

Cyprus' External Competitiveness Assessment[†]

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Abstract

Cyprus' persistent current account deficits over the last decade point to potential competitiveness problems. This note reviews price and non-price indicators to assess the existence of a competitiveness gap in Cyprus and the factors underlying it. Results show that, while productivity growth has been higher in Cyprus than in the euro area, wages growth outstripped productivity gains. As a result, unit labor costs grew more rapidly than in peer countries, implying a steady loss of competitiveness vis-à-vis Cyprus' trading partners. A solid labor market and a dynamic service sector provide some reassurance, but action to restore a healthy competitive business environment is needed. Structural measures to enhance efficiency and labor market flexibility, and a revision of the current wage indexation system would increase the capacity of the economy to adjust to external shocks and curb unit labor cost growth; while curtailing government consumption expenditure would increase national saving thereby reducing the current account deficit.

Keywords: Current account, competitiveness, monetary union, productivity, exchange rate, trade balance.

† The views expressed herein are those of the author and should not be attributed to the IMF, its Executive Board, or its management.

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