



Macroeconomic Environment:

- **In the 2nd quarter of 2018, GDP** (in seasonally adjusted terms) **recorded a positive rate of growth of 3.9%, compared to 4.1% in the 1st quarter of 2018** on an annual basis. The increased activity is mainly attributed to the sectors: hotels and restaurants, retail and wholesale trade, construction, manufacturing, professional, scientific and technical activities and administrative and support service activities while negative growth rate was recorded by the sector financial and insurance activities.
- Developments are currently driven by increases in **private consumption and net exports**.
- **Imports of goods increased by 18.2%** in January-July 2018 compared to January-July 2017. The increase in imports is affected by developments in imports of transport equipment (aircrafts and vessels). Imports of goods, excluding imports of aircrafts and vessels, exhibit an increase of 15.4%.
- **Exports of goods increased by 53.5%** in January-July 2018 compared to January-July 2017 due to exports of transport equipment (aircrafts and vessels) occurred in 2018. Exports of goods, excluding exports of aircrafts and vessels, exhibit an increase of 31.5%.
- During the period January-August 2018 **tourist arrivals increased at a rate of 8%** compared to January-August 2017. An increase of 10.8% was recorded in tourist arrivals from Greece, a 5.3% increase from the UK, a 1.9% increase from Germany, while a 5.1% decrease was recorded from Russia.
- The current account (CA) balance improved in 2018H1, recording a deficit of €391.2 mn (1.9% of GDP), compared with a deficit of €707.8 mn in 2017H1 (3.6% of GDP). This development was mainly attributed to the trade balance, which recorded a surplus in 2108H1 of €85.1 mn (0.4% of GDP) compared to a deficit of €316 mn (1.6% of GDP) in 2017H1. Primary and secondary income accounts contributed to the current account deficit by 2.3% of GDP in 2018H1 compared with 2% of GDP in 2017H1.
- **Inflation (HICP)** in August 2018 recorded an increase of 1.7% compared to an increase of 1.4% in July 2018. For the period January-August 2018, the HICP increase stood at 0.4% compared to the corresponding period of the previous year. All subcategories of HICP presented a decrease except categories of food, housing, health, transport, education and restaurants and hotels.
- Labour Force Survey (LFS) unemployment, in monthly seasonally adjusted terms, decreased to 7.5% in August 2018 compared to 10.5% in August 2017. The most affected segment of the population is youth unemployment, although it has been on a downward trend since the 3rd quarter of 2013 falling to 19% in 2018Q2 from the peak of 40.4% in the 3rd quarter of 2013. Particularly challenging is also the relatively high long-term unemployment.
- Compensation per employee increased by 1.4% in 2018H1 compared to 2017H1.

Banking Sector:

Policy framework for tackling NPEs

Addressing the high level of NPLs in the banking system, is a key priority on the reform agenda and policy action has been taken and continues to be taken to deal with this priority.

The high level of non-performing loans, despite its downward trend, remains one of the most important challenges the banking sector still faces. The de-escalation of the NPEs is the primary objective of the

Government and a prerequisite for achieving sustainable development and financial stability, as it will reduce the burden on banks' profitability and capital with all the positive effects on the financial system and the economy at large.

The policy strategy for the reduction of NPEs which will be implemented in the course of 2018, consists of the following three basic pillars which together will result in a gradual normalization of the Cypriot financial system:

Pillar I: Strengthening the effectiveness of the legal framework related to the management of NPEs

The Government enhanced the legal framework (the legal amendments were approved by the House of Representatives on July 8th 2018) which among others, strengthens the law on foreclosures with a view to tackle the problem of strategic defaulters and facilitates the development of a functioning secondary market for NPFs in Cyprus, through enhancing the sale of loans law and introducing a law on loan securitization.

Pillar II: Addressing the most challenging portfolio of NPEs, that of mortgage NPEs collateralized with the primary residence (ESTIA scheme).

- Through burden sharing, it would incentivize eligible households or SMEs to repay their loans, thus contributing to the stabilization of the banking sector and the creation of the conditions for sustainable growth.
- The State will provide financial assistance to the participating borrowers, covering one third of borrowers' restructured loan repayment obligations.
- The provisions of this scheme are in the stage of finalisation, and it is envisaged that for the participation in the "ESTIA project" eligible borrowers should meet specific pre-defined income and asset criteria in order to exclude free riders or strategic defaulters being transferred, ensure fairness and limit moral hazard.

Pillar III: Addressing Challenges faced by the State Bank (Cyprus Cooperative Bank-CCB)

The Government, as the main shareholder of the Cyprus Cooperative Bank (CCB) has proceeded with the sale of part of the bank's assets and liabilities to Hellenic Bank.

- The perimeter of the transaction comprised a balance sheet of €10,3 bn.
- The above assets have been transferred to Hellenic Bank on September 3rd, 2018.
- HB is expected to benefit from complementarity of the business model and an expanded customer base.
- With the acquired perimeter on its balance sheet, Hellenic became the second largest bank by total assets in Cyprus, with 22% market share by loans and 32% by deposits. The acquired business is complementary to the HB's existing business model. The Government deposited an amount of 3,54 bn to the former CCB in order to facilitate the transaction.
- Against the State's deposit of €3,54 bn (€3.190 plus cash deposits €351 mn) with CCB, CCB pledged assets which will be retained and managed by the residual entity:
 - All immovable property of the bank including branches valued at €625 mn,
 - Performing loans valued at €512 mn including loans to local authorities amounting to €270 mn,
 - Non-performing loans valued at €6,97 bn at gross book value, and
 - Other liquid assets and participation to other entities €230 mn.
 - The state deposit also remains in the residual entity.

- The residual entity has surrendered its banking license at Closing of the Transaction and exited the market, while its subsidiary, which has been established under the Company's Law, has been licensed by the CBC as a credit acquiring company for the sole purpose of managing the assets that remain in its perimeter, with a view to maximising their value.
- The residual entity's governance will be based on best practices and professional management and the daily management of the assets will be undertaken by a private specialised servicing company with no financial links to the State.
- The **capital position** has recently moderately declined, while remaining at adequate levels, following increased provisioning for non-performing exposures (NPEs). CET1 capital ratio of the Cypriot banking sector was 14.1% at 31/03/2018 (14.9% at 31/12/2017).
- **Non-performing exposures** continued their downward trend dropping to €20.3 bn on 31/05/2018, down from €20.9 bn at 31/12/2017). It is noted that, the NPE strategy implemented by the Government in 2018, is expected to lead to a further significant reduction in the banking sector NPEs stock, from:
 - A reduction of €5.68bn resulting from a carve out of former CCB's NPEs.
 - A reduction of €3.4bn from transfers under ESTIA Project.
 - Sale of NPEs portfolios - Bank of Cyprus sold a portfolio of corporate loans of €2.8bn in August 2018, of which €2.7 bn are NPEs, secured by real estate collateral to Apollo Global Management for a gross cash consideration of €1.4 bn. The completion of the transaction is subject to a number of conditions, including regulatory and other approvals.
 - Additional reductions through the implementation of the strategic plans in cooperation with specialized service providers.
- Under provisional estimates of the NPE levels on September 2018, following the CCB carve out and the sale of the BoC portfolio, the NPE levels drop below €12bn, to 29% of the total loans, with the impairment levels remaining at 49%. The ESTIA project impact, is expected to be recorded in the next few months.
- **Provisions** on non-performing exposures continued increasing as a share of the NPEs, reaching 49.2% on 31/5/2018 (up from 47.3% on 31/12/2017).
- **Restructurings** were €11.3 bn on 31/05/2018 (€11.9 bn on 31/12/2017). 68% of undertaken fixed-term loan restructurings abide by the new repayment schedule agreed as part of restructuring.
- **Deposits** in the banking system have been on a rising trend since the second half of 2015 with deposits increasing from €49.4 bn in December 2017, to €51.1 bn in August 2018.
- Total **loans** continued their decreasing trend, being €45.9 bn in August 2018, down from €51.4 bn in December 2017, mainly due to write offs in the context of debt restructurings.
- Despite the overall decline of loans and strict criteria in supplying new credit, **new lending** (including loans transferred from other banks) are on an increasing trend. During 2017, new loans towards Non-Financial Corporations reached €2,141 mn, while those towards Households reached €1,087 mn. The respective figures for the first seven months of 2018, were €1,114 mn and €716 mn.
- **Hellenic Bank** has executed a 10-year service level agreement with APS Cyprus, an independent company, for the management of the Bank's non-performing loan and real estate portfolio retaining ownership of the said portfolios. Furthermore, in January Hellenic Bank entered into an agreement to sell a non-performing loan portfolio of €145 million predominantly non-retail exposures to B2Kapital Cyprus Ltd, a wholly owned subsidiary of B2Holding ASA, a Norwegian corporation listed on the Oslo Stock Exchange.

- Eurostat's **house price index** for Cyprus increased to 75.0 on 31/03/2018 compared to 74.6 on 31/12/2017 and 73.5 on 31/12/2016 (basis of 100: Q1-2010).

Fiscal Developments, 2017 and January-August 2018:

- General government **budget balance** was in surplus in 2017 of the order of €344.2 mn (1.8% of GDP), compared to a surplus of €59 mn (0.3% of GDP) the year before. General government **primary balance** was in surplus in 2017 of the order of €846.8 mn (4.3% of GDP), compared to a surplus of €545.5 mn (3% of GDP) the year before. The above **overperformance** reflects the improving economic environment and labour market conditions.
- General government **budget balance** was in surplus during the period January-August 2018 of the order of €732.6 mn (3.6% of GDP), compared to a surplus of €433.5 mn (2.2% of GDP) during the same period of the year before. General government **primary balance** was in surplus during the period under review of the order of €1,56.7 mn (5.1% of GDP), compared to a surplus of €774.5 mn (4% of GDP) during the same period of the year before.
- **Total revenue** increased in absolute terms to €5,245.7 mn during the period January-August 2018 from €4,822.1 mn in the year before, exhibiting a positive rate of growth of 8.8%.
 - revenue from taxes on production and imports reached €2,114.7 million compared to €1,915.3 million the year before, exhibiting a positive rate of growth of 10.4% attributed mainly to an increase in VAT receipts by 16.5%.
 - revenue from taxes on income and wealth increased by 5.4% from €1,203.6 million during January-August 2017 to €1,268.6 million during the same period of 2018, reflecting the increase both in the employment levels and in salaries.
 - social contributions recorded a positive rate of growth of 9,9%, reaching €1,211.7 million during the period under review compared to €1,102.2 million during the same period of year before, reflecting improving conditions in the labour market.
 - other current recourses reached €585.5 million, compared to €564.8 million, exhibiting a positive rate of growth of 3.7%.
- **Total expenditure** exhibited a positive rate of growth of 2.8% during the period January-August 2018 reaching €4,513.1 million from €4,388.6 million during the same period of the year before.
 - compensation of employees recorded a positive rate of growth of about 2.8%, reaching €1,481.5 million compared to €1,441.1 million the year before, partly attributed to an increase in gratuity payments during the first two months of 2018.
 - intermediate consumption recorded an increase of 7.8% during the period under review compared to the same period of the year before, reaching €431.5 million from €400.1 million, partly reflecting the increase in international oil prices.
 - social transfers recorded an increase of 3.1%, reaching €1,726.8 million compared to €1,674.2 million the year before.
 - subsidies exhibited a positive rate of growth of 8.5% during the period under review (€26.9 million) compared to the same period of the year before (€24.8 million).
 - gross fixed capital formation exhibited a positive rate or growth of 2.4%, from €195.2 million during January-August 2017 to €199.9 million during the same period of 2018.

Public debt and financing:

- On the 14th of September S&P proceeded to upgrade the Republic of Cyprus from BB+ to BBB- raising the debt of the Republic to investment grade. This development means that the Republic's bonds are now eligible for QE.
- On the 18th of September the Republic proceeded to issue through syndication a new €1,5 billion 10-year euro denominated Eurobond. The issuance was very successful with an overall order-book of the order of €5.5 billion with the final yield being 2.4% (coupon 2.375%) from an initial guidance of 2.6%. The Value date for the bond was the 25th of September 2018.

- Available **cash** covers the financing needs up to Q3-2019.
- The Cyprus Government international bond yields have continued to drop in the Period July to September especially during the two week period prior to the S&P announcement as the market took on board the possibility of an upgrade. On the 28th of September 2018 the 2025 bond was trading at a yield of 1.583% (mid yield to maturity) which was close to its minimum value for 2018.
- The yield at the monthly 13-week **Treasury Bill** auctions continue to be negative. During the auction that took place on the 31th of August recorded a yield of -0.24% and a bid-to-cover ratio of 2.

Contacts:

Public Debt Management Office, Ministry of Finance, Nicosia 1439, Cyprus
pdm@mof.gov.cy ; www.mof.gov.cy/pdmo ; Tel: +357 22 601182 ; Fax: +357 22 602749

New publications:

Quarterly Debt Bulletin Q2-2018

[http://www.mof.gov.cy/mof/pdmo/pdmo.nsf/All/64FC3788919C81B3C22581F600239A6A/\\$file/CY%20Qrt%20Bulletin%20Q2_2017%20%CE%95%CE%9D.pdf?OpenElement](http://www.mof.gov.cy/mof/pdmo/pdmo.nsf/All/64FC3788919C81B3C22581F600239A6A/$file/CY%20Qrt%20Bulletin%20Q2_2017%20%CE%95%CE%9D.pdf?OpenElement)

Macroeconomic Monitor July 2018

http://mof.gov.cy/assets/modules/wnp/articles/201801/386/docs/macro_monitor_sep_2018.pdf

Stability Programme 2018-2021

http://mof.gov.cy/assets/modules/wnp/articles/201805/402/docs/stability_programme_2018_2021_final.pdf

Fiscal accounts Jan-Mar 2018:

<http://www.mof.gov.cy/mof/cystat/statistics.nsf/All/62686C5F2EADF920C225831500300A22?OpenDocument&sub=2&sel=1&e=&print>

The information has been compiled and verified to the best of our knowledge. The possibility of a factual mistake cannot, however, be excluded