



CYPRUS

SELECTED ISSUES

June 2021

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Approved By
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Prepared by Estelle Liu, Boyang Sun, Anita Tuladhar (EUR)
and Ke Wang (SPR).

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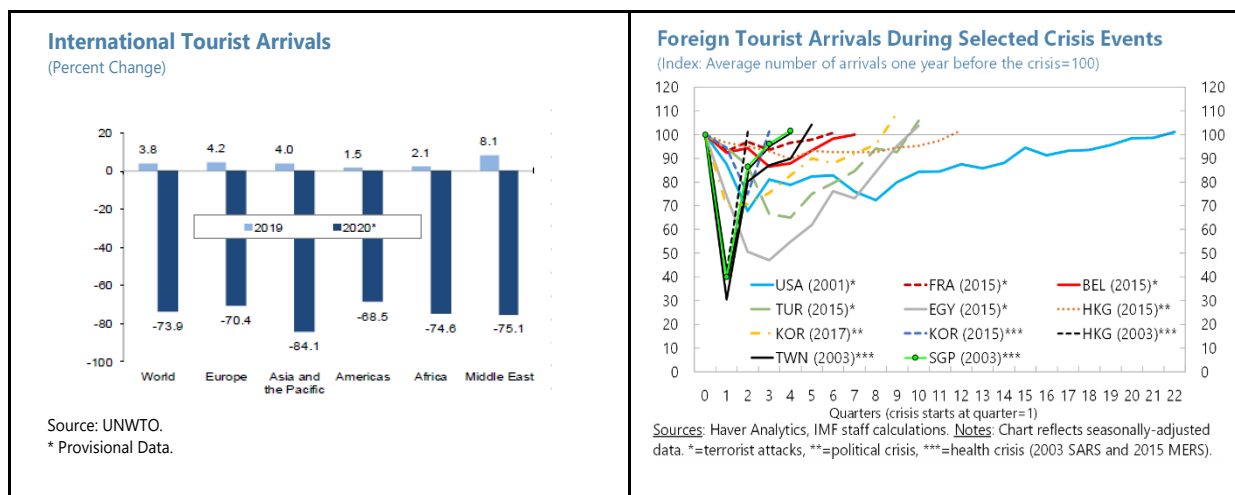
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TOURISM SECTOR IN CYPRUS

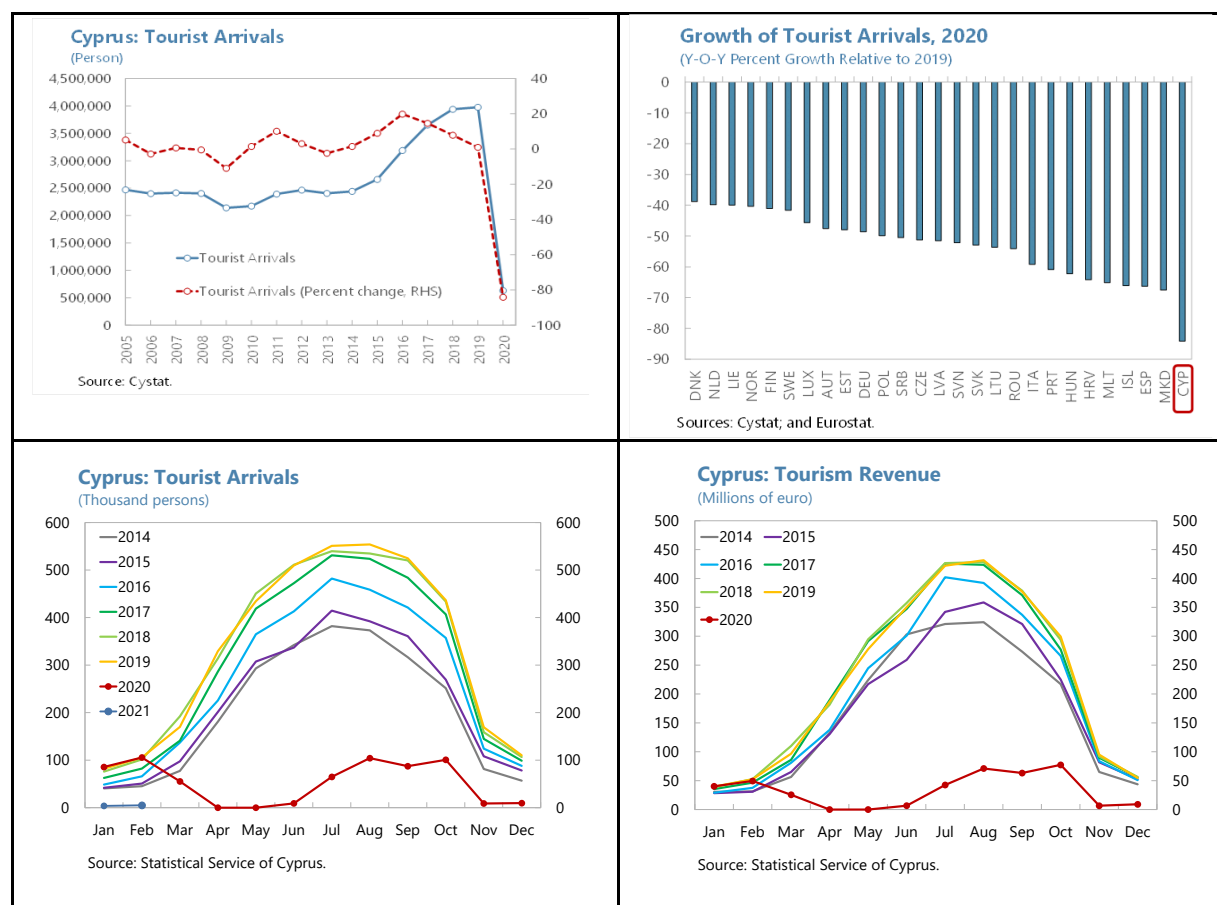
The global pandemic shock has caused an unprecedented shock to the tourism industry, severely impacting tourism-dependent economies such as Cyprus. This chapter seeks to examine the recent developments in the tourism sector in Cyprus. It further examines the outlook for recovery prospects and outlines some policy priorities given the economic vulnerability to the tourism shock and the need to minimize scarring and protect the vulnerable workers.

A. Recent Trends in the Tourism Sector

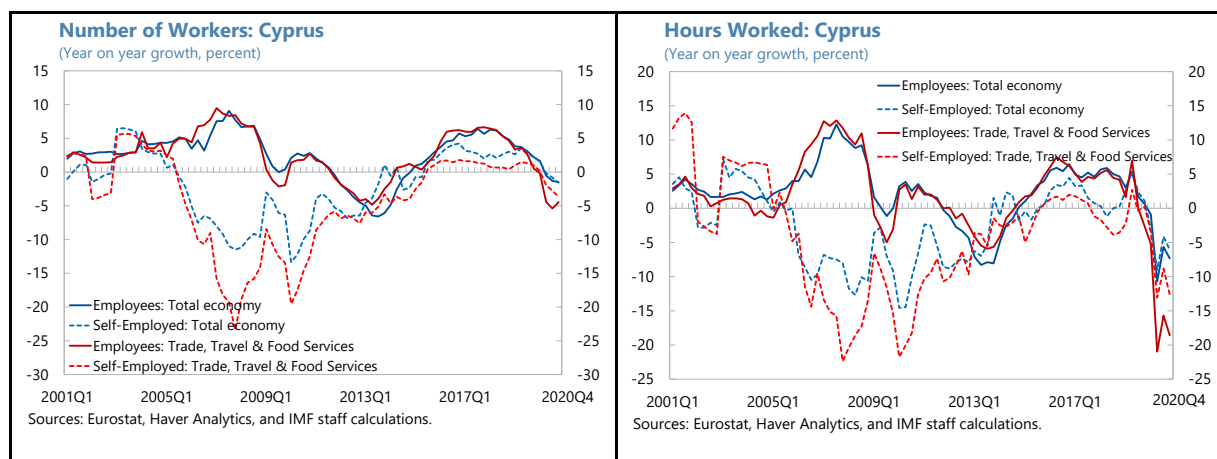
1. Global tourism has suffered the worst year on record in 2020 following the unprecedented fall in demand and widespread travel restrictions. According to UNWTO (2021), international arrivals dropped by 74 percent in 2020 (1 billion fewer arrivals) than in 2019. The collapse in international travel represented an estimated loss of USD 1.3 trillion in export revenues, more than 11 times the loss recorded during the 2009 global economic crisis. The loss in tourism translated into an economic loss of USD 2 trillion in direct tourism GDP (more than 2 percent of the world’s GDP). Europe recorded a 70 percent drop in tourist arrivals in 2020, and the region suffered the largest drop in absolute terms with over 500 million fewer international tourists. By comparison, during the 2009 global financial crisis, international tourist arrivals fell by 4 percent in the world and 10 percent in Europe, with a much smaller economic impact and swift recovery afterwards. Based on a simple event analysis, tourism slumps associated with major terrorist attacks, epidemics, and political crises, showed, on average, 20 to 30 percent declines in tourist arrivals (Salas, et. al, 2020). For instance, tourist arrivals dropped by 5 to 31 percent after terrorist attacks (USA, France, Belgium, Turkey, Egypt) and recovered in one to five years. Tourist arrivals dropped, on average, by above 30 percent and recovered in one year or less in the SARS and MERS epidemics (Hong Kong, Taiwan, Singapore, South Korea).



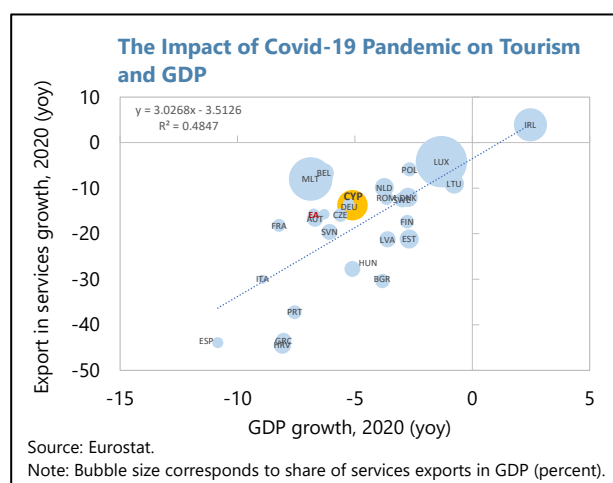
2. Tourism in Cyprus has been hard hit by the Covid-19 shock, among the most severe in Europe. Tourist arrivals experienced an unprecedented collapse since the pandemic. In 2020, tourist arrivals decreased by 84 percent, while tourism revenue decreased by 85 percent, compared to 2019. Travel restrictions led to a significant decrease in tourist demand from the major markets such as the United Kingdom (UK) and Russia. While travel restrictions were lifted in early June for arrivals from a limited number of countries, Cyprus still experienced the most severe decline of tourist arrivals for the year when compared with other European countries.



3. Employment has been largely protected in the tourism sector, but hours worked declined much more severely than during the previous crises. While tourism employment has declined more than in the rest of the economy, with the temporary employment support measures, this decline has been contained so far. The number of workers in Trade, Travel & Food Services decreased by 13 percent in 2020:Q2 and 9 percent in 2020:H2 compared with the previous year. This trend also held for self-employed workers. Nonetheless, hours of work in Trade, Travel & Food Services decreased more significantly in the second, third and fourth quarters of 2020 by 20 percent, 15 percent, and 18 percent, respectively, compared to the previous year.



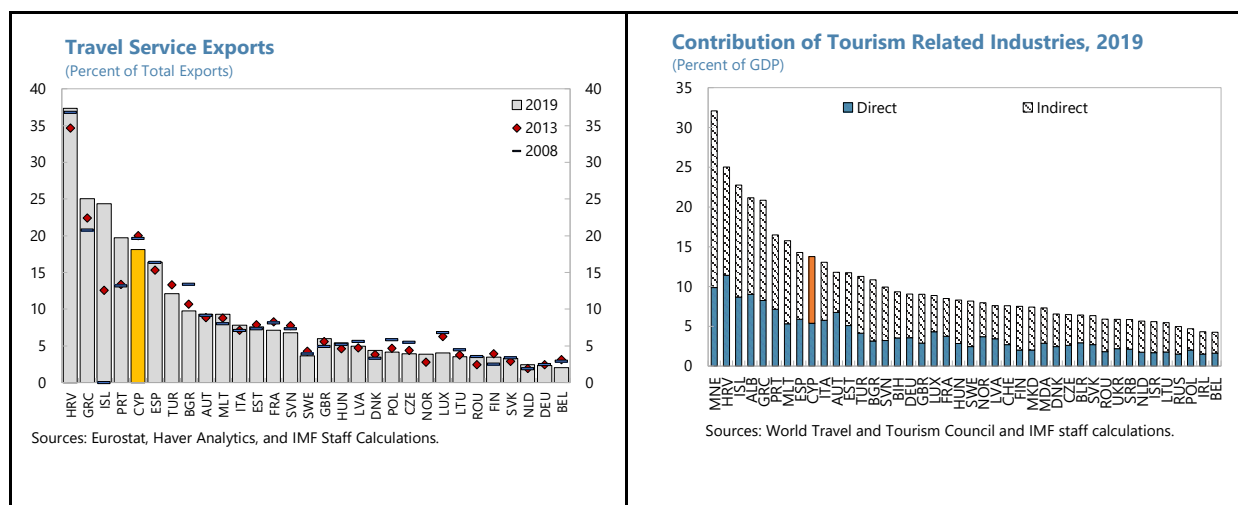
4. The pandemic shock has had a significant impact on exports of services and on GDP growth. The adverse impact on the economy was large since tourism is a key sector for Cyprus. Services exports decreased by around 27 percent in the second and third quarters of 2020 compared to the same periods of 2019, mainly reflecting the fall in demand for tourism. The overall economy also showed a deep recession in 2020, with real GDP declining by around 8 percent in the second and third quarters of 2020.



B. Vulnerability of the Cypriot Economy to the Tourism Sector

5. The Cypriot economy has a high dependence on tourism, which makes it more vulnerable to the impact of the Covid-19 shock. Tourism receipts accounted for more than 18 percent of Cyprus's total exports in 2019. Tourism expenditure balance (inbound minus outbound) reached around 8 percent of GDP in 2019. Tourism also has large spillover effects to related industries outside of hotels (food services, retail, transport, construction, other services). Cyprus's economy has a very high dependence on tourism related industries, with the total of direct and indirect contribution accounting for nearly 14 percent of GDP in 2019, which was higher than in many other European countries.¹ Tourism and related services also provided a large contribution (around 13 percent) to total employment.

¹ Based on the World Travel and Tourism (WTTC) database, the direct contribution of travel & tourism to GDP is calculated to be consistent with the output of tourism-characteristic sectors such as hotels, airlines, airports, travel agents, and leisure & recreation services that deal directly with tourists. The total contribution of travel & tourism includes its wider impacts on the economy (i.e. the indirect and induced impacts), in addition to the direct impacts.



6. High exposure of the Cypriot banking system to the tourism sector also increases the risk of a macro-financial feedback loop. Loans to accommodation and food services was 46 percent of tier 1 capital, one of the highest in the euro area (IMFa, 2020)². The sectors of trade, hotel, restaurant, and transportation accounted for the largest shares of total loans and non-performing loans in Cyprus. These sectors were hit harder by the pandemic with more negative growth rates of gross value added than other sectors. However, the moratorium on loan repayments have helped alleviate the negative impact of the pandemic on the financial sector. The take-up rate of the loan repayment moratorium, at over 90 percent, was particularly high for non-financial corporations involved in tourism related activities, including accommodation and food, arts, entertainment and recreation, and construction. But with the expiry of the moratorium, there are risks of loan distress as the repayments become due. A heatmap table capturing these economic and financial sector exposures placed Cyprus among the highest quintile of countries vulnerable to the tourism sector in the EU³.

The indirect contribution includes the GDP and jobs supported by: travel & tourism investment spending; government 'collective' spending which helps travel & tourism activity; and domestic (non-imported) supply chain purchases of goods and services by the sectors dealing directly with tourists. The induced contribution measures the GDP and jobs supported by the spending of those who are directly and indirectly employed by the travel & tourism sector (WTTC/Oxford Economics 2020).

² Based on IMF (forthcoming), "The Impact of COVID19 on European Banks," EUR Departmental Paper.

³ Based on Salas, et. al. (2020), "Tourism in Europe After the COVID-19 Shock: Impact, Prospects, and Policies." Unpublished slides, European Department, International Monetary Fund.

Loans to Highly Affected Sectors (Percent of Tier 1 capital)							
	Construction	Wholesale & Retail Trade	Transport & Storage	Accommodation & Food Services	Real Estate Activities	Arts & Entertainment	Other Services
AT	29	56	18	16	116	2	4
BE	26	40	15	4	41	3	4
CY	39	59	17	46	44	2	3
DE	10	42	28	4	177	2	11
EE	14	59	24	4	86	3	7
ES	29	70	24	18	48	3	24
FI	20	30	30	4	167	3	10
FR	18	53	25	9	90	2	28
GR	40	91	51	40	29	6	10
IE	6	25	13	21	60	4	8
IT	47	77	24	16	66	3	28
LU	9	3	2	3	22	0	5
LV	12	33	33	14	72	1	5
MT	16	24	10	12	32	4	1
NL	15	68	33	7	88	2	21
PT	34	41	19	18	38	3	19
SI	16	52	39	6	11	1	4
EA SSM	22	47	23	15	90	3	11

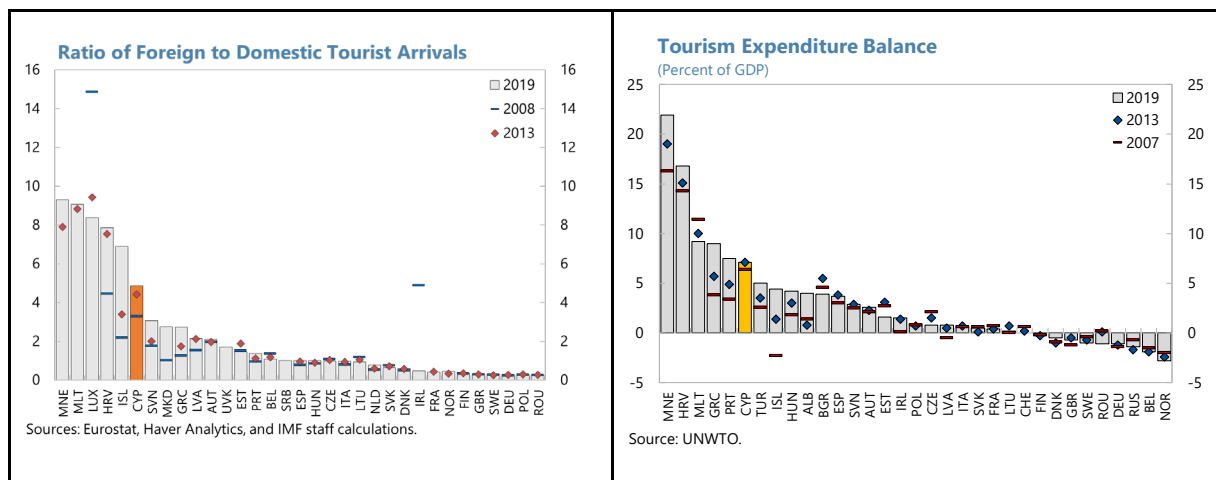
Sources: IMF (2020a) based on data from EBA Transparency Exercises and IMF staff calculations.

Macroeconomic Indicators						
	Share of tourism in total output	Share of tourism (direct and indirect) in total employment	Share of travel services in total exports	Private consumption WEO forecast (2020-2021)	Bank Lending to Accommodation & Food Services Sector	Average quintile
Austria						4.2
Belgium						2.2
Bulgaria						3.4
Croatia						4.3
Cyprus						4.0
Czechia						2.5
Denmark						2.0
Estonia						3.0
Finland						1.8
France						3.2
Germany						2.8
Greece						4.8
Hungary						2.8
Iceland						4.5
Ireland						2.8
Italy						4.4
Latvia						3.2
Lithuania						1.0
Luxembourg						2.4
Malta						4.0
Netherlands						3.4
Norway						2.8
Poland						1.8
Portugal						4.8
Romania						2.0
Slovakia						1.3
Slovenia						3.4
Spain						5.0
Sweden						2.6
Switzerland						2.7
Turkey						3.0
United Kingdom						3.6

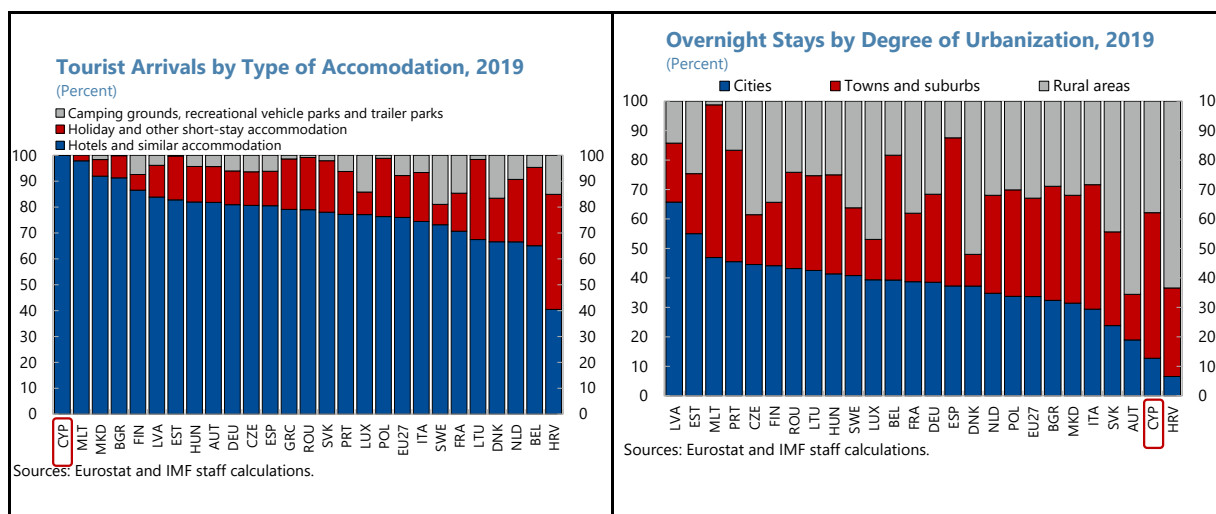
Sources: Eurostat; WTTC; and IMF WEO.

C. Characteristics of the Tourism Sector Affecting the Recovery Prospects

7. The tourism sector in Cyprus is highly reliant on foreign/inbound tourism, which puts Cyprus in a less favorable position regarding the prospects for a near-term recovery. Foreign tourist arrivals reached around 5 times of domestic tourist arrivals in 2019, and the tourism expenditure balance (inbound minus outbound tourism expenditure) was around 8 percent of GDP in 2019, higher than most other European countries. The European Travel Commission (2021) estimated that European international travel declined by 69 percent in 2020, compared to a 35 percent decline for domestic travel. The high reliance of Cyprus's tourism on international arrivals indicates a slower near-term recovery prospect as international travel restrictions will be eased at a slower pace than domestic tourism, and the smaller share of domestic tourism also reflects its relatively minor contribution from its rebound to offset the drop in international arrivals. In addition, the full dependence on air travel also makes it highly susceptible to travel restrictions.

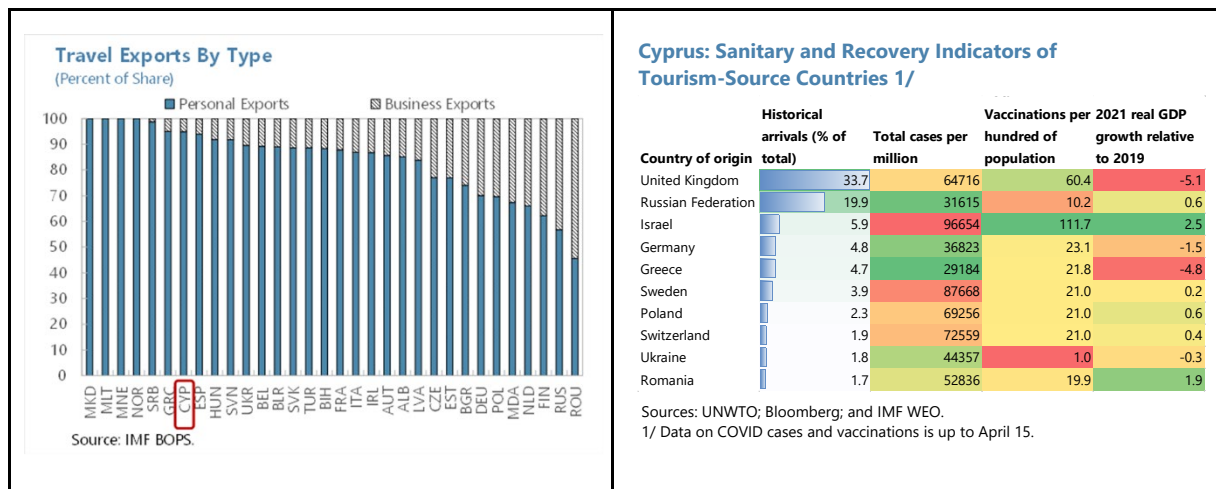


8. High reliance on hotel accommodation makes Cyprus more vulnerable to the Covid-19 shock, while concentration of stays away from cities presents a more favorable outlook. Given the fall in attractiveness of hotels with the pandemic shock, there is potential for non-hotel accommodations to attract tourists, which benefits countries that can provide a greater variety of accommodations. However, in the case of Cyprus, almost all tourists stay in hotels and similar accommodations. On the other hand, the location of overnight stays in Cyprus is more diverse, with more stays in towns and suburbs and rural areas and relatively low ratio of stays in cities. The relatively large size of non-urban tourism is helpful for Cyprus to cope with the pandemic, as rural tourism is likely to increase and could partly offset the decline in urban tourism.



9. Cyprus's lower dependency on business travel and good progress on vaccination in source countries are more favorable for recovery prospects. When evaluating travel exports by type, Cyprus has a very high ratio of personal travel and low reliance on business travel. This trend could suggest a quicker rebound of tourism since business tourism may be more severely affected post-Covid-19. In addition, the major tourist market countries of Cyprus have made good progress

on vaccinations. Two of the top three source countries (UK and Israel) are advanced in vaccinating their population, with around 60 percent and 110 percent of population having completed vaccinations by mid-April. Another positive factor is that two of the top three markets (Russia and Israel) are expecting a faster recovery to pre-pandemic growth rates in 2021. The concentration of tourist sources from Europe also increases the likelihood of travel as travel restrictions ease within Europe and travelers prefer short-haul flights.



10. Furthermore, the relatively good health conditions of Cyprus would help to attract tourists once travel restrictions are lifted. Cyprus has so far ranked relatively well in terms of health conditions. When compared with other European countries, Cyprus has relatively fewer reported cases of Covid-19 per million people, suggesting the relatively high degree of safety of sanitary situation in Cyprus. Cyprus has also conducted more Covid-19 tests per million people than most of the other European countries which could help contain the pandemic. Nonetheless, the health situation remains highly uncertain given the ongoing wave of infections.

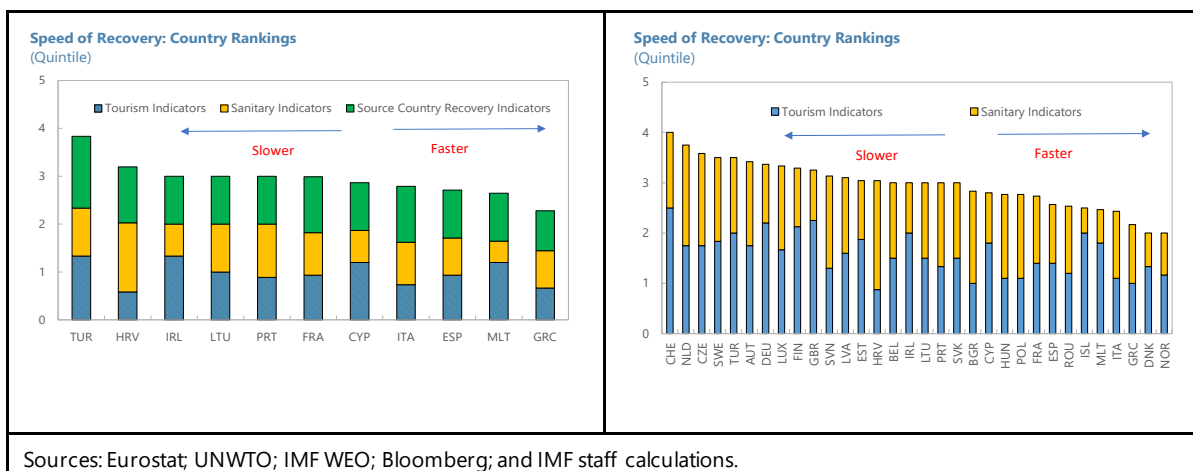
11. Based on a Heatmap Analysis of the overall tourism characteristics and sanitary situation, Cyprus is placed in the fourth and third quintile of EU countries in terms of the risks to the prospect of tourism recovery. As shown in the text table, Cyprus has a score of 3.4 using the tourism indicators⁴, mainly reflecting the large dependence on foreign tourism and air travel. Cyprus fares relatively well in terms of sanitary/health indicators, placing it in the middle quintile with a score of 2.8. This reflects the lower number of cases and high testing rates which is partly offset by the high stringency score on mobility restrictions that deter the attractiveness for travel.

⁴ The Heatmap Analysis based on indicators include: relative size of urban (vs. rural) tourism, relative size of foreign (vs. domestic) tourism, inbound (vs. outbound) tourism spending, share of business (vs. personal) travel, share of hotel stays (vs. other accommodations) and share of tourism by air (vs. other modes). Each indicator is scored in a range between 1–5 with a higher score indicating a higher vulnerability (Salas, et. al., 2020). The relative ranking should however be treated with caution given the missing values in some variables. A similar heatmap for the health/sanitary indicators uses number of COVID-19 cases, vaccination rate, number of COVID-19 tests and stringency of the mobility restrictions (see IMF (forthcoming), "Tourism in Southern Europe: Development and Prospects under the COVID-19 Pandemic," EUR Departmental Paper).

	Tourism Indicators							Average quintile	Sanitary Indicators				
	Relative size of urban (vs. rural) tourism	Relative size of foreign (vs. domestic) tourism	Relative size of tourism by air (vs. other modes)	Relative size of inbound tourism from RoW (vs. from Europe)	Relative size of tourism exports on business (vs. personal)	Inbound (vs. outbound) tourism spending	Share of hotel stays (vs. other accommodations)		COVID-19 cases	COVID-19 vaccines	COVID-19 tests	Stringency Index	Average quintile
Austria								3.0					3.8
Belgium								2.5					3.0
Bulgaria								2.5					3.3
Croatia								2.2					3.5
Cyprus								3.4					2.8
Czechia								3.7					3.8
Denmark								2.6					1.8
Estonia								3.8					2.0
Finland								4.0					2.0
France								2.7					3.0
Germany								3.7					3.0
Greece								2.5					3.0
Hungary								2.7					3.5
Iceland								4.0					1.0
Ireland								3.8					2.8
Italy								2.1					3.3
Latvia								2.9					2.8
Lithuania								3.0					3.0
Luxembourg								3.5					3.3
Malta								4.0					1.3
Netherlands								3.2					4.3
Norway								2.0					2.0
Poland								2.3					3.5
Portugal								3.6					3.8
Romania								2.4					3.0
Slovakia								2.5					3.3
Slovenia								2.8					3.5
Spain								3.0					2.8
Sweden								3.2					3.5
Switzerland								4.0					3.0
Turkey								4.3					3.3
United Kingdom								3.3					2.8

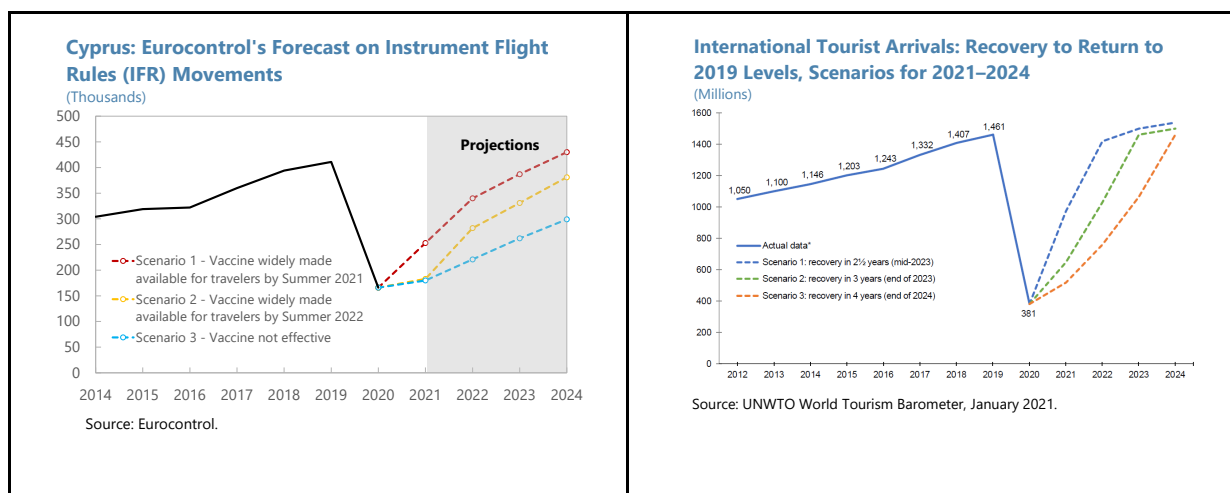
12. Looking ahead, Cyprus fares relatively well in terms of prospects for recovery given the tourism characteristics, sanitary indicators, and recovery in the main source countries.

Using the quantile distribution of countries (combining indicators in the heatmaps), with 1 indicating the least vulnerable and 5 being the most vulnerable, we estimate the speed of recovery for countries assuming each broad category has the same weight. Based on the results, Cyprus should have a relatively faster recovery rate.

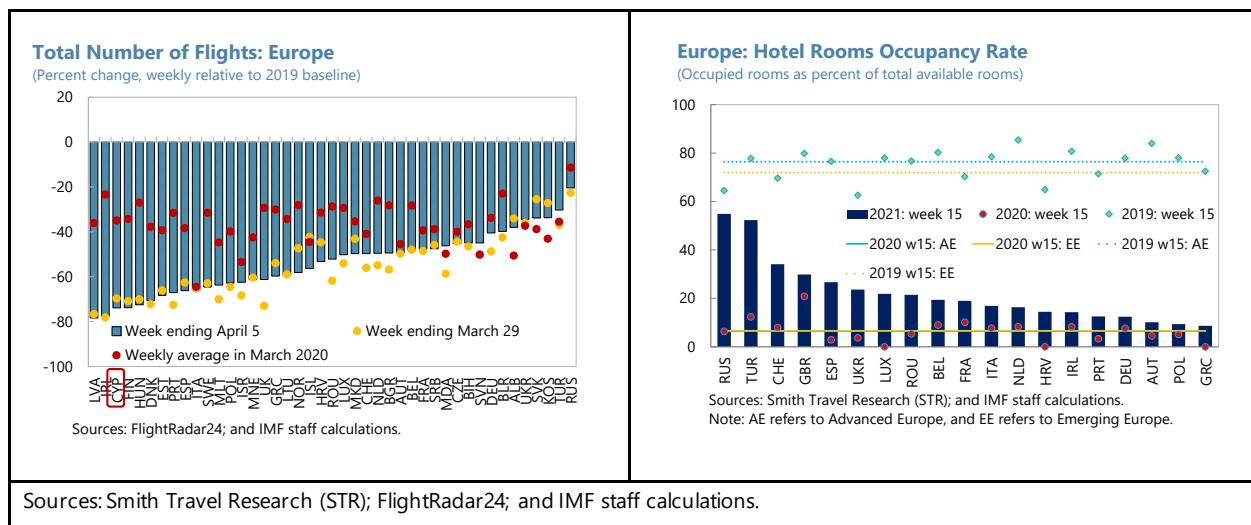


D. Outlook for Tourism

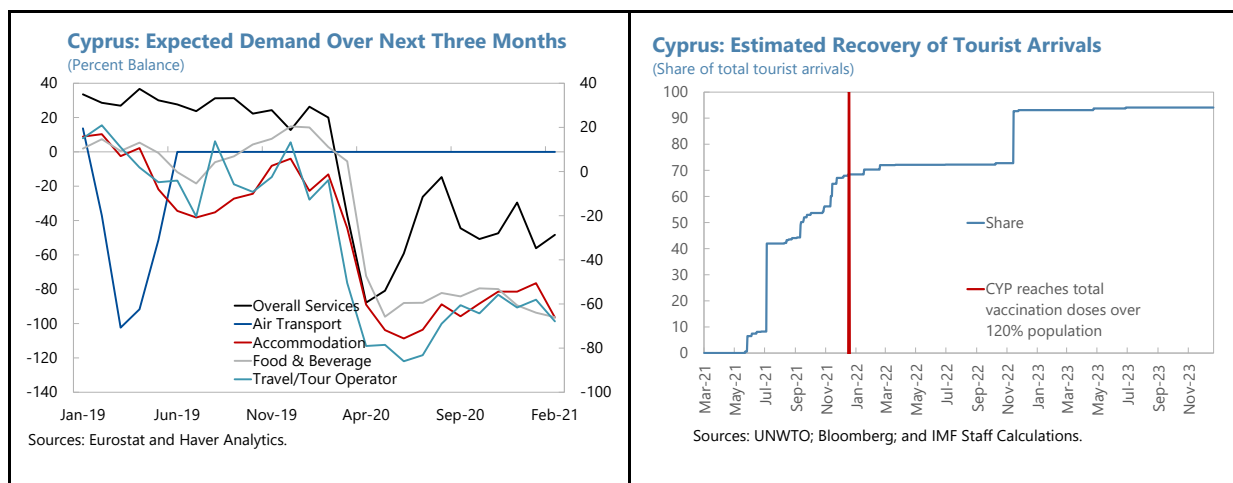
13. The decline in tourism is expected to be partially reversed in 2021 with a full recovery to pre-pandemic levels expected only in the medium term. Eurocontrol forecasts (Nov 2020) shows that air traffic in Europe would only return to 2019 levels by 2024 in the most optimistic scenario, assuming vaccine is made widely available for travelers by summer 2021, while air traffic in 2024 would be at 92 percent of the 2019 level in their second scenario (vaccine widely available in 2022) and 75 percent in their third scenario (vaccine not effective). According to the UNWTO (2021), the recovery outlook for 2021 remains subdued amid high uncertainty, with half of the respondents expecting a rebound in 2021 and the other half only in 2022. The extended UNWTO scenarios for 2021–2024 indicate that it could take between 2½ and 4 years (mid-2023 – end 2024) for international tourism to return to 2019 levels. Based on European Travel Commission (2021), which conducts global tourism forecast using the Global Travel Service model, inbound visitor growth rates of Southern and Mediterranean Europe are projected to be -72 percent in 2020, 132 percent in 2021, 34 percent in 2022, and 16 percent in 2023.



14. The slow recovery is also consistent with recent high frequency indicators. Decline in flights to Cyprus was among the highest in Europe. Flights continue to decline in early 2021, which does not bode well for Cyprus's tourism given its full reliance on air travel. Based on anecdotal evidence, hotel occupancy remains low at around 10 to 15 percent compared to the 50 to 55 percent in 2019, consistent with Southern European peers such as Portugal and Greece. EU business confidence surveys also show continued underperformance of tourism industries although forward-looking expectations have improved slightly since July 2020.



15. The recovery of tourism will be determined by the pace of the vaccination rollout, the coordination among countries on travel procedures and the economic situation. New infection waves and protracted containment measures could further delay the recovery of tourism sector. On the other hand, vaccine developments help to shift the balance of risks and elevate the upside potential. For Cyprus, based on the current pace of vaccine rollout in the country as well as the main source countries, staff has projected that a recovery of 30 percent, on average, of the 2019 level is expected in 2021 with full recovery taking place by 2024.



E. Policy Priorities

16. Cyprus has adopted various measures to support the economy and tourism sector. Main policy measures⁵ include: 1) Income tax measures and VAT reductions; 2) support for bank lending; 3) a Suspended Operations Plan for businesses that decided to suspend their operations or

⁵ Based on UNWTO compilation of country policy measures to support travel and tourism.

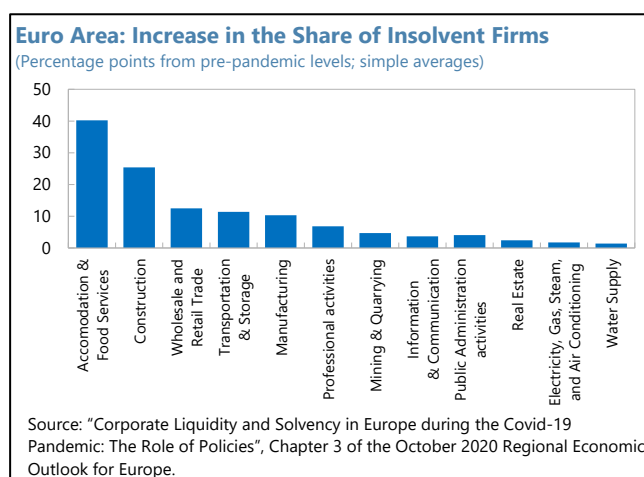
suffered high losses and unemployment allowance; 4) Small Business Support Plan to provide funds and subsidy of employee salaries; 5) Granting of “sickness benefit” and residence allowance for students abroad. More targeted measures for the tourism sector include: 6) a co-promotional program of EUR10 million with tourist agents for the projection of Cyprus as a safe destination for tourists, and additional appropriations of EUR 11 million to support tourism between June and September 2020, in cooperation with airlines and travel operators, as well as actions to boost tourist attraction during the period from October 2020 to March 2021; 7) covering the health cost of travelers who test positive while in Cyprus; 8) allowing vaccinated travelers to avoid quarantine and negative coronavirus test restrictions from March 2021; 9) “Extraordinary Plan for the Support of Domestic Tourism” which offers hotel discounts to permanent residents to support local businesses.

17. Continued targeted support measures to the tourism sector are warranted in the short term given their systemic importance to the economy.

Measures will need to consider solvency support given the high risk of insolvency among tourism sector firms as shown by simulations of corporates in the Euro Area (IMF, 2020b)⁶. Liquidity-type support, such as guaranteed loans or lending rate subsidies, etc. could be considered. These measures would allow public support to benefit from a viability assessment by banks. Since many

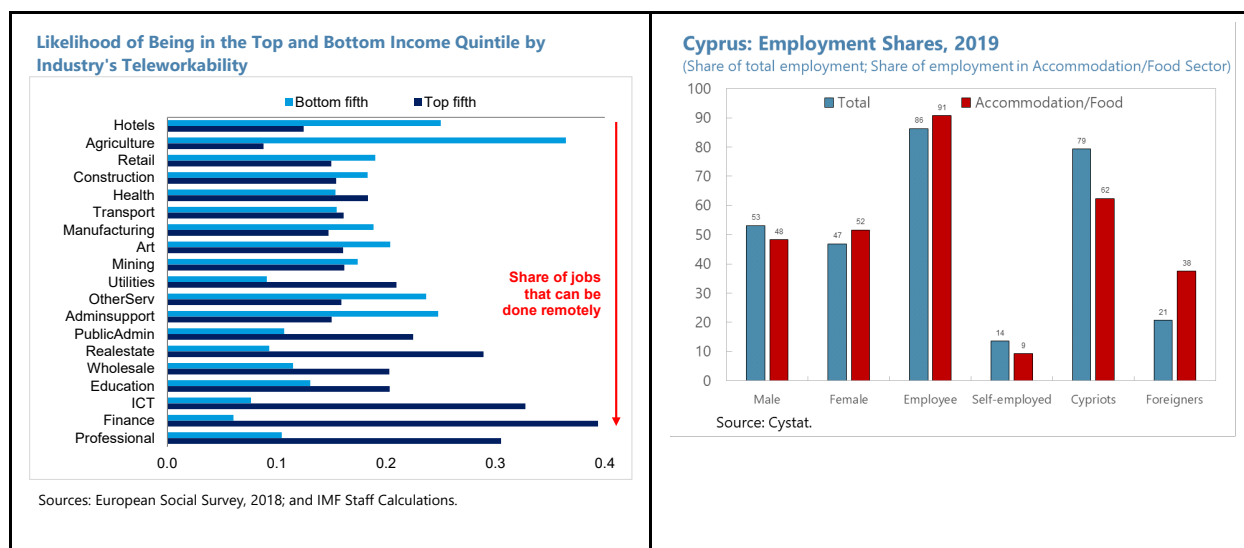
tourism-related businesses would fall under SMEs, increased access to SME restructuring tools would help avoid costly bankruptcies. For larger, strategic businesses, equity-type support—with potential upside for the government down the road as the economy recovers—could also be considered. Since the tourism sector is more likely to suffer for an extended period, these measures could mitigate long-term scarring while ensuring scarce public resources are extended to viable businesses. The length of the support, if fiscal space allows, could last until the end of the crisis, and should reduce as tourism picks up. Other targeted policies such as promoting marketing for tourism, could also boost tourism revenues.

18. Policy design measures should also take into account that tourism sector workforce is among the most vulnerable. Workers in the hotel industry tend to fall disproportionately in the lowest income quintile compared with other industry groups. Given low teleworkability of this industry, these workers are more susceptible to unemployment and income loss. Policies should thus ensure continued income replacement or wage subsidies to maintain employment ties.

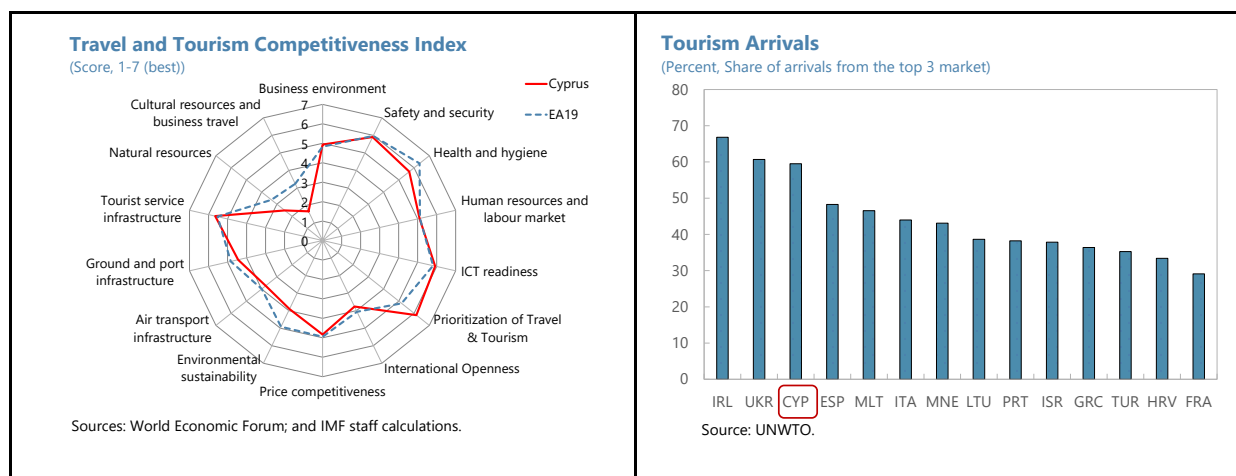


⁶ Based on simulations using firm-level data (ORBIS database) in 13 euro area countries and October 2020 WEO projections and announced policies, the authors find that the share of firms deemed insolvent would rise by 8 percentage points, on average, given high leverage levels and limited scope for equity financing among SMEs. See IMF (2020b), “Corporate Liquidity and Solvency in Europe During the COVID-19 Pandemic: The Role of Policies,” Chapter 3, Regional Economic Outlook (October) for further details.

Workers in this sector appear to be more gender balanced, although women are represented more than in other sectors. At the same time, this sector has a higher reliance on foreign workers in Cyprus. Support measures should appropriately target these populations in terms of safety net support and to facilitate easier transition back into the workforce as the recovery takes hold.



19. The longer-term policy challenge is to steer the sector from mass tourism to sustainable tourism, given the impact of the pandemic and environmental concerns. Mass tourism tries to maximize revenues through demand anticipation and capacity management, notably in airlines, hotels, and rental cars. Risks of future pandemics, overcrowding, and environmental policies may have long-term impacts on international travel and make mass-tourism business model less viable. Sustainable tourism could be a potential alternative which focuses on smaller-scale, regionally more diverse, and higher-end tourism; more strongly based on environmental sustainability, quality of services, and non-price competitiveness. Based on the Travel and Tourism Competitiveness Index by World Economic Forum (WEF), Cyprus has similar competitiveness scores as the average of Euro Area countries. Cyprus also ranks among the most improved (from 55th to 42nd); nevertheless, further improvements will need to focus on environmental sustainability and diversification to different types of markets such as cultural resources. Cyprus has made progress in diversifying the source markets of tourism, although the share of its top three markets (UK, Russia, Israel) remains very high, making it vulnerable to developments in these countries. More diversification of tourist market would help Cyprus to cope with shocks.



F. Conclusion

20. Global tourism has suffered the worst year on record in 2020. The impact on tourism in Cyprus has been among the most severe in Europe, which in turn had a significant impact on exports of services and on GDP growth. Nevertheless, employment has been largely protected in the tourism sector, due to large support packages that were rolled out.

21. Looking ahead, near-term challenges to the tourism sector remain significant. The decline in tourism is expected to be only partially reversed in 2021 with a full recovery to pre-pandemic levels only expected in the medium term, raising risks of scarring. The Cypriot economy remains vulnerable to the COVID-19 shock given its high dependence on tourism. High exposure of the Cypriot banking system to the tourism sector also increases risks of a macro-financial feedback loop. At the same time, Cyprus fares relatively well in terms of prospects for recovery, given its tourism characteristics, sanitary indicators and recovery in the main source countries, once travel restrictions are eased. While uncertainty remains high, the recovery of tourism will be determined by the pace of the vaccination rollout, the coordination among countries on travel procedures and the economic situation.

22. In this context, continued targeted support measures to the tourism sector are warranted in the short term given their systemic importance to the economy. Policy design measures should also take into account that the tourism sector workforce is among the most vulnerable. The longer-term policy challenge is to steer the sector towards sustainable tourism, given the impact of the pandemic and environmental concerns.

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