Financial markets and economic growth: How is the current geopolitical turmoil affecting the markets

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"Financial markets and economic growth: How is the current geopolitical turmoil affecting the markets?"
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''*Geopolitical tensions lead to uncertainty and geo-economic fragmentation, which distorts trade flows, disrupts supply chains, and poses a risk to financial stability. It highlights the importance of European integration for Cyprus*.''

Dear Ladies and Gentlemen, good afternoon. It is a pleasure to speak at the 20th Annual Cyprus Summit.

Geopolitical tensions lead to uncertainty and geo-economic fragmentation, reversing progress towards global economic and financial integration because of political and military conflict and strategic policy decisions. This rising fragmentation distorts trade flows, disrupts supply chains, and poses a risk to financial stability.

Major shocks such as the global financial crisis and the Covid-19 pandemic exposed the vulnerabilities of an interconnected world. Tensions between major economies, especially the US and China, have impacted international trade and capital flows. Armed conflicts in Ukraine and the Middle East have caused tragic human losses and economic disruptions in trade routes, supply chains, and allocation of resources bringing about higher uncertainty.

Cyprus has been particularly exposed to this uncertainty due to international sanctions following the war in Ukraine and its proximity to the Middle East conflict.

The economic costs from geopolitical tensions and geo-economic fragmentation are evident. Global growth suffers and price pressures emerge. The US-China tensions, the predominant global friction, significantly impact global trade, including trade with Europe. As a key player in international trade, this fragmentation has a higher impact on Europe than other world regions. As a key player in international trade, this fragmentation has a higher impact on the EU than other world regions. The EU as the most open among the advanced regions, stands to lose more if globalisation reverses and the world economy becomes more fragmented. The losses stem from higher and more volatile energy costs, changes in supply chains and commercial relationships that disrupt production structures. They necessitate diversification among enterprises as geopolitical tensions diminish the resilience of supply chains.

This also applies to Cyprus, a small, open island economy more vulnerable to external shocks from geopolitical tensions and geo-economic fragmentation. Energy and commodity prices in Cyprus have been higher, trade frictions have lowered global risk appetite and if the risks of geo-economic fragmentation would materialise, borrowing costs would increase. Tourism, a key sector of the Cypriot economy, remains subject to risks of sudden reversals due to geopolitical developments. Ongoing geopolitical tensions also adversely impact foreign investment flows. Another channel is migration. For Cyprus as a leading asylum-receiving country per capita, further escalation of geopolitical conflicts could raise the cost of an increased influx of migrants and strain the resources of the immigration system.

For Europe and for Cyprus, this underscores the importance of European integration and the EU Single Market in offsetting these external pressures. European solidarity and common responses during the financial crisis, the pandemic and the energy crisis have mitigated impacts and strengthened resilience. The Single Market, the 'cornerstone' of European integration, ensured access to goods and services for close to 450 million consumers and over 30 million firms. As an EU Member State, Cyprus contributed to and benefitted from European integration, European solidarity and the EU Single Market. Completing the Single Market would enhance Europe’s competitiveness[1] , enabling Europe and Cyprus to better navigate global developments in green and digital transitions and reinforce their capacity to absorb shocks amid growing uncertainty.[2]

Cyprus is well positioned to face rising geopolitical tensions and geo-economic fragmentation. The strong reform efforts over the last decade have benefitted the economy, leading to strong economic performance and favourable economic projections. Fiscal prudence has led to an expectation of further declining public debt.[3] Cypriot banks have substantially de-risked their balance sheets, and so far, asset quality has remained resilient. The banking sector is in its strongest position in a decade with higher rates boosting earnings and driving solvency ratios above the euro area average.

Let me conclude. Despite this favourable economic outlook, Cyprus remains vulnerable in several areas. Cyprus would do well to maintain reform momentum, address vulnerabilities and harness European integration benefits. This includes accelerating the green and digital transitions under Cyprus’ Recovery and Resilience Plan for future economic growth.

Cyprus would benefit from further diversification of its export and energy markets to make its economy more agile in view of geo-economic fragmentation. This can include ongoing diversification of tourist markets and products, efforts to introduce a greener energy mix from different and greener energy sources, further internationalisation of higher education and healthcare services, and expanding export manufacturing, especially in pharmaceuticals.

The work is not finished. We should strengthen European integration and the Single Market for Europe and Cyprus to meet today’s challenges. Cyprus can contribute and stands to benefit.

Efharisto. Thank you.

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[1] Letta, E., Much more than a market, April 2024; Draghi, M., The future of European competitiveness – A competitiveness strategy for Europe, September 2024.

[2] Advancing Capital Markets Union and Banking Union are part of that and reducing the EU's dependence on external sources of financing needed for defence, welfare and the transition towards a greener and more digital economy.

[3] Reaching 60% of GDP by the end of 2026.

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