An economy’s productivity growth is a reflection of the performance of its individual sectors. In this bulletin we aim in assessing the performance of the Cyprus economy both at the aggregate and at the sectoral level. We do so by employing two of the most widely used measures of productivity, Total Factor Productivity (TFP) and labour productivity. These two measures are interrelated in that labour productivity growth can be attributed to movements in TFP growth and in the relative intensity of the use of capital and labour (capital deepening). We consider a total of ten aggregated industries or sectors, defined according to the classification of economic activities – NACE Rev.2, for the period between 1996 and 2018.

A particularly tough period for the Cyprus economy was the period of the European economic crisis. Over the years from 2007 to 2009, a period by the end of which the European economic crisis began to unfold, as well as up to 2014 is the worse in terms of productivity growth (TFP growth) for all sectors of the economy. The banking crisis that peaked in 2013 also affected sectoral performance. It is not until the last period of our sample, the years between 2015 and 2018, that the Cyprus economy showed a remarkable improvement in terms of productivity growth, both at the aggregate and the sectoral level. This is mainly due to reforms (in the labour market and the public sector) that have taken place since the beginning of the crisis.

Cyprus’ main productivity growth drivers are the Information and communication sector, the Financial and insurance sector and the Wholesale and retail trade transport, accommodation and food service sector. Productivity growth in these backbone sectors over the period 1996-2018 exceeded the productivity growth in all other sectors. On the other hand among the worst contributors to the economy’s productivity growth are the Industry and the Agriculture, forestry and fishing sectors. These two sectors are relatively small and their TFP growth, is on average amongst the lowest relatively to the other sectors.

Policy reforms towards improved legal and institutional environment are crucial to the performance of the backbone sectors. Countries with deeper financial markets, flexibility in their labour markets, more skilled labour, and greater private investment in R&D, are also the countries whose high-tech industries are experiencing higher TFP growth. Further, labour market regulations, like strict employment protection legislation are known to depress productivity in low technology sectors. Labour market flexibility and efficient financial markets can ease the shift of labour and capital from less-to more-productive activities. Overall, policies introducing greater flexibility in the labour market, reforming the public sector to minimize bureaucracy and increase efficiency, as well as policies that support innovation through financial deepening and human capital investment, should be a priority in order to promote and sustain productivity and, consequently, economic growth.