cars up to 1600 cc as from 1.7.2002 and the further reduction of excise duties on small and medium engine volume cars approved by the House of Representatives on November 20th 2003, also exerted a downward impact on the retail prices of imported products. Excluding vehicles, the retail prices of imported industrial products increased by 2,3%. From the above analysis, it is evident that during 2003 the competitiveness of the cypriot agricultural products improved, whereas in contrast, the medium term trend of a deterioration in the competitiveness of the domestically produced industrial goods due to the evolution of relative prices to the benefit of imported and at the expense of domestically produced goods, continued in 2003. In relation to this, it is mentioned that the cumulative difference between the increases in the prices of domestically produced industrial goods and the imported industrial goods, excluding vehicles, over the past five years came to 13,9 percentage points. This medium term trend is attributed mostly to the liberalisation of the import regime as well as to the higher expansion of the production costs in Cyprus compared to its main competitors.

The retail prices of services increased at a rate of 4,4% in 2003. The high rate of increase of the prices of services is owed mainly to the expansion of prices in the sectors of medical care, public services, transport and insurance. In contrast, the prices in the sector of telecommunications recorded a decline. From a medium term perspective, the retail prices of services during the past decade increased at a higher average annual rate, 3,9% as

compared to the average annual rate of increase of the prices of domestically produced goods, 3,6%, whereas their cumulative difference during the same period reached 4,1 percentage points. The medium term data is indicative as to the increasing trend of the profitability of the sectors of services compared to the sectors of agriculture and manufacturing and explain, to some extent, the reallocation of productive resources to the benefit of the sectors of services observed during the past decade. A positive development with regard to the competitiveness of the services sectors' constituted the relative containment of the average annual rate of increase of the prices of services during the past five years to 3,4% on average compared to an average annual rate of increase of 4,4% during the period 1993-1998.

-External Market

Short-term competitiveness

The competitiveness of an economy is reflected in the evolution of the prices of goods it produces and exports, compared to the prices of the goods and services its competitors produce and export.

The price deflator of Cypriot domestic exports exhibited an increase by about 1,7% in 2003 compared to a decline of 5,8% in 2002, reflecting the higher prices of agricultural products, particularly potatoes. The prices of Cypriot domestic exports expressed in euro recorded a marginal increase of the order of 0,2% which was lower than the increase in Cyprus pounds due to the fall in the value of the Cyprus pound vis-à-vis the euro. The prices of industrial exports in national currency fell by 5% in 2003, as compared to a 2% increase in 2002. Expressed in euro, the prices of domestic industrial exports recorded a larger decline of the order of 6,4%.

In the EU member-states, that produce similar to Cyprus' manufacturing products, a higher rate of increase in their export prices in euro was observed as compared to Cyprus⁵. More specifically the prices of Italy's,

⁵ With regard to countries that produce similar to Cyprus industrial goods, it is assumed that the rate of increase of the prices of their total exports is representative of the rate of increase of the prices of their industrial exports.

and Greece's exports of goods expressed in euro increased by 0,7%, and 1,2% respectively, in 2003, the export prices of Spain expressed in euros remained unchanged in relation to 2002, while the export prices of Portugal fell by 2,2%. As a result, the competitiveness of Cypriot industrial exports improved in 2003 as against the respective products of all the above-mentioned countries.

In the British market the competitiveness of Cypriot products vis-à-vis similar British products improved in 2003. Specifically, the prices of Cypriot industrial exports expressed in sterling pounds increased by 2,9% in 2003, marginally lower than the increase of the GDP deflator in Britain 3,1%, thus slightly improving the competitiveness of the Cypriot industrial products vis-à-vis the British products. The increase in the prices of Cypriot industrial exports by 2,9% in 2003, is attributed, mainly to the significant increase in the value of the Cyprus pound vis-à-vis the sterling pound observed in 2003.

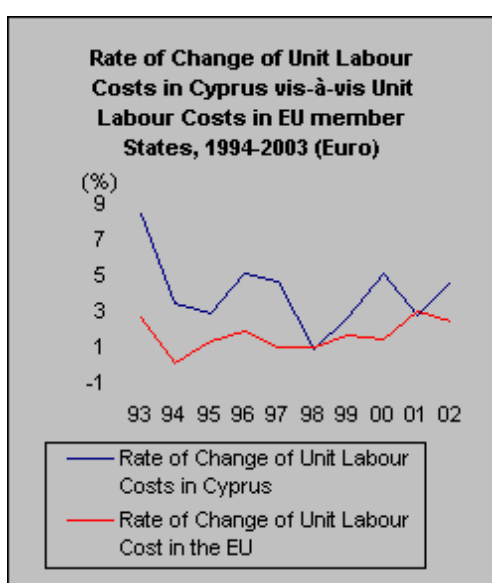
The analysis of the evolution of the relative prices of Cyprus' exports vis-à-vis the export prices of its main competitors in international markets during the course of a year is not deemed sufficient to draw reliable conclusions as to their competitiveness. As a result, medium term trends should be examined. The average annual rate of increase of prices of Cyprus' domestic exports during the period 1993-2003, expressed in euro reached 1,9%, while the prices of industrial exports exhibited a lower average annual rate of growth of 1,6% during the same period. The export prices of Portugal and Spain during the same period increased at a lower rate of 0,8% and 1,1%, respectively, the export prices of Greece increased with the same rate, 1,6%, while the export prices of Italy increased at a higher rate, 3,8%.

The trends of the last decade indicate that the prices of Cypriot industrial exports are increasing at rates relatively higher than in other European countries that produce similar goods to Cyprus such as Portugal and Spain, implying a deterioration of the competitiveness of Cyprus' export products vis-à-vis the competitiveness of the export products of these countries. The improvement of the competitiveness of the Cypriot export

product vis-à-vis the respective Italian products, constitutes a positive development.

In contrast, in the British market a significant improvement in the competitiveness of Cypriot goods and services vis-à-vis the British products was observed during the past ten years. More specifically, the average annual rate of increase of the prices of Cypriot industrial exports, expressed in sterling pounds during the period 1993-2003 reached 0,4%, compared to an average annual rate of increase of the GDP deflator in Britain by 2,6% during the same period. The cumulative difference of the increase of the British GDP deflator and the prices of Cypriot industrial exports expressed in sterling pounds during the period 1993-2003 reached 24,5 percentage points. The lower increase in the prices of Cypriot industrial exports in sterling pounds during the period 1993-2003 which is attributed solely to the appreciation of the sterling pound, despite the opposite trend observed more recently and particularly in 2003, implies a significant improvement in the competitiveness of Cypriot products vis-à-vis British similar products in the British market. It is noted however that other EU member states that compete with Cyprus in the British market, such as Spain and Portugal, exhibited larger improvements in their competitiveness.

Medium-Term competitiveness



With regard to medium-term trends of the competitiveness of the Cyprus economy, as measured by unit labour costs the overall picture in 2003 has been positive.

In Cyprus, unit labour costs exhibited an increase of 3,6% in national currency in 2003 compared to 4,6% in 2002, reflecting mainly the containment in the rate of increase of nominal earnings.

Due to the fall in the value of the Cyprus pound vis-à-vis the euro, the increase in unit labour costs in Cyprus expressed in euro fluctuated at 2% in 2003 and was lower than the average rate of increase in the EU, 2,4%.

The EU countries that produce similar goods to Cyprus exhibited higher increases in their unit labour costs and consequently a deterioration of their competitiveness vis-à-vis Cyprus.

More specifically, the rate of increase of unit labour costs expressed in euro in Italy, Spain, Portugal and Greece fluctuated at 4%, 3,6%, 3,8% and 5,6% respectively.

Analysing the medium term trends during the period 1993-2003 unit labour costs in Cyprus expressed in euro exhibited an average annual rate of increase of 3,5%. In Italy, Spain and Portugal unit labour costs exhibited a lower average annual rate of increase of 3,1%, 1,7% and 3,3%, respectively. In Greece the average annual rate of change of unit labour costs during the same period was higher, 3,8%

Unit labour costs in Cyprus expressed in sterling pounds recorded an increase of the order of 10,6% in 2003, due to the depreciation of the sterling pound against the euro and consequently vis-à-vis the Cyprus pound, as compared to an increase of 3% in unit labour costs in Britain. Analysing the medium term trends during the period 1993-2003, unit labour costs in Cyprus expressed in sterling pounds registered an average annual rate of increase of 2,2% compared to an average rate of growth of 2,6% of unit labour costs in Britain.

Conclusions

The Cyprus economy exhibited a deterioration of its competitiveness vis-à-vis imported industrial products in the domestic market during 2003 and also during the past decade.

In international markets, the competitiveness of Cyprus' industrial exports in international markets, as measured by the evolution of their prices

exhibited an improvement in 2003 compared to the European countries producing similar goods to Cyprus. However, the analysis of the evolution of export prices during the past decade shows a deterioration of the competitiveness of the Cypriot products compared to certain countries that produce similar goods to Cyprus, such as Portugal and Spain, and at the same time an improvement vis-à-vis the export products of Italy. A positive development constitutes the improvement of the competitiveness of Cyprus' products in the British market as against similar British products due to the appreciation of the sterling pound during the past decade, except in the past three years.

As regards unit labour costs, Cyprus exhibited a lower rate of increase of unit labour costs in 2003 compared to its competitors in international markets. However, the comparatively higher expansion of unit labour costs in Cyprus compared to its competitors, observed during the past decade implies a gradual decline in the profitability of business units and an erosion of their competitiveness.

CYPRUS ECONOMY

Structure of the Economy

- Basic Characteristics

The Cypriot economy is a small, robust and fairly flexible economy, and has shown itself able to adapt to rapidly changing circumstances. Intertemporally, the Cypriot economy is characterised by a very satisfactory rate of growth (the average annual rate of growth of GDP amounted to 5,1%, in real terms, over the period 1961-2003), full employment conditions and internal and external macroeconomic stability. As a result, Cyprus has achieved an enviable level of real convergence with the advanced economies, with a per capita GDP in 2003, expressed in purchasing power standards, standing at 76,3% of the EU 15 average, according to the latest Eurostat estimates of May 2004 and exceeds that of Greece and Portugal.

In brief, the basic characteristics of the Cyprus economy are the following:

- The dominant role of the private sector in the production process. The role of the State is a supportive one, and concentrates mainly in:
 - maintaining conditions of macroeconomic stability and a favourable business climate by creating the necessary legal and institutional framework;
 - securing conditions of fair competition;
 - creating modern economic and social infrastructure, utilising, inter alia, the new instruments of public private partnership;
 - ensuring conditions of social cohesion.

- The small size of the domestic market. The population in the Government Controlled Area was 709.600 in 2002, out of which 69,1% live in urban areas and 30,9% in rural areas. The small size of the domestic market constitutes an adverse factor in the realisation of economies of scale and in the development of satisfactory intersectoral relationships.
- The small size of enterprises. According to the Registration of Establishments of 2000, the size of enterprises remained very small, with 4,4 persons on average per unit in 2000, as compared to 4,3 persons in 1995. More than half of the total number of enterprises, 58% employed only one person. The “micro enterprises”, that is the enterprises employing less than 10 persons constituted 95% of the total, other “small-sized” enterprises with 10-49 employees constituted 4% and “medium-sized” enterprises, with 50-249 employees constituted only 0,7% of the total. The large enterprises with a workforce exceeding 250 employees, amounted to solely 67, representing 0,1% of the total number of enterprises. The small size of the business units hinders the exploitation of economies of scale and the adoption of advanced technologies and modern methods of management, production design and marketing.
- The small size of the labour force, given the small population base and certain quantitative and qualitative imbalances in the labour market. The quantitative and qualitative imbalances are evident both at the sectoral and occupational level and have been partly ameliorated by the employment, to a large extent, of foreign labour. At the sectoral level, the imbalances are more evident in the sectors of hotels & restaurants, construction, agriculture and manufacturing, whereas at the occupational level, the shortages are observed in technical and low-skilled occupations.
- The openness of the economy, with total imports and exports of goods and services accounting for around 102% of GDP in 2003 as compared to an EU average of 66,9%.
- The predominance and increasing importance of the services sectors, which accounted for 75,7% of GDP and 71,5% of total gainful employment in 2003. This development reflects the gradual restructuring of the Cypriot

economy from an exporter of minerals and agricultural products, mainly copper, asbestos and citrus fruits in the period 1961-73 and an exporter of manufactured goods, mainly clothing and footwear, in the latter part of the 1970s and the early part of the 80s, to an international tourist, business and services centre during the 1980s and 1990s.

- Partial dependence on the tourism sector, whose total contribution, derived from the value added created, either directly through the purchases of goods and services of tourists in various sectors of economic activity or indirectly, through the intersectoral linkages, amounted to 15-20% of GDP in the period 1990-2003.

- Structure of Production

The predominant and continuously expanding share of the services sectors (55% of GDP in 1980, 66% in 1990 and 75,7% in 2003) at the cost of both the primary sectors of economic activity, agriculture and mining and quarrying and the secondary sectors of manufacturing and construction, reflects the comparative advantages, which Cyprus enjoys in the sectors of services. These advantages derive mainly from:

- its strategic geographical location at the crossroads of three continents;
- the favourable business climate, which is directly related to the prevalence of conditions of macroeconomic stability and a generally favourable tax regime. In relation to this, the recent tax reform introduced a uniform corporate tax rate of 10%;
- the well-educated labour force (according to the Labour Force Survey of 2003, 32,5% of the total gainfully employed population are graduates of tertiary level education), in conjunction with the competitive, as compared to international standards, level of remuneration;
- the relatively satisfactory state of its infrastructure in transport, energy and telecommunications;
- satisfactory living conditions for foreigners, as well as
- the close economic and political relations Cyprus has developed with its neighbouring countries.

The hotels and restaurants sector's share to GDP rose throughout the 1980s (3,6% in 1980, 10,6% in 1990). During the 1990s, however, the sector exhibited fluctuations, and its share was contained to 7,7% of GDP in 2003, confirming its vulnerability to exogenous and imponderable factors.

The sectors of financial services, business and real estate and renting activities, educational and health services, also exhibited an increasing trend in their share to GDP. This development was the result of the utilisation of the comparative advantages of Cyprus as far as the supply of high quality of services are concerned, both in the domestic market and in the external market, as well as the high income elasticity which characterises these services.

The share of public administration and defence to GDP exhibited intertemporally a slight increasing trend, it remained, however, at low levels by international comparison.

The agricultural sector's share to GDP has been decreasing (10% in 1980, 7,1% in 1990 and 4% in 2003), a development that constitutes an international phenomenon, and is attributed to the relatively low-income elasticity of demand for agricultural products, the urbanisation trend and the reallocation of productive resources from agriculture to other more profitable economic activities. In the case of Cyprus, a constraining factor to the growth of the agricultural sector was also the Turkish invasion and the occupation of a large portion of fertile land, the water scarcity for irrigation, a problem which has become more intense in the past few years, the land fragmentation into small units, which prevents the use of advanced technology and the use of agricultural land for tourist development and other uses. In parallel, agricultural production faced intense competition during the 1990s due to the trend towards gradual liberalisation of world trade of agricultural products.

The contribution of the manufacturing sector to GDP also exhibited a falling trend since the early 1980s (18,2% in 1980, 14,7% in 1990, 9,3% in 2003). The sector is characterised by chronic problems of competitiveness,

due, inter alia, to the small size of the majority of manufacturing units, which negatively affects their capacity to utilise advanced technology and modern methods of management, production and marketing. A study conducted by the Department of Economics of the University of Cyprus, in which the total factor productivity index⁶ of the manufacturing sector was estimated, confirmed that during the period 1987-96 the rate of increase of productivity in most Cypriot manufacturing sub-sectors was lower, compared to that of all other countries included in the study, that is, Germany, France, Italy and the UK. The decreasing trend of the contribution of the manufacturing sector to GDP is also attributed to the faster increase of production costs, as compared to competitor countries as well as the intensification of competition due to the implementation of the Customs Union Agreement between Cyprus and the EU and the trend towards liberalisation of world trade.

The construction sector's share to GDP has also been falling (14% in 1980, 9,9% in 1990, 8,2% in 2003), a development attributed to the satisfaction of the housing needs of the vast majority of the population, the reduced interest in the construction of new tourist accommodation and the relative slackening of demand for secondary homes in recent years. Concerning the housing conditions, it is noted that according to the Family Budget Survey 1996/97, 74,3% of the households live in privately owned dwellings and a substantial percentage around 16,5% lives in Government housing estates, such as refugee estates, self-help housing estates etc. It is noted, however, that a reversal of the decreasing trend of the construction sector is observed during the past three years, a development mainly attributed to the expansion of investment demand of the private sector. The increased interest of the private sector is partly explained by the negative performance of the investment in the CSE, which increased the relative profitability of investment in immovable property, as well as the increased external demand for holiday houses, as shown by the applications and approvals for purchase of immovable property by foreigners.

⁶ The total factor productivity index is considered a more reliable indicator than the commonly used labour productivity index, because it measures the productivity of all factors of production; labour, capital and intermediate flows.

In conclusion, the continuing upward trend of the share of the tertiary sectors of services to GDP reflects the comparative advantages of Cyprus in these sectors and denotes the important role of services in a contemporary society.

- Structure of Employment

The change in the structure of production in favour of the tertiary sectors implied a similar change in the structure of employment. The contribution of the tertiary sectors to the total gainfully employed population increased from 45,5% in 1980, to 57,2% in 1990 and around 71,5% in 2003, which was accompanied by a fall in the shares of both the primary and secondary sectors. In parallel, it is noted that as early as from the beginning of the 1960s there was a decrease, in absolute terms, of employment in the primary sectors, while a similar trend is observed in the secondary sectors as from the beginning of the 1990s, a development which implies that the additional posts are exclusively created in the tertiary sectors of services.

Another basic characteristic of the labour market is the employment of large numbers of foreign workers, especially in unskilled or low-skilled occupations. The total number of legally employed foreign workers reached 40.700 in 2003 and represented 12,9% of the gainfully employed population. From a sectoral perspective, in 2003 29,6% of the foreign workers in Cyprus were employed as household help, 19,6% worked in the sector of hotels and restaurants, 8,5% in construction, 8,4% in agriculture, 8,3% in manufacturing and 8,3% in trade.

- Structure of Investment

There has been a decline in gross fixed capital formation as a percentage of GDP over the past years, from 34% in 1980 to 24,5% in 1990 and around 17,5% in 2003. This development reflects the gradual satisfaction of the housing needs of the refugees and, more recently, the reduced interest in investing in new tourist accommodation. In addition, economic activity has

tended in recent years to focus on the tertiary sectors of services, which are more labour-intensive rather than capital-intensive.

The structure of investment continues to display weaknesses, given that about 69% of the total is channeled into construction works. Investment in machinery and equipment, however, improved in recent years, with its share to total gross fixed capital formation rising from 19,5% in 1980 to 26,5% in 2003, but still lacks behind as compared to the respective percentage of the majority of the developed countries, which fluctuates between 40-50%. These figures are indicative of the low level of utilisation of advanced technology, which affects adversely the growth of productivity, particularly in the primary and secondary sectors.

- Structure of Exports

The changing structure of the Cyprus economy is reflected in a parallel change in the structure of exports of goods and services. Characteristic of these changes is the rise in the exports of services, which in 2003 accounted for around 85% of all revenues from the export of goods and services, compared to 50% in 1980. Exports of services, except tourism, constitute the primary source, accounting for about 53% of the total. Tourism contributes around 32% of total receipts from exports of goods and services and the EU countries constitute our main tourist market with a share of 83,3% of the total tourist arrivals. The share of the UK in total tourist arrivals accounted for 58,5% in 2003, while Germany, Greece, Russia and Sweden followed with a percentage share of 5,6%, 4,8%, 4,6% and 3,8% respectively. At the same time, the share of international business activities exhibits an upward trend and has risen from 1% of the total value of exports of goods and services in 1980 to 12% in 2003. Other export-oriented sub-sectors include banking and other business services, such as accounting, market research, consultancy services, etc.

Exports of goods accounted for about 15% of total foreign currency revenue in 2003, with the largest share, around 7%, coming from re-exports. Domestic exports accounted for 6,5% of the total and shipstores for the remaining 1,5%. Cyprus' main agricultural exports are potatoes and citrus fruit, while the most important manufactured products are pharmaceuticals, clothing, despite a steady decline in the past decade, cigarettes, cement and haloumi - cheese.

- Trade Relations

The EU member countries and particularly Britain continue to be the most important trading partners of Cyprus, absorbing 54,5% of domestic exports in 2003. The share of domestic exports, which is absorbed by the EU, exhibited an upward trend during the 1980s, from 33% in 1980 to 61% in 1990. However, during the 1990s, the corresponding share decreased gradually to 54,5% in 2003, reflecting, mainly, the erosion of competitiveness of Cyprus' products in these markets.

The Arab countries absorb about 17% of domestic exports and constitute the second most important trading partner of Cyprus. The Eastern European countries progressively increased their share in domestic exports reaching 10,5% in recent years.

As regards imports, the EU constitutes the main supplier of goods with a percentage of around 55,5% of total in 2003. It is noted that an important part of imports comes from other countries, such as Japan, 5,6%, China, 4,9%, the USA, 4,2% and other Asian countries with a percentage share of around 4,5%.

- Distribution of Income by Factors of Production

The basic characteristic of the Cyprus economy, as far as the distribution of income by factors of production is concerned, is the high, compared to international levels, percentage share of capital earnings (profits, depreciation, interest) to GDP. Over time, a slight downward trend has been observed during the past decade, from 42,8% in 1990 to 40,8% in 2002.

Correspondingly, the percentage share of income of both employees and self-employed rose slightly from 57,2% in 1990 to 59,2% in 2002.

At the same time, it is noted that Cyprus is in a generally favourable position, as regards the distribution of income. Indicatively, the Gini coefficient, which gives an overall picture of the distribution of income and fluctuates between 0 (complete equality in the distribution of income) and 1 (complete inequality), in 1996/97, was estimated, based on the net income per adult equivalent, according to the Family Budget Survey to be 0,324, virtually identical to the corresponding one in the EU, where the Gini coefficient in 1994 was equivalent to 0,322. In addition, according to the same Survey, in 1996/97 the poorest 20% of Cyprus' population received 8% of total disposable income, while the richest 20% received 37% of the total income, that is, 4,6 times more (known as the S80/S20 ratio). In 1994 the corresponding figures for the EU were 8% for the poorest 20% of the population and 39% for the richest 20%, giving an S80/S20 ratio of 4,9. On the basis of this indicator, income distribution was less unequal in Cyprus as compared to the EU.

Developments During 2003

General Assessment

During 2003, the Cyprus economy exhibited for the second consecutive year restrained rate of growth. The unfavourable external environment that Cyprus had to face, which negatively affected primarily the external demand for tourist services, constituted the main factor towards this development. The unfavourable external environment was the result of the climate of uncertainty that prevailed before and during the war in Iraq, as well as the delay observed in the course of recovery of our main economic partners. The substantial fall of the value of the dollar and the sterling pound vis-à-vis the euro and consequently vis-à-vis the Cyprus pound given its pegging to the euro, a development which adversely affected the competitiveness of the Cypriot goods and services in member countries outside the eurozone, constituted an additional restricting factor. The generally favourable weather conditions that

prevailed contributed positively to the volume of agricultural production and prevented a further deceleration of the rate of economic growth.

More specifically, during 2003, the rate of economic growth fluctuated at around 2%, in real terms, following a similar rate of economic growth in 2002. From the demand side, growth was generated by domestic demand and particularly private and public consumption demand and investment in construction.

The rate of growth of private consumption was contained to 2%, in real terms, in 2003, as compared to 2,5% increase in 2002. This development is attributed to the unfavourable climate that prevailed before and during the war in Iraq as well as to its negative consequences on tourist demand. The discussion for a further reduction of excise duties on small and medium engine volume cars before the final approval of a relevant bill by the House of Representatives on the 20th of November 2003, negatively affected the expansion of private consumption. The expansion of private consumption, despite the further deceleration noted as compared to 2002, is attributed to the increase of the real disposable income of households as a result of the expansion of employment and real earnings, as well as to the impact of the broader tax reform. In relation to the latter, according to the tax reform, the highest marginal tax rate for physical persons decreased from 40% to 30%, while a realignment of income tax brackets took place with lower tax rates and the professional tax was abolished as from 1.1.2003, contributing in this way to the increase of the disposable income of the average household. The low level of real interest rates, resulting, on the one hand, from the reduction of nominal interest rates according to the decision of the Monetary Policy Committee to reduce the Lombard rate by 0,5 percentage points in April 2003 and, on the other hand, from the acceleration of the inflation rate, contributed positively, to a limited extent though, to the expansion of private consumption.

The growth rate of public consumption exhibited significant deceleration during 2003, 2,7% in real terms, as compared to 7,5% in 2002; it continued, however, to constitute a leverage of growth from the demand side. The deceleration of the rate of growth of public consumption is attributed to

the containment of defence imports. Excluding defence imports, public consumption expanded by around 6,5% in 2003, following an increase of 4,4% in 2002, a development which reflects the increase of employment in the public sector resulting from the need to recruit additional staff for the creation of new and for strengthening existing structures for the effective implementation of the *acquis communautaire* in various sectors, as well as the efforts of the Government to boost the economy and restrict the negative consequences of the overall climate of uncertainty that prevailed and in particular the unfavourable external environment.

Gross fixed capital formation exhibited a decrease of around 4,5%, in real terms, in 2003, as compared to an increase of 8% in 2002. Excluding the purchases of ships and aircrafts, gross fixed capital formation increased by around 5%, in 2003, as compared to a decrease of 1,4% in the previous year, constituting a significant leverage for economic growth. The satisfactory expansion of investment demand reflects the increased investment activity in construction and machinery and equipment. The expanded investment demand for construction is attributed to the increased investment interest exhibited by the private sector and the increased investment activity of the broad public sector. Fixed investment in machinery and equipment recorded satisfactory expansion, a development attributed to the increased efforts undertaken to face the conditions of intense competition that arise from the accession of Cyprus to the EU. In contrast, fixed investment in transport equipment decreased, negatively affected by the deceleration of the economic activity.

The external demand for goods and services exhibited only a small increase for around 0,5%, in real terms in 2003, following a decrease of 5,1% in 2002, reflecting the further reduction of tourist demand and external demand for goods, which was compensated by the satisfactory expansion of exports of services other than tourism. The satisfactory expansion of export of services, other than tourism is attributed to the dynamism exhibited by the sectors of private services and to the comparative advantages of Cyprus. In contrast, tourist demand decreased during 2003, a development attributed to

the climate of uncertainty that prevailed before and during the war in Iraq, as well as to the delay in the course of recovery of the important tourist markets of Cyprus. In addition, the exchange rate differentiations, resulting from the increase of the value of the Cyprus pound vis-à-vis the sterling pound, the dollar and other currencies pegged to the dollar, negatively affected tourist demand. The decrease of external demand for goods, both for domestically produced and re-exports reflects beyond the deceleration of the economic activity in the major markets of Cyprus, the direct consequences of the war in Iraq on the external demand from the Arab countries as well as the deterioration of the competitiveness of Cyprus' products in the markets outside the eurozone due to the exchange rate developments.

From the supply side, the growth of the Cyprus economy was mainly based on the tertiary sectors and, in particular, the sectors of real estate activities and other business services, telecommunications as well as to the sectors of social and personal services. A positive development was also the very satisfactory growth of the construction sector, as well as the expansion of the agricultural sector. In contrast, the sectors of restaurants and hotels, manufacturing and trade exhibited a decrease in their economic activity.

More specifically, the sector of real estate activities exhibited a very satisfactory expansion, reflecting the differentiation of profitability towards investment in immovable property, due to the continued downward course of the stock market, as well as the increased external demand for holiday houses in Cyprus.

Satisfactory growth was exhibited by the sectors of business services, research and development, private education and health and telecommunications reflecting, from the supply side, the dynamism, which characterises the specific sectors and from the demand side the high income elasticity of these services.

The value added of the sector of financial intermediation (which includes the activities of credit institutions, insurance companies, Cyprus Stock Exchange and brokerage firms) exhibited only a contained increase of

the order of around 1%, in real terms, following a marginal increase of 0,3% in 2002, a development attributed to the containment of the economic growth, in general, which affected the economic activity of commercial banks and insurance companies, as well as the reduced interest for investment in the CSE.

In contrast, the value added of the sector of restaurants and hotels exhibited a decrease of 4%, in real terms, following a reduction of 7% in 2002, as a result of the fall of tourist arrivals, due to the climate of uncertainty that prevailed before and during the war in Iraq, as well as the delay observed in the course of recovery of the economies of our main tourist markets. The intense promotion of the Cyprus tourist product abroad and the contained price policy followed by the owners of tourist accommodation prevented higher decreases in tourist arrivals.

The rate of growth of the value added of the sector of wholesale and retail trade decreased by around 1,5%, in real terms, as compared to an increase of 1% in 2002, negatively affected by the subdued growth of economic activity and private consumption for goods as well as the decrease of tourist demand.

Overall, during 2003, the economic activity of the tertiary sectors of services increased by around 2%, in real terms, following a similar increase in 2002, 1,8%.

A positive development in 2003 constituted the continued course of satisfactory growth of the construction sector, a trend that has been noted since 2001. The rate of growth of the sector of construction reached around 5%, in real terms in 2003, following an increase of 4,5% in 2002. This development is attributed both to the increased investment activity in construction works of the private sector and the broad public sector.

In contrast, the sector of manufacturing exhibited a decline of the order of around 2,5%, in real terms, following a similar decrease in 2002, 2,2%, reflecting the continuation of the chronic structural problems faced by certain

traditional sub-sectors, such as clothing and footwear and the containment of the rate of growth of the economy and consumption demand, as well as the decrease of tourist demand and external demand for certain products of the sector, such as pharmaceutical products, furniture, cathodes of refined copper and cosmetics.

The volume of production of the agricultural sector recorded an increase of the order of around 1,5%, in 2003, following an increase of 5,7% in the previous year, a development attributed to the satisfactory expansion of crop production, mainly cereals and grapes, due to the generally favourable weather conditions that prevailed in 2003. The decrease in the production of potatoes, due to the smaller allocation of potato seeds in production, within the efforts of containing supply and securing better prices in external markets, prevented a higher increase of the volume of crop production. The volume of production of the subsector of livestock also exhibited small expansion.

The continued containment of the rate of growth of the Cyprus economy for the second consecutive year was reflected also in the labour market, with an increase of the unemployment rate to 3,5% of the economically active population from 3,2% in 2002. The increase of unemployment was observed in almost all sectors of economic activity, as a result of the contained rate of growth of economic activity, in general. The highest increase in unemployment was recorded in the sector of restaurants and hotels and trade as a result of the decrease in the volume of production of the specific sectors.

The rate of growth of nominal earnings fluctuated at around 5% in 2003, as compared to 5,6% in 2002. Labour productivity in Cyprus improved by around 1% in 2003, following a similar increase in 2002, reflecting the continued contained rate of economic growth for the second consecutive year. Labour productivity in the EU, however, improved by a lower rate of the order of 0,6% in 2003, thus narrowing slightly further the difference in productivity levels between EU and Cyprus.

The rate of inflation recorded an acceleration and reached 4,1% in 2003, as compared to 2,8% in 2002, a development which was anticipated due to the increase of the VAT rate from 10% to 13% as from 1.7.2002 and from 13% to 15% as from 1.1.2003 as well as the increase of other excise duties, mainly for petroleum products and cigarettes, in the context of harmonisation with the minimum levels prescribed by the acquis communautaire. A positive development was the containment of core inflation, which excludes the temporary factors, to low levels, around 2,5%.

The current account deficit of the balance of payments decreased from 5,4% of GDP in 2002 to around 4,4% in 2003. Despite the decrease observed, the current account deficit remained at high levels, a development attributed mainly to the fall in the receipts from tourism as well as to the decrease of exports of goods. A restraining factor to a further deterioration of the current account deficit constituted the containment of import demand, reflecting the deceleration of the rate of economic growth, in general, as well as the improvement in the terms of trade due to the exchange rate differentiations. The balance in the Capital and Financial Account recorded a surplus of £171,3 mln in 2003 as against £340,2 mln in 2002. The decrease of the surplus reflects the increase of deposits of Cyprus banks abroad and the decrease of foreign direct investment in Cyprus. The official foreign exchange reserves exhibited a decrease offering coverage of 5,5 months of imports of goods and services as compared to 5,7 months in 2002. The percentage of the long-term foreign debt to GDP increased to 35,9% in 2003 from 34% in 2002, mainly as a result of the expanded borrowing of the Government. The foreign debt service ratio decreased to 5,7% in 2003 from 6,2% in 2002, and it continues to compare favourably by international standards.

The fiscal deficit as a percentage to GDP increased to around 6,3% in 2003 from 4,6% in 2002. The deterioration of the fiscal deficit in 2003 is attributed, on the one hand, to the containment of economic activity, which adversely affected public revenue, and, on the other hand, to the significant expansion of public expenditure. The expansion of public expenditure reflects the increase in both current and capital public expenditure. The increase of

public current expenditure is attributed to the expansion of expenditure on wages and salaries, due to the increase of basic salaries of civil servants granted in 2003 covering also increases for 2001 and 2002, as well as expenditure on subsidies (subsidisation of heating oil, increase in the total amount of subsidisation of cereals due to the expanded production) and transfer payments (increase of the grant to local authorities following the abolition of professional tax and the increased transfer payments to the Unemployment Fund, due to the partial increase of unemployment). In addition, public capital expenditure also increased, reflecting the efforts of the Government to contain the negative effects of the war in Iraq on the Cyprus economy. Public debt, excluding intragovernmental debt reached 72,6% of GDP in 2003.

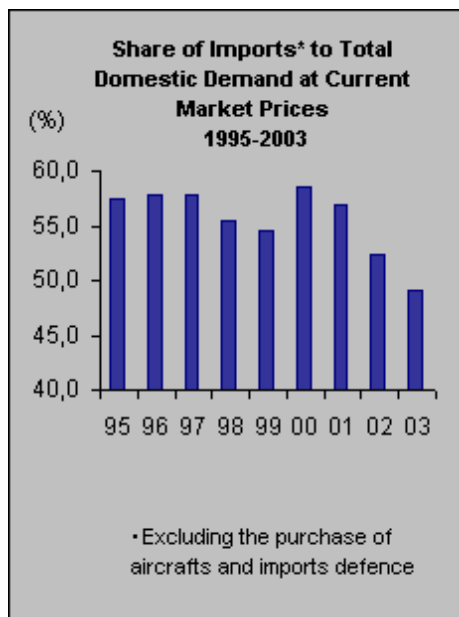
The main characteristic of monetary developments during 2003 was the prevalence of conditions of excess liquidity, which reflect the subdued economic activity and as a result the decreased demand for loans. A worth-mentioning development in the monetary sector in 2003 constituted the cut in the Lombard rate by 0,5 percentage point by the Monetary Policy Committee in April 2003, in an effort to revive economic activity which was adversely affected by the war in Iraq. The rate of growth of money supply exhibited a substantial deceleration in 2003, recording an increase of 4% in December 2003, as compared to 10,3% in December 2002, as a result of the containment of the rate of increase of the claims on private and public sector. Claims on private sector increased by a low rate in 2003 and the average annual rate of growth in December 2003 fluctuated at 5%, as compared to 8% in 2002. This development is attributed to the subdued economic activity as well as to the stricter evaluation of loan applications by commercial banks. The rate of growth of claims on public sector also registered a significant slowdown, reflecting the fact that the fiscal deficit was mainly financed by foreign borrowing.

In summary, the Cyprus economy exhibited a slowdown in 2003, mainly due to the decrease of tourist demand, which was negatively affected by the war in Iraq and the delay in the recovery of economic activity in our major tourist markets. The rate of economic growth fluctuated at 2% in real

terms in 2003, following a similar rate in 2002. The unemployment rate increased to 3,5% in 2003. The rate of inflation accelerated to 4,1%. The current account deficit of the Balance of Payments improved, whereas the fiscal deficit increased.

Demand

- Domestic Demand



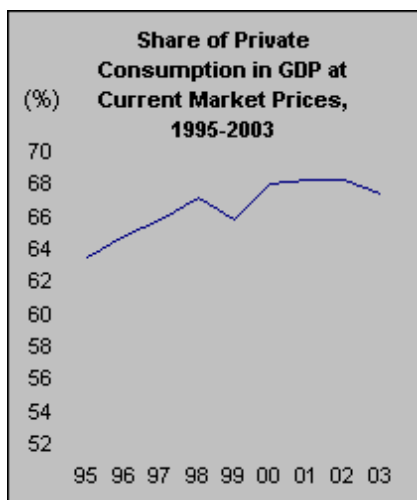
In 2003, the rate of increase of domestic demand, including imports of defence equipment, exhibited significant deceleration around 0,5% in real terms, as compared to 4,5% in 2002. The smaller increase in domestic demand compared to the increase in domestic production led to a relative improvement of the current account deficit of the Balance of Payments.

Consumption

Private consumption constitutes the largest component of domestic demand. It is noted that private consumption, as a percentage to GDP, fluctuated from 66% to 68,5% during the 1998-2003 period. The prevailing trend with regard to the structure of private consumption is the growing importance of the consumption of services, reflecting their high-income elasticity.

Private consumption exhibited a low rate of increase for the second consecutive year around 2% in 2003, in real terms. This development is mainly attributed to the unfavourable climate of confidence that prevailed before and during the war in Iraq and its consequences on tourist demand. A negative factor to the expansion of consumption was also the discussion for a further decrease in excise duties for small and medium engine volume cars

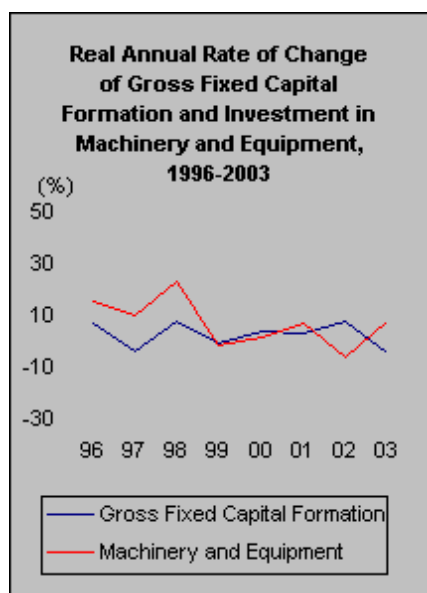
before the final approval of the relevant bill by the House of Representatives on 20th of November 2003. The further expansion of private consumption is attributed to the increase of real disposable income of households as a result of the rise in employment and real earnings as well as to the effects of the broader tax reform. In relation to the latter, according to the tax reform the highest marginal income tax rate for physical persons was lowered from 40% to 30%, while in parallel, a realignment of the income tax brackets was made with lower tax rates and the professional tax was abolished as from 1.1.2003, thus contributing to the increase of the disposable income of the average household. The low level of real interest rates which resulted on, the one hand, the decrease in nominal interest rates following the decision of the Monetary Policy Committee for a reduction of the Lombard rate by 0,5 percentage points in April 2003, and, on the other hand, the acceleration of the rate of inflation, contributed positively, to a limited extent through, to the expansion of private consumption.



The rate of increase of public consumption exhibited significant deceleration in 2003, 2,7%, in real terms, as compared to 7,5% in 2002, a development reflecting the containment of imports of defence equipment, within the efforts of finding a solution to the Cyprus problem. Excluding imports of defence equipment, public consumption expanded by around 6,5% in real terms in 2003, following an increase of 4,4% in 2002, as a result of the expansion of employment in the public sector, aiming at enhancing existing and creating new institutions for the effective implementation of the acquis in various sectors as well as the efforts of the Government to revive the economy and to restrict the negative consequences from the general climate of uncertainty and the particularly unfavourable external environment that prevailed during 2003.

The containment of the rate of increase of private consumption led to a stabilisation of domestic savings to around 12,5% of GDP in 2003, as was in 2002.

Investment



Fixed investment declined by around 4,5% in real terms in 2003, as compared to an increase of 8% in 2002. It is noted that the reduction of investment demand is exclusively attributed to the purchase of ships by a Cypriot ship owning company and aircrafts by Cyprus Airways in 2002. Excluding the purchases of aircrafts and ships, fixed investment increased by around 5%, in real terms in 2003, as compared to a decrease of 1,4% the previous year. This positive development is mainly attributed to the satisfactory expansion of investment activity for construction works, which has been observed as from 2001.

More specifically, in 2003, investment activity in construction increased by 5% in real terms, following an increase of 4,2% in 2002. The satisfactory expansion of investment in construction is mainly attributed to the increased interest of the private sector for dwellings and the expanded investment activity of the broader public sector. The increased interest of the private sector is partially explained by the negative return of investments in the CSE, which increased the relative profitability of investment in immovable property as well as the higher external demand for holiday residences as indicated by the applications and approvals for purchases of property by foreigners.

Investment in machinery and equipment registered also a satisfactory increase of the order of 7,5% in real terms, in 2003, as compared to a decrease of 6,1%, in 2002, a development which reflects the efforts of

confronting the conditions of intense competition arising from the accession of Cyprus in the EU.

In contrast, fixed investment in transport equipment, excluding the purchases of aircrafts and ships, declined by 13%, in real terms in 2003, following a decrease of 28% in 2002, affected by the deceleration of the economic activity, in general.

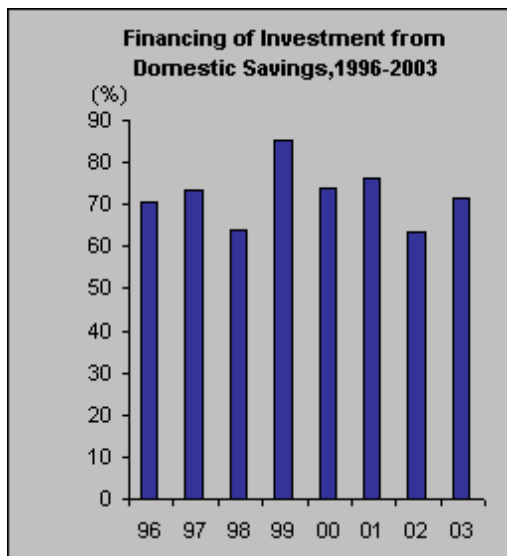
Investment demand was further enhanced by the activities of the Central Government, which increased its investment expenditure for infrastructural works from £173,99 mln in 2002 to £226,2 mln in 2003, or by 30% in nominal terms. The investment activity of the public sector aimed at improving the road network, the continuation of water development projects, the expansion and upgrading of existing infrastructure at Larnaca and Paphos airports, urban planning projects, sewerage systems in rural areas, the tertiary treatment of wastewater in towns, the construction of new public service buildings, school buildings as well as the new Nicosia General Hospital and the Hospital of Famagusta.

Expenditure for the expansion and improvement of the road infrastructure concerned basically the continuation/completion of construction works for the Limassol-Paphos, Dhekelia-Famagusta, Nicosia-Kokkinotremithia-Astromeritis highways and road improvement works in the Dhiarizos valley to Ayios Nikolaos and Mandria and the construction works for the by-pass road of Limassol for upgrading the junctions.

The water development projects concerned, mainly, the major water projects of the Dhiarizos and Ezousa valleys and the water supply of the broader Paphos area, which include, *inter alia*, the drinking water treatment plant in Asprokremmos and the Kannavious Dam and the installation of water conveyor in the broader Paphos area from Geroskipou up to the Coral Bay as well as the construction of various water works in municipalities and Communities and other irrigation works of local interest.

Investment expenditure in urban planning works concerned, mainly, the continuation of the improvement and construction of primary importance roads based on the local plans of the broader areas of Nicosia, Limassol, Larnaca and Paphos (i.e. the Nicosia south by-pass, Limassol tourist coastline road, Spyros Kyprianou Avenue and expansion of Nikou Pattihi Avenue in Limassol, part of the Larnaca-Limassol road in Larnaca and Stratigou Timayia Avenue in Larnaca, the Paphos North by-pass etc.). The expenditure for public buildings included the continuation of the works for the construction of the New Central Government Buildings Complex in Nicosia, the High Court building in Nicosia as well as expansion of the District Court in Limassol and the construction of buildings for the central prisons and the local government buildings in Paphos etc.

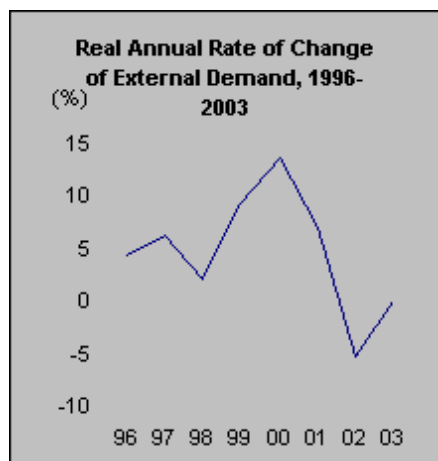
Investment of the Cyprus Electricity Authority fluctuated at around £50 mln in 2003, as compared to £40 mln in 2002. The Authority's investment concerned, mainly, works for the expansion and enhancement of the control, information, transmission and distribution systems, as well as the beginning of construction works for the third production unit of electricity at Vassilikos and the beginning of the construction works for the new central offices of the Authority in Nicosia.



The Cyprus Telecommunications Authority realised investment of the order of around £57 mln in 2003 following a similar amount in 2002, £60 mln. The Authority's investment continued in 2003 to be directed at the expansion, enhancement and upgrading of the telecommunications network, the expansion of the wired telephony network, the underwater cable network and mobile telephony.

The financing needs in 2003 were covered both by domestic savings and capital inflows from abroad, and more particularly from foreign direct investments in Cyprus, foreign borrowing by the banks and the Government, (mainly through the issue of bonds) as well as by non residents deposits to banks in Cyprus.

- External Demand



Due to the small size of the domestic market, the Cyprus economy depends to a great extent, on its ability to expand the external demand for Cypriot goods and services. It is indicative that exports of goods and services, in total, constituted around 48,5% of GDP in 2003, whereas exports of services hold a dominant position, accounting for around 41% of GDP.

In general terms, Cyprus had to face a particularly unfavourable external environment during 2003, which was characterised by a climate of uncertainty that prevailed internationally during the first three months of 2003, the war in Iraq which affected both indirectly (through the deterioration of the international confidence climate) and directly the external demand from the Arab countries, as well as the delay in the course of recovery of our trading partners. The significant reduction of the value of the dollar and sterling pound vis-à-vis the euro and consequently the Cyprus pound due to its pegging to the euro brought additional negative consequences on the external demand.

More specifically, exports of goods and services increased only marginally by around 0,5%, in real terms in 2003, following a decrease of 5,1% in 2002. Exports of services increased by a rate of around 2%, in real terms in 2003, as compared to a decrease of 2,4% in 2002. The increase is attributed to the satisfactory expansion of external demand for services other than tourism and to the comparative advantages of Cyprus. In contrast, tourist demand

decreased in 2003, a development attributed to the climate of uncertainty that prevailed before and during the war in Iraq as well as the delay in the recovery of the main tourist markets of Cyprus. In addition, the decrease of the value of the sterling pound vis-à-vis the Cyprus pound affected negatively tourist demand. The intense promotion of the Cyprus tourist product abroad and the restrained price policy followed by the tourist accommodation owners prevented further reductions. The per capita expenditure of tourists exhibited a decrease due to the negative effects of the fall in the prices of accommodation offered to tour operators, in an effort made by hotel owners to contain the fall in external demand. In relation to this, receipts from tourism decreased by 10,2% in 2003, in nominal terms, whereas the arrivals of tourists decreased by 4,8%.

Exports of goods registered a decrease of the order of around 7%, in real terms in 2003, following a decrease of 16,7% in 2002. This development is attributed to the decrease of both domestic exports and re-exports. The exports of domestically produced manufacturing products declined, reflecting, inter alia, the continued chronic structural problems faced by the traditional sub-sectors, the deceleration of the rate of economic growth in our major markets as well as the fall of external demand from the Arab countries, due to the war in Iraq and the decrease of the competitiveness of Cyprus products due to the increase of the value of the Cyprus pound vis-à-vis the dollar, given that a large part of the exports to the Arab countries are denominated in dollars. The volume of agricultural exports also exhibited a decrease, a development mainly attributed to the fall in the exports of potatoes, due to the smaller quantities of seeds allocated to production, within the efforts to contain the supply and secure better prices in international markets.

From a geographical point of view, domestic exports of manufacturing products exhibited a fall towards all our major export markets, due to the deceleration of the rate of economic growth of the trading partners of Cyprus, the consequences of the war in Iraq and the exchange rate developments which resulted in the deterioration of the competitiveness of Cyprus products

to various exports markets of Cyprus. The highest fall was exhibited by domestic manufacturing exports towards Arab countries.

Domestic Production

The main characteristic of the sectoral developments in 2003 was the subdued growth of the majority of sectors of economic activity, as a result of the decrease of tourist demand for the second consecutive year and the significant containment of the rate of growth of domestic demand. The sectors of restaurants and hotels, manufacturing and trade recorded a decrease in their volume of production. In contrast, the construction sector exhibited a satisfactory expansion.

- Agriculture

The value added of the agricultural sector exhibited a small expansion of the order of 1,5% in real terms in 2003, following an increase of 5,7% in 2002. This development is mainly attributed to the small increase in crop production, due to the relatively favourable weather conditions that prevailed in 2003, as well as to the small increase of livestock production.

The small increase of crop production reflects, on the one hand, a significant expansion of the production of cereals and grapes, and a smaller increase of the production of citrus fruit and, on the other hand, a decrease of the production of potatoes.

More analytically, the production of potatoes fluctuated at around 130.000 tonnes in 2003 and was lower than the 2002 production of 148.500 tonnes, due to the smaller quantities of potato seeds allocated to production, within the efforts of containing supply and securing better prices in international markets. The decreased production was also reflected in the volume of exports of potatoes, which decreased to 81.981 tonnes in 2003 from 94.479 in 2002. A positive development, however, was the securing of high prices in external markets in 2003. As a result, the value of exports of potatoes increased substantially to around £15,1 mln in 2003 from £11,1 mln in 2002.

The total production of citrus fruits registered a small increase from 137.800 tonnes in 2002, to around 139.500 tonnes in 2003, due to an increase in the volume of production of grapefruits, mandarins and oranges, which was partly compensated from the decrease of the production of lemons and mandoras. The satisfactory performance of the production of grapefruits is attributed, beyond the favourable weather conditions, to the successful implementation of the Restructuring Scheme for Citrus Fruits during the past years, which aims at replacing non productive grapefruit crops with new productive varieties (red grapefruits). The production of mandarins, excluding mandoras, and oranges also exhibited a satisfactory expansion, due to the satisfactory rainfall. The production of mandoras and lemons decreased due to unfavourable weather conditions during their blossom period. The total volume of exports of citrus fruits decreased, due to the fall in the volume of production of mandoras. The volume of exports of oranges and grapefruits increased due to the reduced supply from other countries that compete Cyprus in external markets, such as Spain, Italy and Greece, whose production was negatively affected by unfavourable weather conditions during 2003, whereas, at the same time, high prices were secured in external markets. In total, the value of exports of citrus increased to around £19 mln in 2003 from £18,3 mln in 2002.

The production of cereals exhibited a satisfactory increase by around 13% in 2003, following a substantial increase in 2002 and fluctuated at around 160.000 tonnes, as against 141.7500 tonnes in 2002. This development reflects the increase of production of barley and is attributed to the satisfactory rainfall during important, for the cereal production, months of the year. The production of wheat exhibits, from a medium-term perspective a stabilising trend, a development, which is attributed to the implementation of irrigation systems for wheat in Paphos, where most of the wheat is cultivated.

The production of grapes exhibited a satisfactory increase in 2003 following a sharp decrease in 2002, due to the satisfactory rainfall. In addition, in 2003, the production of both table and wine grapes was not negatively affected by diseases that inflicted the production of grapes in the previous year. The

increased volume of production of table grapes led to an increase of the volume and value of exports, with the value of exports reaching £1,1 mln in 2003 from, £0,6 mln in 2002.

Total receipts from exports of agricultural products increased to £43,6 mln in 2003 from £36,9 mln in 2002, mainly reflecting the increase in the value of exports of potatoes, citrus fruits and grapes.

The production volume of the sub-sector of livestock exhibited a slight increase in 2003, a development, which reflects the expansion of the production of pork and beef and cow's milk, which compensated for the small decreases in production of sheep and goats meat and poultry. The decrease of tourist demand prevented a larger growth of the sub-sector. In contrast, the production of goat and sheep meat and poultry registered a decrease in 2003, affected by the fall in tourist demand. The production of cow's milk exhibited a high increase, a development attributed both to the increase in the number of milk packaging companies and the supply of fresh milk and to the spectrum of dairy products produced in Cyprus. The production of pork meat exhibited a comparatively a high increase in 2003, while a smaller increase was registered in the production of beef, due to the expansion of domestic demand. In the case of beef, the increase is explained by the gradual smoothing of demand, following the sharp reductions observed in previous years, as a result of the mad cow disease.

A characteristic development of the sector in 2003 constituted the intensification of the efforts for the creation of the necessary mechanisms for the implementation of the Common Agricultural Policy of the EU.

In summary, from a medium-term perspective, notwithstanding the positive performance of the sector in 2001-2003, the sector of agriculture was unfavourably affected by the conditions of strong competition which the sector faces both in the domestic and international markets. Intense competition in the domestic market is attributed to the completion of the First Phase of the Cyprus' Custom's Union Agreement with the EU and Cyprus' commitments to the World Trade Organisation, which imply a partial liberalisation of imports of

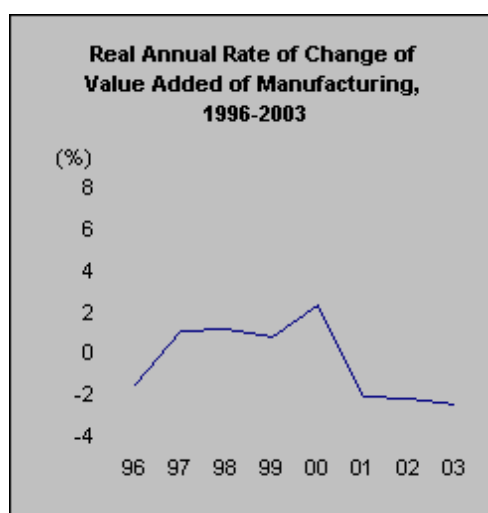
agricultural products. It is noted, that as from the accession of Cyprus in the EU, on 1st of May 2004, the agricultural products of the Community will be imported in Cyprus without any restrictions and as a result the conditions of competition are expected to be further intensified. In parallel, the sector faces structural problems, which are attributed to the weaknesses in the marketing of agricultural products, the relatively small plots of land, which consequently led to the inability to utilise modern technology to the highest possible extent, the concentration of exports on a limited number of products, as well as the concentration of production on varieties of agricultural products whose demand is decreasing. The key for the recovery of the agricultural sector and of crop production, in particular, is traced in the restructuring of crop production and its shift towards higher quality crops, early crops as well as the technological upgrading of the production methods. A positive development is the gradual shift of producers to agricultural products for which demand conditions in the international markets are favourable, such as new crops of citrus fruit, flowers, ornamental plants etc. The Government is contributing towards this direction by promoting various incentive schemes and motives.

[-Mining and Quarrying](#)

The value added of the sector of mining and quarrying exhibited an increase of the order of 1% in real terms in 2003, as compared to a 7% increase in 2004, reflecting the significant expansion in the production of havara, raw gypsum and clay, the marginal decrease in the production of sand and gravel and a bigger decrease in the production of building stone. More analytically, the production of havara, mainly used in supporting construction works, increased, as a result of the expansion of the private demand for the product. An increase was registered in the production of raw gypsum reflecting the increased external demand for this product. The production of clay, which is mainly used in the construction works of water projects, also increased, as a result of the construction of a dam in Paphos. In contrast, the production of building stone decreased, mainly, as a result of the fall of the demand of the broader public sector for the product, after the completion of works for the conservation of the Venetian Walls of Nicosia. The

production of sand and gravel, despite the continued satisfactory expansion of the economic activity of the construction sector, exhibited a marginal decrease, due to the completion of the construction works on the Limassol-Paphos and Dhekelia-Famagusta highways and the south bypass road of Nicosia.

-Manufacturing⁷



The value added of the manufacturing sector exhibited a decline of the order of 2,5% in real terms in 2003, following a decrease of 2,2% in 2002. The reduction of the production of the sector is mainly attributed to the fall of external and tourist demand as well as to the containment of private consumption. In particular, with regard to external

demand, it is noted that characteristic of developments in 2003 were the generally unfavourable external environment, mainly due to the negative consequences of the war in Iraq, as well as the deceleration of the rate of economic growth of EU member states, beyond Britain and the Middle East, which constitute the most important markets for manufactured products of Cyprus. Additional restraining factor constituted the deterioration of the competitiveness of the Cyprus products in international markets, outside the eurozone, which resulted from the fall of the value of the dollar and the sterling pound vis-à-vis the Cyprus pound, due to its pegging with the Euro.

More analytically, the majority of the sub-sectors exhibited a decrease, with the exception of the sub-sectors of food, beverages and tobacco, non-metallic mineral products as well as paper-pulp, production of paper and paper products and publishing and printing activities. The following sub-sectors exhibited the biggest decrease: (a) leather products, (b) clothing and

⁷ The analysis of the manufacturing sector that follows is based on the European classification system of economic activities (NACE).

textile products (c) electrical and optical equipment (d) the sub-sector of refined petroleum products (e) manufacturing of machinery and equipment (f) the sub-sector of the other manufacturing industries, a major part of which concerns the production of furniture and goldsmith and silversmith (g) the production of basic metals and fabricated metal products (h) the production of rubber and plastic products and (i) the production of chemicals, chemical products and man-made fibres. A marginal decrease was exhibited by the sub-sector of manufacturing of transport equipment and wood and wood products.

More specifically, the volume of production of the sub-sectors of clothing and textile products as well as leather and leather products exhibited a significant decline, mainly due to the decrease of the external demand for the products of these particular sub-sectors as well as the containment of private consumption and the decrease of tourist demand. This development reflects the structural problems faced by the particular sectors, as well as the constant erosion of the competitiveness of the sub-sector's products in the external and domestic market.

The sub-sector of production of electrical and optical equipment also exhibited a significant decrease due to the termination of production of batteries by a Cypriot manufacturing company in 2003.

A relatively significant decrease was also recorded by the sub-sector of refined petroleum products, which, in the case of Cyprus, is mainly limited to the production of oil products by the Cyprus Oil Refinery. This development is partly attributed to the interruption of the works of the Cyprus Oil Refinery for around seven weeks for the maintenance of its equipment, as well as to the reduction of demand for crude oil and mazut by the sub-sectors of the manufacturing sector, which exhibited a decrease in their volume of production.

A decrease was observed in the sub-sector for the manufacturing of machinery and equipment, which mainly concerns the assembling of machinery, turbines and air-conditioning systems. The decrease is mainly

attributed to the decrease in the production of commercial refrigerators and turbines and is explained by the fall of the external demand for the specific products.

The sub-sector of other industries also exhibited a decrease, however, at a lower rate. The major part of its production consists, mainly, in the manufacturing of furniture as well as gold and silver items. This negative development is attributed to the decrease of tourist demand as well as to the fall of external demand for furniture.

A smaller decrease in production was exhibited by the sub-sector of plastic products, due to the fall in external demand for specific products of the subsector.

The sub-sector of chemicals, chemical products and synthetic fibres also registered a small decrease, a development attributed to the containment of external demand mainly for pharmaceutical products, due to the adverse effects of the war in Iraq, which negatively affected the external demand from the Arab Countries and the decrease of the competitiveness of the products due to the increase in the value of the Cyprus pound vis-à-vis the dollar, given that a large part of the exports are denominated in dollars. From a medium-term perspective, however, the exports of pharmaceutical products during the past years exhibit a high average annual rate of increase of the order of 13,8% in nominal terms, during the 1998-2003 period.

The production of the sub-sector for the manufacture of transport equipment exhibited a marginal fall, as a result of the relocation of the production of exhausts for cars from Cypriot manufacturing companies to neighbouring countries.

A marginal fall was exhibited by the sub-sector of wood and wood products, despite the recovery of the construction activity, a development, which reflects the increased import penetration for certain products of the sub-sector.

In contrast, a satisfactory increase of production was exhibited by the sub-sector of the manufacturing of other non-metallic products, a development

attributed to the continued, for the third consecutive year, satisfactory expansion of the construction activity.

The volume of production of the sub-sector of food, beverages and tobacco registered a smaller increase, a development attributed to the expansion of the external demand for cigarettes from the Arab Countries, due to the shift of the policy of multinational cigarette companies to satisfy the additional demand by their subsidiary companies located in Cyprus, as well as the stabilisation of the external demand for the rest of the products to around the levels of the previous year. The decrease of tourist demand prevented a further increase in the production of the sub-sector.

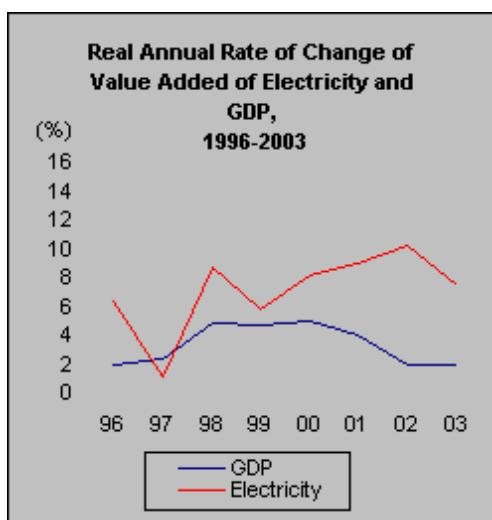
The volume of production of the sub-sector of paper-pulp, production of paper and paper products and publishing and printing activities, registered a marginal increase, despite the fall of the demand for the products of the sub-sector, due to the fall of tourist demand. The positive development of the sub-sector is attributed to the growth of publishing activities of magazines observed during the past years.

In general, the manufacturing sector and, in particular, the clothing and footwear branches, continued to face structural problems for which more time is still needed to tackle them effectively. A positive development constitutes the restructuring observed to the benefit of new competitive activities, such as the pharmaceutical industry and some branches of food and beverages, production of metallic products and printing and publishing activities. The gradual restructuring of the sector in combination with the measures promoted by the Government for the modernisation of the manufacturing sector and enhancement of its export orientation, in the context of the Strategic Development Plan 2004-2006 permit a constrained optimism with regard to the medium-term prospects of the sector.

- Electricity, Gas and Water

The rate of expansion of the value added of the sector of electricity, gas and water exhibited a small deceleration and increased by 7,5%, in real

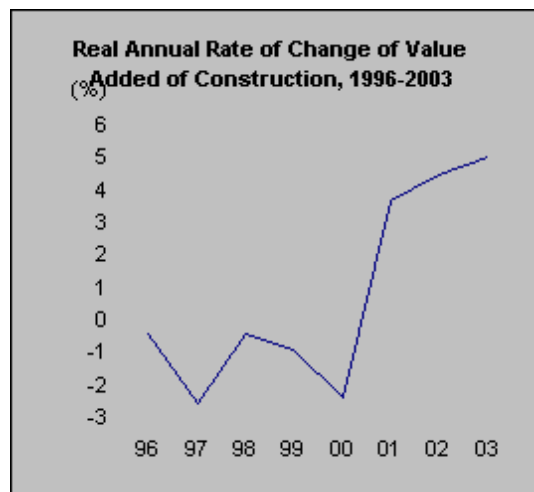
terms in 2003, as against an increase of 10,2% in 2002. The lower rate of increase is attributed to the containment of the demand for electricity by business units, reflecting the low rate of economic growth for the second consecutive year. The consumption of drinking water expanded by a relatively high rate, despite the decrease in tourist demand. This development is attributed to the continued adaptation of households to the new conditions of water supply after the lifting of restrictive measures in 2001 with the operation of the second desalination unit. Particularly high was the consumption of electricity by households, a development attributed to the weather conditions that prevailed, a relatively heavy winter and high temperatures during summer, combined with the continued increase of the number of households installing air conditioning systems.



- Construction

The recovery of economic activity of the sector of construction that started in 2001 was accelerated in 2003. The value added of the sector of construction increased by around 5% in real terms in 2003 following an increase of 4,5% in 2002. This development is attributed both to the expanded investment demand of the private sector and the broader public sector, a large part of which concerns construction works. The increased demand of the private sector is partly explained by the negative return of investments in the CSE, which increased the relative profitability of investments in immovable property. At the same time, increased external demand for holiday residences was also recorded, as indicated by the applications and approvals for purchases of property by foreigners. Investment activity in tourist accommodation exhibited an increase in 2003, despite the fall of tourist flows to Cyprus for the second consecutive year, as shown by the increase of tourist beds under construction to 3.800 at the end of December 2003 from 2.672 at the end of December 2002. This

development is attributed to the beginning of works, which were planned and approved some time ago, which could not be further delayed.



The satisfactory expansion of the economic activity of the sector of construction is expected to continue in the near future, given that the building permits increased substantially in 2003, by 14,8%, following an increase of 10,8% in 2002 and the planned investments of the broader public sector. The rise in interest rates by the Central Bank at the end of April is

estimated to adversely affect the rate of expansion of the sector due to the higher financing cost it implies; it will not, however, reverse the positive course of the sector.

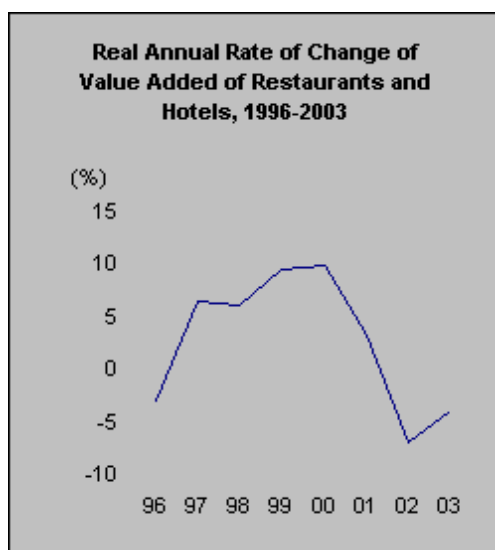
- Trade

The containment of the rate of economic growth in general and consumption demand in particular, for the second consecutive year, as well as the decrease of tourist demand was also reflected in the trade activity. The value added of the sector of wholesale and retail trade decreased by 1,5%, in real terms in 2003, as compared to a 1% increase in 2002. The sub-sector of wholesale trade exhibited a decline as indicated by the fall of the value of total exports and imports of goods (excluding defence equipment). In parallel, the sub-sector of retail trade also registered a decrease in its economic activity, a development reflected in the fall of the volume index of retail sales. The volume of retail sales was particularly lower in the purchases of toys, furniture, vehicles and multi-store products. The big fall in the volume of retail sales of toys and multistore products as well as the smaller decrease of the volume of retail sales of food, beverages and tobacco and clothing is attributed, in general, to the containment of private consumption and to the fall of tourist demand. The decrease in the purchases of vehicles was greater in the second half of the year, a development, which is explained by the anticipation of

consumers for a new decrease of excise duties, mainly for small and medium engine volume cars during the period July-November 2003. A decrease was also exhibited in the volume of retail sales for electrical appliances and furniture, a development that was anticipated, to a certain extent, after the increases observed in the past three years. In contrast, a satisfactory increase was exhibited in the volume of retail sales of petroleum, leather and pharmaceutical products.

The activities of the Grain Commission⁸ further decreased the value added of the trade sector in 2003. In relation to this, the amount of subsidies and the subsequent deficit of the Grain Commission fluctuated at higher levels as compared to 2002, due to the increase of the total domestic production for grain and the higher prices for grain in international markets. In contrast, the subsidies and the subsequent deficit of the Vines Products Commission fluctuated at lower levels compared to 2002, but did not influence the value added of the trade sector, due to the small size of the relevant amount.

- Hotels, Restaurants (Tourism)



The sector of hotels and restaurants exhibited a decline of its activity in 2003. The sector's value added fell by 4% in real terms, in 2003, following a decrease of 7% in 2002. This development is attributed to the climate of uncertainty that prevailed before and during the war in Iraq as well as to the delay in the course of recovery of the major tourist markets

of Cyprus. In relation to this, the arrivals of tourists decreased by 4,8% and the per capita expenditure of tourists by around 5,7%, in nominal terms. The satisfactory growth of domestic demand for tourism, as shown by the

⁸ The economic activity of the trade sector is influenced by the activities of the Vines Products Commission and the Grain Commission. The widening of the deficits of the above organisations implies a decline in the gross output and the value added of the sector.

increased number of overnight stays of Cypriots and the further expansion of demand by Cypriots for restaurants prevented a further decrease of the economic activity of the sector.

A marginal increase was observed in tourist arrivals from the United Kingdom, due to the acceleration of the rate of economic growth of the country. The decrease, however, in the value of the sterling pound vis-à-vis the Cyprus pound adversely affected the further expansion of the tourist flow from Britain. The tourist flow from the rest of the tourist markets of Cyprus, with very few exceptions, such as Greece, Ireland, Spain, France and certain countries of lesser importance for Cyprus exhibited a reduction.

Per capita tourist expenditure exhibited a significant decrease of around 5,7% in nominal terms, reflecting a decrease of the daily expenditure. The per capita tourist expenditure was negatively affected by the reductions in the prices of tourist accommodation offered to tour operators, in an effort by the hotel owners to contain the fall of the external demand as well as the appreciation of the sterling pound and the dollar and other currencies pegged to the dollar vis-à-vis the euro and consequently the Cyprus pound. A negative development constituted the fall of the per capita expenditure of tourists outside their place of accommodation.

Investment activity in tourist accommodation exhibited an increase during 2003, as indicated by the rise in the number of beds under construction to 3.800 in December 2003 compared to 2.672 in the corresponding period of 2002. This development is attributed to the beginning of works that has been planned and approved some time ago, which could not be further delayed. In 2003, 1.788 new beds came into operation bringing the total number of licensed beds to 95.185 at the end of 2003, as against 94.466 at the end of 2002.

From a medium-term perspective, the Cypriot tourist product continues to exhibit weaknesses, reflected, *inter alia*, in its one-dimensional development and standardisation of the tourist product, in the adverse consequences on both the environment and the cultural identity of Cyprus and in the high

operational costs and the seasonality of tourist demand. The development of new types of tourism, the promotion of auxiliary projects which enrich the tourist product, the expansion and improvement of the infrastructure and, in general, the upgrading of the tourist product as well as the further diversification of the markets, are necessary prerequisites in order for Cyprus to maintain the competitive position of its tourist industry, both in the medium and the long-run.

- Transport

The sub-sector of transport is an infrastructural sector and encompasses a broad spectrum of activities such as land transport, air transport, sea transport and activities of travel and shipping agencies. This sub-sector upholds the development of the economy and especially tourism and trade.

The value added of the sector of transport in 2003 remained at the levels of 2002, in real terms, as against a marginal increase of 0,3% in 2002, negatively affected by the containment of the rate of expansion of the overall economic activity and the reduction in tourist flow to Cyprus. More analytically, the volume of production of the sub-sector of air transport, despite the fall of the total passengers movement, exhibited a small increase, a development attributed to the increase in the share of Cypriot air carriers to the total air movement.

The sub-sector of land transport also exhibited an increase, a development reflecting mainly the increased use of buses and the use of cargo transportation vehicles, primarily due to the expansion of the construction sector.

The sector of services related to transport, which mainly consist of the activities of travel and shipping agencies recorded a small increase in their volume of production during 2003, reflecting, on the one hand, the expansion of the activities of shipping companies, due to the gradual recovery of international trade and, on the other hand, the marginal containment of the

activities of travelling agencies, which is explained by the small decrease of the number of Cypriots travelling abroad.

In contrast, the sea transport sub-sector, both the movement of passengers by sea and the transportation of cargo by sea, exhibited a decrease. The movement of passengers by sea was negatively affected by the fall of tourist demand in general and in particular by the climate of uncertainty created before and during the war in Iraq and the tension that prevailed in the Middle East, which adversely affected the demand for cruises to our neighbouring countries. The transportation of cargo was affected by the decrease in the total volume of import of goods.

- Communication

The value added of the sector of communication expanded by around 10% in real terms in 2003 following an increase of 7,6% in 2002, reflecting the continued rapid growth of communication services and more specifically of domestic and international telephony. In contrast, the postal services recorded a decrease, due to the fall in tourist traffic.

The main characteristic of the sub-sector of telecommunications is that it consists of services used for intermediate consumption by all other sectors of economic activity. For this reason, this sub-sector is becoming increasingly more important in a contemporary economy. The rapid technological advances in the sub-sectors of telecommunications and information technology have made possible the immediate transmission of data bases and information, thus overcoming important barriers in the trade of services, and bringing about a substantial increase in the productivity particularly of the sectors of services.

In 2003, the Cyprus Telecommunications Authority continued to upgrade and enrich its services. The Authority succeeded in 2003 to certify its quality system according to ISO 9001:2000. The services of the Authority were enriched by the introduction of the MMS service of mobile telephony as well as the introduction of the service miVision, on a pilot basis, which satisfies the

needs in interactive digital television, video by demand and access to the Internet with the use of one telephone line. In parallel, the upgrading of the existing services continued, such as CYTANET and mobile telephony.

Furthermore, CYTA offered substantial reductions in the rates of international calls and the rates of mobile telephony in 2003, in the context of intense competition. An important development is also the offer of special discount scheme for the clients of the ATM/Frame Relay service and the offer of free itemised statements to the clients of fixed telephony.

Following the adoption of the new Law for the Regulation of Telecommunications and Postal Services, which fully complies with the relevant acquis, the procedures for recruiting, training and in general strengthening the administrative capacity of the Independent Regulatory Authority for the telecommunications and postal services, were completed, thus making it competent to secure conditions of fair competition in the sector of communications and postal services. Noteworthy developments in the course of liberalisation of the sector and entry of new suppliers of telecommunication services constituted the granting by the competent Regulatory Authority, of a second licence for mobile telephony to a Lebanese company in October 2003, as well as licences for the establishment and supply of other telecommunication services, such as Internet services, to a significant number of companies.

- Financial Intermediation

The output of the sector of financial intermediation consists mainly of the activities of commercial banks, co-operative credit institutions and other financial institutions, insurance companies and stockbrokers as well as the Cyprus Stock Exchange.

In total, the value added of the sector exhibited a small increase of the order of around 1% in real terms in 2003, as compared to an increase of 0,3% in 2002. The growth of the sector in 2003 reflects the partial expansion of the activities of credit institutions as well as insurance companies. The expansion

of the economic activity of credit institutions is attributed to the further increase of credit to the private sector, despite the significant deceleration observed in 2003. The expansion of the sub-sector of insurance is attributed to the increased activities of motor, health and accidents insurance, whereas, life insurance exhibited stagnation. The economic activity of stockbrokers was subdued, as a result of the continued negative return of the investment in the CSE.

From a medium-term perspective, the sub-sector of banks and the other financial institutions has shown a momentum and a remarkable growth as regards the modernisation of its activities and the constant upgrading and enrichment of its products. The observed expansion of the activities of the sub-sector abroad is also significant. This development constitutes a basic pillar for the successful encountering of the conditions of intense competition in the context of the liberalisation of the financial sector.

Notwithstanding, the problems that the sub-sector of private insurance faced during the past years, the prospects for further growth of the sector are encouraging, given the high-income elasticity of demand for insurance and the low per capita expenditure on premiums compared to other developed countries.

- [Real Estate, Renting and Business Activities](#)

The production of the sector is made up mainly of the real estate services, ownership of dwellings, the sub-sectors of information technology, research and development and other business services, such as consultancy, legal, accounting, advertising etc. The value added of the sector increased by around 5,5%, in real terms, in 2003, following an increase of 5,2% in 2002, mainly as a result of the increased activity exhibited by the sub-sector of real estate services and the dynamism of the business services during the past years.

More analytically, the value added of the sub-sector of real estate services expanded at a very high rate of around 10% in real terms in 2003, following an

increase of 8% in 2002, mainly due to the differentiation of profitability in favour of investments in immovable property, as a result of the continued fall of the Stock Exchange Index as well as the increased demand for purchases of immovable property by foreigners as indicated by the relevant applications and approvals.

The value added of the sub-sector of ownership of dwellings expanded by around 3% in real terms in 2003 following an increase of 2,9% in 2002 reflecting the increased activity in the construction of dwellings. This development implies the further improvement of the housing conditions, given that the average annual increase of households, and thus the natural increase in the demand for new houses, fluctuates at lower levels. From a medium-term perspective, the slight deceleration in the rate of growth of the sub-sector during the past years reflects the gradual satisfaction of the housing needs of the majority of the population. Indicatively, it is worth mentioning that according to the Family Budget Survey of 1996/97, 74,3% of households owns a house and an additional further significant percentage of around 16,5% lives in dwellings granted by the Government.

In parallel, the efforts initiated by the Government in the past years in cooperation with the Research Promotion Foundation (RPF) for upgrading research activity and technological advancement in Cyprus was intensified in 2003. The activities and initiatives developed towards this direction could be classified into three major pillars:

- The development of measures for promoting programmes for subsidisation of research aiming at strengthening the research web of Cyprus and at the same time the undertaking of research activities of a high standard, on a broad spectrum of subjects related directly with the Cyprus reality. In 2003, The Foundation proclaimed the RPF Framework Programme for Research and Technological Development”, which covers the period 2003-2005 and includes eleven, in total, Programmes and 34 specialised Actions. The budget of RPF Framework Programme exceeds the amount of CYP 20 mln out of which CYP 11,65 mln will constitute

Government contribution. The RPF Framework Programme is expected to support 250 research projects and 150 supporting actions.

- The development of measures for promoting the participation of Cypriot researchers in the international research activities. During 2003, the Foundation developed specific initiatives for the promotion and effective management of European research programmes in Cyprus, the facilitation of the networking of Cypriot researchers with the international research community, the networking of the RPF with international organisations promoting research and the acceleration and follow up of the implementation of bilateral agreements of Cyprus with other countries. In relation to this, important measures were adopted for the promotion of participation of Cyprus in the 6th Framework Programme of the EU, the European programme COST as well as the utilisation by Cypriot researchers of the activities of European Organisations, such as the European Science Foundation (ESF), the Organisation EUREKA and the Joint Research Centre (JRC) of the EU.
- The promotion of specific measures for the upgrading of research infrastructure in Cyprus. The activities of the Foundation towards this direction are focussed both on the level of development of infrastructure in human resources and on the level of upgrading and development of new research equipment. The activities at the first level include programmes aiming at the cultivation of research culture for young generations, the access of new researchers in the research procedure and the utilisation of the Cypriot migrants scientists. The development and upgrading of research equipment is promoted through specialised competitive programmes developed by the Foundation.

The value added of business services increased by 6,5% in real terms, in 2003, following the same increase in 2002, reflecting the dynamism that characterises the sub-sector, mainly as regards the activities of accounting and auditing firms, enterprises specialising in data processing and the

development of computer programmes, advertising agencies and consulting firms. The observed rapid expansion of the sub-sector over the years is attributed, from the demand side, to the increasing demand by business units for such type of services in an effort to upgrade and improve their organisational structure. At the same time, the growing trend for purchase of services from the private sector by the Government constituted an additional boosting factor. From the supply side, the high educational level of the labour force in Cyprus - according to the Labour Force Survey for 2003, 32,5% of the gainfully employed population are graduates of tertiary education - coupled with the relatively lower level of remuneration compared to other countries, assign significant comparative advantages to enterprises of the sub-sector for expanding their activities abroad.

- Public Administration and Defence

The value added of the sector of public administration and defence increased at a rate of around 3% in real terms in 2003 compared to an increase of 2,6% in 2002. This development reflects the expansion of employment in public administration, which resulted from the need to recruit additional staff for the enhancement of existing or the creation of new structures for the effective implementation of the acquis in various sectors.

- Education

The value added of the sector increased by around 3% in real terms in 2003 following an increase of 3,3% in 2002. Over the years, the sector records satisfactory rates of growth reflecting the effort of the Government and of the private sector to upgrade the educational system in Cyprus.

More analytically, public education expanded by around 2% in real terms in 2003 following an increase of 2,4% in 2002.

It is noted that in 2003 the institution of all day school was expanded and 84 all day schools were established in elementary education. In parallel, during the same academic year, the programme for the use of information technology was expanded, covering all schools of secondary education as

well as the school in the occupied Rizokarpaso, and offering access to the Internet. The Ministry of Education and Culture, within its efforts to effectively confront the particular educational needs of the foreign language speaking children, elaborated an official policy for multicultural education. In this context, a scheme for the enhancement of teaching of these children, which constitute about 4,5% of the total number of pupils in public elementary schools in Cyprus, was promoted. With regard to the pre-elementary education, the subsidisation of transportation of children attending public regional nurseries and living in other communities, mainly downgraded areas was approved.

As regards secondary education, the Evaluation Committee of the institution of the reformed type of Comprehensive Lyceum, which was applied on a pancyprian basis during 2000-2001 and expanded gradually in the year 2002-2003 until the third class of Lyceum, prepared and submitted an evaluation report for the institution, which includes suggestions and corrective interventions. In 2003, the Turkish language was introduced as an optional class for the pupils of the Comprehensive Lyceum. In addition, the Council of Ministers approved the introduction of the international programme “CISCO Networking Academy Programme” aiming at educating the pupils at the designing, installation and maintenance of electronic networks. The education of pupils at designing is expected that will positively contribute to the confrontation of the shortages in information technology technicians observed in the labour market. In parallel, the programme “Eyagora’s Gate” was promoted in cooperation with the University of Cyprus aiming at using technology in the classes of Greek and History and with the possibility to be extended into other classes.

Regarding the tertiary education, important developments during 2003 constituted the approval by the House of Representatives of the bill for the Technological University of Cyprus (the so renamed University of Applied Sciences and Arts) as well as the appointment of the Temporary Administration Committee aiming at the promotion of the procedures for the beginning of the operation of the Open University of Cyprus. Furthermore,

during the academic year 2003-2004 the functioning of the Polytechnical School of the Department of Biological Sciences of the University of Cyprus started.

Private education expanded at a rate of 6% in real terms in 2003, following a similar increase, 5,5% in 2002. The sub-sector has gained momentum in the past years. This is true in particular for the sector of tertiary education, which attracts a significant number of foreign students, a development prompted further by the evaluation and certification of the majority of the academic qualifications obtained in institutions of tertiary education in Cyprus, covering both the undergraduate and postgraduate levels.

- Health and Social Welfare

The value added of the sector of health grew at a rate of 4% in real terms in 2003 following a similar growth in 2002, 4,2%.

The sub-sector of public health and social welfare expanded at a rate of 2% in real terms in 2003, following an increase of 2,7% in 2002, a development, which reflects the emphasis given to the upgrading of the public health services. The sub-sector of private health also expanded by around 5,5%, in real terms in 2003, following the same increase in 2002. In the medium term perspective, the sector of health, and in particular private health, is characterised by satisfactory growth, reflecting, from the demand side, the high-income elasticity for these services and from the supply side, the ongoing investment activity in the establishment of polyclinics, which respond better to the contemporary needs of the population as well as the establishment of health centres of tertiary level.

- Other Community, Social and Personal Services Activities

This sector covers mainly sanitary activities, the activities of business and employers' organisations, trade unions as well as leisure, cultural and sports activities.

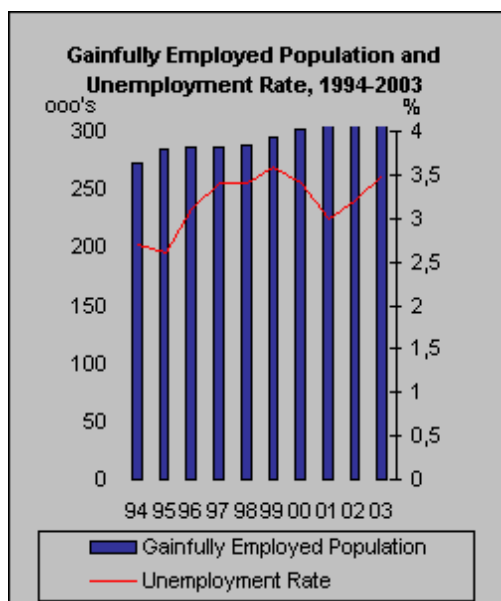
The value added of the sector increased at rate of 4% in real terms in 2003, following a similar increase in 2002. A restraining factor to the further increase of the sector constituted the reduction of tourist demand in 2003, as well as the deceleration of private consumption. In the medium-term, the satisfactory performance of the sector is attributed, mainly, to the improvement of the standard of living and the high-income elasticity of demand for social and personal services. As far as the supply conditions are concerned, the private sector, by responding to increased demand and utilising the remarkable educational standard of the domestic labour force, upgrades and constantly diversifies its services. Private radio and television broadcasting has been exhibiting a rapid rate of growth and has played a positive role in the development of this sector in recent years.

- Private households with employed persons

The value added of the sector increased at a rate of around 12% in real terms in 2003, following an increase of 17,7% in 2002, reflecting the significant increase in the number of foreign workers employed in households as housemaids. With regard to the above, it should be noted that this sector exhibits, over the years, very high rates of growth, attributed mainly to the increased participation of women in the labour market, a development which creates demand for this specific type of services, as well as to the continued improvement of the standard of living in Cyprus.

Labour Market

The subdued economic activity for a second consecutive year led to a containment in the rate of increase of the demand for labour. Consequently, the gainfully employed population increased by around 0,9% in 2003 following an increase of 1% in 2002. From the sectoral point of view, an increase in employment was observed particularly in the tertiary sectors of services, while another positive development was the small rise in employment in the construction sector.



The subdued demand for labour in conjunction with the further increase in the employment of foreign workers, led to a small increase in the unemployment rate from 3,2% of the economically active population in 2002 to 3,5% in 2003. Despite its increase, the unemployment rate remained at low levels, indicating the existence of almost full employment conditions, in contrast with high unemployment conditions in the EU, where the

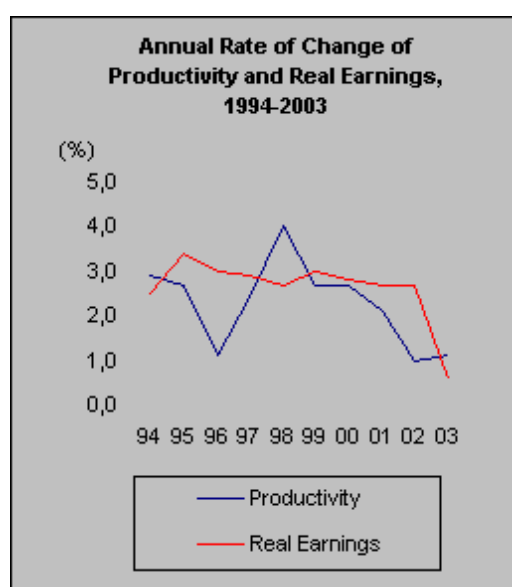
average unemployment rate was 8%. From a sectoral point of view, an increase in unemployment was observed in almost all sectors of economic activity, the quarrying sector being an exception. The highest increase in unemployment was observed in the sector of restaurants and hotels and trade, reflecting the decline in the volume of production of these sectors. In general, conditions of almost full employment prevailed in all categories of the labour force, even in those, which are considered vulnerable, such as women and the elderly.

According to the Labour Force Survey⁹, conducted by the Statistical Service the rate of unemployment reached 4,1% in the second quarter of 2003, i.e. it was 0,9 percentage points higher than the respective unemployment rate derived from the registered unemployed at the District Labour Offices, which during the same period fluctuated at 3,2%. In relation to this, the basic difference with the unemployment rate derived from the registered unemployed at the District Labour Offices is that the Labour Force Survey registers also persons who claim willing to work, but for several reasons are not registered at the District Labour Offices. In the case of

⁹ In Cyprus, the number of unemployed and the unemployment rate are traditionally estimated on the basis of registered unemployed at the District Labour Offices. This methodology is different than the one used in the EU, which is based on the results of a Labour Force Survey, on the basis of the answers of a representative sample of households to a relevant questionnaire. For the past four years, Cyprus conducts a harmonised with the *acquis communautaire* Labour Force Survey, which however covers only the second quarter of each year.

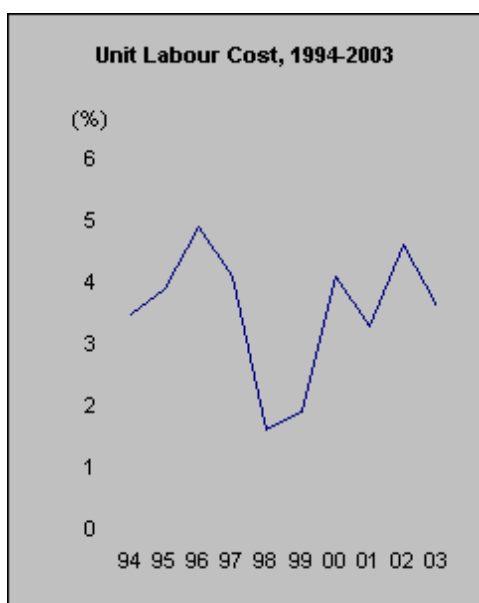
Cyprus, the difference is attributed, to a great extent, to persons (mostly women) who do not register as unemployed, but they wish to work only on a part time basis.

The maintenance of full employment conditions in Cyprus is attributed to the satisfactory growth exhibited over the medium term by the tertiary sectors of services, which are labour intensive, and constitute the main driving force of economic growth. Another positive factor is the relative flexibility, which generally characterises the functioning of the labour market. Furthermore, in Cyprus, the substitution of labour with capital has not taken significant dimensions. This is a common phenomenon in advanced countries, in the context of their efforts to adjust to the conditions of globalisation and intense competition. Therefore, the phenomenon of technological unemployment is not observed in Cyprus. The most common type of unemployment in Cyprus continues to be the frictional unemployment, given the relatively short average duration of unemployment. More specifically, the majority of registered unemployed people - around 69% - remain unemployed between 15 days and 6 months. This reflects the necessary period for newcomers in the labour market to find an appropriate job or for people who were already part of the labour force to find another job.



Labour productivity improved by a rate of the order of 1,1% in 2003, following an increase of 1% in 2002. The relatively low improvement of productivity in 2003 is attributed mainly to the low rate of economic growth for a second consecutive year. For comparison purposes, it is noted that the rate of increase of productivity in the EU fluctuated at lower levels, 0,6% on average for 2003. This positive

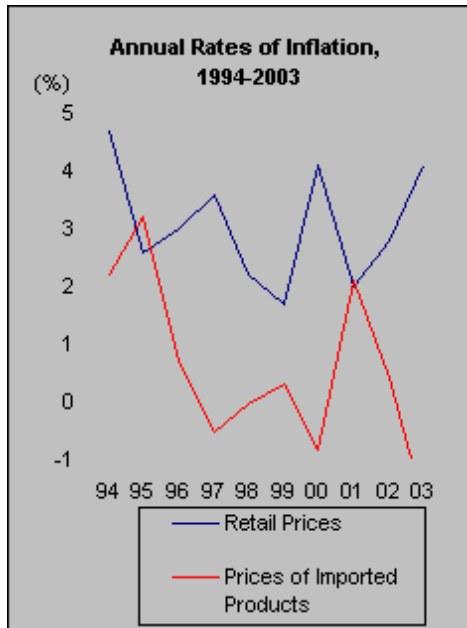
development for Cyprus is valid in the medium-term perspective as well. Indicatively, it is noted that the average annual rate of growth of labour productivity in Cyprus fluctuated around 1,9% for the period 1999-2003, as against 0,8% in the EU over the same period, indicating a gradual decrease in the difference between productivity levels in Cyprus and the EU. The relatively satisfactory rate of growth of labour productivity in Cyprus is attributed to the generally high educational level of its labour force, which endows it with flexibility and adaptability in the rapidly changing conditions of intense competition, to the gradual progress observed in the sector of training as well as to the relatively high rate of expansion of investment in machinery and equipment during the past few years. A restraining factor to the further improvement of labour productivity in Cyprus constitutes the employment of foreign workers in large numbers; the majority of them being semi-skilled or unskilled.



Nominal earnings, including COLA, increased at a rate of around 4,8% in 2003, following a 5,6% increase in 2002. Over the years, a slowdown is observed in the rate of growth of nominal earnings, given that during the five-year period of 1999-2003, nominal earnings expanded at an average annual rate of 5,4% compared to 6% in the period 1994-98. A positive development during 2003 constituted

the lower rate of increase of unit labour costs, around 3,6% as against 4,6% in 2002, a development attributed mainly to the lower rate of increase of nominal earnings. The rate of increase of unit labour costs in Cyprus expressed in euro, was lower than the respective rate of increase of the unit labour costs in the EU, 2,4%, implying an improvement of the competitiveness of the Cyprus economy with regard to labour costs.

Inflation Rate



The Consumer Price Index in 2003 registered an increase of 4,1% compared to 2,8% in 2002 and 2%, which was the average rate of inflation in EU member states. The expansion of the rate of inflation during 2003 is attributed mainly to the increase of the VAT rate from 10% to 13% as from 1.7.2002 and from 13% to 15% as from 1.1.2003, as well as to the increases imposed on the excise duties mainly on petrol and tobacco products, within the

framework of harmonisation with the minimum levels prescribed by the *acquis communautaire*. A restraining factor to the further expansion of the inflation rate constituted the fall in the prices of imported industrial products (excluding petroleum). The maintenance of the core inflation rate, which excludes temporary factors, at around 2,5%, constituted a positive development.

More analytically, the prices of domestically produced goods rose by 6,2% compared to an increase of 3,4% in 2002, reflecting the substantial increase in the prices of the domestically produced industrial goods, excluding petroleum. Specifically, the prices of domestically produced goods, excluding petroleum products rose by 6,7% as against a 4% increase in 2002. This development is attributed, as already mentioned, to the increase of the VAT rate from 10% to 13% as from 1.7.2002 and from 13% to 15% as from 1.1.2003 and the increases imposed on excise duties on cigarettes and soft drinks primarily within the framework of harmonisation with the minimum levels prescribed by the *acquis communautaire*. The prices of agricultural goods, also increased at a higher rate of the order of 4,5% in 2003 as against 1,8% the respective period of 2002.

The prices of electricity and petroleum products also registered an increase, as a result of the rise in the price of oil in international markets during the first months of 2003, the imposition of higher excise duties on petroleum products as from 1.7.2002 and 1.1.2003, as well as from the implementation of the first phase of the tariff rebalancing in electricity as from 1.3.2003 within the context of abolishing cross subsidisation. The tariff rebalancing implies an increase in the price of electricity for household use and a fall in the prices for commercial use.

The prices of services increased at a rate of 4,4% in 2003 compared to a lower rate of increase of 3,7% in 2002, and was owed, among other things, to the increase of the VAT rate from 10% to 13% as from 1.7.2002 and from 13% to 15% as from 1.1.2003. Particularly high increases were observed in the prices of the medical care sector, public services, insurance and restaurants and coffee-shops. In contrast, the prices of telecommunication services registered an absolute decline vis-à-vis 2002.

The prices of imported products declined by 2,5% in 2003 compared to a smaller decline of 1,8% in 2002, thus exerting a downward impact on the price level. The decline in the prices of imported products reflects the fall in the prices of imported industrial products (excluding petroleum products), and is attributed mainly to the increase in the value of the Cyprus pound vis-à-vis the sterling pound, the US dollar, and the yen. The reduction as from 1.7.2002 of the excise duty on saloon cars up to 1600 cc as well as the further reduction of the excise duties on small and medium engine volume cars approved by the House of Representatives on November 20th, 2003, contributed positively to the decline of the prices of imported products in the domestic market.

Balance of Payments

Introduction

Within the context of harmonisation with the *acquis communautaire* and international statistical standards, the Central Bank of Cyprus has adopted the

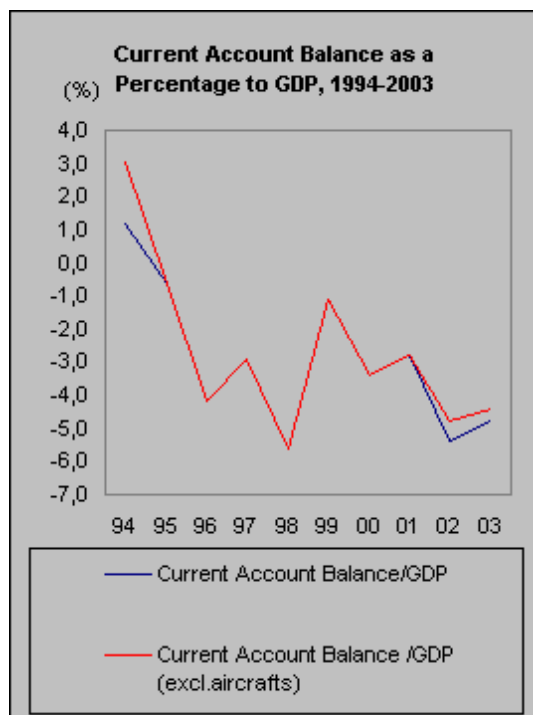
methodology recommended by the International Monetary Fund in its 5th edition of the Balance of Payments Manual (BPM5) for the compilation of the Balance of Payments. According to the new methodology, which entered into force as from 1.1.2002, the presentation of both the current account balance as well as the capital movements account has changed. The invisibles balance is now divided in three categories: services, income and current transfers. In addition, reflecting the increasing importance of services, the subcategories of services have expanded. The capital movement account is now divided in two categories: capital account and financial account. The financial account includes most of the transactions previously classified under the capital account, while the new capital account includes only capital transfers (debt forgiveness, migrant's transfers and other transfers) and the acquisition/disposal of non-produced, non-financial assets. The financial account is divided in the following categories: direct investments, portfolio investments, other investments (loans/credits, currency and deposits) and reserve assets (covering only reserves held by the monetary authorities).

For the collection of the necessary information, the Central Bank of Cyprus has introduced a new system of data collection for the Balance of Payments, which will constitute the basis for the collection of data, after the abolition of exchange controls. The new open market settlements system is based on the provision of statistical data to the Central Bank of Cyprus by the commercial banks for transactions executed with non-residents, either on their own account or on the account of client residents, and is completed with sample surveys and direct reporting by special categories of residents.

In addition as from 1st January 2002 when the new system entered into force, the statistical data for the Balance of Payments are being compiled on the basis of the new residency definition, as defined in the Balance of Payments Manual of the IMF. According to the new definition, residents are considered the physical persons that reside or intend to reside for a period exceeding one year in a country, as well as legal entities, which operate through their own physical presence in a country. Consequently, the international business activities that operate in Cyprus are considered under

the new methodology as residents and their transactions are classified in the relevant categories of the export of services depending on their field of activity.

-Current Account Balance



The current account deficit exhibited an improvement in 2003, as a result of the decline in the value of imports, reflecting the subdued economic activity and the fall in re-exports, as well as the exchange rate developments of the Cyprus pound vis-à-vis the sterling pound, the dollar and other currencies pegged to the dollar, which led to a fall in the prices of imported products in Cyprus pounds from countries, whose currency has depreciated vis-à-vis the Cyprus

pound. The value of exports of goods and services, registered a marginal increase, as a result of the satisfactory expansion of the exports of services, in conjunction with the fall in the exports of tourist services and goods. The small widening of the services surplus combined with the fall of the trade deficit, led to a containment of the current account deficit from £330,9 mln or 5,4% of GDP in 2002 to £291,3 mln or 4,4% of GDP in 2003.

-Goods, Services and Income

Goods

Total exports of goods (including goods procured in ports by carriers) registered a decline of the order of 7,3%, in nominal terms, following a larger decline of the order of 18,1% in 2002, as a result of the fall of both domestic exports and re-exports. Analytically, the value of domestic exports declined by about 7,2% in 2003, following a 5,1% decrease in 2002, reflecting the fall of

manufacturing exports by around 12,5% as against a smaller decline of 3,3% in 2002. In contrast, agricultural exports registered an increase of the order of 18,2% as against a decrease of 15,8% in 2002.

The increase in the value of agricultural exports observed in 2003 as against the previous year is attributed to the higher prices secured in international markets for Cypriot potatoes compared to the respective prices secured in 2002. The increase in the value of exports of citrus fruit, vegetables and grapes, constituted also a positive development.

The value of exports of manufactured goods exhibited a decline of the order of 12,5% in 2003, compared to a smaller decrease of 3,5% in 2002, a development attributed to the fall in external demand for certain products of the sector such as clothing and footwear, pharmaceuticals and furniture. The decline in the value of exports of clothing and footwear is attributed to the chronic structural problems of the sector, while the fall in the value of pharmaceuticals and furniture reflects the fall in the external demand from Arab countries, due to the war in Iraq and the deterioration of the competitiveness of Cypriot products owing to the increase in the value of the Cyprus pound vis-à-vis the dollar, given that large part of exports to Arab countries are conducted in US dollars. In contrast, exports of cigarettes and cement registered an increase. The exports of paper and aluminium products as well as the exports of wines and cathodes of refined copper also exhibited a positive course.

Re-exports registered a decline by 9,1% in 2003 following a substantially higher fall of 26,7% in 2002, as a result of the sharp decrease of re-exports to Arab countries, and particularly Syria and the United Arab Emirates and Central and Eastern European countries and particularly Bulgaria, Russia, Romania and Ukraine. In contrast, re-exports to EU countries increased, reflecting an increase of re-exports to the UK, a development attributed also to the acceleration of the rate of growth of the British economy.

The value of imports of goods (cif) declined by 8% following a smaller decline of 1,6% the year before. The fall in the value of imports, in absolute terms, is due to the subdued economic activity for a second consecutive year, the fall of re-exports and the depreciation of the sterling pound, the dollar, and other currencies pegged to the dollar vis-à-vis the Cyprus pound during 2003.

Analytically, the value of oil imports (cif) registered a decline in absolute terms, of 15,9% in 2003 following a decrease of 10,8% in 2002, reflecting the the fall in the value of the dollar vis-à-vis the Cyprus pound which compensated for the higher oil prices that prevailed in international markets during 2003, as well as the fall of energy-intensive activities such as sub-sectors of the transport sector.

Imports of consumer goods (cif) registered a decline of the order of 6,5% following a larger fall of 10% in 2002, a development attributed to the lower rate of expansion of private consumption, as well as to the further decline of re-exports, part of which concerns consumer goods, in combination to the fall in the prices of imported goods, due to the exchange rate developments observed in 2003.

Imports of raw materials (cif) increased marginally by 0,2% as against a decrease of 1,6% the year before, reflecting the subdued rate of expansion of economic activity for a second consecutive year, and the decline of re-exports, part of which concerns raw materials. The significant increase of imports of raw materials for the construction sector, is noted, however, reflecting the satisfactory growth of the sector.

Imports of capital equipment (cif) recorded a substantial increase of the order of 6,5% as against a decline of 8,4% in 2002, as a result of the expansion of investment activity. The increase concerned mostly imports of capital equipment in the sectors of transport and communication, as well as construction.

Imports of transport equipment (cif) decreased at a rate of 17,7%, following an increase of 20,8% in 2002. This development is attributed mainly

to the fact that the value of imports of transport equipment in 2002 was particularly high reflecting the purchase of aircraft by Cyprus Airways.

The above developments in exports and imports of goods led to a narrowing of the trade deficit in absolute terms to £1594,6 mln in 2003 from £1739 mln in 2002 and, to its containment in relative terms from 28,2% of GDP in 2002 to 24,1% of GDP in 2003.

Services

The surplus in the services balance declined in 2003, due to the further decline in tourist arrivals to Cyprus; it continued however, to act as an offsetting factor to the trade deficit. Receipts from the exports of services increased slightly by 1,6% and reached £2754,8 mln in 2003 as against £2712 mln in 2002, as a result of the satisfactory expansion of the exports of other services, beyond tourism, which more than compensated for the fall in tourism revenue. Tourism receipts, notwithstanding a 10,2% decline, continued to constitute the main source of foreign exchange and in 2003 reached £1020mln compared to £1136 mln in 2002, representing 37% of total receipts from the export of services compared to 42% the year before. Tourist arrivals declined further by 4,8% in 2003 following a larger decline of the order of 10,3% in 2002, due to the negative consequences of the insecurity climate that prevailed from the war in Iraq, on tourism demand, the slow pace of recovery of our main tourist markets, and the exchange rate developments observed in 2003. Per capita tourist expenditure recorded a decline of the order of around 5,7% following a smaller decrease of 0,8% in 2002. In contrast, the value of the exports of services other than tourism recorded a satisfactory expansion, reflecting the dynamism exhibited by the sectors of private services, beyond tourism, as well as the comparative advantages of Cyprus.

The payments for the import of services registered an increase of around 6% and came to £1469,6 mln compared to £1379,2 mln in 2002. Transport related expenditure exhibited the largest expansion.

-Capital and Financial Account

During 2003 the Capital and Financial Account exhibited a surplus of £171,3 mln as against £340,2 mln in 2002. The decline in the surplus of the capital and financial account is owed to the conversion of the net inflows of £564,8 mln in the category of other investments during 2002 into net outflows of the order of £346,4 mln in 2003, reflecting the increase in Cypriot banks' deposits abroad. In addition, the substantial decline of foreign direct investments in Cyprus also led towards the same direction. In contrast, the outflows of portfolio investments exhibited a significant fall, partly as a result of the change in the investment strategy of Cypriot banks towards liquidating their bonds held abroad and transferring part of them in deposits abroad.

Foreign exchange reserves

The official foreign exchange reserves fell from £1734,9 mln in 2002 to £1607,3 mln in 2003, reflecting the reduced capital inflows from abroad but also the exchange rate developments and particularly the weakening of the US dollar vis-à-vis the Cyprus pound, which led to the fall in the value of dollar reserves in Cyprus pounds, thus decreasing the coverage of imports of goods and services to 5,5 months in 2003 from 5,7 months in 2002.

External Debt

The official foreign exchange reserves covered 67,7% of the long-term external debt in 2003 compared to 82,8% in 2002. Long-term external debt increased to £2373,5 mln in 2003 from £2095,6 mln in 2002, mainly as a result of the increased foreign borrowing of the Government and the financial institutions of the private sector. As a percentage of the Gross Domestic Product, the external debt increased to 35,9% in 2003 from 34% in 2002. The external debt service ratio, defined as the ratio of interest and loan repayment expenditure (excluding EMTN repayments) on the exports of goods, services and income declined to 5,7% in 2003 from 6,2% in 2002, mainly due to the fall of the Government's repayments based on its financial obligations, and it compares very favourably with international standards.

Public Finances

In 2003 the fiscal deficit of the general Government, as defined by Eurostat for fiscal surveillance purposes and covers beyond the Central Government, the local authorities and a number of semi- governmental organisations, that according to the relevant definition fall under the general Government, increased to £417 mln, or 6,3% of GDP, compared to £284 mln, or 4,6% of GDP in 2002, a level that exceeds the relevant Maastricht criterion. ($\leq 3\%$ of GDP). This development reflects the larger expansion of public expenditure as compared to the rate of increase of public revenue.

The deterioration of the fiscal situation in 2003 is attributed, on the one hand, to the low rate of economic growth for a second consecutive year, that affected adversely the rate of expansion of public revenue, as well as to the decline of revenue from direct taxation due to the reduction of the highest marginal tax rate for natural persons from 40% to 30% as from 1.1.2003, and on the other, to the expansion of the rate of increase of public expenditure, as a result mainly of the increased expenditure on wages and salaries, higher subsidies and transfer payments as well as the increased capital expenditure. The deterioration of the fiscal situation was also reflected in public savings, which from negative of the order of £45,5 mln in 2002 expanded to negative of the order of £106,7 mln in 2003.

- Public Revenue¹⁰

The rate of increase of public revenue accelerated to 14,1% in 2003 compared to 1,8% in 2002 and in absolute terms public revenue reached £2505,7 mln in 2003 compared to £2196 mln in 2002. The acceleration of the rate of increase of public revenue, is owed to the expansion of the rate of growth of revenue from indirect taxation and non tax revenue. In contrast, revenue from direct taxation registered a decline in absolute terms.

¹⁰ It includes receipts from direct and indirect taxes, social security contributions, foreign aid as well as non-tax receipts.

Analytically, revenue from direct taxation declined, in absolute terms, by 8,3% in 2003, following a smaller decline of 2,7% in 2002, reflecting the fall in revenue from income tax both on individuals and legal entities. Specifically, the fall in the revenue from the income tax on individuals is owed to the reduction of the highest marginal tax rate from 40% to 30% as from 1.1.2003, while the containment in the revenue from the income tax on legal entities is owed to the introduction of a uniform corporate tax rate of 10% as from 1.1.2003 which implies a substantial reduction in the taxation of the profits of Cypriot firms, since up to 2002 the tax rate fluctuated at 20% for profits up to £40.000 and 25% for profits exceeding £40.000.

In contrast, the rate of expansion of revenue from indirect taxation registered a substantial acceleration and fluctuated at 24,2% compared to 10,5% in 2002, due to the increases imposed on excise duties mainly on petroleum products and tobacco products, as well as the increase in the VAT rate from 10% to 13% as from 1.7.2002 and from 13% to 15% as from 1.1.2003, within the framework of harmonisation with the minimum levels prescribed by the *acquis communautaire*. It is noted, however, that the low rate of economic growth had an adverse effect on revenue from both direct and indirect taxation.

Non-tax revenue exhibited a significant expansion, as a result of the dividend policy adopted with the transfer of a part of previous years profits of the semi-governmental organisations CYTA and EAC of the order of £80mln and £45mln, respectively to the Government Funds in the form of dividend income.

- Public Expenditure¹¹

Public expenditure registered an increase of the order of 17,8% in 2003 compared to 8,4% in 2002 and reached £2922 mln in 2003 from £2480 mln in 2002, reflecting the acceleration of both the rate of increase of current expenditure as well as capital expenditure.

¹¹ It includes expenditure on wages and salaries, purchase of goods and services, interest payments and other transfer payments, investment, capital transfers and net lending to third parties.

The expansion of current expenditure is attributed mainly to the expansion of expenditure on wages and salaries, subsidies and transfer payments. Analytically, the large increase of the expenditure on wages and salaries is attributed mainly to the increases granted on the basic salaries of the civil servants of the order of 7,5% that cover also increases for 2001 and 2002. Additional factors that had an increasing impact on the expenditure for wages and salaries constituted the higher rate of expansion of COLA as against 2002, due to the increases on the VAT rate, as well as the rise in public employment which resulted from the need to strengthen existing or create new structures for the effective implementation of the acquis communautaire. At the same time, subsidies increased substantially as against a decline in absolute terms in 2002, due to the subsidisation of heating oil (£11 mln) and the higher grain subsidies granted owing to increased production.

Transfer payments increased at a higher rate compared to the previous year, reflecting, inter alia, the higher transfer payments to the Unemployment Fund due to the partial increase in unemployment and the adoption of an additional grant to the local authorities following the abolition of the professional tax, combined with the continuation in 2003 of the special grant given in 2002 to pensioners or receivers of any other benefit, whose total income does not exceed £500 per month

The rate of expansion of capital expenditure registered a substantial acceleration in 2003, as a result of the larger increase of the Government's investment expenditure in infrastructural projects and the significant increase of capital transfers. The higher investment activity of the public sector is also related to the efforts to contain the negative effects of the war in Iraq on the Cyprus economy. The greater expansion of capital transfers is owed to the increased land acquisition expenditures within the context of promoting the implementation of infrastructural projects.

In order to confront the increasing fiscal deficit the Government is promoting the immediate implementation of measures included in the revised fiscal consolidation programme, which constituted part of the Pre- Accession

Economic Programme 2002-2006, as well as the adoption of a tighter fiscal policy as regards public consumption expenditure and transfer payments. It is noted that the improvement of the fiscal situation based on the revised fiscal consolidation programme, will result from the increase in public revenue, mainly through the improvement of the tax collection ability of the competent Government authorities and through combating tax evasion, in conjunction with the containment of the rate of expansion of public expenditure and the increase in the fees charged for the provision of Government services.

- Financing-Public debt

The coverage of the financing needs of the Government which came to £416,7 mln in 2003 was based almost equally on domestic borrowing from the private sector and on external borrowing. Specifically, net domestic borrowing came to £209,4mln in 2003 compared to £228,6 mln in 2002 and was derived mainly from the private sector, while net external borrowing came to £207,3 mln in 2003 as compared to £46,9 mln in 2002.

Public debt including intergovernmental debt reached £7453 mln by the end of 2003 from £6559,5 mln in 2002 and as a percentage of GDP it recorded an increase from 106,5% in 2002 to 112,7% in 2003. Public domestic debt recorded an increase and reached £6392,8 mln compared to £5710 mln in 2002, while public external debt expanded to £1060,3 mln in 2003 from £849,5 mln in 2002.

Public debt excluding intergovernmental reached £4801,8 mln by the end of 2003 from £4153,2 mln in 2002. As a percentage of GDP, public debt excluding intergovernmental increased to 72,6% of GDP from 67,4% in 2002.

Monetary- Credit

Monetary developments during 2003 were marked by the excess liquidity conditions that prevailed, reflecting the subdued economic activity and consequently the reduced demand for loans. An additional characteristic of monetary developments during 2003, constituted the decision of the Monetary Policy Committee, in April 2003, to further lower the Lombard rate by 0,5

percentage point. The decision of the Monetary Policy Committee was aiming at reviving economic activity, which was negatively affected by the war in Iraq.

The rate of increase of money supply registered a substantial deceleration in 2003 compared to the previous year, and expanded by 4% in December 2003, compared to 10,3% in December 2002. This development is owed mainly to the substantial containment in the rate of increase of credit extended to the private and public sector. In contrast, net foreign assets registered a significant increase as against a decline in 2002.

Analytically, bank credit extended to the private sector expanded at a low rate in 2003, with the average annual rate of growth reaching 5%, compared to 8% in 2002. The low rate of expansion of bank credit extended to the private sector is owed to the conditions of restrained growth for a second consecutive year that resulted in a reduced demand for loans by the private sector, as well as to the stricter loan applications evaluation policy followed by banks. The rate of expansion of credit extended to the public sector also registered a substantial deceleration from 17,1% in 2002 to 9,7% in 2003, reflecting the financing of the fiscal deficit, to a greater extent, through foreign borrowing.

The total foreign currency borrowing of Cypriots came to £799 mln at the end of December 2003 compared to £785,2 mln at the end of 2002 recording an increase of 1,8%. The foreign currency borrowing of Cypriots', as a percentage of the bank credit extended to the private sector, fell to 9,6% in December 2003 from 9,9% in December 2002. According to the distribution of foreign borrowing by currency, borrowing in euros continued to absorb the largest share, 70,5%, followed by loans in US dollars, 9,3% and Swiss francs, 10,9%.

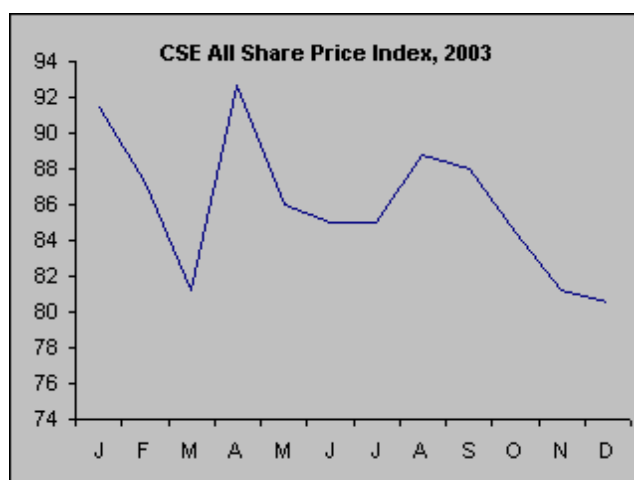
The distribution of new net bank credit changed in 2003 towards the benefit of the construction sector. Specifically, the share of the construction sector to the new net bank credit increased from 21,6% in 2002 to 44,6% in 2003. A marginal increase was observed in the share of personal loans from

44,2% in 2002 to 45% in 2003, while the shares of the trade and tourism sectors declined.

Credit from Cooperative Credit Institutions (CCIs) increased at an annual rate of 10,3% in December 2003 as against an increase of 6,1% in the respective period of 2002. The share of CCIs in the total credit extended by the banking system in Cyprus pounds increased from 24,4% in 2002 to 25,3% in 2003. Deposits with CCIs increased at an annual rate of 13,5% in 2003 as against an increase of 13% in 2002. The share of CCIs in the total deposits of the banking system in Cyprus pounds expanded to 32,5% in 2003 from 30,1% in 2002.

Stock Market

A main characteristic of developments during 2003 in the stock market was the continued downward course of the Cyprus Stock Exchange All Share Price Index observed during the previous three years. Specifically the CSE All Share Price Index closed at 80,58 units at the end of 2003, compared to 94,52 units at the end of the previous year, registering a decline of the order of 14,8%. The greatest losses were recorded in the sectors of tourism, insurance companies and approved investment organisations. In contrast, the sector of trade registered capital gains of the order of 3,8% as against December 2002.



Analytically, during the period January-December 2003 the stock market followed a downward trend, with the exception of two upward breaks (April and July-August 2003). A determining factor to the course of the stock exchange

index during 2003 constituted the negative psychology that continued to prevail among investors, while the war in Iraq worsened the already negative

psychology of investors. The stock market rebounded in April. The termination of the war in Iraq in April, the interest rate cuts by the Central Bank of Cyprus in the same month, combined with the signing of the Accession Treaty by the 10 EU new member states on the 16th of April, improved the psychology of investors during this month, and as a result, the All Share Price Index closed at 92,67 units on April 30th 2003 recording gains of the order of 14,2% vis-à-vis March, reducing the losses from December 31st 2002 to 2%. The upward trend of the stock market observed in April was reversed in the following months of the year, while in July it stabilised at the levels of June. In August the stock market showed signs of recovery with the All Share Price Index closing at 88,7 units recording gains of the order of 4,4% vis-à-vis July and limiting losses from the beginning of the year to 6,1%. During the period September-December 2003 the stock market followed a downward course with the All Share Price Index closing on December 31st at 80,58 units registering losses of the order of 14,8% as from December 31st 2002.

The total market capitalisation, in current market prices (excluding approved investment organisations), reached £2,2 bln by the end of the year compared to £2,6bln the end of 2002, with the banking sector holding the largest share, 46,3%. The sectors of manufacturing, 10,2%, construction companies, 8,3%, hotels, 7,7%, trading companies, 5,2%, financial services, 3,5%, tourism enterprises, 2%, information technology, 1,3%, insurance companies, 1,3% and fishing companies 0,4% followed, while other companies held the remaining share of 13,9%.

The volume of transactions for the whole year came to £154,5 mln with an average daily volume £630,6 thousands, compared to £370,5 mln and an average daily volume of £1,5 mln in 2002.

A worth-mentioning development during 2003, constituted the accession of the Cyprus stock market as a full member to the European System of Central Depositories on April 11 2003 and the completion of the dematerialization and registration of all shares listed on the stock market on the Central Registry. Another important development during 2003 in the stock market constituted the operation of the new FTSEMed 100 Index on June 20

2003. The FTSEMediterranean 100 Index consists of 100 companies from Greece, Israel and Cyprus (60 Greek, 5 Cypriot and 35 Israeli) and its basis is 5.000 units. In addition, within the context of modernising the stock market in Cyprus, the CSE proceeded with the lengthening of the trading hours by one hour as from July 4, 2003. A worth-mentioning development in 2003 also constituted the practice as from November 2003 of remote trading.

At the same time, it is noted that within the framework of harmonisation and modernisation of the institutional framework governing the operation of the stock market, the Collective Investments in Transferable Securities Law (UCITS), entered into force as from March 2003, harmonising the Cypriot law with a number of community directives. In addition, the Securities and Exchange Commission and the Central Bank issued in 2003 the Code of Conduct for Investment Services Firms and for their employees in accordance with article 41 of the Investment Services Law of 2002.

Overall the stock market continued throughout 2003 on the downward trend of the previous three years, reflecting mainly the negative psychology that continued to prevail among investors and in general the subdued economic activity. However, significant progress has been achieved in the modernisation and harmonisation of the institutional framework of the capital market with the *acquis communautaire*.

Developments in the European Union

Accession Treaty

The signing of the Accession Treaty by the 10 acceding countries (Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia), in Athens, on April 16th 2003 marked EU developments in 2003. The signing of the Treaty was the conclusion to a lengthy preparation and negotiation process, which was completed at the Copenhagen European Council of 12 and 13 December 2003, opening up the way to the fifth and largest expansion in the history of the EU. The results of the accession negotiations in terms of transitional arrangements agreed and the technical adaptations to the *acquis* as a result of the enlargement have been embodied in the Treaty.

The 1st of May 2004 was set as the date of accession of the new member states to the EU, following the ratification of the Accession Treaty by the National Parliaments and the European Parliament. Cyprus ratified the Treaty on July 14 2003.

Following the signing of the Accession Treaty, all acceding countries, started to participate as “active observers” to the various Committees and other bodies of the European Commission and the Council, however, having no voting right. In addition, members of Parliament of the acceding countries participated in the European Parliament as observers.

European Constitution

Another significant development in 2003 constituted the preparation by the European Assembly in July 2003, following 16 months of work, of a draft European Constitution. This draft was submitted to the Intergovernmental Conference, in which representatives of the existing member states and the acceding countries participated. At the Brussels European Council (12-13 December 2003), the Heads of State and Government did not come to an agreement on the final draft of the Constitution and therefore it was decided to

continue the workings of the Intergovernmental Conference during 2004. The final draft to be adopted by the Intergovernmental Conference will have to be ratified by the 15 member states as well as by the 10 acceding countries.

The under preparation European Constitution which will replace in a uniform text the main existing European Treaties, will constitute an important landmark in the “building up” of Europe. It is being drafted under the light of the needs recorded in the Declaration for the Future of Europe, which was approved by the Heads of State and Government in the Leaken European Council on December 15, 2001: to make the Union more democratic, more transparent and more effective and to open up the way to a Constitution for European Citizens.

The draft of the European Constitution consists of four parts. The theme of the first part is the institutional architecture of the European Union, the second part's theme is the inclusion of the Charter of the Fundamental Rights of the Union, the third part describes the policies and actions of the Union and finally the fourth part includes the final provisions, including also, the procedures for approval and review of the Constitution.

Reform of the Common Agricultural Policy

On June 26th 2003, at the Luxembourg European Council, the Ministers of Agriculture of the EU member states adopted a radical reform of the Common Agricultural Policy (CAP). In the future, the majority of subsidies will be granted independently from the volume of production. In order to avoid the abandonment of production, the member states may opt to maintain, under well specified conditions and clear time schedules, a limited link between the subsidy and the volume of production. The new “single farm payments” will be granted subject to compliance with certain requirements as regards environment, food safety and animal welfare standards. Breaking up the link between subsidies and production will boost the production of more competitive products, while, at the same time, it will provide producers with the necessary income stability. The Council also decided to review the

common market organisations for milk, rice, cereal, durum wheat, dried fodder and nuts. The Ministers have also decided to adopt a mechanism of financial discipline aiming at maintaining the upper limit of the budget for the EU-25 up to 2013.

Cyprus will implement the single farm payments in 2007. In the transitional period up to 2007, it has been decided by the Council of Ministers to implement the simplified approach of the single area payment system, in order to grant farmers, the direct payments during the first three years following accession (2004-2006).

The New Enlargement

Following the accession of 10 new member states as from May 1st 2004, the new enlargement will follow. Bulgaria and Romania, which have not completed their negotiations with the EU in time, are expected to accede to the Union in 2007, provided they comply with the required preparation deadlines.

The third candidate country, Turkey, has not yet received a clear date for starting negotiations. At the end of 2004, the EU will make an assessment to determine whether Turkey meets the political criteria for membership, with regard to the respect of human rights, the rule of law and the protection of minorities and depending on the outcome of the assessment, it will decide as to whether or not to start negotiations with Turkey.

Moreover, the European Commission is currently considering the application submitted by Croatia in February 2003, in order to decide whether negotiations may start for Croatia's accession to the EU.

Cyprus' Accession Course

The European Framework – Historic Summary

The starting point of Cyprus' accession course was the application for accession to the EU submitted in July 1990. Following the positive avis of the European Commission in June 1993, the prospects for the accession of Cyprus to the European family took shape. The decisions of the European Council at Corfu (June 1994) and Essen (December 1994), which determined that the next enlargement phase of the EU would include Cyprus and Malta, are also considered to be of great importance. Next, the Council of Ministers of the fifteen member states, with its landmark decision of March 1995, determined that accession negotiations with Cyprus would begin six months after the completion of the 1996 Intergovernmental Conference.

At all subsequent Summits of the European Council, the above were repeatedly reaffirmed, whilst the successful conclusion of the Inter-Governmental Conference in June 1997 led to a series of specific decisions by the EU, included in Agenda 2000, concerning the enlargement process and the reinforcement of the pre-accession strategy for the benefit of all candidate countries. The European Council at Luxembourg (December 1997) decided to initiate a comprehensive enlargement process for the ten applicant countries of Central and Eastern Europe and Cyprus in March 1998.

The process provided for an enhanced pre-accession strategy for the Central and Eastern European countries, and a special pre-accession strategy for Cyprus comprising the following:

- (a) Participation in certain targeted projects, in particular the boosting of the judicial and administrative capacity and projects in the field of Justice and Home Affairs;

- (b) Participation in certain Community programmes and organisations (in line with the approach followed for the other applicant States);
- (c) Use of technical assistance provided by TAIEX (Technical Assistance Information Exchange Office).

Agenda 2000, reiterated the Union's determination to play a positive role in bringing about a continuous and lasting settlement to the Cyprus problem and clarified that if progress towards a settlement was not reached before the negotiations were due to begin, the latter should begin with the Government of the Republic of Cyprus, as the only authority recognized by international law. This position was also adopted by the Helsinki European Council (December 1999), when the EU heads of state explicitly decided that a solution to the Cyprus problem was not a precondition for Cyprus's accession to the Union.

Other major developments also took place which aimed at the further strengthening and implementation of the special pre-accession strategy for Cyprus. The focal point of these developments was the establishment of the Accession Partnership with Cyprus (Council Decision of 20 March 2000) as well as the enactment of the new Financial Regulation for Cyprus and Malta for the period 2000 – 2004 (Council Regulation of 13 March 2000) for the implementation of the pre-accession strategy as defined in the Accession Partnership. The EU approved an amount of EUR 57 mln for the financing of the pre-accession strategy for Cyprus for the period 2000-2004.

In the Copenhagen European Council of 12 and 13 December 2002, the negotiations of the EU with the ten candidate countries for accession to the EU including Cyprus, were completed, and, inter alia, the financial framework related to the enlargement for the period 2004-2006 was determined. Following the first step taken during the Brussels European Council and following the subsequent adaptations that resulted from the negotiating “package” prepared by the Danish presidency, the Heads of State and Government of the Union ratified a relevant provision of the order of Euro 40,8 bln in the Copenhagen European Council.

In addition, the EU aiming at helping new member states to enhance their administrative structures for the effective implementation of the *acquis communautaire* during the first years after accession (2004-2006), decided, within the framework of the Accession Treaty (April 2003) to grant financial aid through a new financial means, the “Transition Facility”. This aid is divided into two parts: a) the vertical aid to be given separately to each new member state and which in the case of Cyprus amounts to 18,6 mln Euro and b) the horizontal programmes that concern all new member states (such as informative/educational activities organised by TAIEX, statistical cooperation through Eurostat and issues concerning the Public Sector) for the exploitation of which, programming will be conducted at a central level by the European Commission.

Accession Negotiations

According to the procedures set out by the European Commission, accession negotiations comprised of two phases. The first phase concentrated on the analytical examination of the *acquis communautaire* (*acquis screening*), while the second covered the substantive negotiations of special arrangements/transitional periods. The *acquis screening* process consisted of multilateral and bilateral meetings with representatives from the European Commission and the candidate countries. The objective of these meetings was to identify the gaps, divergences and difficulties in the adoption and implementation of the *acquis* and to set a specific timetable for

harmonisation. For this purpose, the acquis communautaire was divided into thirty-one chapters.

The screening phase of the acquis communautaire, as in force on 1 March 1998, began on 31 March 1998 and was completed in October 1999. For the new acquis communautaire, adopted after 1 March 1998, the written procedure was adopted.

Deliberations on the negotiating positions of the Government of the Republic of Cyprus, began in November 1998 with the Intergovernmental Conference for the Accession of Cyprus to the EU and were completed for all the chapters in December 2002.

Accession Negotiations Results

The main special arrangements/transitional periods that were agreed, per chapter, for Cyprus during the accession negotiations are the following:

Chapter 1: Free Movement of Goods

- Transitional period until 31.12.2005 for specific pharmaceutical products for human use and veterinary medicinal products used in Cyprus with marketing authorisations (5 years duration) issued prior to the adoption of the harmonising legislation.

Chapter 3: Freedom to Provide Services

- Transitional period until the end of 2007 for the Co-operative Credit and Savings Societies to comply with the relevant provisions of the community acquis on Credit Institutions.

Chapter 4: Free Movement of Capital

- A five-year transitional period from the date of accession during which the existing regime will continue to apply regarding the acquisition of secondary residences by EU residents.

Chapter 6: Competition Policy

- Maintenance by international business enterprises until 31.12.2005, of the benefit of the Income Tax Law acquired by 31.12.2001 (taxation at a rate of 4,25% on their net taxable profits).

Chapter 7: Agriculture

- Granting of supplementary payments from national funds to producers, in order to maintain their income at a level not lower than that which existed before accession. In cases where the support provided by Cyprus is greater than the respective support provided by the Union, a seven-year transitional period was granted during which full harmonisation will be achieved.
- A five-year transitional period during which Cyprus will apply a higher ceiling for the withdrawal of surplus products than the one provided by EU Regulations for apples, pears, peaches, table grapes and citrus fruit excluding grapefruit.
- The requirements relating to the minimum fat content of whole milk shall not apply to drinking milk produced in Cyprus for five years from the date of accession. The drinking milk, which does not comply with the requirements relating to fat content may be marketed only in Cyprus or exported to third countries.

- Transitional period of five years for the phasing in of the stocking density requirements of livestock in Cyprus (for compliance with the requirements of the relevant directive) from 4,5 Livestock Units (LU)/ha to 1,8 LU/ha.
- Transitional period of five years during which Cyprus will have the right to provide increased incentives in relation to the levels provided for by EU Regulations on Rural Development mainly in relation to the rural-environmental development and preservation of the traditional landscape schemes, so that the income of the producers participating in these schemes in the viniculture and mountainous areas of Cyprus does not fall below the 80% of the national average level. Agricultural investments are excluded from this measure.
- The following special arrangements will apply for the rural development sector:
 - Special aid for five years for the establishment of Producer Organisations in sectors that are not usually supported by the E.U.
 - Increase in the subsidy provided for the investment in agricultural exploitations from 40% to 50% (and in special cases up to 65%) during the first three years after accession.
 - Provision of a special annual subsidy of £1.000 during the first five years after accession to small units that will undertake to improve their viability with a suitable improvement plan.
 - Provision of technical assistance to Cyprus and support for financing of consultancy services that will be provided to farmers both by the State and private certified agriculturists.
 - Special arrangements for the first three years after accession to support agricultural exploitations and allow the manufacturing units to comply fully with the various E.U. standards.

- The requirements regarding analytical purity for the barley seed shall not apply in Cyprus for five years from the date of accession in relation to the marketing of such seed produced in Cyprus. During this period, such seed shall not be marketed in the territory of other member states.
- Cyprus may postpone for a period of five years from the date of accession the application of Directives 2002/53/EU and 2002/55/EU with regard to the marketing in its territory of seeds of varieties listed in its respective national catalogues on agricultural and vegetable plant species, which have not been officially approved in accordance with the provisions of these Directives. During this period, such seeds shall not be marketed in the territory of other member states.

Chapter 9: Transport Policy

Land Transport

- Transitional period until 31.12.2005 for the installation and use of recording equipment (tachographs) on vehicles which are registered before 1.1.2002 and are engaged exclusively in domestic road transport operations for the carriage of goods or passengers.

Chapter 10: Taxation

- Maintenance of the zero VAT rate on foodstuffs and pharmaceuticals until 31.12.2007.
- Maintenance of the reduced VAT rate (5%) on restaurants until 31.12.2007
- Maintenance of the zero VAT rate on international passenger transport.
- Exemption from the VAT rate on the supply of building land until 31.12.2007.

Chapter 14: Energy

- Transitional period until the end of 2007 for the maintenance of oil stocks for 90 days.

Chapter 21: Regional Policy and Structural Funds

During the period 2004 – 2006 Cyprus will receive from the different funds of the European Union, in 1999 prices, EUR 115,1 mln for agriculture (EUR 48,7 mln from the Common Agricultural Policy for the direct payments to the farmers and for market supporting measures and EUR 66,4 mln for rural development), EUR 85,5 – 116,5 mln for structural actions [EUR 52,8 mln from the Structural Funds (of which EUR 24,9 mln for Objective 2, EUR 19,5 mln for Objective 3 and EUR 3 mln for Fisheries) and EUR 32,7 – 63,7 mln from the Cohesion Fund] as well as EUR 47,7 mln for other programmes and actions.

Chapter 22: Environment

Waste Management

- Transitional period until 31 December 2005 in order to achieve the recovery and recycling targets for packaging materials.

Water Quality

- Transitional period until 31.12.2012 in order to comply with the requirements of the Directive on Urban Waste Water for collecting systems and treatment of urban waste water in areas with population over 2000 people.

Industrial Pollution Control and Risk Management

- At the large combustion plants of Dekhelia and Vasiliko, which were in operation in September 2002, the lower marginal values of 1700mg/Nm³ will apply.

Chapter 29: Budgetary and Other Financial Provisions

During the period 2004 – 2006, Cyprus will receive a net amount of EUR 91 mln (1999 prices). This amount constitutes an additional financial flow over and above the budgetary compensation that Cyprus will receive for the difference between Cyprus' contribution to the EU Budget and the flow of Funds from the various Community Funds and Policies to Cyprus, according to the Acquis Communautaire.

Harmonisation Effort

Cyprus must be fully harmonised with the *acquis communautaire* by 1 May 2004, the transitional arrangements agreed during the negotiations being the only exception. This entails the complete transposition of community legislation into national legislation as well as its effective implementation and enforcement, which also requires institutional and organisational changes.

During 2003 the House of Representatives approved 99 harmonisation Laws and 106 harmonising Regulations. Indicatively, a number of these harmonisation measures which are considered of particular importance are mentioned:

- In the area of **Free Movement of Goods**, an important measure constituted the harmonisation with the *acquis communautaire* of public procurement with the approval by the House of Representatives of The Award of Contracts (Supply, Works, Services) of Entities

Operating in Water, Energy, Transport and Telecommunications Sectors Law and the Award of Public Contracts (Public Supply, Public Works and Public Services) Law and the relevant Regulations which include, inter alia, the Regulations for the operation of the Tenders Review Authority .

- In the field of **Free Movement of Persons**, the approval by the House of Representatives of the new Free Movement and Residence for EU Nationals of Member States of the European Union and Members of their Family Law, is considered of particular importance.
- On **Freedom to Provide Services**, of particular importance is the approval of the Banking Law as well as of the Cooperative Credit and Savings Society (Amendment) Law through which full harmonisation of the banking sector with the *acquis communautaire* is achieved upon accession. It is noted that in the sector of Cooperative Credit Institutions, the full harmonisation of the sector with the *acquis communautaire* will be completed by the end of 2007, since a relevant transitional period has been granted.
- In the area of **Free Movement of Capital**, particularly important are the Capital Movement Law and the Acquisition of Immovable Property (Aliens) (Amendment) Law through which all remaining restrictions on capital movements are lifted including the acquisition of immovable property, the only exception being the acquisition of a secondary residence.
- In the sector of **Agriculture**, particularly important is the enactment of the Agricultural Paying Agency Law, which provides for the establishment of the Agricultural Payments Organisation.
- In the **Energy** sector, particularly important is the approval by the House of Representatives of the Promotion and Encouragement of

the Use of Renewable Sources of Energy and the Conservation of Energy Law, the Electricity Market Regulation Law which provides for the liberalisation of the sector upon accession, as well as, the establishment of the Cyprus Energy Regulatory Authority (CERA) and the Maintaining of Petroleum Products Stocks Law which provides for the establishment of a Cyprus Oil Stock-holding Organisation (COSA).

- In the sector of **Telecommunications** the legal framework which liberalises fully the telecommunications and postal services market has been completed.
- In the area of the **Environment**, important is the enactment of the Genetically Modified Organisms (Release into the Environment) Law.
- Furthermore, in the sector of **Justice and Home Affairs**, Cyprus has ratified various conventions that concern the judicial cooperation in matters of civil and criminal law and the protection of the financial interest of the European Communities member states, while it enacted a number of harmonisation laws concerning asylum issues.

Further progress has also been achieved during 2003 with regard to the strengthening/establishment of the necessary administrative structures for the more effective implementation and enforcement of the *acquis*. Some indicative examples with regard to the establishment of new administrative structures are:

- In the field of **Public Procurement** the Tenders Review Authority has been established in order to examine appeals against actions or decisions of the commissioning authorities that fall under the Public Contracts Laws and which infringe any provision of the legislation in force.

- In the **Free Movement of Persons** field, the National Coordinator for the Recognition of Professional Qualifications was appointed.
- In the sector of **Agriculture**, the Commissioner and the Assistant Commissioner of the Organisation of Agricultural Payments have been appointed and the relevant authority was set up.
- In the field of **Energy** the Energy Regulatory Authority aiming at promoting the liberalisation of the sector as well as the Cyprus Oil Stock-holding Organisation, have been set up.
- In the field of **Social Policy and Employment**, the competencies of the Ombudsman for Administration have expanded so as to include the tasks for the implementation and imposition of the anti-discrimination Directives.
- As regards the **Regional Policy and Structural Funds** area and following a previous decision of the Council of Ministers for the manner of managing Structural Funds and defining the relevant Authorities involved, a new decision by the Council of Ministers was taken in 2003, according to which the competencies and tasks of all involved bodies are being defined in detail.
- In the area of **Justice and Home Affairs**, new structures for first and second instance examination of asylum applications have been set up.
- Finally, in the **Financial Control** field, the Commissioner for Internal Audit was appointed and an independent authority whose competency is to control the National Budget as well as the projects/measures co-financed by EU resources, was set up.

In parallel, and appreciating the vital role of information for the successful completion of the work undertaken, the competent authorities continue to promote intensively the further training and education of the Civil Service on European affairs as well as the briefing of the private sector on the course of the harmonisation process. Within this context, and with an aim to disseminate information, the Awareness Coordinating Committee was set up, under the chairmanship of the Coordinator for Harmonisation aiming at briefing citizens on the consequences of the implementation of the *acquis communautaire* in every day life (benefits but also obligations that emerge). This campaign has as its central point the briefing of specific groups, such as consumers, farmers, students, the young, firms and the provision of information for ways to utilise community resources (Funds and Community Programmes). In addition, a special web site is available on the internet.

Finally in November 2003 the European Commission issued the final Monitoring Report on Progress achieved by Cyprus as regards the compliance with commitments undertaken in view of Cyprus accession to the EU and which concern its ability for the effective implementation of the *acquis communautaire*. In the Report, the achievement of satisfactory progress by Cyprus was noted and a limited number of problems concerning mainly the sectors of merchant shipping, the organisation of agricultural payments and the trade mechanisms were identified. In the time period that followed the submission of the report, the Government intensified its efforts to promote the required measures in the above fields so as to secure the effective implementation of the *acquis*.

Cyprus – European Union Trade Relations

EU continues to be Cyprus' main trading partner, despite the downward trend of domestic exports to the Community market observed in recent years (1996 – 2003). Specifically, while in 1995 domestic exports to the EU reached around £141 mln and represented 60,7% of total domestic exports in 2003 domestic exports fell to around £117,2 mln or 54,6% of total

domestic exports. This development is attributed mainly to the low competitiveness of the manufacturing sector which led to a fall in industrial exports and to the intensified conditions of competition in the case of agricultural products.

The exports of manufactured products to the EU market recorded a downward trend in recent years (1996 – 2002), and in 2003 they fell further to £80,2, as against £87,3 in 2002. However, due to their larger decline towards the other export markets, the share of EU to the total exports of manufactured products increased from 48% in 2002 to 50,4% in 2003. The traditional export sectors such as clothing and footwear continue to face problems, whilst the same applies for the exports of manufactured agricultural products.

The exports of agricultural products to the EU reached £34,9 mln in 2003 and represented around 80% of total agricultural products exports, compared to £28,2 mln or 76,4% in 2002. The observed increase is mainly due to the higher prices secured for potatoes in the EU market. It is noted that the exports of agricultural products face, in recent years, increased competition from respective products of other Mediterranean countries, which have significantly improved the quality and earliness of their products. Despite these problems, the EU continues to be the main destination of Cyprus' agricultural produce.

In 2003, imports for home consumption from the EU reached around £1214 mln representing around 57,6% of total imports for home consumption, as against £1258,5 mln or 55,8% in 2002.

The trade deficit in favour of the EU narrowed to £1016,9 mln in 2003, compared to £1059,6 mln in 2002.

Economic Convergence between Cyprus and the European Union

In conjunction with Cyprus' accession course, there is also the need to maintain the robustness of the Cyprus economy and to introduce the necessary corrective measures, in order to achieve gradually the greatest possible convergence with the economies of the EU Member States.

Nominal Convergence

The implementation of the third stage of the Economic and Monetary Union (EMU) on 1 January 1999 with the participation of eleven Member States of the EU¹² in the euro zone rendered the need to safeguard the continuous process of convergence of the economies of all Member States even more imperative. To this end, at the Cologne Summit, the necessity of the stringent compliance with the provisions of the Growth and Stability Pact adopted at the Amsterdam Summit was reiterated. The main objective is the securing of healthy budgetary policies at national level.

The performance of the Cyprus Economy with respect to the convergence criteria is summarised as follows:

- The fiscal deficit is estimated at 6,3% of GDP in 2003, compared to 4,6% in 2002, diverging from the relevant convergence criterion, which provides for the fiscal deficit to be maintained under 3% of GDP ($\leq 3\%$).
- The public debt increased in 2003 to 72,6% of GDP compared to 67,4% of GDP in 2002, thus also diverging from the relevant convergence criterion set by the Maastricht Treaty ($\leq 60\%$).
- In 2003 the harmonised inflation rate increased to 4% compared to 2,8% in 2002 diverging from the relevant Maastricht convergence criterion, as the reference value was 2,7%. It is noted, that the increase of the inflation rate

¹² Greece entered the Eurozone in 2001.

in 2003 is due exclusively to temporary and external factors such as the increases in the excise duties imposed mainly on tobacco and petroleum products during the year and the increase of the VAT rate from 10% to 13% as from 1 July 2002 and to 15% as from 1 January 2003.

- The long-term interest rates fluctuated around 4,7% in 2003, satisfying the relevant convergence criterion, since the reference value was 6,1% in 2003. In relation to this, it is noted that as from 1 January 2001 the interest rates in Cyprus are flexible.
- The exchange rate parity of the Cyprus pound, pegged to the Euro as of January 1999, remained stable vis-à-vis this currency. It is worth noting, that in 2001 Cyprus abandoned the policy of maintaining the exchange rate of the Cyprus pound against the Euro within the narrow margin of $\pm 2,25\%$ and widened the fluctuation band to $\pm 15\%$. It should also be noted that the relevant Maastricht criterion does not apply in the case of Cyprus, which does not participate in the ERM.

Real Convergence

The robustness of the Cyprus economy and its ability to respond satisfactorily to the challenges of accession are also indicated by the performance of the economy's real magnitudes. The relevant indicators confirm that the performance of Cyprus as regards the main economic and social parameters compares favourably with those of its future partners and that its accession to the European family will not pose any significant problems.

For many years now, the growth rate of the Cyprus economy continues to fluctuate above the corresponding EU average. In 2003, the rate of growth of the Cyprus economy remained at the levels of the previous year, 2%, which although lacks far behind the potential rate of growth of the economy, continued to remain higher than the EU average rate of growth, 0,8%. In

parallel, the unemployment rate in Cyprus continued to fluctuate at low levels, reaching 3,5% in 2003 based on the registered unemployed. In contrast, and despite all corrective measures adopted, the EU is still plagued by high unemployment rates averaging 8% for the same period. Per capita GDP continued its upward trend reaching EUR 15.815 in 2003 in nominal terms, which compares favourably to Portugal (EUR 12.531) and Greece (EUR 13.850).

It is also noted that the social indicators recorded in Cyprus, which are also reflected in the standard of living, reveal that basic parameters such as the level of social benefits, education and vocational training, public health, consumer protection, environmental protection etc, meet EU requirements.

Financial Cooperation between Cyprus and the European Union

(1) Structural Funds and Cohesion Fund

In the context of the Cohesion Policy of the European Union, Cyprus will benefit from financing through the Structural Funds and the Cohesion Fund. In 2003 the preparation of the Strategic Development Plan 2004-2006 was completed, which forms the basis for the preparation of the Programming Documents which include actions and projects for co-financing under Objective 2 (EUR 28 mln¹³), Objective 3 (EUR 21,9 mln¹³) of the Structural Funds, the Fund for Fisheries (EUR 3,4 mln¹³), the Community Initiatives Equal (EUR 1,8 mln¹³) and Interreg (EUR 4.3 mln¹³) as well as the Cohesion Fund (approximately EUR 55 mln¹³) of the European Union.

For the timely programming of the procedure required to absorb the funds provided through the Structural Funds in Cyprus for the period 2004-2006, Cyprus submitted to the European Union, following a relevant approval

¹³ These amounts have been agreed during the accession negotiations at 1999 constant prices as follows:

Objective 2: 24,9 mln EUR,
Objective 3: 19,5 mln EUR,
Fund for Fisheries: 3 mln EUR,
Community Initiative EQUAL: 1,6 mln EUR,
Community Initiative INTERREG: 3,8 mln EUR, and
Cohesion Fund: 32,7-63,7 mln EUR.

of the Council of Ministers, the programming documents which constitute three year programmes that describe the recommended strategy and particularly the priorities for the utilisation of the relevant funds.

All programming documents were submitted in 2003 and were unofficially approved by the European Commission at the end of 2003, while their official approval is expected right after Cyprus' accession to the EU.

For the preparation of the documents mentioned above, the views and recommendations of all public and private sector bodies involved were taken into consideration through a consultation process within the context of the Programming Advisory Committee.

The objective of the Objective 2 Programme is the economic and social regeneration of the urban and rural areas. The programme will be implemented through two priorities that target the sustainable development of the rural areas and the regeneration of the urban areas in decline in the Nicosia and Ayios Dometios Municipalities that are adjacent to the ceasefire line.

The strategic objective of the Objective 3 Programme is the development and full utilisation of human capital under conditions of social cohesion and equal opportunities. It will be implemented through two priorities that aim at the development and promotion of active labour market policies and the promotion and improvement of the educational, training and life long learning systems.

The basic objective of the Fisheries Programme is the restructuring and upgrading of the fisheries sector. The Programme consists of three priorities that aim at the adjustment of the fisheries efforts, the renewal and modernisation of the fisheries fleet and the protection and development of water resources as well as aquaculture and equipment of fishing ports.

The Cohesion Fund will co-finance major infrastructure projects in the sectors of transport and environment. In the sector of transport the projects proposed are the upgrading of the Yermasoyia and Ayios Athanasios roundabouts and the upgrading of part of the Nicosia-Limassol highway, while in the environment sector, the creation of Sanitary Landfills in Larnaca and Famagusta Districts as well as the establishment of a Sanitary Landfill in the Limassol District are proposed.

The overall management system of the Structural Funds will be incorporated in the existing institutional framework of programming and implementation of development programmes. More specifically, the main body involved is the Planning Bureau, which has been nominated as the Single Managing Authority for the Structural Funds in Cyprus.

The Single Managing Authority is, according to the EU Regulations, the competent authority which has the final responsibility for securing the legality and effectiveness of the management of the programmes implemented within the context of the Structural Funds.

Other competent authorities to which responsibilities relevant to the management of Programmes co-financed by the Structural Funds were assigned will also have a significant contribution to the management of the Funds. In particular, the Ministry of Labour and Social Insurance has been defined as the Intermediate Body for the management of the Objective 3 Programme and the Ministry of Agriculture, Natural Resources and Environment as the Intermediate Body for the management of the Fisheries Programme, while the Ministry of Internal Affairs has been defined as the Intermediate Body for certain measures of the Objective 2 Programme. Other Ministries and Government Departments as well as semi-governmental organisations will be responsible for the implementation of specific projects or schemes. Finally, the Treasury of the Republic has been nominated as the Paying Authority which will be responsible of the payments for the co-financed projects.

The involved Services mentioned above have undergone the necessary organisational arrangements in order to be able to respond adequately to their increased responsibilities.

In early 2004, the Programme Complements will be approved by the Shadow Monitoring Committees. The Programme Complements, are documents which describe in detail the measures to be co-financed by the above-mentioned Programmes and subsequently the implementation of the measures will begin. The participants of the Shadow Monitoring Committees¹⁴ are bodies of the public and the wider public sector, the local authorities, the economic and social partners as well as representative non-governmental organisations. Moreover, representatives of the Commission participate as observers, with no voting rights, while in some Shadow Monitoring Committees there are representatives of the European Investment Bank.

Pre-accession Financial Regulation

Within the framework of the *“Council Regulation (EC) No 555/2000 of 13 March 2000 on the implementation of operations in the framework of the pre-accession strategy for the Republic of Cyprus and the Republic of Malta”*, Cyprus absorbed EUR 11,8 mln in 2003. Out of this amount EUR 7,9 mln were utilised for supporting the harmonisation effort and EUR 3,9 mln for projects/schemes contributing to the reconciliation of the two Cypriot Communities.

The commitment of funds for the utilisation of the pre-accession aid takes place on an annual basis.

Due to Cyprus’s accession to the EU in 2004, the pre-accession financial aid of EUR 13,2 mln that corresponded to that year will not be granted, as is also the case in all other acceding countries. The provision of a

¹⁴ The Temporary Monitoring Committees will become Permanent Monitoring Committees following Cyprus’ accession to the EU, according to the provision of the relevant EU Regulation.

EUR 18,6 mln under the “Transition Facility” after accession (2004-2006) for developing the administrative structures for the implementation of the acquis communautaire can be considered as a countermeasure. In addition, Cyprus was allowed to participate in Community Programmes, without paying a national contribution, as from 1.1.2004 instead as from the date of accession.

The Financing Memorandum entitled “**National Pre-accession Programme 2003 for Cyprus**” signed on June 12th 2003, encompasses the following projects/schemes:

(a) Harmonisation projects

- SME’s Facility (EUR 1.500.000).
- Air Pollution Monitoring System (EUR 1.380.000)
- Upgrading of the Solid Waste Management System (Landfills) (1.300.000)
- Participation of Cyprus in the Phare Multi-beneficiary Programme 2001 and 2002 on Statistical Co-operation (EUR250.000)
- Administrative Co-operation Programme (EUR 1.050.000)
- Participation in activities organised by TAIEX (EUR 500.000)
- Cyprus participation in EU Programmes and Agencies (EUR 1.920.000).

(b) Bi-communal projects

- Rehabilitation of Nicosia – Phase 4 and Conservation of Historical Buildings in Pyla (EUR 2.000.000).
- Business Support Project Phase 2(EUR 1.300.000).
- Strengthening links between G/C and T/C trade unions (EUR 300.000).
- Communication Strategy for Cyprus (EUR 300.000).

The implementation of most projects financed by pre-accession funds is under way, while for some others it has been completed.

As regards implementation procedures, most of the above projects will be implemented according to the Decentralised Implementation System (DIS) of the European Commission, which imposes the ex-ante control by the European Commission. In addition, it is envisaged, that, wherever possible with regard to time schedules, certain projects might be implemented according to the Extended Decentralised Implementation System (EDIS), which provides the possibility for the Government of Cyprus to manage financial aid with a limited number of ex-post controls by the European Commission. This would facilitate, to a large extent, the implementation of projects. The Republic of Cyprus submitted on 5 April 2002 a request to the Commission for the granting of this possibility and it is anticipated that the final approval for the implementation of this system will be granted within 2004.

The bi-communal projects/schemes are an exception to the above implementation procedures. Most of these will be implemented through the United Nations Office for Project Services (UNOPS), on the basis of an agreement signed in 1999 between the European Commission and the United Nations High Commission for Refugees (UNHCR).

(3) Transition Facility

The EU, aiming at assisting new member states to enhance their administrative structures for the effective implementation of the *acquis communautaire* during the first years after accession i.e. 2004-2006, decided, to grant financial aid through a new financial means, the "Transition Facility". The total assistance granted comprises vertical aid to be given separately to each new member state and horizontal programmes that concern all new member states.

The vertical aid to be given to Cyprus during this three-year period amounts to 18,6 mln Euro. The projects financed will cover mainly technical assistance and programmes of "Twinning" of various Services of the Public Sector in Cyprus with corresponding Services in EU member states.

In addition, within the context of the Transition Facility, Cyprus will benefit from the horizontal programmes that cover informative/educational activities organised by TAIEX, statistical cooperation, issues concerning the Public Sector and audit and evaluation.

Participation in Programmes and Initiatives of the European Union

Cyprus's active participation in EU Programmes continued during 2003, while it is expected that in 2004 the number of EU Programmes and Initiatives in which Cyprus participates will increase considerably. The full participation of Cyprus in EU Programmes and Initiatives as an equal member state as from January 1st 2004, according to the Accession Treaty, is expected to contribute substantially towards this direction. It is noted that as from January 1st 2004, Cyprus will be allowed to participate in all the Programmes and Initiatives of the EU without any financial contribution.

The EU Programmes from which Cyprus can benefit during the pre-accession period can be classified in two categories: The first category involves programmes specifically offered to third countries (non-EU Members) without any financial contribution to the Community budget. The second category concerns programmes, in which accession countries are allowed to participate, provided they have signed relevant bilateral agreements or Memoranda of Understanding with the EU and have paid their corresponding annual financial contribution to the budget of these programmes.

A. Programmes addressed to Third Countries – Non Members (without financial contribution)

(a) “MEDA” Programme (Euro-Mediterranean Partnership) (2000-2006)

The MEDA financial instrument was set up for the promotion of the Euro-Mediterranean Partnership. Cyprus is entitled to financing only within the context of the “Horizontal/Regional Co-operation”, that is only a small part of the MEDA Programme (10% of total budget) covering projects/programmes in

areas such as the environment, energy, research/ information technology, the audiovisual sector, small and medium-sized enterprises etc.

Despite the limited funds allocated for “Regional Co-operation”, Cyprus is offered opportunities for the development of initiatives for co-operation in the region of the Eastern Mediterranean. It is noted that the financing regime for Cyprus will change as from 1.5.2004 and Cyprus will enjoy a “vertical” financing. In the previous phase of the MEDA Programme (1995-1999), as well as in the new phase of the MEDA Programme (2000-2006) Cyprus has participated actively in a number of meetings and initiatives for the shaping of regional dialogue and specific co-operation programmes.

Within the scope of “Regional Co-operation”, special decentralised actions/sub-programmes in various sectors are in operation, such as EMPRIATI (maritime transport), SMAP 2000 (urban waste management), Euromed-Heritage II (cultural heritage), Med-Media (mass media), Euromed-Audiovisual (cinema, mass media), MEDRC (Middle-East Desalination Research Centre), NATP (telecommunications), MEDSTAT I (statistics), as well as other initiatives of regional co-operation. In the context of these actions, Cypriot educational institutions, chambers, municipalities and other organisations have participated actively in joint projects.

(b) “COST” Programme (European Co-operation in Research and Technology Matters)

The European research programme “COST” was set up in 1971 based on the Treaty of Rome. Its objective is to promote and strengthen scientific and technological cooperation in Europe. The programme has developed into one of the biggest frameworks for research cooperation in Europe. In the “COST” programme 43 countries participate, including Cyprus.

Following Cyprus upgrading from an Observer to a Full Member of the Programme (May 1999), the Research Promotion Foundation (RPF) has undertaken the task to co-ordinate the activities of the Cypriot representatives in the various committees of the Programme as well as to promote the programme with the objective to achieve the maximum possible participation of Cypriot researchers and Cypriot research foundations/organisations in this Programme.

The RPF continued to brief the research community in Cyprus about the “COST” programme and its intense activation towards this direction resulted in the increase in the number of Cypriot participants in the actions of the programme. For the year 2003, Cyprus took part or expressed interest to participate in 66 actions of the “COST” Programme, compared to 52 in 2002. These actions fall under 17 thematic fields of the Programme. The research community of Cyprus shows special interest for the thematic fields of Environment, Agriculture and Biotechnology, Information Technology and Social Sciences.

(c) “LIFE” Programme for the Environment (2000-2004)

The “LIFE” Programme was renewed for the period 2000-2004 as “LIFE III”. “LIFE” is the financial instrument covering projects/actions in the sector of the environment. In 2003, within the framework of LIFE the following projects have been approved:

- “Noise Policy” (Planning and application of noise policy) of the Environment Service;
- “Capacity Building for enabling the incorporation of urban sustainability parameters in Spatial Urban development and planning policy and practices through the use of indicators in Cyprus” of the Department of Town Planning and Housing;
- “Development of best management systems for high priority waste streams in Cyprus”, of the Environment Service”;

- “Guidelines to the Cyprus Competent Authorities for Policy Formulation for Sustainable Management of pig-farming wastes in Compliance with EU practice” of the Institute of Agricultural Research.

B. Programmes in which Cyprus, as a candidate country, participates after the conclusion of a bilateral agreement and the payment of a financial contribution

(a) Programme for vocational training “Leonardo da Vinci” (2000-2006), Programme in the Field of Education “Socrates” (2000-2006) and Programme for “Youth” (2000-2006)

Cyprus, as of November 1997, participated in the first phase of the Programmes “Leonardo da Vinci”, “Socrates” and “Youth”. Since 2000, the said Programmes have entered a new phase, which covers the period 2000-2006. During the new period 2000-2006, Cyprus continues to participate fully, paying an average annual contribution up to 2003 of EUR 483.000 for the “Leonardo da Vinci” Programme, EUR 622.000 for “Socrates” and EUR 526.000 for the “Youth” Programme.

The competent national bodies for these Programmes are the following: The Cyprus Productivity Centre for “Leonardo da Vinci”, the Ministry of Education and Culture for “Socrates” and the Youth Board for “Youth”. A National Co-ordinating Committee, presided by the Planning Bureau, oversees the smooth operation of the Programmes.

Eligible organisations/persons have shown great interest in participating in these Programmes. In particular, in the framework of “Leonardo da Vinci” several multi-country projects were financed with a Cypriot organisation as co-ordinator, while partners from Cyprus have participated in a large number of projects submitted by organisations from EU Member States. Within the framework of “Socrates”, parallel projects of transnational cooperation have been financed with a coordinating institution of tertiary education from Cyprus and other institutions as partners. Students and professors from tertiary

education institutions participate in mobility and co-operation activities. Also, other institutions of primary and secondary education take part in co-operation activities with corresponding institutions from EU countries and a large number of teachers are sponsored in order to participate in educational seminars. Furthermore, officials responsible for decision making on issues of educational policy take part in study visits for the analysis of educational systems in order to improve the quality of education. In addition, individuals and foundations engaged in adult education and in the promotion of “lifelong learning” take part in educational co-operation activities and personnel training seminars. Finally, a large number of young people from Cyprus benefit from the “Youth Programme” through youth exchange programmes, voluntary service, youth initiatives, seminars, conferences and training programmes.

(b) Sixth Framework Programme of the EU for Research and Technological Development (1998-2002)

The Sixth Framework Programme of the EU for Research and Technological Development (6FP) which covers the period 2002-2006, provides the means of the European Commission to finance research activities at a European level. Through these activities that concern mainly applied research, the effective confrontation of problems of economic and social nature that concern Europe are pursued. The total budget of the Programme is expected to reach Euro 17,5 bln.

Cyprus participates as a full member in this programme, after signing the relevant Memorandum of Understanding (MoU) as from 29 October 2002. Overall, Cyprus contributed the amount of Euro 3 mln in order to secure equal participation of the Cyprus research community in the programme.

On the basis of the Memorandum of Understanding, research bodies and researchers from Cyprus have the possibility to take part in all the sub-programmes of the 6FP and as a result they can secure immediate financing from the Programme’s budget and can therefore utilise the Government’s financial contribution to the Programme.

The Research Promotion Foundation which has undertaken the task to coordinate actions for the participation of Cyprus in the 6FP, continues and expands its awareness activities as well as its actions to support the Cypriot research bodies (research and academic centres, private bodies and firms and services of the public and wider public sector) for their participation in the Programme. Specifically, two special actions have been included in the RPF Framework Programme for Research and Technological Development in the period 2003-2005. The Action "Participation in the 6FP" which allows Cypriot bodies to be reimbursed with a lump-sum amount of up to 5.000 CP from the RPF on the condition that they provide proof that they have undertaken some expenditures for the preparation of proposals, as well as the Action "Participation in a Conference" which concerns the reinforcement of bodies from the private sector that participate in significant conferences organised within the context of the Programme. At the same time, for the full utilisation of the Programme and aiming at facilitating the participation of Cypriot bodies in the 6FP, bodies have been nominated, by a decision of the Minister of Finance (of the wider public sector but also private sector), as National Contact Points.

The participation of Cypriot bodies in proposals submitted within the context of the first calls of proposals of the 6FP in 2003 is considered satisfactory since bodies from Cyprus participated in almost 200 proposals, out of which 40 were approved for financing.

(c) Multi-Annual Community Programme in the field of Enterprise and Entrepreneurship (2001-2006)

Cyprus took part in the previous phase of the programme (Third Multi-Annual Programme for small and medium sized enterprises). The new phase of this Programme (Multi-Annual Programme for enterprises and Entrepreneurship) covers the period 2001-2006. The relevant Memorandum of Understanding came into force on 24 October 2002. The total financial

contribution of Cyprus amounts to EUR 230.000. The Ministry of Commerce, Industry and Tourism is responsible for the management of the Programme.

Cyprus participates in all the sub-programmes and entrepreneurs take part in various EU committees for studying the problems that Small and Medium sized Enterprises face. Furthermore, in the framework of this new Multi-Annual Programme, it was decided that the European Information Centre in Cyprus, which operated as a Response Office for the European Information Centre Network, be upgraded as a full European Information Centre, thus gaining an equivalent status to the rest of the 280 Information Centres that operate in the EU Member States. The European Information Centre is stationed at the Cyprus Chamber of Commerce and Industry, providing information to private businesses, persons and government departments on projects, programmes, developments in the EU, national legislation of Member States and to foreign businesses interested to co-operate with local businesses.

(d) “Fiscalis” (2003-2007) and “Customs ” (2003-2007) Programmes

Cyprus participates in the above Programmes which constitute the new phase of the “Fiscalis” (1998-2002) and “Customs” (1996-2002) Programmes. These Programmes aim at the education/training of public officers in indirect taxation and customs issues. Cyprus’ financial contribution for “Customs 2007”, according to the relevant Memorandum of Understanding, amounts to EUR 31.000 and covers the period from 1.1.2003 till 31.3.2004. Cyprus’ participation in “Fiscalis” was carried out on a selective basis and was financed by the Government Budget or pre-accession funds. Cyprus participates in these programmes with officers from the Customs Department, the VAT Service and the Ministry of Finance, who take part in seminars, workshops, working groups and exchange programmes organised within the context of these Programmes. The Programmes aim at ensuring the more effective application of Community legislation as well as determining the gaps and/or difficulties in applying the relevant Community legislation. In addition, these Programmes aim at the establishment of an international customs code

for the better management and control of external borders, the improvement of communications between social partners and the effective operation of indirect taxation systems applied in the internal market. Furthermore, Cyprus participates in the Committees responsible for the management of these Programmes.

(e) Social Policy Programmes: Community Action Programme to Combat Discrimination (2001-2006), Programme relating to the Community Framework Strategy on Gender Equality (2001-2005) and Community Action Programme to Combat Social Exclusion (2002-2006)

The Social Policy Programmes deal with combating discrimination based on gender, nationality, religion, age, combating poverty and social exclusion, gender equality issues and supporting women for the protection of their rights. Cyprus participates in these programmes since the end of 2002. The financial contribution of Cyprus is EUR 90.000 for the Strategy Programme on Gender Equality, EUR 60.000 for the Community Action Programme to Combat Discrimination and EUR 90.000 for the Community Action Programme to Combat Social Exclusion.

More specifically, within the context of the Programme relating to the Community Framework Strategy on Gender Equality (2001-2005) Cyprus organised a seminar in May 2003 on “European Policies and Strategies in the field of Gender Equality and the National Mechanisms necessary for their Application”. Experts from the EU, government officials as well as women organisations, unions and other non-government organisations took part.

In the context of the Community Action Programme to Combat Social Exclusion (2002-2006), Cyprus participates in the Committee meetings of the Programme. The creation of a network of experts (e.g. from academic and research institutions, governmental and non governmental bodies) and the systematic cooperation for the encouragement of Cyprus participation in the

Programme constitutes a vital part of the procedure for the participation in the Programme.

The Programme constitutes part of the Open method of coordination followed in the social inclusion policies. The basic material of the Programme is derived from the National Action Plans for Social Inclusion. Cyprus, as all new members of the EU, will submit in July 2004 the National Action Plan for Social Inclusion 2004-2006.

In December 2003, the Minister of Labour and Social Insurance of Cyprus and the Commissioner of the EU responsible for Employment and Social Affairs co-signed the Joint Memorandum on Social Inclusion (as all new member states), which forms a political document with Cyprus' commitments in social inclusion issues. The National Action Plan 2004-2006 will constitute the implementation of the Joint Memorandum.

Finally, in the context of the Community Action Programme to Combat Discrimination (2001-2006), Cyprus takes part, as an observer, in the meetings of the ad-hoc Working Group for Legal Issues for the implementation/transposition of EU Directives on discrimination and the Monitoring Committee of the Implementation of the Programme. An information day was held in June 2003 on "EU policy and Community Legislation against Discrimination" in which experts from EU Member States analysed the acquis in this field. Government officials as well as people from the public and judiciary service, the private sector and various other independent bodies participated in this event. The Ministry of Justice and Public Order circulated, during the information day, informational publications as well as EU publications, which include detailed reports with regard to the acquis, EU policy and Cyprus' stance against discrimination (legislation, practices/policies and bodies supporting human rights).

(f) Audiovisual Sector Programmes, “Media Plus” and “Media Training” (2001-2005)

Cyprus took part in the previous phase of the Programme (MEDIA II), in the context of which, grants were given for various actions such as the distribution and projection of European movies, the training of filmmakers and the drafting of a script concept. Following the completion of Media II, Cyprus joined in December 2001, the new phase of the programme (Media Plus). The start of the new community programme Media Plus was announced in Nicosia, on May 8th 2003 by the Permanent Secretary of the Directorate General of Culture of the EU. In the time that elapsed, Cyprus proceeded to the establishment of a Media Office in Cyprus, as well as to the appointment of the coordinator of the Programme. Cypriot professionals of the audiovisual sector continue to take part in the various programmes that constitute part of the Media Plus.

(g) “Culture 2000” (2000-2004) Programme

The “Culture 2000” Programme contributes to the development of a common European cultural area, favouring co-operation between creators, cultural agencies and cultural foundations of the Member States.

Cyprus participates in the “Culture 2000” Programme since 2002. Within the context of promoting our participation, the Cultural Services of the Ministry of Education and Culture informed the public on the basic guidelines of the Calls for Proposals for 2004.

On September 20th 2003 an Information Day for the public was organised on issues relating to the basic aspects of the Programme.

As from May 2003 the Cultural Contact Point-CCP operated officially in the grounds of the Ministry of Education and Culture, with full time personnel. A similar office operates in all participant countries aiming at promoting the Programme and serving the public.

Cultural Heritage has been set as a priority for the year 2004 by the European Commission. Several Cypriot cultural bodies have expressed interest in 2003 for the programme and have submitted applications, either as coordinators or as co-organisers of projects. The Ministry of Education and Culture again provided guarantees to those bodies that applied for financial support, in the event their projects are selected by the European Commission.

During 2003, three new annual Projects received Community Funding in which Cypriot bodies participated as co-organisers

(h) “Action Programme in the field of Public Health” (2002-2006)

The Action Programme in the field of Public Health aims at delineating a European Policy in the Health Sector and at securing a high level of health services to all EU citizens, combating inequalities in the health sector and encouraging cooperation among EU member states. It is based on three pillars: a) Health Information aiming at collecting, analysing and disseminating information on health issues, b) Rapid reaction to health threats aiming at preventing the spreading of infectious diseases through the development of networks for rapid awareness and response at a community level and c) Health Promotion through addressing Health Determinants aiming at developing networks for the collection of information and evaluating health indicators.

The Programme has a duration of 6 years, as from January 1st 2003 up to December 31st 2008 with a budget of Euro 312 mln.

In 2003, 426 proposals were submitted out of which 8 projects were approved without any changes, while another 50 projects were approved under certain conditions and 66 will be financed if financial resources are found.

Cyprus participates in the following 3 of the 8 projects which have already been approved:

1. "Alcohol Policy Network in the Context of a Larger Europe: Bridging the gap
2. "Application for funding HI/2003 and GHP EUROPEAN centre AIDS & Mobility.
3. EU Evidence-based consensus conference on Prevention of Cardiovascular Disease.

At the same time, Cyprus participates in 16 of the projects approved under conditions and 24 of the projects that will be funded if resources are found.

**(i) "Community Incentive Measures in the Field of Employment"
(2002-2006)**

The Programme "Community Incentive Measures in the Field of Employment" operates for the period 2002-2006 with a total cost of Euro 55 mln. Cyprus participates in the Programme as from mid 2003, following the signing of a relevant Memorandum of Understanding and with a financial contribution of Euro 30.000. The main objective of the Programme is the promotion of analysis, research and cooperation among member states, through the exchange of experiences and knowledge in employment and labour market issues, to support the European Employment Strategy.

Cyprus participated in 2003 in four actions of the Programme: (a) Analysis and Research (b) Exchange of Experiences and Know-how (which includes participation in the European Employment Observatory, the two expert networks that support it, the MISEP and SYSDEM and the peer reviews, (c) Public Employment Services and (d) Encouragement of Local Development.

Cyprus participation in the said Programme facilitated its preparation for implementation of the European Employment Strategy, while it is expected to be expanded progressively to additional activities/ action fields of the Programme.

**CYPRUS AND THE CONVERGENCE CRITERIA SET BY THE
MAASTRICHT TREATY FOR TRANSITION TO THE THIRD STAGE OF
ECONOMIC AND MONETARY UNION (EMU)**

	Average of the three member states with the best performances in 2003	Cyprus 2003 (%)
Inflation	It should not exceed, by more than 1,5%-points, the average of the three member states with the lowest inflation rate ¹⁵ (reference value) (%)	1,2 ¹⁶ (2,7) ¹⁶ 4,0 ¹⁶
Long-term interest rates	The long-term interest rates should fluctuate freely and should not exceed by more than 2%-points the average of the three member states with the best performance in price stability (reference value) (%)	4,1 (6,1) 4,7 ¹⁷
Fiscal Deficit	≤3% of GDP	6,3
Public Debt	≤60% of GDP	72,6 ¹⁸
Exchange Rate Stability	Participation in the ERM and no devaluation for two years	It does not apply to Cyprus

¹⁵ The three EU member states with the best performance in the field of price stability in 2003 were Austria, Germany and Finland.

¹⁶ Refers to the Harmonised Inflation Rate.

¹⁷ As from 1.1.2001 interest rates in Cyprus fluctuate freely.

¹⁸ Including short-term debt and excluding intergovernmental debt.

Progress in the Implementation of the Strategic Development Plan, 1999-2003

The main objectives of the Strategic Development Plan covering the period 1999-2003 were the completion of the harmonisation process and the creation of the necessary structures for the effective implementation of the acquis communautaire as well as the preparation of the economy in view of the accession of Cyprus to the EU, the parallel attainment of the three-fold goal of growth, macroeconomic stability and social cohesion, the restructuring of all sectors of the economy, the modernisation of business units, the utilisation of Cyprus' comparative advantages, the enhancement of its competitiveness and its adaptation to emerging conditions within the context of globalisation, the upgrading of the role of Cyprus as a regional and international services centre of excellence, the adaptation to the information society and the reform of the public sector. Furthermore, emphasis is placed on factors that improve the quality of life such as the environment, cultural development and the upgrading of the population's standard of health.

At the macroeconomic level, the Plan's main objectives were the attainment of a satisfactory rate of economic growth, taking into account the exogenous and endogenous restrictive factors, the maintenance of conditions of full employment and the parallel consolidation of conditions of internal and external macroeconomic stability.

The Plan's quantitative targets were set, taking into consideration the economy's growth potential, in view of the structural changes required in order to succeed in the large European internal market.

Progress in the implementation of the Strategic Development Plan for the period 1999-2003 was, in general terms, satisfactory, despite the deviations observed in partial objectives set by the Plan.

More analytically, the average annual growth rate of GDP reached 3,5% in real terms, as against 4% which was the target of the Plan. The main restricting factor was the unfavourable external environment that Cyprus had to face in 2002 and 2003, which adversely affected the external demand for both tourist services and goods, and as a result the rate of economic growth was contained to 2% in the specific years, significantly lacking behind the potential rate of growth of the economy. In contrast, the favourable climate that prevailed amongst consumers and investors during the first three years of the implementation of the Plan, until the events of the 11th of September 2001, as well as the favourable external environment during the same period, in particular, the satisfactory economic growth in Great Britain and more generally in the EU, prevented a greater divergence from the Plan's target.

From the demand side, growth was based, mainly, on domestic demand and particularly private consumption and to a lesser extent on external demand, deviating in this way from the provisions of the Plan for a more substantial contribution of external demand to growth. This deviation is mainly attributed to the reduction of tourist demand in 2002 and 2003, due to the deterioration of the external environment of Cyprus, after the events of the 11th of September in the USA and the climate of uncertainty that prevailed internationally until the middle of 2003. Regarding the investment demand, a positive development constituted the relatively satisfactory expansion of fixed investment, satisfying the target of the Plan, in general. The expansion of investment in machinery and equipment, however, lacked behind the relevant target of the Plan, due to the decrease in investment in machinery and equipment in 2002, which is explained by the intense climate of uncertainty that prevailed the specific year, preventing a more positive picture.

From the sectoral point of view, the tertiary sector of services and, in particular, telecommunications, real estate and business services, financial services, trade and to, a lesser extent, other sectors of services, were the driving force of economic growth. This development complies with the Plan's provisions for the upgrading of the role of Cyprus as a regional and international services centre and reflects the utilisation of Cyprus' comparative

advantages in these sectors. Despite this, the continued partial dependence on tourism, a sector, which confirmed its vulnerable character to external and unanticipated factors during the period covered by the Plan, particularly in 2002 and 2003, implies the imperative need for a further diversification of the structure of the economy in favour of other services, beyond tourism. The manufacturing sector exhibited a small decrease during the period of the Plan, with a recovery during the period 1999-2000, which was, however, reversed in the subsequent years, a development which indicates that the Plan's objectives for restructuring and modernising the sector need more time to be achieved. The agricultural sector exhibited an increase of its production during the five-year period 1999-2003, positively affected by the favourable weather conditions that prevailed during the past three years; at the same time however, the sector also exhibited significant fluctuations, which are attributed to the fluctuations of crop production affected by the change in the prevailing weather conditions.

The satisfactory growth of the economy, under the circumstances, during the five-year period, led to a corresponding increase in the demand for labour. The gainfully employed population rose, on average, by 1,6% during 1999-2003, as compared to the Plan's objective of 1,2%. Consequently, the conditions of almost full employment continued to prevail, with the registered unemployment rate fluctuating at around 3,3% on average during the period 1999-2003, while at the same time employment of foreign workers continued to increase. The rate of improvement of productivity reached 1,9% on average during 1999-2003, which is lower than the objective set in the Plan, due to the containment of the rate of improvement of productivity in particular, in 2002 and 2003, a development mainly attributed to the deceleration of the rate of economic growth.

Nominal earnings rose on average by 5,4% during the period 1999-2003, as compared to the set objective of 4%. This development is due, partly, to the significant increase in the inflation rate in 2000, as a result of external and transitory factors, which had a corresponding impact on earnings increases granted automatically through the COLA mechanism. The unit labour cost

increased on average by 3,5%. The corresponding increases in nominal earnings and unit labour cost in euro fluctuated at 5,3% and 3,4%, respectively. The labour cost in the EU increased, however, by a lower rate, with earnings increasing by 3,1% annually and the unit labour cost by 2,2% on average. As a result, despite the moderation exhibited by the social partners during the recent collective negotiations, the competitiveness of the Cyprus economy with regard to labour cost further deteriorated.

The inflation rate amounted to 2,9%, on average, in 1999-2003, deviating from the Plan's objective, 2%. This deviation is attributed to external and transitory factors and particularly to the increases of indirect taxation in 2000, 2002 and 2003, in the context of harmonisation with the minimum levels required by the acquis. In relation to this, core inflation, which excludes the external and temporary factors, fluctuated at 2%, in compliance with the target of the Plan.

A deviation from the Plan's set objectives was also observed with regard to the current account deficit of the Balance of Payments. In 1999, the current account deficit exhibited a significant improvement and it was contained to 1,1% of GDP from 5,6% in 1998. Despite the satisfactory performance of tourism and other exporting services, the current account deficit widened to 3,4% of GDP in 2000, mainly as a result of the sharp increase of the oil price in international markets, in conjunction with the significant appreciation of the dollar. In 2001 a partial improvement of the deficit to 2,8% of GDP was observed, mainly due to the containment of the import demand, reflecting mainly the partial deceleration of the economy. In 2002, however, a deterioration of the conditions of external stability was observed and the current account deficit expanded to 5,4% of GDP, a development primarily attributed to the significant decrease of tourist flow to Cyprus. In 2003, the current account deficit exhibited a partial improvement and was contained to 4,4% of GDP, despite the decline in the receipts from tourism, due to the fall in imports of goods. The total external debt as a percentage to GDP rose to 35,9% in 2003 from 26,3% in 1998, a development attributed to the substantial recourse of borrowing in foreign currency during 2001, due to the

lower interest rates for loans in foreign currency compared to the interest rates in Cyprus pound. However, the debt service ratio remained at low levels compared to international standards, 6,8% in 2003. Official foreign exchange reserves followed an upward trend and covered 5,3 months of imports of goods and services in 2003. This performance compares very favourably by international standards and is attributed to the increase in external or foreign currency accounts of non-residents of Cyprus.

As regards public finances, the Government recognising the importance of fiscal consolidation and the containment of fiscal deficit for the course of the Cyprus economy prepared and applied as from mid 1999 a Fiscal Consolidation Programme, which included measures both for the containment of the rate of increase of public expenditure and the increase in public revenue. As a result of the implementation of the Programme, the fiscal deficit decreased from 4,9% in 1998 to 2,8% of GDP in 2001. The deceleration, however, of the rate of economic growth in 2002 and 2003 and the increased transfer payments to households granted in the context of the broader tax reform led to a deterioration of the fiscal stance during the past two years of the implementation of the Plan. The fiscal deficit in 2003 reached 6,3% of GDP, diverging from the target of the Plan, 2%. Public debt, excluding the intergovernmental¹⁹ debt, reached 72,6% of GDP in 2003. It is noted that the divergence observed with regard to the fiscal targets explains partially the deterioration of the current account balance of the Balance of Payments.

In contrast, the monetary and credit objectives set were realised to a great extent and contributed to the maintenance, in general, of price stability conditions.

In general, the Plan's objectives were attained in terms of the labour market and partially the level of investment. The major deviations from the set objectives concerned the rate of economic growth, external and internal stability, but were almost exclusively due to external and transitory factors; moreover, there was a deviation with regard to public finances.

¹⁹ The Government's debt toward the Social Security Funds.

**MAIN QUANTITATIVE TARGETS OF THE
STRATEGIC DEVELOPMENT PLAN 1999-2003 (%)**

	Average Annual Rate of Change	
	(%)	
	1999-2003 (Target)	1999-2003 (Estimate)
1. Rate of Economic Growth	4,0	3,5
- Agriculture	1,5	2,6
- Manufacturing	2,0	-0,8
- Restaurants & Hotels	6,0	2,1
- Other Private Services ²⁰	5,1	4,9
2. Domestic Savings/GDP	18,9 (2003)	12,5 (2003)
3. Fixed Investment/GDP	16,4 (2003)	17,4 (2003)
4. Rate of Change of Unit Labour Cost	1,2	3,5
5. Inflation Rate	2,0	2,9
6. Current Account Balance/GDP	-2,0 (2003)	-4,4 (2003)
7. Fiscal Deficit/GDP	-2,0 (2003)	-6,3 (2003)
8. Public Debt/GDP		
(Excluding Intergovernmental Debt)	59,7(2003)	72,6 (2002)
9. Rate of Increase of Total Liquidity	10,0	10,7

²⁰ Tertiary sector excluding the sectors of hotels and restaurants, public administration, public education and public health.

Prospects for 2004

Analysis of Macroeconomic Magnitudes

-Demand-Domestic Production

Short-term developments in a small and open economy such as that of Cyprus depend, to a great extent, on conditions prevailing in external markets, the competitiveness of the Cyprus goods and services both in the domestic market and in external markets as well as the ability of the Cyprus economy to adapt to the conditions of intensified competition that arise from its accession to the EU. The prospects for the external environment for 2004 are significantly more favourable as compared to 2003. In Britain, the major market of Cyprus' goods and services, the rate of economic growth is expected to accelerate to 3%, in real terms, as compared to 2,2% in 2003, while the situation is also positive in the rest of the member countries of the EU, where an acceleration of the rate of economic growth and the rate of increase in the volume of imports of goods and services is expected. The main export markets of Cyprus in Arab Countries, such as Lebanon, Jordan, Egypt, United Emirates and Syria are also expected to exhibit an acceleration in the rate of economic growth, whereas the rate of economic growth of the countries of Central and Eastern Europe and Russia, which constitute economic partners of increasing importance for Cyprus, will stay at satisfactory levels. The 2004 Olympic Games in Athens also constitute a positive factor expected to affect tourist flow to Cyprus.

An additional contributory factor to the prospects of the Cyprus economy in 2004 is the improvement of the climate of confidence among investors and consumers, despite the moderation that prevailed during the first months of 2004, as shown by the Business and Consumer Surveys conducted by a Cypriot private company on behalf of the European Commission.

A restrictive factor to the expansion of investment and consumption demand is expected to constitute the rise in interest rates following the

decision of the Monetary Policy Committee to increase the Lombard rate by one percentage point at the end of April 2004.

The projections for 2004 are based on the assumption of maintenance of the exchange rates of the currencies of the economic partners and competitors of Cyprus at the average level of March 2004. As regards the oil price, the projections of the European Committee of April 2004 have been adopted, which envisage an increase of the oil price from \$28,5 per barrel (Brent) in 2003 to \$31,1 in 2004. A possible maintenance of the price of oil at the higher levels that fluctuated in mid May 2004 will affect the rate of economic growth and the current account of Cyprus as well as the inflation rate.

Based on the above and assuming that receipts from tourism will be maintained at the levels of the previous year, which is the combined result of an increase in tourist arrivals by 5% and a similar decrease of the per capita expenditure of tourists, due to the lower prices offered by the tourist accommodation owners to tour operators²¹, the rate of economic growth is estimated to fluctuate at around 3,5%, in real terms, in 2004, as compared to an increase of 2% in 2003, with both external and domestic demand and more particularly private consumption and investment being the main sources of growth.

Analytically, domestic demand is expected to expand at a rate of around 2,5%, in real terms, in 2004, as compared to around 0,5% in 2003. The rate of increase of private consumption is expected to accelerate to around 3,3% in real terms in 2004, as against an increase of around 2% in 2003. The expansion of private consumption is attributed mainly to the expected increase of the real household disposable income, as a result of the further

²¹ As regards the new status at the dividing line, which allows the movement of tourists from the Government Controlled Areas to the Occupied Areas, it is not expected to have significant consequences, as it is expected that the majority of the tourist movement will be in the form of daily trips by buses, which are legally registered in the Government Controlled Areas and they will be accompanied by guides registered to the CTO. Given the above assumption, a substantial part of the lost consumption expenditure of tourists will be compensated by the expenditure to the agencies of the daily excursions for the transfer and guide of tourists.

increase of the tax free income and the further realignment of the income tax brackets, within the framework of the implementation of the last phase of the broader tax reform, as well as the greater increase of real earnings which will be the result of a lower inflation rate, and the expansion of employment. A restrictive factor to the expansion of private consumption constitutes the increase in interest rates, which implies a higher increase in the cost of financing the purchase of durable consumption goods.

The rate of expansion of public consumption is expected to be negative in real terms, around -3% in 2004, as against an increase of around 2,7% in 2003, reflecting the decrease in imports of defence equipment and the contractionary fiscal policy that the Government will follow in 2004, in the context of the revised Fiscal Consolidation Programme, prepared by the Government and included in the Convergence Programme submitted to the European Commission in May 2004.

The expected containment of public consumption, despite the acceleration of private consumption, is estimated to lead in an increase of domestic savings as a percentage of GDP to around 13,5% in 2004 from around 12,5% in 2003.

The rate of expansion of gross fixed capital formation, including the purchases of aircrafts and ships, is expected to fluctuate at around 4,5%, in real terms, in 2004, as against a decrease of around 4,3% in 2003. Excluding the purchases of aircrafts and ships, gross fixed capital formation is expected to increase by around 4,5% in 2004, as compared to an increase of 5% in 2003, reflecting the small deceleration of the rate of expansion of investment in construction works, a satisfactory expansion of investment in machinery and equipment and a recovery of investment in transport. Analytically, a partial deceleration of the rate of expansion of investment in construction works is projected, due to the increase in interest rates and to the lower projected increase, as compared to the previous year, in investment expenditure of the Central Government, in the context of implementation of the Fiscal Consolidation Programme. Contributory factor to the expansion of

investment in construction works constitutes the significant increase of the volume of building permits, 14,8% in 2003 following an increase of 10,8% in 2002. Investment activity in machinery and equipment is expected to continue to expand by a satisfactory rate in 2004, due to the increased pressure for adjustment of business units to the conditions of intense competition, which will be further enhanced due to the accession of Cyprus to the EU as from 1st of May 2004. Investment in transport equipment, excluding the purchases of ships and aircrafts, is also expected to exhibit an increase following the decline observed in 2003.

Total external demand, with the assumption of maintenance of receipts from tourism, in nominal terms, at the levels of the previous year, is expected to increase by around 5,5% in real terms in 2004, as against a 0,5% increase in 2003, as a result of the projected continued satisfactory expansion of services other than tourism and the partial recovery of domestic exports. More analytically, exports of services beyond tourism are expected to continue to exhibit the dynamism observed in the past years, positively affected by the more favourable external environment as well as the accession of Cyprus in the internal market of the EU. An increase in the volume of domestic exports is also anticipated, as a result mainly of the small increase in the volume of agricultural exports, given the relatively favourable weather conditions that prevailed at the beginning of 2004, as well as the anticipated increase in the volume of domestic manufacturing exports, which will be positively affected by the acceleration of the rate of economic growth in our major markets of manufacturing products. As regards re-exports, it is assumed that their volume will remain at the levels of the previous year.

From the supply side, the main engines of growth are expected to emanate again from the tertiary sectors of services and particularly the sectors of telecommunications, trade, real estate services and business and social and personal services. The contribution of the sector of restaurants and hotels will be positive albeit small.

More analytically, a continuation of the satisfactory rate of growth of telecommunications, social and personal, business and real estate services is expected. The main factors for the projected satisfactory expansion of production of these sectors constitutes the high income elasticity of the domestic demand for the services of these sectors.

The rate of growth of the value added of the wholesale and retail trade sector is expected to fluctuate at around 3%, in real terms, in 2004, as against a decrease of 1,5% in 2003, a development reflecting the anticipated acceleration of the rate of expansion of private consumption and the partial recovery of the tourist flow.

The value added of the sector of hotels and restaurants is expected to exhibit an increase of around 2,5% in real terms in 2004, as against a decrease of 4% in 2003, due to the anticipated small increase of the tourist flow and the continued satisfactory expansion of domestic demand. The increase of tourist traffic is attributed to the anticipated strengthening of the rate of economic growth in our major tourist markets as well as the 2004 Olympic Games in Athens, which is expected to positively affect the flow of tourists to Cyprus as well.

The sector of manufacturing is expected to exhibit stagnation in 2004, as against a decrease of 2,5% in 2003, reflecting the difficulties of the sector in adapting to the conditions of intense competition. The projected recovery of domestic and external demand is expected to prevent a continuation of the negative course of the sector observed in the past three years.

The positive course of the construction sector observed since 2001 is expected to continue in 2004, to a lesser extent however, negatively affected by the increase in interest rates as from the end of April 2004 and the relatively lower increase of investment expenditure of the Central Government, in the context of the implementation of the Fiscal Consolidation Programme. More specifically, the value added of the sector of construction is expected to increase by 3%, in real terms in 2004, following an increase of 5%

in 2003, a development anticipated to result mainly from the increased interest of the private sector, as indicated by the significant increase in the volume of building permits granted during 2003.

Finally, the volume of production of the sector of agriculture is expected also to exhibit an increase by 1% in real terms in 2004, following an increase of 1,5% in 2003, reflecting the projected expansion of crop production, due to the satisfactory rainfall observed during the first months of 2004.

- Labour Market

The anticipated acceleration of economic activity in 2004 is expected to affect positively the labour market. The gainfully employed population is projected to increase by 1% in 2004 following an increase of around 0,9% in 2003, leading to the creation of approximately 3.100 additional posts. From a sectoral perspective, an increase in employment is expected particularly in the sectors of private services, reflecting the continued trend of restructuring the production base of the Cyprus economy towards the benefit of these sectors. In the public administration sector, a small increase in employment is anticipated, which, however will be lower than the respective increase in 2003. The increase in employment in the public administration sector in 2004 will result from the need to reinforce existing structures for the effective implementation of the *acquis communautaire*. Employment in the construction sector is also expected to increase, as a result of the anticipated satisfactory growth of the sector, notwithstanding its partial deceleration compared to 2003. In the sectors of manufacturing, employment is expected to register a small decline, due to the stagnation in the output of the sector anticipated for 2004.

The additional labour supply is expected to come from secondary and tertiary education graduate newcomers in the labour market, while no substantial change is assumed in the number of foreign workers employed in Cyprus. The rate of unemployment is projected to fluctuate at 3,4% of the economically active population in 2004, as compared to 3,5% in 2003.

Labour productivity is expected to increase by 2,4% in 2004, following a 1% increase in 2003 and nominal earnings by around 4,8% as in 2003. Real earnings are expected to increase at a rate of 2,7% in 2004, as against a smaller increase of 0,6% in 2003, reflecting the lower rate of inflation anticipated for 2004.

Unit labour costs, in nominal terms, are anticipated to increase at a rate of 2,3% in 2004, following a higher increase in 2003, 3,6%. The containment in the rate of increase of unit labour costs in 2004 is not expected to lead to an improvement of the competitiveness of the Cyprus economy, with regard to labour costs, given that the average rate of growth of unit labour costs in the EU is expected to fluctuate at lower levels, 1,3%.

-Rate of Inflation

The inflation rate in 2004 is expected to fluctuate at around 2%²² compared to 4,1% in 2003, since no additional increases on excise duties are envisaged in 2004 following the increases imposed on the VAT rate and on excise duties on cigarettes and petroleum products in 2002 and 2003. The imposition of a VAT rate on children clothing and footwear, on non-bottled water, gas, newspapers, magazines and books as from May 1st 2004, constitutes a small exception. The recent approval by the House of Representatives in November 2003 of a reduction in the excise duty of small and medium engine volume cars will have a positive effect on the containment of the inflation rate. In addition, Cyprus accession to the EU as from May 1st 2004 and consequently the free movement of goods and services, is anticipated to lead to an intensification of competition with a dampening impact on the inflation rate. Finally, the further reduction in the value of the US dollar and the sterling pound vis-à-vis the euro and consequently the Cyprus pound observed in the first months of 2004, given that there will be no change in the remaining months of the year, in conjunction with the projection for a small decline of the inflation rate in EU countries to 1,8% in 2004 from 2% in 2003, are estimated to lead to a containment in the prices of imported goods

²² As already mentioned, a maintenance of the price of oil at the high levels observed in mid-May 2004 will have an increasing impact on the inflation rate.

in general, acting therefore as a restraining factor to the further increase of the inflation rate.

-Balance of Payments

The country's external transactions are not expected to exhibit a substantial differentiation vis-à-vis the previous year. The anticipated partial recovery of exports of Cypriot goods and services, as a result of the acceleration of the rate of economic growth of our main export markets, is estimated to be accompanied by a parallel expansion of imports of goods and services.

Analytically, exports of goods, in nominal terms, are expected to expand at a rate of around 2,5% as against a decline of 7,3% in 2003, reflecting the partial recovery of both domestic exports and re-exports. Domestic exports are projected to expand at a rate of the order of 2% in 2004 compared to a decline of 7,2% in 2003, mainly as a result of the anticipated small recovery of the manufactured domestic exports following their decline in 2003, in conjunction with a higher increase of domestic agricultural exports. Overall, domestic exports are expected to benefit, to a certain extent, from the higher rate of economic growth and the volume of imports of our most important export markets. Re-exports are expected to expand by 2% in 2004, in nominal terms, following a 9,1% decline registered in 2003, benefiting from the favourable external environment of Cyprus.

Imports of goods (cif) are projected to increase at a rate of the order of 4,4% in 2004 as against a decline of 8,1% in 2003, reflecting the recovery of private consumption and economic activity in general.

The anticipated developments with regard to imports and exports of goods will lead to a widening of the trade deficit, in absolute terms, to £1670 mln in 2004 from £1594,6 mln in 2003, while, in relative terms, the trade deficit is projected to remain at approximately the levels of the previous year, around 24% of GDP.

The rate of increase of exports of services is anticipated to register a substantial increase by 6,8% compared to a small increase of 1,6% in 2003, reflecting the continued satisfactory expansion of exports of other services, beyond tourism, in conjunction with the maintenance of tourism revenue, based on the working assumption, at the levels of the previous year.

The rate of increase of imports of services is projected to exhibit a partial acceleration, around 7% in 2004 compared to 5,8% in 2003, due to the anticipated acceleration of the rate of economic growth and the subsequent increased purchases of services from abroad.

As a result of the above developments, the current account deficit is expected to register a deficit of £310 mln in 2004 as against a deficit of £291,3 mln in 2003, whereas as a percentage of GDP, it is projected to fluctuate at the 2003 levels, 4,4%.

-Public Finances

The fiscal deficit of the general Government, both as a percentage of GDP and, in absolute terms, is anticipated to register a small improvement in 2004. Specifically, the fiscal deficit is projected to be contained to £363 mln in 2004 from £417 mln in 2003 and as a percentage of GDP is projected to fluctuate at 5,2% from 6,3% in 2003. The anticipated decline of the fiscal deficit in 2004 is expected to result from the implementation of the revised fiscal consolidation plan prepared by the Government, following the divergences observed in public finances during 2002 and 2003, within the context of the Convergence Programme submitted to the EU in May 2004. It is noted that the improvement of the fiscal situation, based on the revised fiscal consolidation programme, will result from the increase of public revenue, mainly through the improvement of the tax collection ability of the competent Government authorities and through combating tax evasion, as well as through the increase in the fees charged for the provision of Government services, in conjunction with the containment in the rate of expansion of public expenditure, within the context of a tighter fiscal policy to be adopted.

Analytically, public revenue is expected to increase at a rate of 8,1% in 2004 compared to a higher rate of growth in 2003, 14,3%. The slowdown of the rate of increase of public revenue is due to the anticipated deceleration of the rate of increase of revenue from indirect taxation, since the harmonisation process with the minimum levels prescribed by the relevant acquis communautaire, with a limited number of exceptions, has been completed since early 2003. The measures to be promoted by the Government within the fiscal consolidation programme, which include the promotion of the approval of the draft laws on banking confidentiality and tax amnesty pending before the House of Representatives, as well as the amendment of the relevant law in order to allow the transfer of ownership titles to owners of construction works to which minor irregularities of the relevant law have occurred, is estimated to prevent a higher reduction of the rate of increase of public revenues.

More specifically, the indirect taxation revenue is expected to expand at a rate of 9% in 2004 as against a higher increase of 24,3% in 2003.

In contrast, the rate of growth of revenue from direct taxation is projected to register a substantial increase of the order of 8,9%, following a decline of 8,3% in 2003. The increase of revenue from direct taxation anticipated for 2004 will result mainly from the direct taxation of legal entities. The increase in public revenue from the direct taxation of individuals will be limited, as a result of the implementation of the last phase of the tax reform as from 1.1.2004, which provides for the further increase of the non-taxable income and a readjustment of the tax brackets.

The acceleration of the rate of economic growth is estimated to have a positive effect on total public revenue.

The rate of expansion of public expenditure is expected to decelerate substantially from 18,2% in 2003 to 5% in 2004, reflecting both the slowdown of the rate of increase of current and capital expenditure, within the context of implementation by the Government of measures aiming at containing public expenditure, as well as the fact that in 2003 public expenditure was

particularly high owing, inter alia, to the 7,5% increase granted on the basic salaries of civil servants covering also increases for 2001 and 2002.

Analytically, current public expenditure is projected to expand by approximately 5,2% in 2004, compared to a significantly higher rate of growth in 2003, 16,9%, as a result of the anticipated deceleration of the rate of increase in all categories of public expenditure. The deceleration of the rate of increase of expenditure on wages and salaries is owed, as already mentioned, to the particularly high rate of increase observed in 2003, due to the increases granted on the basic salaries of civil servants, but also to a smaller extent, to the lower COLA anticipated for 2004, and the slowdown of the rate of expansion of employment in the public sector. In addition, the reduction in subsidies anticipated in 2004 as well as the significant containment in defence expenditure, are projected to have a decreasing impact on current public expenditure.

Public capital expenditure is anticipated to increase at a rate of 3,8% in 2004 compared to a substantially higher rate of increase of 29,7% in 2003, reflecting the expected deceleration of the rate of expansion of both the Governments investment expenditure and capital transfers, within the framework of implementation of the fiscal consolidation programme.

The financing of the fiscal deficit during 2004 is expected to come from both external sources as well as domestic borrowing, mainly from the private sector.

Public debt excluding intergovernmental debt, is anticipated to rise to £5232,8 mln in 2004 from £4801,8 mln in 2003. As a percentage of GDP it is expected to rise to 75,2% from 72,6% in 2003.

-Monetary

With a view of securing sufficient financing of the economy's productive activities and attaining the goal for the improvement of monetary stability conditions, the expansion of the total money supply envisaged for 2004, is estimated at around 6,5%, while the expansion of bank credit extended to the

private sector is targeted at 6%. A significant development during the first months of 2004 constituted the decision of the Monetary Policy Committee on April 30th 2004 to increase the basic interest rates of the Central Bank, i.e. the Lombard rate and the Overnight Deposit Facility rate by 1 percentage point to 5,5% and 3,5%, respectively. This decision of the Monetary Policy Committee aimed at sending a powerful message of support to the Cyprus pound.

TABLES
INTERNATIONAL ECONOMY
CYPRUS ECONOMY

A. INTERNATIONAL ECONOMY
Output and Investments, 1999-2004, (%) ^a

Table 1

	1999	2000	2001	2002	2003 (Est.)	2004 (Proj.)
Growth Rate^b						
World	3,7	4,7	2,4	3,0	3,9	4,6
Advanced Economies ^c	3,5	3,8	1,1	1,7	2,1	3,5
EU	2,9	3,6	1,7	1,1	0,8	2,0
Developing Countries and Other Emerging Markets ^d	4,0	5,9	4,1	4,6	6,1	6,0
Fuel Exporters	1,3	5,8	4,6	3,6	5,6	4,6
Non-Fuel Exporters	4,2	5,9	4,0	4,7	6,1	6,2
Middle East ^e	2,1	5,9	4,3	4,2	5,4	4,1
Central and Eastern Europe	0,4	4,8	0,3	4,4	4,5	4,5
Real Gross Fixed Capital Formation						
Advanced Economies ^c	5,5	5,4	-1,1	-1,8	2,2	5,2
EU	5,3	4,9	0,5	-1,7	-0,5	2,9
Gross Fixed Capital Formation as a Percentage to GDP						
Developing Countries and Other Emerging Markets ^d	24,9	25,3	25,9	26,4	27,8	28,6
Middle East ^e	22,8	22,4	23,4	24,1	24,3	24,9
Central and Eastern Europe	23,7	24,8	21,9	22,6	21,8	21,9

^a Numbers refer to annual rates of change, unless otherwise specified. Data has been taken from the IMF World Economic Outlook issue of April 2004. Data regarding EU member states has been taken from the European Commission Publication, European Economy No2/2004, Economic Forecasts, Spring 2004.

^b Refers to the real rate of growth of GDP.

^c As from the May 2001 World Economic Outlook issue, the IMF classifies Cyprus as an advanced country.

^d It also includes the former socialist economies.

^e During the period 1984-2000 it includes Cyprus, Malta and Turkey. As from 2001 onwards Cyprus is classified by the IMF as an advanced country, whereas as from the April 2004 issue of World Economic Outlook of the IMF Turkey and Malta are included in the countries of Central and Eastern Europe.

Labour Market and Inflation Rate, 1999-2004, (%) ^a

Table 2

	1999	2000	2001	2002	2003 (Est.)	2004 (Proj.)
Unemployment Rate						
Advanced Economies ^b	6,4	5,8	5,9	6,4	6,6	6,4
EU	8,7	7,8	7,4	7,7	8,0	8,1
Productivity in the Manufacturing Sector						
Advanced Economies ^b	3,7	5,2	0,8	4,2	3,7	3,6
EU	2,3	5,1	1,0	1,7	2,3	2,4
Nominal Earnings in the Manufacturing Sector						
Advanced Economies ^b	3,2	5,4	2,9	3,1	3,9	3,6
EU	3,0	3,9	3,6	3,5	3,3	3,3
Inflation Rate^c						
Advanced Economies ^b	1,4	2,1	2,1	1,5	1,8	1,7
EU	1,2	1,9	2,2	2,1	2,0	1,8
Developing Countries and Other Emerging Markets ^d	10,4	7,3	6,8	6,0	6,1	5,7
Middle East ^e	11,0	8,5	7,1	7,5	8,6	8,9
Central and Eastern Europe	23,3	23,0	19,6	14,8	9,2	6,9

^a Numbers refer to annual rates of change, unless otherwise specified.

^b As from the May 2001 World Economic Outlook issue, the IMF classifies Cyprus as an advanced country.

^c Refers to the rate of change of the retail price index.

^d It also includes the former socialist economies.

^e During the period 1984-2000 it includes Cyprus, Malta and Turkey. As from 2001 onwards Cyprus is classified by the IMF as an advanced country, whereas as from the April 2004 issue of World Economic Outlook of the IMF Turkey and Malta are included in the countries of Central and Eastern Europe.

International Trade and Commodity Prices, 1999-2004, (%) ^a

Table 3

	1999	2000	2001	2002	2003 (Est.)	2004 (Proj.)
Trade Volume						
World	5,9	12,5	0,1	3,1	4,5	6,8
Import Volume						
Advanced Economies ^b	8,2	11,6	-0,8	2,3	3,5	5,7
EU ^c	7,1	10,9	1,4	0,7	2,4	5,7
Developing Countries and Other Emerging Markets ^d	0,5	15,9	3,0	6,2	8,9	10,2
Middle East ^{e,c}	1,3	11,7	9,5	9,2	2,8	3,1
Export Volume						
Advanced Economies ^b	5,6	11,7	-0,8	1,9	2,7	6,3
EU ^c	5,1	12,2	2,9	1,3	0,5	5,2
Developing Countries and Other Emerging Markets ^d	4,5	14,6	3,2	6,5	8,7	8,1
Middle East ^{e,c}	-1,3	8,0	2,4	3,3	7,1	-1,4
Terms of Trade ^f						
Advanced Economies ^b	-0,3	-2,4	0,3	0,9	0,7	0,1
Developing Countries and Other Emerging Markets ^d	3,6	7,3	-3,2	0,7	0,2	-0,1
Middle East ^{e,c}	35,8	38,7	-9,9	2,5	0,8	0,5
World Commodity Prices ^g						
Manufactures	-1,7	-4,8	-2,8	2,4	14,5	7,7
Oil	37,5	57,0	-13,8	2,5	15,8	3,8
Non-oil Primary Commodities	-6,7	4,5	-4,0	0,5	7,1	7,6

^a Numbers refer to annual rates of change, unless otherwise specified. Refers to the international trade of goods and services.

^b As from the May 2001 World Economic Outlook issue, the IMF classifies Cyprus as an advanced country.

^c Refers to the trade of goods.

^d It also includes the former socialist economies.

^e During the period 1984-2000 it includes Cyprus, Malta and Turkey. As from 2001 Cyprus is classified by the IMF as an advanced country, whereas as from the April 2004 issue of World Economic Outlook of the IMF Turkey and Malta are included in the countries of Central and Eastern Europe.

^f Refers to the rate of change of the ratio of commodities' export prices to commodities' import prices.

^g Refers to the rate of change of prices in terms of U.S. dollars.

Current Account Balance and External Debt, 1999-2004

Table 4

	1999	2000	2001	2002	2003 (Est.)	2004 (Proj.)
Current Account Balance, (U.S.\$ b.)						
Advanced Economies ^a	-102,2	-246,3	-206,7	-193,3	-241,9	-184,1
EU	3,0	-53,7	-5,7	66,8	36,1	48,3
USA	-290,8	-411,5	-393,7	-480,9	-541,8	-495,8
Japan	114,5	119,6	87,8	112,7	136,4	144,0
Fed. Rep. of Germany ^b	-25,0	-25,8	3,7	56,3	57,5	82,7
Developing Countries and Other Emerging Markets ^c	-18,1	88,1	37,9	83,6	121,0	85,4
Middle East ^d	11,5	69,6	38,1	29,0	51,7	43,8
Central and Eastern Europe	-25,4	-31,7	-14,8	-22,2	-31,7	-36,5
External Debt as a Percentage of Exports of Goods and Services (%)						
Developing Countries and Other Emerging Markets ^c	165,5	131,7	132,1	124,6	109,9	100,5
Middle East ^d	144,2	103,5	112,3	108,3	95,8	92,4
Central and Eastern Europe	135,6	130,5	122,6	127,0	113,7	102,8
External Debt Service Ratio (%)						
Developing Countries and Other Emerging Markets ^c	25,4	21,4	21,7	19,7	18,1	15,7
Middle East ^d	11,7	7,9	9,9	7,2	8,0	7,9
Central and Eastern Europe	19,6	19,9	21,0	20,8	18,6	17,3

^a As from the May 2001 World Economic Outlook issue, the IMF classifies Cyprus as an advanced country.

^b As from July 1990 it refers to unified Germany.

^c It also includes the former socialist economies.

^d During the period 1984-2000 it includes Cyprus, Malta and Turkey. As from 2001 onwards Cyprus is classified by the IMF as an advanced country, whereas as from the April 2004 issue of World Economic Outlook of the IMF Turkey and Malta are included in the countries of Central and Eastern Europe.

Monetary-Public Finances, 1999-2004, (%)

Table 5

	1999	2000	2001	2002	2003 (Est.)	2004 (Proj.)
Short-Term Interest Rates^a						
Seven Major Industrial Countries	3,4	4,4	3,2	2,0	1,6	1,6
USA ^b	4,8	6,0	3,5	1,6	1,0	0,9
Japan ^b	0,1	0,1	0,1	0,0	0,0	0,0
Fed. Rep. of Germany ^c	3,0	4,4	4,3	3,3	2,3	n.a.
Britain	5,5	6,2	5,0	4,1	3,8	n.a.
France	3,0	4,4	4,3	3,3	2,3	n.a.
Italy	3,0	4,4	4,3	3,3	2,3	n.a.
Canada ^b	4,7	5,5	3,9	2,6	2,9	2,0
EU	3,5	4,7	4,4	3,5	2,6	n.a.
Long-Term Interest Rates						
Seven Major Industrial Countries	4,7	5,0	4,4	4,2	3,7	3,9
USA ^b	5,6	6,0	5,0	4,6	4,0	4,1
Japan ^b	1,7	1,7	1,3	1,3	1,0	1,4
Fed. Rep. of Germany ^c	4,5	5,3	4,8	4,8	4,1	n.a.
Britain	5,0	5,3	5,0	4,9	4,2	n.a.
France	4,6	5,4	4,9	4,9	4,1	n.a.
Italy	4,7	5,6	5,2	5,0	4,2	n.a.
Canada ^b	5,6	5,9	5,5	5,3	4,8	4,3
EU	4,7	5,4	5,0	4,9	4,2	n.a.
Central Government Fiscal Deficit as a Percentage of GDP (%)						
Advanced Economies	-1,1	0,2	-1,0	-2,5	-3,3	-3,2
Developing Countries and Other Emerging Markets ^d	-3,8	-3,0	-3,2	-3,5	-3,0	-2,7
Middle East ^e	-1,9	3,4	-0,7	-2,7	-0,6	-0,9
Central and Eastern Europe	-4,9	-5,3	-6,3	-6,8	-5,1	-5,2

^a Interest rates on three-month certificates of deposit or paper.

^b March data for 2004.

^c As from July 1990 refers to unified Germany.

^d It also includes the former socialist economies.

^e During the period 1984-2000 it includes Cyprus, Malta and Turkey. As from 2001 onwards Cyprus is classified by the IMF as an advanced country, whereas as from the April 2004 issue of World Economic Outlook of the IMF Turkey and Malta are included in the countries of Central and Eastern Europe.

**Economic Indicators of Cyprus Trading Partners
and Competitors, 1999-2004, (%)^a**

Table 6

	1999	2000	2001	2002	2003 (Est.)	2004 (Proj.)
Export Unit Values^b						
Cyprus (\$US)	-8,5	-1,3	-0,3	-0,4	19,4	10,7
Italy (Euro)	0,0	7,6	3,2	1,4	0,7	-1,2
Spain (Euro)	-0,5	8,4	2,1	-0,1	0,0	0,4
Cyprus (Euro)	-3,5	13,9	2,7	-5,7	0,2	1,9
Unit Labour Costs (Local Currency)						
EU	1,5	1,9	3,0	2,4	2,4	1,3
Italy	1,5	1,8	3,1	3,5	4,0	2,3
Spain	2,1	3,1	3,4	3,3	3,6	2,9
Cyprus	1,9	4,1	3,3	4,6	3,6	2,3
Prices of Non-Fuel Imported Industrial Commodities (C£)	1,3	2,1	0,3	-2,0	-2,8	n.a.
Cyprus Inflation Rate	1,7	4,1	2,0	2,8	4,1	2,0

^a Numbers refer to annual rates of change, unless otherwise specified.

^b For Cyprus data refers to prices of domestic exports up to 2003, while for 2004 it refers to prices of total exports.

Medium-Term Forecasts, (%) ^a

Table 7

	2009/2005
Growth Rate	
World	4,2
Advanced Economies ^b	2,9
Developing Countries and Other Emerging Markets ^c	5,7
Inflation Rate^d	
Advanced Economies ^b	2,1
Developing Countries and Other Emerging Markets ^c	4,0
World Oil Price	-1,9
Current Account Balance as a Percentage of Exports of Goods and Services ^e	
Developing Countries and Other Emerging Markets ^c	-2,7
Middle East	0,2
External Debt as a Percentage of Exports of Goods and Services ^e	
Developing Countries and Other Emerging Markets ^c	79,7
Middle East	87,9

^a Numbers refer to average annual rates of change, unless otherwise specified.

^b As from the May 2001 World Economic Outlook issue, the IMF classifies Cyprus as an advanced country.

^c It also includes the former socialist economies.

^d Refers to the consumer price index.

^e Refers to the year 2009.

B. CYPRUS ECONOMY
GDP by Economic Sector, 1999-2004, €mIn
(constant market prices of 1995)

Table 1 (continued)

	1999	2000	2001	2002 (est.)	2003 (proj.)	2004 (Proj.)
Primary Sector	221,4	211,0	218,5	230,6	234,0	237,3
Agriculture and hunting	193,7	178,1	185,4	196,0	198,9	200,9
Fishing	12,4	15,8	15,9	16,2	16,5	17,2
Mining and quarrying	15,3	17,1	17,2	18,4	18,6	19,1
Secondary Sector	903,8	915,4	926,9	943,5	958,9	978,3
Manufacturing	476,6	487,8	477,6	467,1	455,4	455,4
Electricity, gas and water	101,7	109,9	119,7	131,9	141,8	150,3
Construction	325,5	317,7	329,6	344,5	361,7	372,6
Tertiary Sector	3179,5	3392,7	3554,3	3619,2	3696,2	3842,8
Wholesale and retail trade	574,9	603,5	635,6	642,1	632,5	651,4
Restaurants and hotels	406,7	446,9	461,6	429,3	412,1	422,4
Transport, storage and communication	420,9	477,5	516,7	534,7	558,9	594,1
Transport	255,1	281,9	291,6	292,5	292,5	298,4
Communication	165,8	195,6	225,1	242,2	266,4	295,7
Financial intermediation	268,8	290,6	296,4	297,4	300,4	309,4
Real estate,renting and business activities	600,6	632,0	666,5	701,3	740,1	777,5
Real estate activities	98,2	106,5	111,7	120,6	132,7	137,3
Letting of own property	175,3	179,2	183,9	189,3	195,0	200,8
Rent industry dummy	137,2	142,0	146,1	151,2	156,5	163,5
Renting of machinery and equipment	21,4	23,3	24,2	24,7	25,3	26,5
Computer and related activities	12,9	17,1	24,3	27,9	30,7	34,4
Research and development	3,7	3,8	3,8	3,9	4,3	4,7
Other business activities	151,9	160,1	172,5	183,7	195,6	210,3
Public administration and defence	370,8	382,0	393,6	403,8	416,0	424,4
Education	202,0	208,1	216,1	223,3	230,5	238,8
Public	143,5	146,1	150,8	154,4	157,5	160,6
Private	58,5	62,0	65,3	68,9	73,0	78,1
Health and social work	141,5	144,5	148,0	154,2	160,2	166,9
Public	67,9	68,3	69,2	71,1	72,5	74,0
Private	73,6	76,2	78,8	83,1	87,7	92,9
Other community social and personal services	169,4	179,8	187,0	194,5	202,3	213,4
Private households with employed persons	23,9	27,8	32,8	38,6	43,2	44,5
Total Gross Value Added	4304,7	4519,1	4699,7	4793,3	4889,2	5058,4
Less: Imputed bank service charge	167,7	191,1	222,5	224,4	220,6	227,3
Plus: Import duties						
Plus: Value added tax (net)	461,7	500,0	543,9	551,9	554,7	572,9
Gross Domestic Product at market prices	4598,7	4828	5021,1	5120,8	5223,2	5404,0

Table 1 (concluded)

	Annual Rate of Change (%)		
	2002/01	2003/02	2004/03
Primary Sector	5,5	1,5	1,4
Agriculture and hunting	5,7	1,5	1,0
Fishing	1,9	2,0	4,0
Mining and quarrying	7,0	1,0	3,0
Secondary Sector	1,8	1,6	2,0
Manufacturing	-2,2	-2,5	0,0
Electricity, gas and water	10,2	7,5	6,0
Construction	4,5	5,0	3,0
Tertiary Sector	1,8	2,1	4,0
Wholesale and retail trade	1,0	-1,5	3,0
Restaurants and hotels	-7,0	-4,0	2,5
Transport, storage and communication	3,5	4,5	6,3
Transport	0,3	0,0	2,0
Communication	7,6	10,0	11,0
Financial intermediation	0,3	1,0	3,0
Real estate,renting and business activities	5,2	5,5	5,1
Real estate activities	8,0	10,0	3,5
Letting of own property	2,9	3,0	3,0
Rent industry dummy	3,5	3,5	4,5
Renting of machinery and equipment	2,1	2,5	4,5
Computer and related activities	14,8	10,0	12,0
Research and development	2,6	10,0	10,0
Other business activities	6,5	6,5	7,5
Public administration and defence	2,6	3,0	2,0
Education	3,3	3,2	3,6
Public	2,4	2,0	2,0
Private	5,5	6,0	7,0
Health and social work	4,2	3,9	4,2
Public	2,7	2,0	2,0
Private	5,5	5,5	6,0
Other community social and personal services	4,0	4,0	5,5
Private households with employed persons	17,7	12,0	3,0
Total Gross Value Added	2,0	2,0	3,5
Less: Imputed bank service charge	0,9	-1,7	3,0
Plus: Import duties			
Plus: Value added tax (net)	1,5	0,5	3,3
Gross Domestic Product at market prices	2,0	2,0	3,5

**Percentage Distribution of GDP
by Economic Sector, 1999-2004 (%)
(current market prices)**

Table 2

	1999	2000	2001	2002 (est.)	2003 (est.)	2004 (proj)
Primary Sector	4,5	4,1	4,3	4,4	4,5	4,4
Agriculture and hunting	3,9	3,6	3,8	3,9	4,0	3,9
Fishing	0,3	0,2	0,2	0,2	0,2	0,2
Mining and quarrying	0,3	0,3	0,3	0,3	0,3	0,3
Secondary Sector	20,8	20,1	19,9	20,0	19,8	19,5
Manufacturing	11,0	10,6	10,2	9,9	9,3	9,0
Electricity, gas and water	2,0	2,2	2,2	2,2	2,3	2,4
Construction	7,9	7,3	7,5	7,9	8,2	8,2
Tertiary Sector	74,7	75,8	75,8	75,6	75,7	76,1
Wholesale and retail trade	12,9	12,9	13,0	13,0	12,3	12,2
Restaurants and hotels	9,1	9,5	9,7	8,7	7,7	7,3
Transport, storage and communication	9,2	9,4	9,7	9,1	9,0	9,1
Transport	5,8	5,9	5,9	5,5	5,6	5,5
Communication	3,4	3,5	3,8	3,6	3,5	3,5
Financial intermediation	7,1	7,4	6,7	6,4	6,3	6,3
Real estate,renting and business activities	14,0	14,0	14,2	14,8	15,2	15,5
Real estate activities	2,3	2,3	2,4	2,5		
Letting of own property	4,1	4,0	3,9	4,0		
Rent industry dummy	3,2	3,2	3,1	3,2		
Renting of machinery and equipment	0,5	0,5	0,5	0,5		
Computer and related activities	0,3	0,4	0,5	0,6		
Research and development	0,1	0,1	0,1	0,1		
Other business activities	3,4	3,5	3,6	3,9		
Public administration and defence	9,1	9,3	9,1	9,5	10,4	10,5
Education	5,1	5,1	5,2	5,4	5,8	6,0
Public	3,5	3,5	3,5	3,6	4,0	4,0
Private	1,6	1,6	1,7	1,8	1,9	1,9
Health and social work	3,6	3,5	3,6	3,8	4,1	4,2
Public	1,7	1,6	1,6	1,7	1,8	1,8
Private	1,9	1,9	1,9	2,2	2,3	2,4
Other community social and personal services	4,0	4,1	4,1	4,1	4,2	4,4
Private households with employed persons	0,5	0,5	0,6	0,7	0,7	0,7
Total Gross Value Added	100	100	100	100	100	100

GDP by Category of Expenditure, 1999-2004, £mIn
(current market prices)

Table 3 (continued)

	1999	2000	2001	2002 (est.)	2003 (est.)	2004 (proj.)
GDP at current market prices	5037,1	5525,3	5876,9	6161,0	6614,3	6959,7
Private Consumption	3316,3	3764,1	4011,6	4208,6	4455,9	4685,8
Government Consumption	923,9	929,7	1067,9	1171,2	1330,8	1350,2
Gross Fixed Capital Formation (excluding purchase of aircrafts and ships)*	935,4	981,7	1041,4	1162,1	1148,1	1230,1
Increase in Stocks	75,0	124,3	60,0	72,3	44,2	38,5
Domestic Demand (Excluding Imports of Military Equipment, aircrafts and ships)*	5250,6	5799,8	6180,9	6614,2	6978,9	7304,6
Exports of Goods & Services	2758,3	3137,0	3359,4	3184,8	3188,9	3386,6
Imports of Goods & Services (Excluding Military Equipment and aircrafts)**	2908,7	3425,8	3619,5	3632,6	3531,0	3724,2
Resource Gap (Excluding Military Equipment and aircrafts)**	-150,4	-288,8	-260,1	-447,8	-342,1	-337,6
Statistical Discrepancy	-63,1	14,3	-44,0	-5,4	-22,5	-7,4
Indicators (%)						
1. Domestic Savings / GDP	15,8	15,0	13,6	12,7	12,5	13,3
3. Domestic Savings/Investments (excluding purchases of aircrafts and ships)*	78,9	75,2	72,4	63,3	69,4	72,8
4. Investment /GDP (excluding purchases of aircrafts and ships)*	20,1	20,0	18,7	20,0	18,0	18,2
5. Resource Gap/GDP (excluding the purchase of military equipment and aircrafts)**	-3,0	-5,2	-4,4	-7,3	-5,2	-4,9
	-2,1	-4,7	-2,8	-4,4	-3,6	-4,3

Table 3 (concluded)

	Annual Rate of Change (%)		
	2002/01	2003/02	2004/03
GDP at current market prices	6,4	4,8	7,4
Private Consumption	6,6	4,9	5,9
Government Consumption	14,9	9,7	13,6
Gross Fixed Capital Formation (excluding purchase of aircrafts and ships)*	6,1	11,6	-1,2
Increase in Stocks	-51,7	20,5	-38,9
Domestic Demand (Excluding Imports of Military Equipment, aircrafts and ships)*	6,6	7,0	5,5
	5,5	6,5	6,1
Exports of Goods & Services	7,1	-5,2	0,1
Imports of Goods & Services	3,7	-1,8	-0,9
(Excluding Military Equipment and aircrafts)**	-10,0	72,2	-23,6

* Excluding the purchases of ships in 2000 worth of CYP22,5mln, at current prices and the purchases of aircrafts by Cyprus Airways in 2002 worth of CYP45mln, at current prices, purchases of ships in 2002 worth of CYP40,4mln at current prices and net receipts of CYP9,4mln, at current prices, from the sale of aircrafts by the Cyprus Airways in 2003

** Excluding the purchases of aircrafts by Cyprus Airways in 2002 worth of CYP40,5mln at current prices fob and the net receipts of CYP8,5mln, at current prices fob, from the sale of aircraft by the Cyprus Airways in 2003.

GDP by Category of Expenditure, 1999-2004, £mln
(constant market prices)

Table 4 (continued)

	1999	2000	2001	2002 (est.)	2003 (est.)	2004 (proj.)
GDP at current market prices	4598,7	4828,0	5021,1	5120,8	5223,2	5404,0
Private Consumption	3063,6	3313,3	3466,9	3552,5	3623,6	3743,1
Government Consumption	802,2	761,6	856,8	921,2	946,4	916,3
Gross Fixed Capital Formation (excluding purchase of aircrafts and ships)*	855,0	887,2	915,4	988,6	946,2	989,5
Increase in Stocks	68,1	108,0	51,0	59,6	35,0	30,0
Domestic Demand (Excluding Imports of Military Equipment, aircrafts and ships)*	4788,9	5070,1	5290,1	5521,9	5551,2	5679,0
	4745,8	5041,2	5200,9	5402,2	5459,2	5646,4
Exports of Goods & Services	2498,7	2724,1	2815,6	2671,4	2687,9	2831,8
Imports of Goods & Services (Excluding Military Equipment and aircrafts)**	2708,3	2953,3	3064,8	3111,5	3070,5	3171,9
	2665,9	2926,5	2982,0	2962,1	2979,2	3139,5
Resource Gap (Excluding Military Equipment and aircrafts)**	-209,6	-229,2	-249,2	-440,1	-382,6	-340,1
	-167,2	-202,4	-166,4	-290,7	-291,3	-307,7
Statistical Discrepancy	19,4	-12,9	-19,8	39,0	54,6	65,1

Table 4 (concluded)

	Annual Rate of Change (%)		
	2002/01	2003/02	2004/03
GDP at current market prices	2,0	2,0	3,5
Private Consumption	2,5	2,0	3,3
Government Consumption	7,5	2,7	-3,2
Gross Fixed Capital Formation (excluding purchase of aircrafts and ships)*	8,0	-4,3	4,6
Increase in Stocks	16,9	-41,3	-14,3
Domestic Demand	4,4	0,5	2,3
(Excluding Imports of Military Equipment, aircrafts and ships)*	3,9	1,1	3,4
Exports of Goods & Services	-5,1	0,6	5,4
Imports of Goods & Services	1,5	-1,3	3,3
(Excluding Military Equipment and aircrafts)**	-0,7	0,6	5,4

* Excluding the purchases of ships in 2000 worth of CYP20,7mln, at constant prices and the purchases of aircrafts by Cyprus Airways in 2002 worth of CYP39,8mln, at constant prices, purchases of ships in 2002 worth of CYP35,3mln at constant prices and net receipts of CYP8,3mln, at constant prices, from the sale of aircrafts by the Cyprus Airways in 2003

** Excluding the purchases of aircrafts by Cyprus Airways in 2002 worth of CYP33,9mln at constant prices fob and the net receipts of CYP7mln, at constant fob, from the sale of aircraft by the Cyprus Airways in 2003.

Gross Fixed Capital Formation by Capital Asset, 1999-2004 £mln
(current market prices)

Table 5 (continued)

	1999	2000	2001	2002 (est.)	2003 (est.)	2004 (proj.)
New buildings and works (construction)	617,1	616,5	665,0	720,2	794,0	842,4
Buildings	307,7	312,7	324,7	355,7	n.a.	n.a.
Non-residential buildings	161,4	156,9	178,0	188,4	n.a.	n.a.
Other construction works	148,0	146,9	162,3	174,8	n.a.	n.a.
Machinery and equipment	269,9	277,4	300,8	287,9	303,3	334,1
Transport Equipment	46,3	82,5	68,4	147,5	43,6	46,4
(excluding the purchase of aircrafts and ships)*	46,3	60,0	68,4	48,6	43,6	46,4
New tree plantation, Breeding stock etc	2,1	5,3	7,2	6,5	7,2	7,2
T o t a l	935,4	981,7	1041,4	1162,1	1148,1	1230,1
(excluding the purchase of aircrafts and ships)*	935,4	959,2	1041,4	1063,2	1148,1	1230,1

Table 5 (concluded)

	Annual Rate of Change (%)		
	2002/01	2003/02	2004/03
New buildings and works (construction)	7,9	8,3	10,3
Buildings	3,8	n.a.	n.a.
Non-residential buildings	13,4	n.a.	n.a.
Other construction works	10,5	n.a.	n.a.
Machinery and equipment	8,4	-4,3	5,3
Transport Equipment	-17,1	115,6	-70,5
(excluding the purchase of aircrafts and ships)*	14,0	-28,9	-10,4
New tree plantation, Breeding stock etc	35,8	-9,7	10,8
T o t a l	6,1	11,6	-1,2
(excluding the purchase of aircrafts and ships)*	8,6	2,1	8,0

* Excluding the purchases of ships in 2000 worth of CYP22,5mln, at current prices and the purchases of aircrafts by Cyprus Airways in 2002 worth of CYP45mln, at current prices, purchases of ships in 2002 worth of CYP40,4mln at current prices and net receipts of CYP9,4mln, at current prices, from the sale of aircrafts by the Cyprus Airways in 2003

Gross Fixed Capital Formation by Capital Asset, 1999-2004 £mln
(constant market prices of 1995)

Table 6 (continued)

	1999	2000	2001	2002 (est.)	2003 (est.)	2004 (proj.)
New buildings and works (construction)	543,2	536,5	556,7	580,1	609,1	627,4
Buildings	270,5	271,8	271,1	286,4	n.a.	n.a.
Non-residential buildings	142,1	136,5	149,3	152,8	n.a.	n.a.
Other construction works	130,6	128,2	136,3	141,1	n.a.	n.a.
Machinery and equipment	264,0	268,0	287,6	270,1	290,4	313,6
Transport Equipment	46,0	78,1	64,8	132,9	40,5	42,3
(excluding the purchase of aircrafts and ships)*	46,0	57,4	64,8	46,5	40,5	42,3
New tree plantation, Breeding stock etc	1,8	4,6	6,3	5,5	6,3	6,3
T o t a l	855,0	887,2	915,4	988,6	946,2	989,5
(excluding the purchase of aircrafts and ships)*	855,0	866,5	915,4	902,2	946,2	989,5

Table 6 (concluded)

	Annual Rate of Change (%)		
	2002/01	2003/02	2004/03
New buildings and works (construction)	4,2	5,0	3,0
Buildings	5,6	n.a.	n.a.
Non-residential buildings	2,3	n.a.	n.a.
Other construction works	3,5	n.a.	n.a.
Machinery and equipment	-6,1	7,5	8,0
Transport Equipment	105,1	-69,6	4,5
(excluding the purchase of aircrafts and ships)*	-28,2	-13,0	4,5
New tree plantation, Breeding stock etc	-12,7	14,5	0,0
T o t a l	8,0	-4,3	4,6
(excluding the purchase of aircrafts and ships)*	-1,4	4,9	4,6

* Excluding the purchases of ships in 2000 worth of CYP20,7mln, at constant prices and the purchases of aircrafts by Cyprus Airways in 2002 worth of CYP39,8mln, at constant prices, purchases of ships in 2002 worth of CYP35,3mln at constant prices and net receipts of CYP8,3mln, at constant prices, from the sale of aircrafts by the Cyprus Airways in 2003

Manpower Balance, Productivity and Prices, 1999-2004

Table 7 (continued)

	1999	2000	2001	2002 (est.)	2003 (est.)	2004 (proj.)
Gainfully Employed Population, (000' s)	295,3	302,0	308,6	311,7	314,5	317,6
Employed by Foreign Organisations in Cyprus, (000' s)	2,8	2,8	2,8	2,8	2,8	2,5
Unemployed, (000' s)	11,4	10,9	9,5	10,6	12,0	11,5
Other, (000' s)	9,3	9,4	9,7	10,0	10,0	10,0
Economically Active Population (E.A.P.), (000' s)	318,7	325,1	330,6	335,1	339,3	341,6
Population (mid-year), (000' s)	686,4	693,6	701,3	709,6	713,9	718,1
Unemployment Rate (%)	3,6	3,4	2,9	3,2	3,5	3,4
E.A.P. as percent of Total Population (%)	46,4	46,9	47,1	47,2	47,5	47,6
GDP £mln, (at 1995 prices)	4598,7	4828,0	5021,1	5120,8	5223,2	5404,0
Productivity £000' s (at 1995 prices)	15,6	16,0	16,3	16,4	16,6	17,0
Consumer Price Index (1992=100)	101,6	105,8	107,9	111,0	115,6	117,9
Index of Nominal Earnings (1980=100)	124,5	133,0	139,8	147,7	154,7	162,2
Index of Real Earnings (1980=100)	112,1	115,1	118,6	121,8	122,5	125,8
Unit Labour Cost (1980=100)	113,1	117,7	121,6	127,2	131,7	134,8

Table 7 (concluded)

	Annual Rate of Change (%)		
	2002/01	2003/02	2004/03
Gainfully Employed Population, (000' s)	1,0	0,9	1,0
Employed by Foreign Organisations in Cyprus, (000's)	0,0	0,0	-10,7
Unemployed, (000's)	11,0	13,2	-4,2
Other, (000's)	3,1	0,0	0,0
Economically Active Population (E.A.P.), (000's)¹	1,4	1,3	0,7
Population (mid-year), (000's)	1,2	0,6	0,6
Unemployment Rate (%)	10,3	9,4	-2,9
E.A.P. as percent of Total Population (%)	0,2	0,6	0,1
<hr/>			
GDP £mln, (at 1995 prices)	2,0	2,0	3,5
Productivity £000's (at 1995 prices)	0,6	1,2	2,4
Consumer Price Index (1992=100)	2,8	4,1	2,0
Index of Nominal Earnings (1980=100)	5,7	4,7	4,8
Index of Real Earnings (1980=100)	2,7	0,6	2,7
Unit Labour Cost (1980=100)	4,6	3,5	2,4

Balance of Payments Summary, 1999-2004, £m.

Table 8 (continued)

	1999	2000	2001	2002	2003 (Est.)	2004 (Proj.)
Current Account Balance	-57,1	-188,4	-166,5	-330,9	-291,3	-307,6
Current Account Balance (excl. defence equipment and purchase of aircrafts)	-11,6	-157,3	-59,0	-164,4	-201,3	-217,6
Goods, Services and Income	-97,1	-228,4	-206,5	-371,0	-346,9	-347,6
Goods and Services	-112,1	-249,4	-219,5	-406,1	-299,4	-293,9
Goods	-1239,3	-1576,7	-1663,3	-1739,0	-1594,6	-1673,1
Goods (excl. def. equip. and purchase of aircraft)	-1180,5	-1527,0	-1552,3	-1564,5	-1489,6	-1635,1
Exports	542,7	591,7	627,9	514,4	476,8	488,8
Imports	1782,0	2168,4	2291,2	2253,4	2071,4	2161,9
Imports (excl. def. equip. and purchase of aircrafts)	1723,2	2118,7	2180,2	2078,9	1966,4	2123,9
Services	1127,2	1327,3	1443,8	1332,9	1295,2	1379,2
Exports	2253,9	2584,7	2772,1	2712,1	2754,8	2941,5
Imports	1126,7	1257,4	1328,3	1379,2	1459,6	1562,3
Income	15,0	21,0	13,0	35,1	-47,5	-53,7
Transfers	40,0	40,0	40,0	40,1	55,6	40,0
Capital and Financial Account ^a	204,2	162,1	95,4	340,2	171,3	n.a.
Capital Account	0,0	0,0	0,0	-3,1	11,8	n.a.
Financial Account	204,2	162,1	95,4	343,3	159,5	n.a.
Net Errors and Omissions	-147,1	26,3	71,1	-9,3	120	n.a.
Official Foreign Exchange Reserves	1135,7	1153,3	1558,4	1734,9	1607,3	n.a.
Coverage of Imports of Goods and Services by Official Foreign Exchange Reserves (no. of months)	4,7	4,0	5,2	5,7	5,5	n.a.

Table 8 (concluded)

	Annual Rates of Change (%)		
	2002/01	2003/02 (Est.)	2004/2003 (Proj.)
Current Account Balance	98,7	-12,0	5,6
Current Account Balance (excl. defence equipment and purchase of aircrafts)	178,6	22,4	8,1
Goods, Services and Income	79,7	-6,5	0,2
Goods and Services	85,0	-26,3	-1,8
Goods	4,6	-8,3	4,9
Goods (excl. def. equip. and purchase of aircraft)	0,8	-4,8	9,8
Exports	-18,1	-7,3	2,5
Imports	-1,6	-8,1	4,4
Imports (excl. def. equip. and purchase of aircrafts)	-4,6	-5,4	8,0
Services	-7,7	-2,8	6,5
Exports	-2,2	1,6	6,8
Imports	3,8	5,8	7,0
Income	170,0	-235,3	13,1
Transfers	0,2	38,7	-28,1
Capital and Financial Account ^a	256,6	-49,6	n.a.
Capital Account			
Financial Account	259,9	-53,5	n.a.
Net Errors and Omissions	-113,1	-1390,3	n.a.
Official Foreign Exchange Reserves	11,3	-	-
Coverage of Imports of Goods and Services by Official Foreign Exchange Reserves (no. of months)	10,9	-	-

Current Account Balance Analysis, 1999-2004, £m.

Table 9 (continued)

	1999	2000	2001	2002	2003 (Est.)	2004 (Proj.)
Current Account Balance	-57,1	-188,4	-166,5	-330,9	-291,3	-307,6
Goods, Services and Income	-97,1	-228,4	-206,5	-371,0	-346,9	-347,6
Goods and Services	-112,1	-249,4	-219,5	-406,1	-299,4	-293,9
Goods	-1239,3	-1576,7	-1663,3	-1739,0	-1594,6	-1673,1
Exports	542,7	591,7	627,9	514,4	476,8	488,8
General Merchandise	503,9	523,4	570,9	469,0	430,4	439,2
Agricultural	36,5	34,4	43,8	36,9	43,6	45,8
Minerals	2	1,6	1,9	3,1	3,1	2
Industrial	167,8	187,8	188,2	181,9	159,2	162,4
Re-exports	297,6	299,6	337	247,1	224,5	229
Goods procured in ports by carriers	38,7	68,3	57,1	45,5	46,4	49,6
Imports						
General Merchandise (FOB)	1782,0	2168,4	2291,2	2253,4	2071,4	2161,9
General Merchandise (CIF)	1970,9	2402,0	2528,7	2486,3	2314,5	2402,1
Consumer Goods	689,1	793,1	793,2	713,6	666,6	706,6
Raw Materials	611,4	710,3	736,7	725,0	726,4	766,4
Capital Goods	199,7	254,8	269,6	246,8	262,9	289,2
Transport Equipment	251,7	302,4	328,9	397,2	326,8	366
Fuels and Lubricants	173,5	310,3	302,5	269,7	226,8	235,9
Other	45,5	31,1	97,8	134,0	105,0	38
Goods procured in ports by carriers						
Services	1127,2	1327,3	1443,8	1332,9	1295,2	1379,2
Exports of Services	2253,9	2584,7	2772,1	2712,1	2754,8	2941,5
Tourism	1022,0	1194,0	1277,0	1136,0	1020,0	1019,6
Income	15,0	21,0	13,0	35,1	-47,5	-53,7
Transfers	40,0	40,0	40,0	40,1	55,6	40,0

Table 9 (concluded)

	Annual Rates of Growth (%)		
	2002/01	2003/02 (Est.)	2004/03 (Proj.)
Current Account Balance	98,7	-12,0	5,6
Goods, Services and Income	79,7	-6,5	0,2
Goods and Services	85,0	-26,3	-1,8
Goods	4,6	-8,3	4,9
Exports	-18,1	-7,3	2,5
General Merchandise	-17,8	-8,2	2,0
Agricultural	-15,8	18,2	5,0
Minerals	63,2	0,0	-35,5
Industrial	-3,3	-12,5	2,0
Re-exports	-26,7	-9,1	2,0
Goods procured in ports by carriers	-20,3	2,0	6,9
Imports			
General Merchandise (FOB)	-1,6	-8,1	4,4
General Merchandise (CIF)	-1,7	-6,9	3,8
Consumer Goods	-10,0	-6,6	6,0
Raw Materials	-1,6	0,2	5,5
Capital Goods	-8,5	6,5	10,0
Transport Equipment	20,8	-17,7	12,0
Fuels and Lubricants	-10,8	-15,9	4,0
Other	37,0	-21,6	-63,8
Goods procured in ports by carriers			
Services	-7,7	-2,8	6,5
Exports of Services	-2,2	1,6	6,8
Tourism	-11,0	-10,2	0,0
Income	170,0	-235,3	13,1
Transfers	0,2	38,7	-28,1

Capital and Financial Account, 1999-2004, £m.

Table 10 (continued)

	1999	2000	2001	2002	2003	2004
Capital and Financial Account	204,2	162,1	95,4	340,2	171,3	n.a.
Capital Account	0,0	0,0	0,0	-3,1	11,8	n.a.
Financial Account	204,2	162,1	95,4	343,3	159,5	n.a.
Direct Investments	-15,0	-29,8	-55	363,9	324,4	n.a.
Cypriot Residents Abroad	-80,9	-131,0	-160	-281,7	-172,4	n.a.
Non Residents in Cyprus	65,9	101,2	105	645,6	496,8	n.a.
Portfolio Investments	0,9	-126,6	47,5	-309,2	60,8	n.a.
Assets	-257,8	-182,2	-284,5	-668,7	-342,7	n.a.
Liabilities	258,7	55,6	332	359,5	403,5	n.a.
Other Investments	565,0	313,4	496,7	564,8	-346,4	n.a.
Assets	-205,6	-865,3	-343,9	875,7	-1290,3	n.a.
Liabilities	770,6	1178,7	840,6	-310,9	943,9	n.a.
Reserve Assets	-346,7	5,1	-393,8	-245,2	111,2	n.a.

Table 10 (concluded)

	Annual Rates of Change (%)		
	2002/01	2003/02 (Est.)	2004/03 (Proj.)
Capital and Financial Account	256,6	-49,6	n.a.
Capital Account			
Financial Account	259,9	-53,5	n.a.
Direct Investments	-761,6	-10,9	n.a.
Cypriot Residents Abroad	76,1	-38,8	n.a.
Non Residents in Cyprus	514,9	-23,0	n.a.
Portfolio Investments	-750,9	-119,7	n.a.
Assets	135,0	-48,8	n.a.
Liabilities	8,3	12,2	n.a.
Other Investments	13,7	-161,3	n.a.
Assets	-354,6	-247,3	n.a.
Liabilities	-137,0	-403,6	n.a.
Reserve Assets	-37,7	-145,4	n.a.

Fiscal Deficit of the Public Sector 1999-2004 £m.^{a b}

Table 11 (continued)

	1999	2000	2001	2002	2003 (Est.)	2004 (Proj.)
Public Revenue	1593,8	1864,2	2084,3	2084,5	2385,6	2579,9
Current Revenue	1593,2	1863,6	2083,5	2083,8	2385,6	2579,9
Tax Revenue	1356,7	1595,5	1776,5	1760,8	1920,6	2070,9
Direct Taxes	564,3	632,7	692,1	640,0	587,0	639,0
Income Tax	334,0	393,9	438,2	420,6	405,5	437,1
Employees	158,8	184,8	209,2	204,1	224,6	223,3
Companies	175,2	209,1	229,0	216,5	180,8	213,8
Other	230,3	238,8	253,9	219,4	181,5	201,9
Indirect Taxes	565,5	718,9	806,4	819,4	1018,7	1110,0
Import Duties	56,5	62,6	68,4	73,3	58,0	40,2
Excise Duties	128,5	160,7	178,4	199,9	288,4	337,5
V.A.T.	236,1	296,6	344,7	405,8	545,1	581,2
Other	144,5	199,0	214,9	140,4	127,2	151,1
S.I.F. Contributions	226,8	244,0	278,0	301,4	314,9	321,9
Non Tax Revenue	236,6	268,0	307,0	323,0	465,0	509,0
Capital Revenue	0,6	0,7	0,8	0,7	0,0	0,0
Grants	0,9	2,5	2,5	2,0	0,0	0,0
Total Public Revenue & Grants	1594,8	1866,7	2086,8	2086,5	2385,6	2579,9

Table 11 (concluded)

	1999	2000	2001	2002	2003 (Est.)	2004 (Proj.)
Public Expenditure	1823,9	2000,6	2225,5	2370,4	2802,2	2943,0
Current Expenditure	1652,6	1795,2	2010,5	2131,3	2492,0	2621,0
Wages & Salaries	541,3	587,0	624,9	646,0	760,0	798,0
Purchase of Goods and Services	204,9	220,7	300,5	380,0	408,0	339,0
Interest Payments	161,1	193,9	208,8	200,0	218,0	250,0
Subsidies	38,7	78,4	87,0	67,3	80,0	70,0
Other Transfer Payments	706,6	715,2	789,3	838,0	1026,0	1164,0
Capital Expenditure	171,3	205,4	215,0	239,1	310,2	322,0
Investment	130,2	169,6	181,6	199,5	259,8	241,6
Capital Transfers	41,1	35,8	33,4	39,6	50,4	80,8
Fiscal Deficit	-229,1	-133,9	-138,7	-283,9	-416,6	-363,1
Fiscal Deficit as a Percentage of GDP (%)	4,0	2,7	-2,4	-4,6	-6,3	-5,2
Public Savings	-58,4	70,8	75,5	-45,5	-106,4	-41,1

^a Includes the Ordinary budget, the Public Loans Fund, the Cyprus Defence Fund, the Social Insurance Funds, the Sinking Fund as well as the Grain Commission and Vine Products Commission Deficit.

^b According to Ministry of Finance data.

Table 11 (concluded)

	Annual Rates of Change (%)		
	2002/01	2003/02 (Est.)	2004/03 (Proj.)
Public Revenue	0,0	14,4	8,1
Current Revenue	0,0	14,5	8,1
Tax Revenue	-0,9	9,1	7,8
Direct Taxes	-7,5	-8,3	8,9
Income Tax	-4,0	-3,6	7,8
Employees	-2,4	10,1	-0,6
Companies	-5,5	-16,5	18,2
Other	-13,6	-17,3	11,2
Indirect Taxes	1,6	24,3	9,0
Import Duties	7,2	-20,9	-30,7
Excise Duties	12,0	44,3	17,0
V.A.T.	17,7	34,3	6,6
Other	-34,7	-9,4	18,8
S.I.F. Contributions	8,4	4,5	2,2
Non Tax Revenue	5,2	44,0	9,5
Capital Revenue	-16,0	-100,0	-
Grants	-19,4	-100,0	-
Total Public Revenue & Grants	0,0	14,3	8,1

Table 11 (concluded)

	Annual Rates of Change (%)		
	2002/01	2003/02 (Est.)	2004/03 (Proj.)
Public Expenditure	6,5	18,2	5,0
Current Expenditure	6,0	16,9	5,2
Wages & Salaries	3,4	17,6	5,0
Purchase of Goods & Services	26,5	7,4	-16,9
Interest Payments	-4,2	9,0	14,7
Subsidies	-22,6	18,9	-12,5
Other Transfer Payments	6,2	22,4	13,5
Capital Expenditure	11,2	29,7	3,8
Investment	9,9	30,2	-7,0
Capital Transfers	18,6	27,3	60,3
Fiscal Deficit	104,7	46,8	-12,8
Fiscal Deficit as a percentage of G.D.P. (%)	95,3	36,7	-17,2
Public Savings	-160,2	134,1	-61,4

Table 12 (continued)

Public Debt, 1999-2004

	1999	2000	2001	2002	2003 (Est.)	2004 (Proj.)
Public Debt (including intergovernmental)	4943,8	5402,9	5993,4	6554,7	7448,3	8141,6
Public Debt (excluding intergovernmental)	3123,7	3402,5	3776,7	4153,2	4801,8	5232,8
Foreign Debt	850,7	820,8	760,6	844,7	1055,5	1520,9
Domestic Debt	4093,1	4582,1	5232,8	5710,0	6392,8	6620,7
-Debt to Commercial Banks	964,7	881,0	1384,4	1472,7	1746,0	1764,1
-Debt to Central Bank	531,0	868,9	791,3	1022,7	1022,7	1022,7
-Debt to Private Sector	664,6	712,6	693,7	658,4	816,8	758,4
-Intergovernmental Debt	1820,1	2000,4	2216,7	2401,5	2646,5	2908,8
-Local Authorities	112,8	119,2	146,7	154,7	160,7	166,7
Public Debt (including intergovernmental) as a Percentage of GDP (%)	98,2	97,8	101,9	106,4	112,6	117,0
Public Debt (excluding intergovernmental) as a Percentage of GDP (%)	62,0	61,6	64,2	67,4	72,6	75,2

^a Includes long-term and short-term foreign debt, debt for defence and domestic debt.

^b According to Ministry of Finance data.

Table 12 (concluded)

	Annual Rates of Change (%)		
	2002/01	2003/02 (Est.)	2004/03 (Proj.)
Public Debt (including intergovernmental)	9,4	13,6	9,3
Public Debt (excluding intergovernmental)	10,0	15,6	9,0
Foreign Debt	11,1	25,0	44,1
Domestic Debt	9,1	12,0	3,6
-Debt to Commercial Banks	6,4	18,6	1,0
-Debt to Central Bank	29,3	0,0	0,0
-Debt to Private Sector	-5,1	24,1	-7,2
-Intergovernmental Debt	8,3	10,2	9,9
Public Debt (including intergovernmental) as a Percentage of GDP (%)	4,4	5,8	3,9
Public Debt (excluding intergovernmental) as a Percentage of GDP (%)	5,0	7,7	3,6

Table 13 (continued)

Monetary- Credit, 1999-2004

	1999	2000	2001	2002	2003 (Est.)	2004 (Proj.)
Total Money Supply (£m.)	6069,0	6552,5	7402,6	8165,2	8491,8	9043,8
Velocity of Circulation of Money ^a	0,942	0,875	0,842	0,792	0,794	0,794
Claims on Private Sector (£m.)	5648,8	6492,8	7320,1	7904,1	8299,3	8797,3
Total Bank Deposits (£m.) (excluding deposits in foreign currency)	5969,0	6488,4	7342,6	8142,4	8265,5	-
Deposits with Co-operative Credit Institutions (£m.)	2570,7	2821,6	3109,1	3513,0	3985,9	-
Deposits with Co-operative Credit Institutions/Total Deposits (%) ^b	30,1	30,3	29,7	30,1	32,5	-
Credit Extended by the Co-operative Credit Institutions to the Private Sector (£m.)	2410,2	2483,9	2519,1	2672,1	2947,0	-
Credit Extended by the Co-operative Credit Institutions/Total Credit to the Private Sector (%) ^b	28,9	26,8	24,8	24,4	25,3	-

Table 13 (concluded)

	Annual Rates of Change (%)		
	2002/01	2003/02 (Est.)	2004/03 (Proj.)
Total Money Supply (£m.)	10,3	4,0	6,5
Velocity of Circulation of Money ^a	-6,0	0,3	0,0
Claims on Private Sector (£m.)	8,0	5,0	6,0
Total Bank Deposits (£m.) (excluding deposits in foreign currency)	10,9	1,5	-
Deposits with Co-operative Credit Institutions (£m.)	13,0	13,5	-
Deposits with Co-operative Credit Institutions/Total Deposits (%) ^b	1,3	7,8	-
Credit Extended by the Co-operative Credit Institutions to the Private Sector (£m.)	6,1	10,3	-
Credit Extended by the Co-operative Credit Institutions/Total Credit to the Private Sector (%) ^b	-1,6	3,7	-

^a Refers to the ratio of GDP to the average level of liquidity for the year.

^bTotal bank deposits and credits of the banking system include also the Co-operative Central Bank.

Long-Term Foreign Debt, 1999-2004 £m. ^a

Table 14

	1999	2000	2001	2002	2003 (Est.)	2004 (Proj.)
Debt Outstanding	1502,3	1538,5	2012,1	2095,9	2373,5	n.a.
Government ^a	762,0	795,6	738,2	843,0	965,4	n.a.
Public Corporations	399,8	398,9	398,9	448,6	443,2	n.a.
Private Sector	340,5	344,0	875,0	804,3	964,9	n.a.
Principal Repayments	85,7	145,6	195,3	130,7	117,3	n.a.
Government ^a	32,2	16,0	86,5	36,3	13,1	n.a.
Public Corporations	31,5	105,6	82,8	63,9	70,8	n.a.
Private Sector	22,0	24,0	26,0	30,5	33,4	n.a.
Interest Payments	61,8	82,8	107,8	89,4	90,4	n.a.
Government ^a	30,4	43,8	45,4	38,0	42,9	n.a.
Public Corporations	17,5	21,5	21,2	20,0	17,3	n.a.
Private Sector	13,9	17,5	41,2	31,4	30,2	n.a.
Total Debt Service Payments	147,5	228,4	303,1	220,1	207,7	n.a.
Government ^a	62,6	59,8	131,9	74,3	56,0	n.a.
Public Corporations	49,0	127,1	104,0	83,9	88,1	n.a.
Private Sector	35,9	41,5	67,2	61,9	63,6	n.a.
Exports of Goods & Services ^b	3023,8	3492,9	3762,6	3464,9	3462,4	3430,3
Gross National Product (GNP)	5090,4	5585,7	5930,5	6237,8	6609,5	6949,7
Debt Service Ratio (%)	4,9	6,5	8,1	6,4	6,0	n.a.
Debt Service Payments/GNP (%)	2,9	4,1	5,1	3,5	3,1	n.a.
External Debt/GNP(%)	29,5	27,5	33,9	33,6	35,9	n.a.
Official Foreign Exchange Reserves/ External Debt (%)	75,6	75,0	77,5	82,8	67,7	n.a.

^a Includes long-term external debt which contains defence debt.

^b It is mentioned that the Central Bank in its methodology for calculating exports of goods and services does not include transfer receipts.

^c Refers to the ratio of total debt service payments to the exports of goods and services.

Structure of the Planning Bureau

Permanent Secretary

Economic Planning Service

Directorate for Macroeconomic Policy, Research and Studies

- i Preparation of the macroeconomic part and composition of the Strategic Development Plans.
- ii Annual evaluation of progress and preparation of specialised studies and policy proposals on macroeconomic issues.
- iii Preparation of models of the Cyprus economy for forecasting and assessing the effect of policy changes.
- iv Coordination of work for the liberalisation of services within the context of the GATS Agreement and for issues relating to the demographic problem.
- v Preparation of annual publications (Economic Outlook, Economic and Social Indicators) as well as reports on current economic developments on a regular basis.
- vi Coordination of the preparation of the Single Programming Document and the Programme Complement for Objective 3 of the EU Structural Funds and the Community Initiative EQUAL.
- vii Preparation and submission to the EU of the annual progress report on the implementation of structural reforms in Cyprus (Cardiff Report).
- viii Coordination and promotion of the implementation of the Lisbon strategy in Cyprus.

Two Directorates for Sectoral Economic Policy, Studies and Project Evaluation

- i Preparation of the sectoral part of Development Plans.
- ii Formulation of sectoral economic policy and submission of recommendations for new policy, measures and projects.
- iii Economic evaluation and ranking of projects and development schemes
- iv Coordination of the preparation of the Single Programming Document and the Programme Complement for Fisheries and of the Rural Development Plan
- v Preparation of a Strategic Framework and preparation of projects submitted for financing under the Cohesion Fund of the EU
- vi Coordination of the promotion of infrastructure projects funded through the Public- Private Partnership.
- vii Defining the strategy, formulation of policy and coordination of actions for developing Research, Technology and Information Society.
- viii Coordination, monitoring and promotion of the participation of Cyprus in bilateral agreements and EU Programmes for Research/ Technology and Information Society.
- ix Promotion and Coordination of the "Thraki-Aegean-Cyprus" Programme.

Directorate for Economic Relations with the European Union

- i Follow- up of the developments in the European Union and the evaluation of the implications on the Cyprus economy from the harmonisation process.
- ii Promotion and coordination of the implementation of the commitments undertaken for harmonisation with the acquis communautaire within the framework of the accession negotiations with the EU as well as the preparation of periodical progress reports.
- iii Preparation of studies, policy positions and recommendations for the integration of Cyprus to the EU.
- iv Medium-term planning of all the necessary actions for the promotion of the accession course within the framework of the Strategic Development Plan as well as coordinating the implementation of the harmonisation process through the Budget-Development Expenditure.
- v Planning and utilising preaccession funds and technical assistance from the EU as well as coordinating the participation of Cyprus in Programmes/ Initiatives, Organisations and Committees of the EU.
- vi Formulation of regional policy
- vii Management of Structural Funds- Processing and implementation of the management system (formulation, promotion, monitoring of Programmes).

Economic Coordination Service

Directorate for the Budget-Development Expenditure

- i Preparation and follow up of the implementation of the annual Budget-Development Expenditure.
- ii Preparation of reports with recommendations for measures for the removal of bottlenecks impeding the implementation of the various goals and objectives of the public development programmes.
- iii Coordination of the development work carried out in the various Ministries/ Departments/ Services and Semi-Government organisations.
- iv Funding and coordinating the implementation of the Ministries' harmonisation Programmes and financing pre-accession financial assistance through the Budget-Development Expenditure.
- v Coordination of the implementation, monitoring and funding of Structural Funds and Cohesion Fund projects.
- vi Design and operation of the Management Information System for the Structural Funds and the Cohesion Fund
- viii Design and Monitoring/Follow-up of the monitoring system of Structural Funds and the Cohesion Fund including the monitoring of the system and of projects/ measures / programmes.

Directorate for the International Economic Relations and General Administrative Work

- i Coordination of the acquisition and use of foreign aid and the follow up of the progress of implementation of approved projects/programmes.
- ii Coordination of all work in connection with the convening of the Mixed Intergovernmental Committees for Economic, Scientific, Technical and Industrial Cooperation and for the conclusion of Agreements on the Mutual Promotion and Protection of Investments.
- iii Monitoring and coordination of projects under the Pre-accession Financial Regulation and the Transition Facility.
- iv Preparation, coordination and follow up of technical assistance schemes offered to Third Countries.
- v Coordination and follow up of the cooperation with international organisations.