

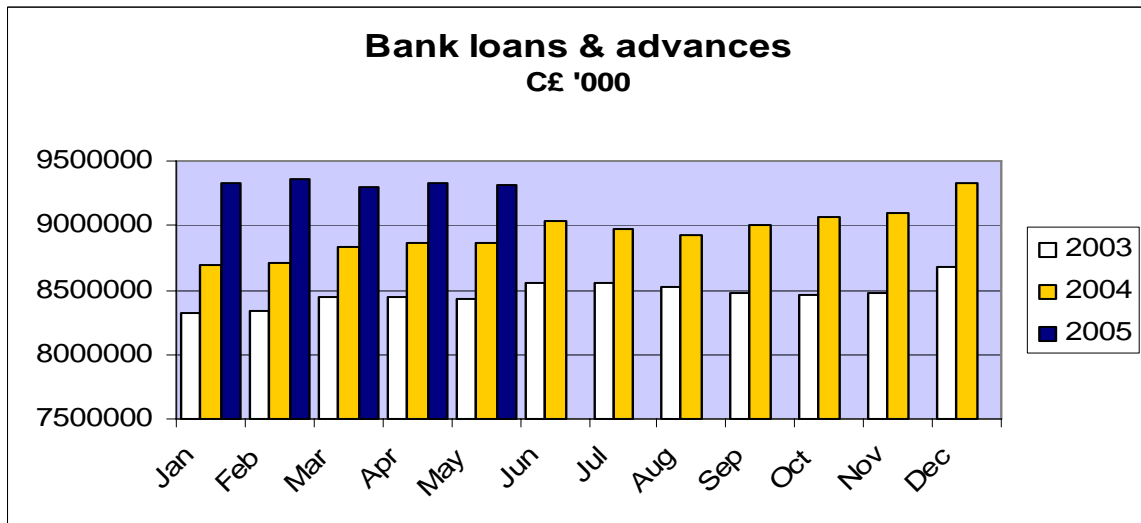
S. Platis EXPRESS ECONOMIC ANSWERS™

Bank lending

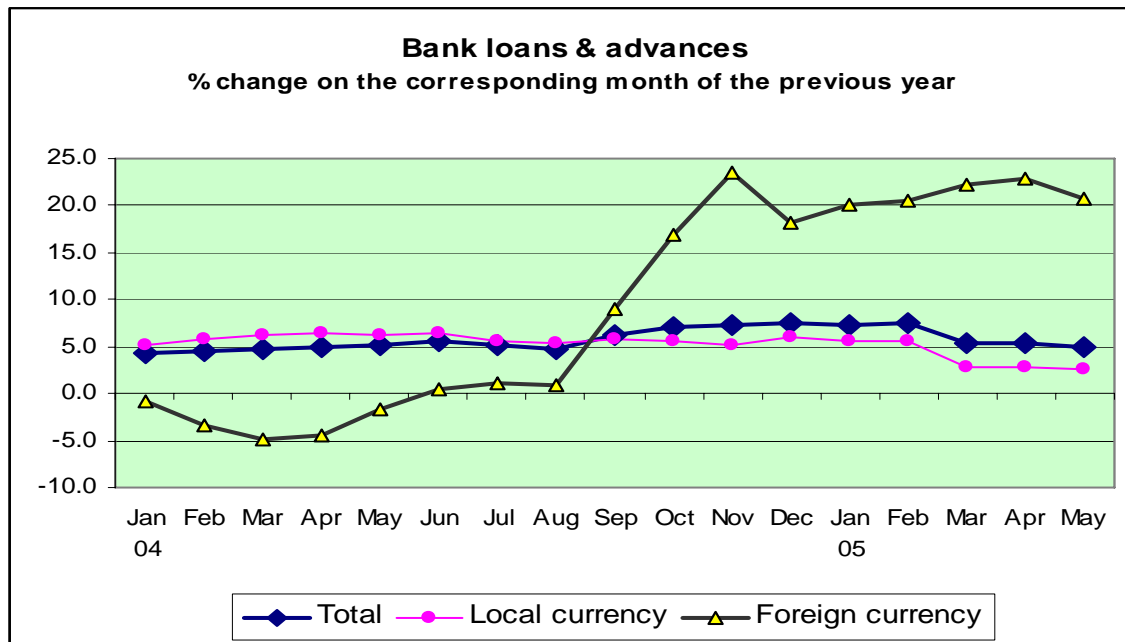
July 2005

Advances and Loans

Total advances and loans by the banking sector reached C£9,4bn in May 2005. This figure was 5,0% higher than in May 2004 and 10,4% higher than in May 2003. In the period January-May 2005, total loans and advances rose by 6.1% compared with the corresponding period of 2004, or 3,3% in real terms, whereas in the period January-May 2004, total loans and advances rose by 4,7% compared with the corresponding period of 2004, or 3,5% in real terms.



Of the C£9,4bn total, advances and loans denominated in local currency reached C£7,9bn, or 85,2% of the total, whereas loans denominated in foreign currency reached C£1,4bn, or 14,8% of the total, compared with 9,8% of the total in May 2004. Continuing a trend which began in September 2004, the growth rate of loans denominated in foreign currency was much higher than that of loans denominated in local currency: in May 2005 foreign-currency loans rose by 20,8% compared with May 2004, whereas local-currency loans rose by just 2,7%.



Growth in Foreign Borrowing

There are two main reasons for the rapid growth in foreign borrowing since August 2004. First, the full liberalisation of foreign capital, which happened upon the entry of Cyprus into the European Union on May 1st 2004, lifted all remaining restrictions on foreign borrowing by residents of Cyprus. This, in turn, has encouraged borrowers to take advantage of lower interest rates on euro-denominated loans. In May 2004, official interest rates in Cyprus were 250 basis points higher than in the euro area, although since the three interest-rate cuts in February (by 25 basis points), May (50 basis points) and June (50 basis points), this spread has now fallen to 125 basis points.

The Way Ahead

When adjusted for inflation, growth in total lending rose less quickly in the first five months of 2005 (3,3%) than in the first five months of 2004 (4,7%), which suggests that overall demand was slightly weaker in the first five months of 2005 than in the same period of 2004. However, the large reduction in borrowing costs during 2005 is expected to increase demand for loans in the second half of 2005. The reduction in the spread between Cyprus interest rates and euro-area rates may also lead to a slowdown on the growth of foreign borrowing.

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