Can Cyprus Cope Inside the EMU?
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Abstract
The purpose of this paper is to investigate whether Cyprus was ready to join the euro area and whether it can cope with the challenges inside the Economic and Monetary Union (EMU), given the loss of monetary policy autonomy. We examine the performance of the economy of Cyprus towards the road to the EMU, in terms of satisfying the Optimum Currency Area (OCA) criteria and achieving nominal and real convergence. We find that Cyprus satisfied the OCA criteria to a satisfactory degree and achieved full nominal convergence and relatively high real convergence. However, Cyprus needs to preserve fiscal consolidation given the recent inflation pressures and accelerate structural reforms with emphasis on the labour market, thus enhancing productivity and flexibility and offsetting possible adverse effects on competitiveness resulting from the real effective appreciation of the euro. Reforming the social security system is also imperative in order to improve the long-term sustainability of public finances.

Keywords: Optimum Currency Area, EMU, Real Convergence, Nominal Convergence.