# The long road to new normality

## The corona virus and its impact on the Cyprus economy

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# Introduction

- Uncertainty makes todays exercise challenging, nevertheless useful to identify trends and support informed policy decisions
- Going forward revisions of projections likely to be huge
- **My focus** : main findings & policy recommendations
- **Main conclusion** : Unprecedented crisis despite timely government action – for the future strong fiscal action & adaptation of private sector key

# Theoretical framework

- Pandemic led to a severe supply shock (via supply chain disruptions & employment reduction & idle capital)
- … and at the same time to a severe demand shock via (negative effects on disposable income & confidence as well as lower export demand (tourism)
- Timely fiscal action led to amelioration of some of the losses
- Continuing social distancing & health care measures - though necessary also from an economist view - increase compliance costs and reduce demand - thus affects corporate sector profitability and viability

# Main factors affecting developments going forward (1)

## Health sector

- Cyprus in favourable position in the health sector – however, until vaccine or effective medical treatment is found, return to normality will be slow

## Tourism

- Furthermore, Cyprus highly dependent on external demand (tourism) severely affected by the pandemic – WTO projects declines between 60-80% - main tourism markets (UK & Russia), among countries mostly affected by pandemic (& real effective appreciation vis a vis sterling and rubble) – costly access to remote islands - adaptation to "new normality" in tourism a challenge – safety first will lead to cost increases and profitability squeeze - preference towards home tourism or tourism in neighbouring countries

# Factors affecting developments going forward (2)

**Disposable income**

- Tentative estimate (based on surveys) loss of 20%, despite generous government support measures – loss of profitability and confidence affecting domestic demand components - low oil prices provide small support to households and corporations

- Available fiscal space but not without limits due to relatively high public debt

**Financing**

- Availability of bank lending mainly for working capital purposes - if political agreement is reached backed by government guarantees – however take up may be low given already high corporation leverage

# Prospects

- Hopes for quick V shape recovery fading – gradual U shape recovery best case scenario – levels of 2019 not to be reached before 2022 – production losses compared to pre-corona scenario substantial, likely to exceed 1 bln
- Cyprus to be strongly affected because of high dependence on tourism & external transactions
- Construction & public sector likely growth drivers
- Based on expert views and experiences of previous crisis, social implications likely to be negative (unemployed & low skilled)

# Long-term effects

- Interesting discussion among economist – consensus that pandemic also affects potential medium-term growth via employment losses & unavoidable bankruptcies & unavoidable restrictive fiscal policies after return to "normality" to reduce accumulated public debt
- Ongoing trade tensions and Brexit additional risk factors
- Countries with comparative advantages in advance technology will belong to the "winners"
- Moreover, industrial countries due to a tendency to reduce dependency on foreign imports and avoid in the future abrupt supply chain disruptions

# Policy recommendations (1)

- General consensus – expansionary monetary and fiscal policies necessary to support the economy at least until 2021 – "what ever it takes" – expenditure based to partially offset lower activity in the private sector – priorities health care capacity & social spending (minimum income & unemployment benefits & incentives part time )& e- government & digital economy & climate change & infrastructure

- Containment of public wages (freeze) & non-essential public expenditure necessary to avoid excessive built up of debt

- Utilization of EU initiatives (via ESM & SURE & EIB & recovery fund could contribute as much as 5pp of GDP with favourable financing terms - grant element should form a considerable part of EU initiatives to avoid debt crisis down the road – given that desirable debt mutualization and monetary financing of public deficits not politically feasible options)

# Policy recommendations (2)

- Additional precautionary financing likely to be needed and should be based on adverse scenario – currently conditions in sovereign debt markets remain favourable, despite increase in risk premia – (however in 1-2 years market perceptions against vulnerable economies expected to worsen)
- EU coordinated, gradual fiscal consolidation after 2022
- Development of non debt financing instruments (equity fund), to avoid further built up of corporate debt
- Re–thinking of growth model: Sustainable tourism & services with VA component & renewable energy & tertiary health & tertiary education (distance learning) & government on line

# Concluding remarks

- Despite timely government action worst crisis since 1974 – worse than 2013
- World - wide "winners" will be those countries that use prudently available fiscal space & manage to adapt & invest in the future