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The role of the banking system, the private investors and the government in the rise and fall of the Cyprus property market

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«No human agency has achieved so much economic destruction in such a short period of time without the use of weapons »

Pawel Morski about Cyprus

Chapter 1

Introduction

The property market in Cyprus is of enormous importance to the economy as it plays an important role in the wealth of households and portfolio investors alike (Boydell and Clayton, 1993).

During the last decade in Cyprus, due to various socio-economic changes (such as the liberalization of the financial markets, low interest rates, increase in stock market returns, increase of the purchasing power of sterling against the euro and the accession of Cyprus to the European Union and the Eurozone), property values witnessed phenomenal growth particularly during the period between 2002 and 2008.

Property is the bulk of a household's wealth as the value of their property assets has a significant effect on the propensity for consumption and savings. So any changes in real estate prices will have an impact on the behaviour of the household.

The importance of the housing sector is not confined within the narrow limits of family and household since it is connected with the creation of positive externalities related to economic development, public health and social environment (Warnock, VC & Warnock, FE, 2008; Montgomery, MR, & Hewett, PC, 2003, Atterhog, M., 2005).

For participants in the financial system and the property market, the level and uncertainty of future property prices play a decisive role.

Particularly on the part of financial institutions, housing is the most common form of loan guarantees for households therefore housing loans constitutes a large portion of banks' assets. During the last decade mortgage lending has experienced unprecedented growth. While in the past buying a house was