REPUBLIC OF CYPRUS
MINISTRY OF FINANCE
PUBLIC DEBT MANAGEMENT OFFICE

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Macroeconomic Environment:

- In the 1st quarter of 2015, GDP (in seasonally adjusted terms) recorded a positive rate of growth of 0.2% compared with a negative rate of growth of -1.8% in the 4th quarter of 2014 on an annual basis.
- The business operating environment shows signs of stabilization and gradual improvement given that lending to non-financial corporations is marginally positive and interest rates are in decline and we assume return to growth in 2015.
- The economic sentiment indicator by CypERC decreased by 3.9 points in July 2015 compared to June 2015. This decrease is due to a deterioration of the business climate in services and in industry, as well as to the weakening economic confidence of consumers.
- Exports of goods increased by 34% in January-May 2015 compared to January-May 2014, mainly due to the transfer of economic ownership of mobile transport equipment, with total value of €158.6 mn in January 2015.
- In January-June 2015 tourist arrivals increased by 5.7% compared to January-June 2014. An increase of 48.6% was recorded in tourist arrivals from Israel, a 25.2% increase from Germany, a 14.3% increase from the UK and a 42.1% increase from Greece. On the other hand a 20.9% decrease was recorded in arrivals from Russia.
- Inflation (HICP) for June 2015 was -2.1% compared to -1.7% in May 2015 and for 2015 so far it stands at -1.4%.
- Labour Force Survey (LFS) unemployment, in monthly seasonally adjusted terms, remained at 16.2% in June 2015 compared to June 2014. The most affected segment of the population is youth, although it has been on a downward trend since January 2014. Particularly challenging is also the increase in long-term unemployed.
- Compensation per employee in the 1st quarter of 2015 declined by around 1.3% compared to the 1st quarter of 2014, contributing to a decline of nominal unit labour cost and improving cost competitiveness further. The observed wage adjustment is expected to help containing the upward pressure on unemployment.

Banking Sector:

- The Foreclosure Law, the Insolvency Framework and the relevant Regulations which are important for addressing the Non-Performing Loans issue, have been enacted by the House of Representatives on the 17th of April 2015, and are being implemented.
- Banking Institutions continue to reduce their operational costs and improve their profitability, as well as strengthening their capital position.

- Deposits exhibited a small increase in January 2015 and December 2014, for the first time resersing the decreasing trend that persisted for the last few years. This however was not sustained as there was a moderate decrease in the next 5 months, due to the developments in Greece (especially in the Greek subsidiary banks). Deposits stabilized in June-July 2015, after the agreement reached on the Greek issue at the European Council.

- The level of deposits was not affected by the abolition of Restrictive Measures on financial transactions on the 5th of April 2015.

- Excluding extraordinary transactions, loans are still on a modest decreasing trend, due to the deleveraging efforts by banks, and mostly the actions undertaken by the Greek subsidiaries to reduce exposure to Greece and their parent companies.

<u>Cooperative Credit Institutions:</u>

- The CCB has announced the three-months results for 2015 as well as the Key Performance Indicators (KPIs) regarding the progress on the implementation of the restructuring plan by the end of March 2015.

  http://www.ccb.coop.com.cy/userfiles/f8ce1af3-1709-4976-a785-1a5a8d552da1/Kyrioi_deiktes_apodoshs_31032015.pdf

  http://www.ccb.coop.com.cy/userfiles/f8ce1af3-1709-4976-a785-1a5a8d552da1/Mh_elegmenes_enopoihmenes_katastaseis_31032015_2.pdf

- Regarding the three-month results, the CCB announced a net profit of €37.1 mn in the first quarter of 2015 due to the lower provisions and despite the decrease in revenues. In 2014 the profits of the Cooperatives amounted to €41.2 mn. The cost of provisions for the period amounted to €22.4 mn, pushing the accumulated provisions as at March 31, 2015 to €3.04 bn and keeping the coverage ratio of loans in arrears of more than 90 days at the level of 44.1%. The balance sheet stands at €14.2 bn and includes €1.29 bn in net equity, with the Common Equity Tier 1 ratio reaching 13.3% against the supervisory requirement of 8%.
- Net income from interest fell to €89.5mn due to a significant downward adjustment in lending rates offered by the Coops to its customers from March 1, 2015. In 2014 net income from interest amounted to €378.8 mn. Operating profit amounted to €59.9 mn, significantly improved compared with the trend in previous quarters primarily due to lower costs as part of the strategy adopted by the Coops. In 2014 the profit from operations amounted to €192 mn. Expenses totaled €41.8 mn. Last year, they amounted to €200.3 mn. The cost to income ratio stood at 37.2%.
- In the first quarter of 2015 loans and advances amounted to €10 bn after provisions, marginally lower compared with December 31, 2014 as a result of weak demand for new borrowing and the deleveraging process attempted by both individual and business customers. Loans in arrears of more than 90 days increased by €200 mn compared with December 31, 2014 primarily due to the recognition of interest and amount to €6.9 bn.
- Deposits and other customer accounts amounted to €12.6 bn and have recorded an increase of €242 mn compared with end of 2014.

- The Coops managed to strengthen their liquidity index to 23.9% compared to 20.3% at the beginning of the year, and to maintain the funding ratio (net loans to deposits) at 79.3% compared with 81.6% at the beginning of the year.

<u>Fiscal Developments – January-June 2015:</u>

- General government budget balance (GGBB) was in deficit during the first semester of 2015 of the order of €31.2 mn (-0.2% of GDP) compared to a deficit of €5.6 mn during the same period of the previous year. GGBB exhibited a positive deviation of 0.9 percentage points of GDP vis-à-vis a target of a fiscal deficit of the order of 1.1% of GDP, which was agreed in the context of the 6th review[1] of the macroeconomic adjustment programme. In nominal terms, the positive deviation of the fiscal outcome of the GGBB vis-à-vis the target is about €168 mn.
- General government primary balance (GGPB) was in surplus during the period under review, of the order of €202.5 mn (1.1% of GDP) compared to a surplus of €187.8 mn (1.1% of GDP) during same period of the previous year.
- Total revenue exhibited a slightly negative rate of growth of around 0.8% during January-June 2015, reaching €3,159 mn compared to €3,186 mn during the same period of the year before. This outcome is mainly attributed to a lower Central Bank dividend received this year compared to the one received during April 2014, by about €30 mn. Total revenue exhibited a positive deviation of about €106 mn, vis-à-vis a target of the order of €3,053 mn, as agreed in the context of the 6th review of the macroeconomic adjustment programme.
- Total expenditure during the period under review remained almost unchanged compared to the same period of the year before, reaching €3,190 mn, compared to €3,191 mn during the same period of the year before. Intermediate consumption, compensation of employees and social transfers exhibited a decline of the order of 7.7%, 1.7% and 1.5% respectively, whereas capital expenditure increased by 5.8%, attributed to seasonality. Total expenditure exhibited a negative deviation of about €62 mn, vis-à-vis a target of the order of €3,252 mn, as agreed in the context of the 6th review of the macroeconomic adjustment programme.

<u>Public debt and financing:</u>

- The General Government Debt at the end June 2015 (preliminary data) stood at €19.2 bn. The increase in Debt since March is mainly attributed to the accumulation of cash by the Republic during the period April-June.
- The issuance of Treasury Bills continued during the months of June and July. Auctions have continued to perform well although there was one non-successful auction on the 13th of July. This was attributed solely to the Greek situation which was at its maximum at the time and created nervousness to investors. This has proven to be an one-off event as during the last auction of 13 Week Treasury Bills that took place on the 3rd of August the issue was oversubscribed and yields continued their downwards trajectory. Average yield for the last auction was 2,08% down from 2,18% in the last 13 week TB auction on the 2nd of July while

[1] April-May 2015

total bids amounted to €143,7 million for a €100 mn issue. We expect these trends to continue in the coming auctions.

- Long term bond yields showed stability during the months of June and July despite the general uncertainty that existed in the periphery market during those months due to the Greek situation. The bond issued in May 2015 has performed well and is now trading above par at 101,8. Spreads with comparable countries have been reduced since the beginning of the year with the spread to Portugal for the 2020 maturity falling by 126 b.p. and the spread to Ireland for the2020 maturity falling by 149 b.p.. The spread to Germany for the 2020 maturity dropped by 169 b.p. during the same period (as at 03/08/15).

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Links:
Macroeconomic monitor:
http://www.mof.gov.cy/mof/mof.nsf/page23_en/page23_en?OpenDocument

Public Debt Quarterly Bulletin:
http://www.mof.gov.cy/mof/pdmo/pdmo.nsf/All/F0C650FEBD5E4C11C225788D00208D2A/$file/CY%20Qrt%20Bulletin%20Q1_2015.pdf