MEDIUM-TERM PUBLIC DEBT MANAGEMENT STRATEGY 2024-2026

REPUBLIC OF CYPRUS

MINISTRY OF FINANCE

PUBLIC DEBT MANAGEMENT OFFICE

Nicosia - Cyprus

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I. Introduction

A strong public debt management strategy constitutes a basic element of sound fiscal management. Following the Covid-19 crisis which presented a big challenge for sovereign debt managers, it seems that the impact of the protracted war between Russia-Ukraine on the external environment and the ongoing monetary policy tightening process remain the most important risks for the future path of real interest rates creating an environment with high uncertainty for the said debt managers.

Despite the challenges stemming from the interest rate environment and the uncertainty in the external environment, through the implementation of the current Medium-Term Debt Management Strategy (MTDS) 2023-2025, the majority of the targets set under the said strategy has been achieved at a very satisfactory level. The objective of funding the majority of gross financing needs in 2023 by issuing the first 10-year sustainability bond in the international markets has been satisfied increasing the visibility of the EMTN issued by the Republic of Cyprus in the international markets and strengthening the country's potential for economically, socially and environmentally sustainable long-term growth and welfare. In the context of the target of a portfolio with low risk at a reasonable cost, the basic strategy followed in the previous year, will be continued during the period 2024-2026 with the main efforts being the retention of refinancing risk at low level, the development of the government securities market and the development of the investor relations, taking into consideration both the current conditions that have been recently created and the future challenges.

Pursuant to the selected strategy, the fixed rate EMTN remains the most realistic option and is therefore considered to be the optimal tool to achieve the best possible outcome under an acceptable cost-risk level. However, due to the high interest rate environment, the borrowing from the international capital markets is expected to be realized within the maturity spectrum of 5 to 10 taking also into accounts the open windows on the debt maturity profile of the Republic of Cyprus. Assuming normal market conditions, the financing operations will be implemented within a framework consisting of three pillars:

(i) Refinancing risk: The main objective of the Public Debt Management Office (PDMO) is to maintain a balanced debt maturity profile with manageable gross financing needs as a percentage of GDP. In addition, in order to reduce both the interest rate risk and the exchange rate risk due to the exchange rate variations, the new loans will be primarily in the form of fixed interest rates and in euro. The cash buffer will continue to be maintained, albeit at lower level compared to the previous year, in order to meet the gross financing needs throughout the year, as defined in the MTDS 2024-2026 and the relevant decisions of the Council of Ministers. The reason is to provide an adequate time to take actions if any unexpected events might take place.

(ii) Development of the government securities market: The stock of government securities will continue to grow in the following years through the international bonds issuances since they will replace different types of debt maturing such as loans. The development of the government securities market will continue to be a strategic objective for the next three years, focusing on two sub-objectives: (a) In the primary market, a benchmark bond issue on a regular basis, at least one issuance per year, through the EMTN program will be targeted and (b) In the secondary market, the enhancement of the pricing mechanism, the transparency and the liquidity of Cyprus bond markets will be targeted through the operation of the international bank group which was appointed by the Republic of Cyprus.

(iii) Development of investor relations: The PDMO will continue its efforts to maintain contacts with existing investors and find new investors in order to extent the investor base and diversify it geographically. The overall objective will be to further extend the demand for Cyprus government securities to more and less correlated investors.

The above guidelines are interrelated, and a single action can contribute to the satisfaction of multiple guidelines at the same time. In conclusion, the above pillars are expected to contribute positively to the minimization of the debt portfolio cost and the containment of financial risks.

In addition to the broader guidelines, quantitative benchmark targets are set in order to concretize the cost-risk appetite. It is noted that, space is allowed for flexibility in order to facilitate the response to unusual market conditions or adverse economic events.

The second chapter that follows, analyzes the institutional framework of the MTDS and the objectives of the strategy. The third chapter presents the macroeconomic-fiscal developments and the risk factors for the economy.

In the fourth chapter, the financing needs of the State for the period 2024-2026 and the main borrowing tools are presented. The fifth chapter illustrates the review of the implementation of MTDS 2023-2025 and the sixth chapter presents the strategic framework of the new strategy 2024-2026.

Finally, in the seventh chapter, the final provisions related to the proposed strategy 2024-2026 are described.

II. Legal Framework and objectives

A. Legal and Institutional framework

Pursuant to paragraph 1 of Article 9 of the Public Debt Management (PDM) Laws of 2012 to 2016, the MTDS, which covers a time horizon of three to five years, is prepared and revised at least once a year on a rolling basis by the PDMO.

Pursuant to paragraph 2 of Article 9 of the PDM Laws of 2012 to 2016, the strategy and its updates are submitted by the Minister of Finance to the Council of Ministers after informing the 'Finance and Budget' Committee of the House of Representatives for approval. The said Committee is given a deadline no later than the end of October of the year preceding the launch of the strategy. After final approval, borrowing and other operational functions are planned based on the strategy. The actions for each calendar year constitute an integral part of the Annual Funding Plan (AFP) which should, as far as possible, be consistent with the MTDS.

The PDMO was established under the same Law of 2012 within the Ministry of Finance with its main responsibilities being:

(i) the execution of public debt management operations,
(ii) the management of government cash reserves,
(iii) lending transaction risk assessment and
(iv) the preparation of any legislation regarding the regulation of public debt management operations.

B. Ultimate objective of public debt management and the scope of strategy

The ultimate objective of public debt management is to ensure that financing needs are always met in time and that the cost of borrowing is the lowest possible in the medium term, within the framework of an acceptable level of financial risk.

The analysis covers the Central Government debt which comprises almost 100% of the debt of the General Government. In terms of the range of financing needs analyzed, sources of risk, such as government guarantees, or potential revenues, are included in the strategy only to the extent that they are incorporated in the budget forecasts.

The MTDS 2024-2026 is a policy paper, describing the direction and actions of public debt management during this period. The design of the new strategy was based on the existing strategy, with its basic guidelines remaining the same.

The objective of the strategy is dual:

- the definition and explanation of the strategic pillars for the State financing actions and the continuation of the development of the Cypriot bond market,

- the implementation of a framework with quantitative and qualitative objectives in order to implement the strategy pillars.

In addition, the existing cost-risk ratio of the portfolio, the new environment on the bond market and the macroeconomic framework were considered in the design of the strategy.

III. Basic macroeconomic assumptions and risk factors

Following the strong growth rate of the economy in 2022, by 5.6% of GDP in real terms, in 2023 a deceleration is expected due to the ongoing Russia-Ukraine military conflict and to the expected deterioration of the external economic environment and to the impact of the continued rise of energy prices, coupled with the increases in interest rates, that will put a pressure on both domestic and external demand. In 2023 the growth rate of the economy is projected at 2.4%. The positive GDP growth rate is widespread, however it is mainly due to the sectors “Hotels and Restaurants", "Transport and Storage", "Information and Communication", "Wholesale and Retail Trade, Repair of Motor Vehicles", "Arts, Entertainment and Recreation" and "Other Service Activities”. Growth in the medium term is expected to continue on a positive path. Over the period 2024-2026, growth is expected to stabilize, with real GDP growth projected at 2.9%, 3.1% and 3.2% respectively.

Even though the forecasts are positive, there are various risks which are related to internal and external environment such as:

1. geopolitical factors;
2. deteriorating business and consumer confidence;
3. the high percentage of non-performing exposures;
4. higher and/or more prolonged period of higher interest rates;
5. any prolonged prevalence of strong inflationary pressures;
6. the continuation of the Russia-Ukraine crisis and the EU sanctions effects;
7. the global climate change.

Consumption and investments will continue to contribute positively to growth. The largest drivers of growth are expected to remain the Retail, Tourism, Shipping and IT services - and the Construction sector. Despite the loss of Russian tourists, due to EU sanctions against Russia, the Tourism sector has performed better than expected in the first seven months of 2023, and it is projected to fully recover and return to the levels of previous years already by 2023, nevertheless, its impact will be significant in the medium term.

In addition, the gradual implementation of the National Recovery and Resilience Plan of a total amount of EUR 1.2 bn for the period 2021-2026 which is subject to the achievement of specific milestones and policy targets, is expected to have a positive impact on the growth profile and on the diversification of Cyprus economy. For the period 2021 to 2022, an amount of EUR 26 mn in the form of loans has already been disbursed in September 2021 whilst an amount of EUR 216 mn in the form of grants has already been disbursed within the period 2021-2022. During the last quarter of the year, it is expected that Cyprus will submit a payment request for the 2nd and 3rd dose of the order of €200 mn, in the form of grants, through the Recovery and Resilience Fund, if, specific milestones will be completed by the Cyprus Coordinating Authority for the implementation of the RRF.

Inflation (CPI) is projected to remain positive during 2023, averaging at 3.2%, falling from 8.4% compared to 2022, despite the decreases recorded in the international oil prices. The expected increase of CPI during 2023 is a result of continued increases mainly in food prices, in the prices of housing and electricity, as well as of the increases in the price of restaurants and hotels. In 2024 it is forecasted to fall further at 2.5% and hover around 2.0% in 2025 and 2026. Unemployment rate was 6.8% in 2022 whilst it is projected to gradually decline to 6.5% in 2023, 5.8% in 2024, 5.3% in 2025 and 5% in 2026.

The fiscal balance of the General Government is projected to remain in surplus in 2023 of about 2% of GDP compared to a surplus of 2.1% of GDP the year before, despite the impact of the continued energy-related measures during the first half of the year. This is mainly attributed to the further improvement of the economic environment. For the coming years, the fiscal balance is projected to improve further hovering around 2.4% of GDP in 2024-2026, on average.

Government debt is projected to drop further by 5.4 percentage points of GDP in 2023, falling to 81.1% of GDP in 2023 from 86.5% in 2022. In 2024 it is projected that the debt-to-GDP ratio will continue its downward trend falling to 72.9% and decreasing further to 67.3% and 60.1% of GDP in 2025 and 2026, respectively. It is worth noting that, at the end of 2023, cash reserves are projected to account for around 11.4% of GDP. The percentage will meet the target of the MTDS to cover the financing needs of the next 9-12 months.

The banking sector has strengthened further in recent years. In the first half of 2023, the CET1 capital ratio stood at 18.1%, mainly because of the recognition of profits by financial institutions compared to 17.8% at the end of 2022. The solvency ratio increased from 21.7% at the beginning of the year to 22.5% in June 2023 compared to 20.8% at the end of 2022. The bank asset size in relation to GDP follows a declining path and is estimated at around 230% of GDP, close to the European average. In general, solvency in the Cypriot banking sector compares well with the EU average.

The asset quality has continued to improve within the first half of 2023 with the NPL ratio declining further from 11.2% in June 2022 to 8.7% in June 2023. Specifically, the reduction of non-performing exposures (NPEs) continued, as NPEs dropped from €5.2 bn on 31st of December 2020 to €2.1 bn on 30th of June 2023. Banks continue their deleveraging efforts, with further significant sales of NPEs portfolios expected to be completed and accounted for within the next periods. With regards to liquidity, it seems that excess liquidity will be a key driver for more profitability in the following years, benefiting from the positive high interest rates. In addition, new lending both for mortgages and non-financial corporations has contracted thanks to the tightening monetary policy affecting the cost of borrowing.

Profitability has improved markedly within the first half of the year 2023 with enhanced return on equity that compared well with the EU average benefiting from the high interest rate environment. The return on equity has marked a significant increase reaching 25.1% by the end of June 2023 compared to 7.1% which was at the end of June 2022, well above the EU average, whilst a significant reduction of cost to income ratio has been recorded, dropping to 36%. The strong profitability of the banking sector is expected to improve the position of the banks to absorb any hit from new nonperforming exposures as well as from higher funding costs due to MREL requirement. Finally, spillover risks from the banking sector to the sovereign are assessed as low.

IV. Financing needs and funding sources

A. Financing Needs

The strategy period 2024-2026 is characterized by manageable financing needs, despite the impact of protracted war between Russia-Ukraine and the ongoing monetary policy tightening process, the external environment and therefore on public finances. The period 2024-2026 is characterized by low to moderate gross financing needs, with the fiscal surplus to be estimated to stabilise around 2023 level during the reference period. In addition, in relation to the size of the economy, gross financing needs are projected to range between 4.0% and 5.6% of GDP over the three-year period. Specifically, the gross financing needs as a percent of GDP is projected to reach 5.2% in 2024, 4.0% in 2025 and 5.6% in 2026.

Table 1: Central government gross financing needs

	2024	2025	2026
	in EUR bn		
Long term debt redemptions	2.12	1.83	2.46
Fiscal deficit/(surplus)[1/]	(0.52)	(0.55)	(0.55)
Gross financing needs	**1.60**	**1.28**	**1.91**

1/= The fiscal balance projections are based on the data available up to date and may differ in view of the high level of uncertainty surrounding the effects of the Russia-Ukraine war, EU sanctions effects as well as the ongoing monetary policy tightening process.

B. Financing Sources and Instruments

The European Medium-Term Bonds (EMTN) will continue to be the main source of borrowing to meet the government's financing needs according to the MTDS 2024-2026 for strategic reasons since issuers can attract investors beyond the domestic market through the international market, thus expanding the investment base in size, geographically and by category. In addition, issuers usually achieve lower borrowing costs through external sources. It is noted that these bonds are issued through the Euro Medium Term Note Program, are governed by English law and are listed on the London Stock Exchange. The bond clearing is performed through the Euroclear / Clearstream repositories.

The domestic market will continue to be used as a supplementary source of funding to meet the State's financing needs. For the reporting period, priority will be given to the issuance of retail bonds to individuals for a period of 6 years on a quarterly basis, which is a financial tool available to cover the special characteristics of individuals as investors.

Treasury Bills remain a short-term financial instrument in the domestic market, which are aimed at improving the management of government cash reserves and at reducing the weighted average cost of government debt. However, due to the current interest rate environment the

PDMO has already reduced the rollover debt to around EUR 25 mn per month in order to curb the increase of the weighted average cost of public debt. As for the European Commercial Papers Program, although it can be used as an alternative source of financing in the short term by attracting funds from abroad, it remains inactive since the end of 2014, although it is not ruled out that it can be used again in the near future.

Another financing tool that can be adopted by the Government, is the borrowing from supranational organisations either for new projects or for the continuation of ongoing infrastructure projects, which combine low borrowing costs and long repayment periods. Furthermore, a new financing tool, in the form of loans and grants, has been introduced by the European Commission since 2021, namely Next Generation EU in order to repair the economic and social damage caused by the COVID-19 pandemic as well as to be greener, more digital and more resilient to better adapt to current and future challenges.

C. Potential Funding Sources

This sub-section provides a brief overview of the government's potential funding sources and the cost and risks associated with various financing sources. The available funding is being provided either through marketable or non-marketable borrowing instruments. Table 2 exhibits the cost and risk characteristics of the potential marketable and non-marketable borrowing instruments of Cyprus.

The Government has to meet its gross financing needs either from external or domestic sources, considering the government's cost and risk level of tolerance. Given that domestic funding is limited, the focus of the Government is to finance its gross financing needs mainly through external funding. It is noted that external funding will continue to be, de facto, the government's preferred financing source in the upcoming years as the said financing has the necessary funds and it cost effective and could be provided with long-term maturity. A target has been set underlining that at least 65% of the gross financing needs for the period 2024-2026 will be covered by external sources, of which the majority will be through EMTN issuances in the international market.

Table 3: Characteristics of potential borrowing instruments

Market instruments					
Security	**Maturity**	**Interest rate type**	**Governing Law**	**Investors Base**	**Benefits and potential risks**
Treasury Bills	Up to 12 months	Zero coupon	Cyprus law	Domestic Monetary Financial Institutions	**Benefit**: lower cost compared to other domestic financing instruments, facilitate the development of the domestic capital market **Risk**: higher refinancing risk
Euro Commercial Papers	Up to 12 months	Zero coupon	English law	International and /or institutional foreign investors	**Benefit**: lower cost compared to other domestic financing instruments and access to international investors **Risk**: higher refinancing risk
Domestic Retail Bonds	6 years	Step-up structure	Cyprus law	Domestic natural persons	**Benefit**: help diversify funding sources for the Government, facilitate the development of the domestic capital market **Risk**: higher refinancing risk, higher cost.
Domestic Bonds	Beyond 12 months	Fixed only	Cyprus law	Mainly domestic banks, Insurance Companies, Provident Funds and small domestic institutional investors	**Benefit**: Facilitate the development of the domestic capital market **Risk**: Higher interest cost, limited available financing
Euro Medium Term Notes (EMTNs)	Beyond 12 months	Fixed only	English law	Foreign and domestic institutional investors	**Benefit**: Strong available financing, higher flexibility in terms of currency-maturity, diversity (larger pool of investors) **Risk**: principal documents are required (offering circular, program agreement, legal opinions e.t.c). Any negative developments not correlated to the Cypriot economy.
Non-market instruments					
Type	**Maturity**	**Interest rate type**	**Governing Law**	**Creditors**	**Benefits and potential risks**
Foreign Loans	Typically more than 10 years	Fixed or variable	European law	European Investment Bank, Council of Europe Development Bank, EE, Domestic market	**Benefit**: highly concessional loans; lowers financing cost; grace period, long-term maturity. **Risk**: Fluctuations of interest, exchange risk in case of foreign currency borrowing

V. Review of the implementation of MTDS 2023-2025

This section focuses on the overview of public debt management and the events that affected the current Public Debt Management Strategy 2023-2025 objectives, which was approved by the Council of Ministers and published in October 2022.

A. Review of debt management operations

During the period January – August 2023, the Medium-Term Debt Management Strategy 2023-2025 was implemented within the context of a challenging economic environment characterized by high market volatility. Throughout this period, the PDMO remained committed to its objectives set, by raising funds in the market in an efficient and effective way through the implementation of its Annual Funding Plan. The PDMO achieved, despite high uncertainty thanks to the ongoing war crisis between Russia and Ukraine and the persistent inflation as well as the significant increases in ECB's basic interest rate, successfully to meet all of its funding requirements within the specified timeframes. At the same time, issuance amounts and maturities, excluding roll over debt, remained within the targets set under the annual funding plan, and financing terms were, albeit at higher levels than in the previous years, within reasonably acceptable and manageable levels of financial risk. Further details of the PDMO's debt management operations during that period are given below.

In November 2022, the PDMO announced its funding plan for the year 2023 with the maximum borrowing limit determining at €1.2 bn excluding roll-over debt. During the period January – August 2023 the total borrowing amount reached €1.1 bn whilst it seems that the strong cash position of the Republic of Cyprus will be continued supported by the continuation of the positive growth rates and fiscal surpluses. More specifically, the government's budgetary position during January – July 2023 was in surplus of about 1.5% of GDP compared to a surplus of about 0.4% of GDP and the primary balance for the same period was in surplus of about 2.4% of GDP compared to a primary balance of 1.4% of GDP the corresponding period the year before. In addition, public debt to GDP ratio has declined by around 6.4 percentage points (p.p.) by the end of August 2023, reaching around 80.1% of GDP compared to 86.5% of GDP in 2022. However, about 11.4% of the public debt as a % of GDP represents the cash buffer which is held in the Central Bank of Cyprus.

Therefore, the maximum borrowing limit as determined in the AFP 2023 is expected to be remain unchanged given also the fact that the current cash balance is enough to cover more than three times the gross financing needs of the next 9-month period.

The main part of the funding plan 2023 has been completed in April 2023. Specifically, the PDMO came to market by issuing a new 10-year bond (EMTN) of the order of €1.0 bn, which was the first Sustainable bond issued by the Republic of Cyprus. The intention of the Government for sustainable borrowing was to complement the objectives of the Recovery and Resilience Plan (2021-2026). The transaction was very successful and oversubscribed, despite the volatility in rates observed over the period 2023, with the bid coverage ratio closing over €12.1 bn representing the largest orderbook achieved in a single-tranche syndicated transaction. A reoffer yield of 4.219% and a coupon rate of 4.125% were achieved.

Within the period January - August 2023, an additional amount of €123 mn was disbursed for the implementation of either new projects or ongoing infrastructure projects. Of this amount, €80 mn was provided by the European Investment Bank, while the remaining amount of €43 mn granted by the Council of Europe Development Bank. During the same period, retail bonds with a total value of €12.3 mn were issued. These bonds carry an interest rate ranging from 0.75% to 1.50%.

In summary, the total financing for the period January – August 2023, excluding the roll-over debt, amounted to approximately €1136 mn, of which €1000 mn was raised through the international bond market. During the same period, the total repayments of capital amounted to €1309 mn of which €1000 mn was related to a 7-year EMTN due in July 2023.

For the remaining of the year 2023, an additional amount of up to €20 mn is estimated to be issued in the form of retail bonds and around €60 mn in the form of bilateral loans for project financing either for new projects or ongoing projects. In addition, during the last quarter of the year, it is expected that Cyprus will submit payment request for the 2nd and 3rd dose of the order of €200 mn, in the form of grants, through the Recovery and Resilience Fund, if specific milestones will be completed by the Cyprus Coordinating Authority for the implementation of the RRF.

The better-than-expected fiscal performance of 2022, combined with the continued improvement of the government's fiscal position in 2023 is expected to lead to steady reduction of the public debt. The Cyprus economy has proven to be resilient to the aforementioned external shocks and due to significant accumulated fiscal surpluses, the PDMO is in the process of negotiating an early debt repayment of a domestic bond of the order of €300 mn through the utilization of cash buffer reducing equally the outstanding amount of public debt.

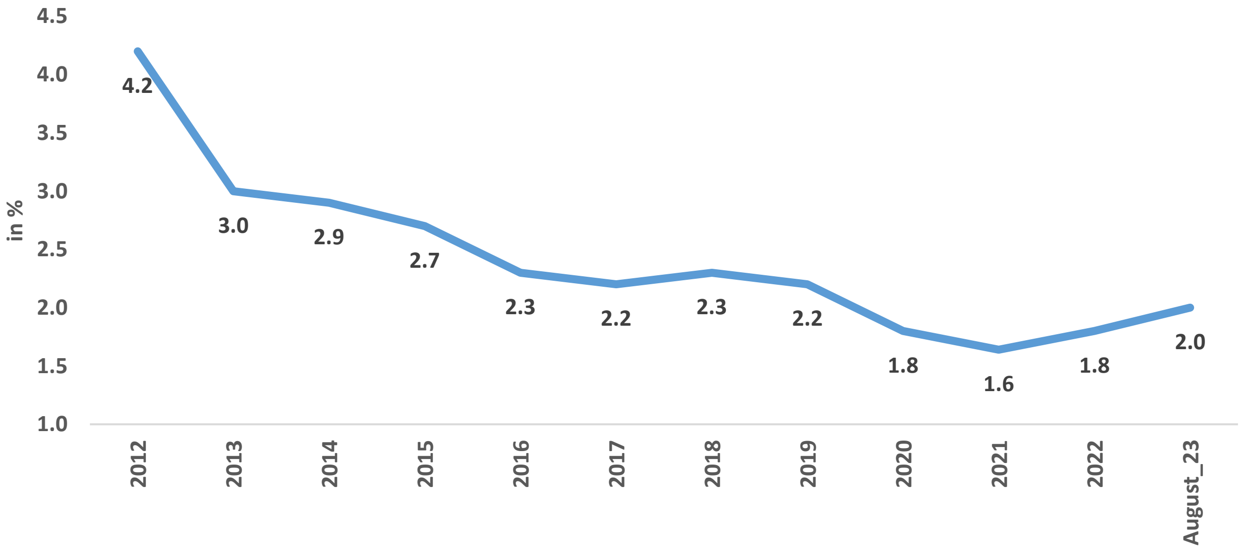
B. Cost Outcome

B1: Cost of the debt portfolio

The weighted average debt portfolio cost, as shown in Figure 1 below, followed a downward path from 2012 until the end of 2021 and then followed an upward path increasing from 1.8% in 2022 to 2.0% in August 2023. This run has been halted by the imposition of back-to-back hikes (nine hikes so far, up to August 2023) in the ECB's basic interest rate, in an effort to curb stubbornly persistent inflation. This minor increase is due both to the existing public debt which is priced at floating interest rates as well as to the increased cost of borrowing to refinance the public debt. By the end of August 2023, the floating rate debt granted by the European Stability Mechanism (ESM) constituted approximately 27% of the total public debt whilst the cost of new EMTN issuance, as mentioned earlier, determined at 4.125%. It is noted that the ESM loans are expected to be gradually repaid from 2025 onwards.

Finally, it should also be noted that the increase was limited to some extent by the favourable credit rating upgrades of the long-term bond of the Republic of Cyprus but also by a series of portfolio liability transactions that took place in the past, as well as, due to the debt management strategy to issue new loans only at fixed interest rate in order to avoid the volatility of interest rates. However, we expect the cost of public debt to rise slightly in the upcoming years as long as the key lending rate is kept at the same levels by the European Central Bank.

Figure 1: Weighted average cost of public debt

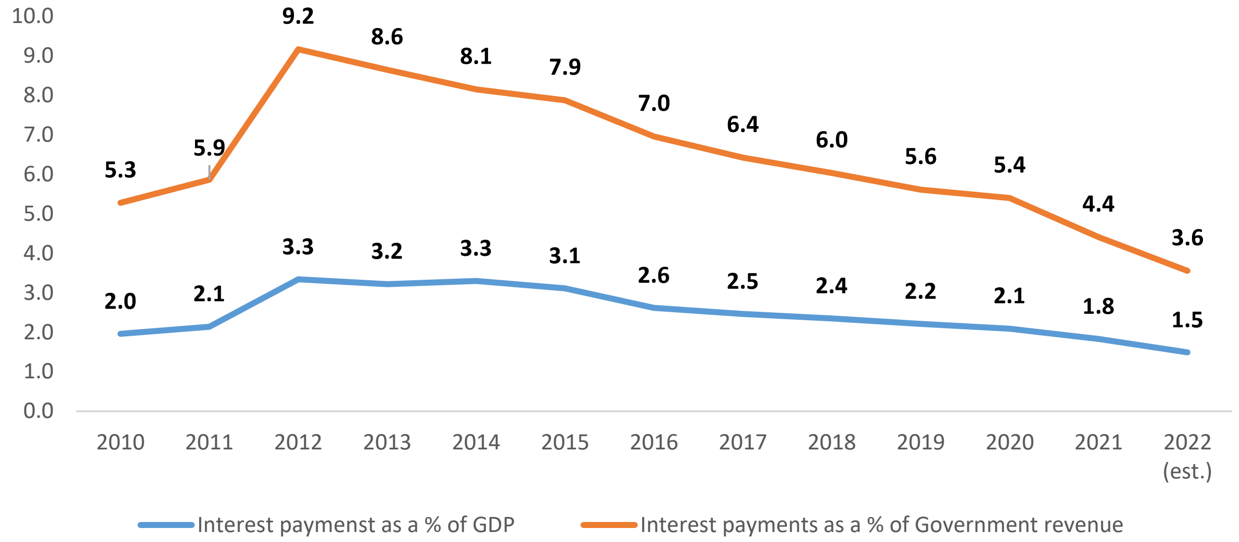


(Source: PDMO)

B2: Debt affordability

Interest payments as a percentage of GDP and government revenue, crucial indicators of public debt sustainability, have demonstrated a consistent decline since 2013, as illustrated in Figure 2 below. The improvement was mainly attributed to the new low-cost issues replacing existing debt carrying a higher interest rate as well as to the improvement of the economic activity leading to higher revenue and GDP. During the last two years the improvement of the interest payments as a percentage of GPD was attributed to the reduction of the interest payments (numerator effect) and the increase of the nominal GDP (denominator effect) whilst the improvement of the interest payments as a percentage of government revenue was attributed to the reduction of the interest payments (numerator effect) and the increase of the revenue (denominator effect) reflecting the improvement of the economic environment, the increase in private consumption and the improvement in labour market conditions.

Figure 2: Share of interest to GDP and government revenue



(Source: PDMO)

C. Risk Indicators Outcome

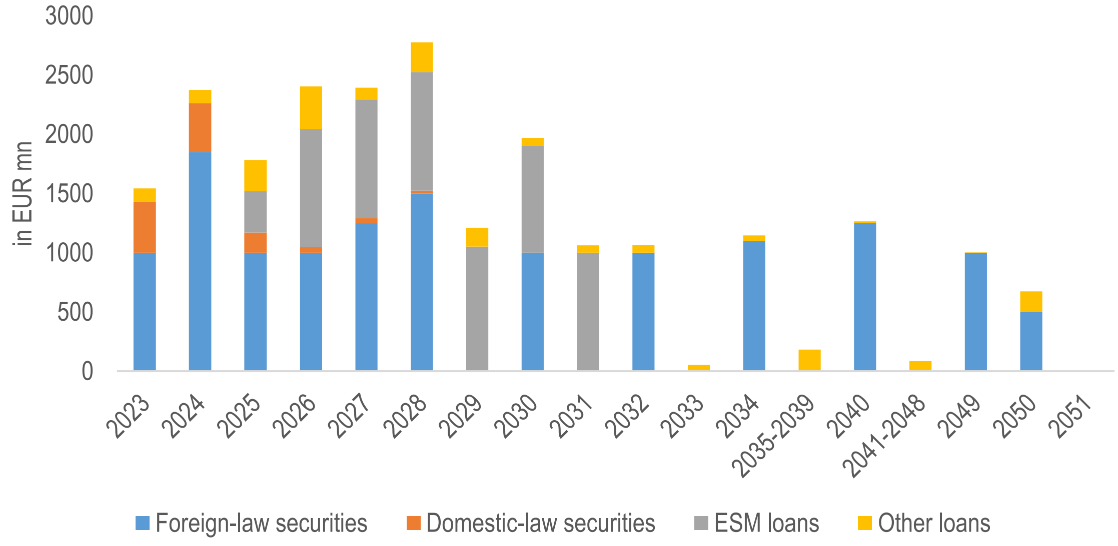
C1: Refinancing risk

Debt settlement smoothing and lengthening the average remaining debt maturity were at the epicenter of debt management activities. The results were apparent in all indicators reflecting the refinancing risk. Figures 3 and 4 show the repayment schedule at the end of 2022 and at the end of August 2023.

The new points of debt which were added in the debt maturity profile as at the end of August 2023 are in years 2033 and 2043 due to the EMTN issuance and loans disbursed from the European Investment Bank and Council of Europe Development Bank as well as in year 2029 as a result of retail bonds issued during the current year.

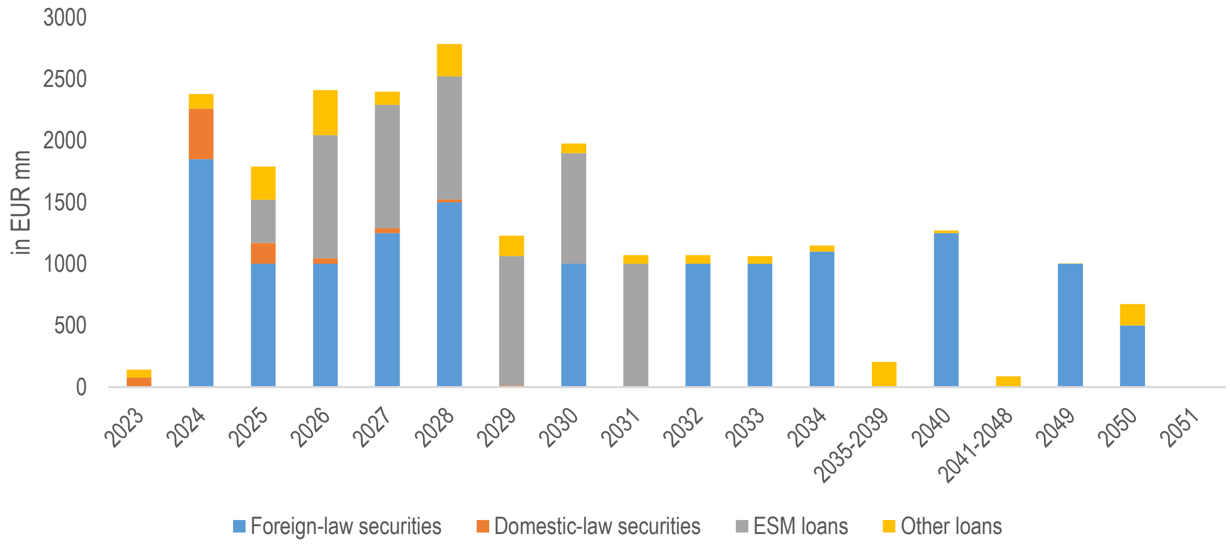
Despite the spike in public debt in year 2028, the debt maturity profile in 2023 remained within comfortable/manageable levels, reducing the refinancing risk of the Government. The borrowing plan of the Government in 2023 is expected to move at similar levels compared to 2022 as a result of the continued better-than-expected fiscal performance during the last two years which led to less utilization of cash buffer accumulated in the previous years as well as to the continuation of the positive growth rate in 2023.

Figure 3: Public debt maturity profile, at the end of 2022



(Source: PDMO)

Figure 4: Public debt maturity profile, at the end of August 2023



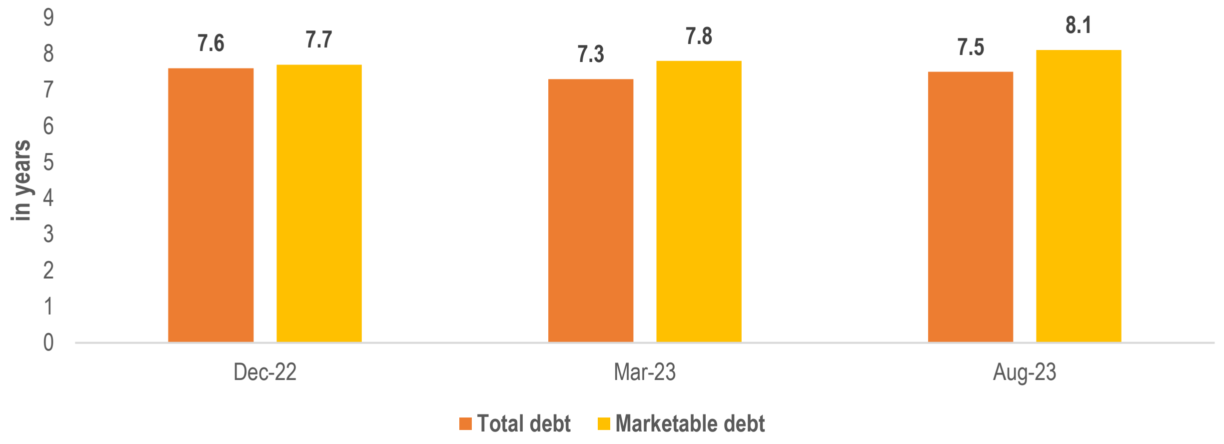
(Source: PDMO)

Other commonly used indicators for refinancing risk are the average remaining maturity of marketable debt and the ratio of debt maturing within one year and five years. Figure 5 and 6 below show these indicators at the end of March and August 2023 compared to the end of 2022.

The average remaining maturity of marketable debt recorded a significant increase in 2023 approaching 8.1 years at the end of August 2023 compared to 7.7 years at the end of 2022 as a result of the 10-year EMTN issuance (numerator effect) and the reduction of public debt (denominator effect). The corresponding total debt ratio has recorded a minor decrease compared to the year 2022 reaching 7.5 years by the end of August 2023. However, the said indicators compare very well in relation to euro area average and are well above the target set in the MTDS.

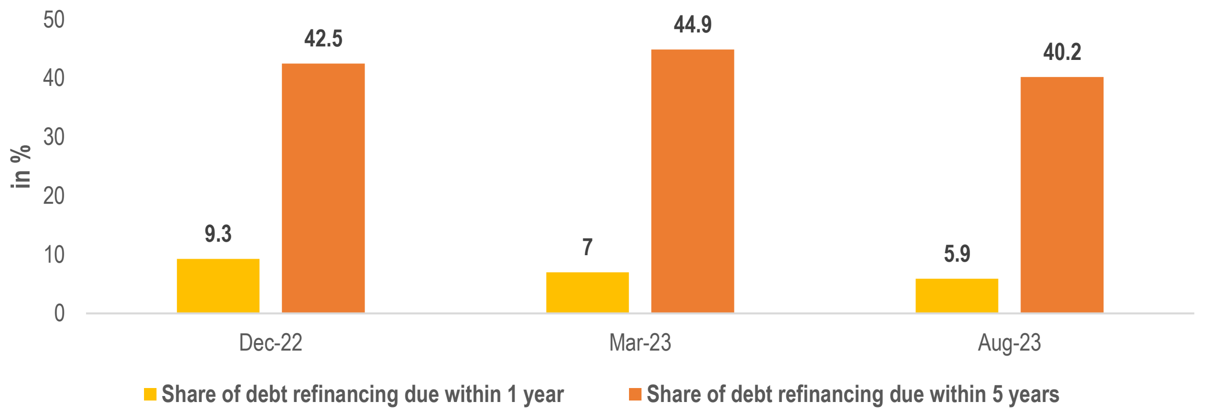
The ratio of debt maturing within one year recorded a reduction of 3.4pp reaching 5.9 percent in August 2023 compared to December 2022, whilst the ratio of debt maturing within five years recorded a reduction of 2.3pp reaching 40.2 percent by the end of August 2023.

Figure 5: Average remaining maturity of debt



(Source: PDMO)

Figure 6: Share of debt due within one-year and five-year

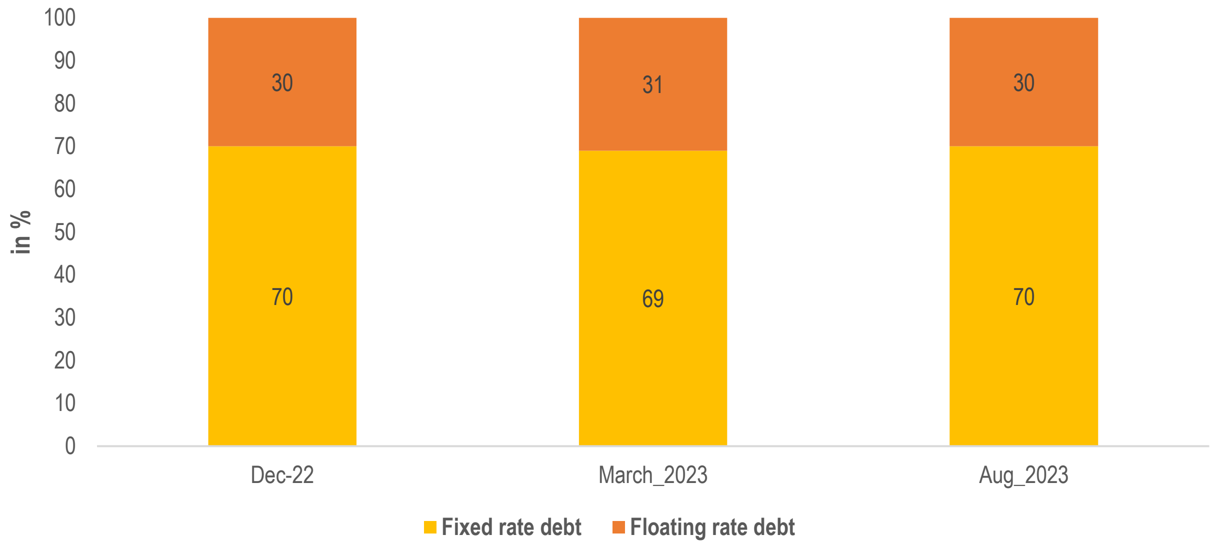


(Source: PDMO)

C2: Interest rate risk

The share of debt with floating interest rates relative to total debt recorded a slight uptick in the first quarter of 2023 as illustrated in the Figure below. Then, the floating rate debt has marked a minor reduction reaching 30 percent, the same level as it was in the year 2022. However, the floating rate debt is expected to be maintained at similar levels in the following years, and from 2025 onwards the said debt is expected to follow a downward path as a result of the repayment of the ESM loans which carry floating interest rates. The reduction of the floating rate debt will continue to be a priority in the new MTDS 2024-2026.

Figure 7: Share of floating-rate debt against total debt

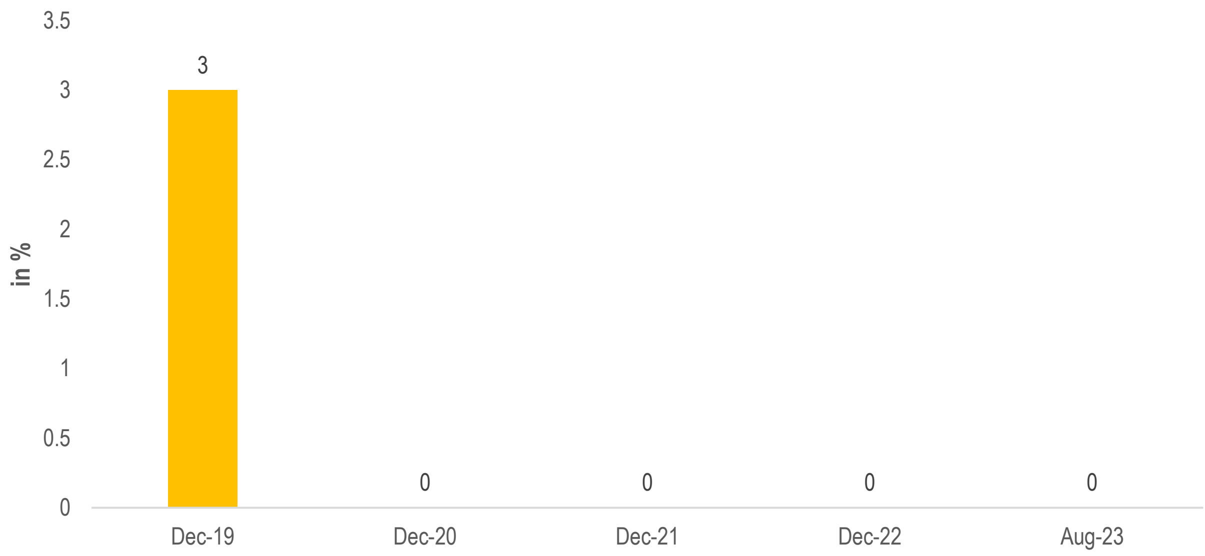


(Source: PDMO)

C3: Currency risk

Figure 8 below illustrates the evolution of foreign currency debt against total debt, which has been zero since March 2020 after the early repayment of the IMF loan, eliminating both foreign exchange and interest rate risk. It is noteworthy that the outstanding debt to the IMF at the end of 2019 was approximately €704 million and two months later when it was repaid, it amounted to €717 million, reflecting the risk of exchange rate fluctuations.

Figure 8: Share of foreign-currency debt against total debt



(Source: PDMO)

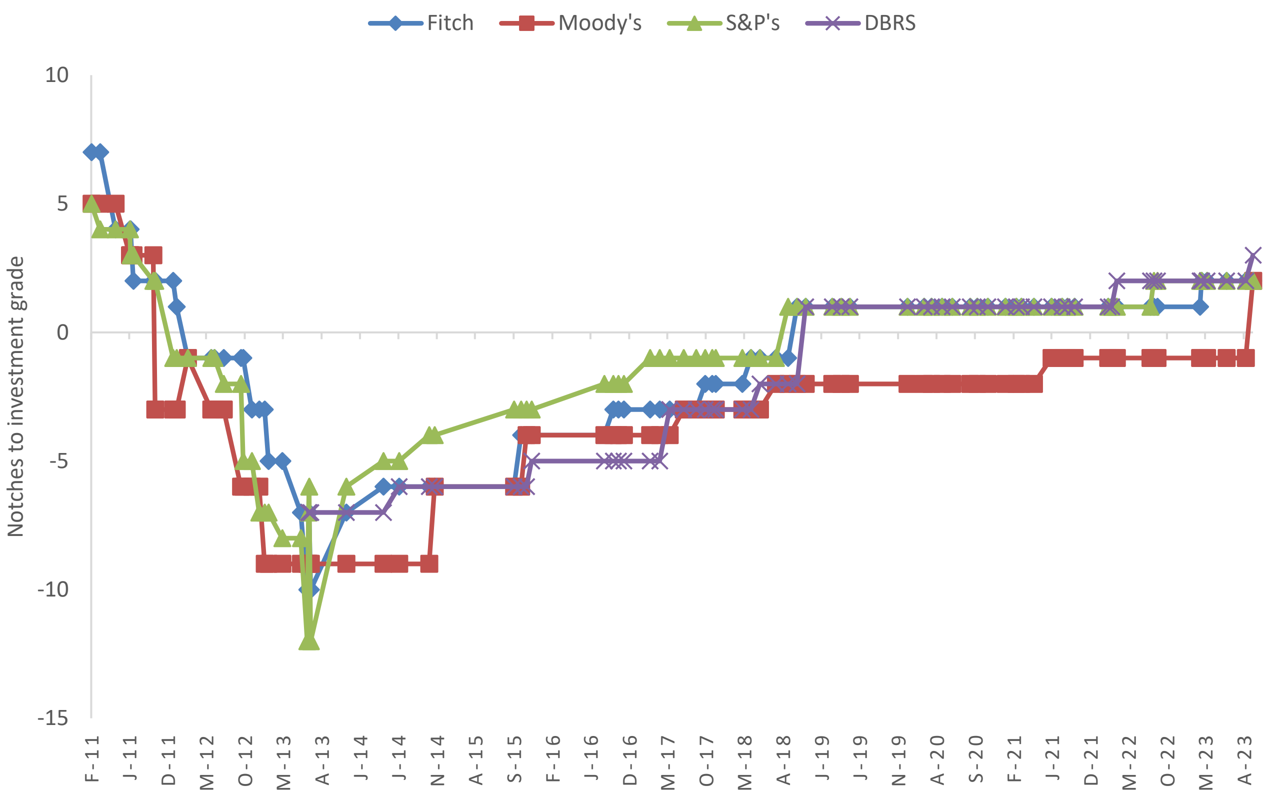
C4: Liquidity Risk

The MTDS objective of maintaining cash reserves to meet the financing needs of the next 9-12 months, has been met throughout 2023 with cash reserves at the end of August 2023 covering more than three times the gross financing needs of the next 9 months. As a result of the cash strong position of the Government, the liquidity risk is very low.

D. Evolution of credit rating, credit spreads and investor base

The credit rating of the long-term debt of the Republic of Cyprus was maintained in the investment category by all Credit Rating Agencies in 2023. Specifically, Fitch and DBRS upgraded the long-term sovereign rating of Cyprus to BBB and BBB(high) from BBB- and BBB respectively whilst Moody's upgraded the sovereign rating of Cyprus to Baa2 from Ba1. Finally, S&P's affirmed the Cyprus's long-term issuer default rating at BBB changing the outlook from stable to positive. Figure 9 below shows the historical development of the ratings of the Republic of Cyprus during the period 2011-2023.

Figure 9: Long-term credit rating of the Republic of Cyprus 2011-2023



(Source: PDMO)

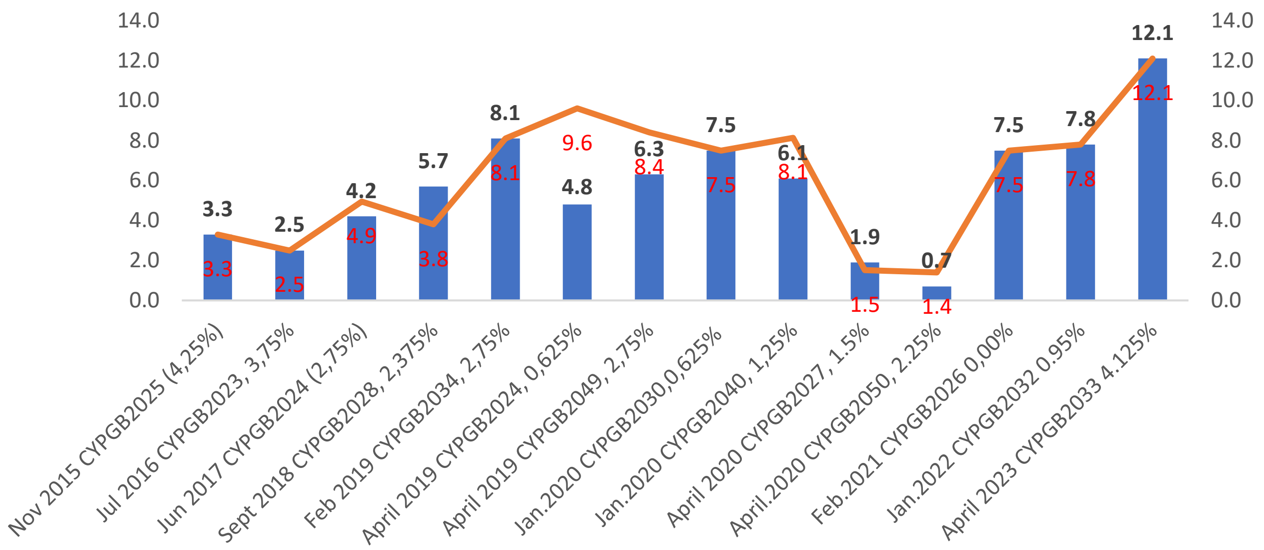
The improvement of the credit rating of the Republic of Cyprus in recent years and the fact that three the rating Agencies affirmed the Cyprus's long-term issuer default rating for six consecutive years at the investment category, two of them upgraded the long-term issuer default rating by one notch and one of them by two notches this year and the fourth CRA affirmed the Cyprus's long-term issuer default and changed the outlook from stable to positive were, amongst others, factors that facilitate the market access of Cyprus to international markets, enrich the bonds yield curve and sustain the cost of borrowing at moderate level.

Figure 10 below shows the historical evolution of the order book in conjunction with the investor coverage ratio for the EMTN issued by the Republic of Cyprus for the period 2014-2023. As shown in the Figure below, the coverage ratio of bond issues is at a very satisfactory level, mainly as of the year 2018, reflecting the great interest of investors to participate in the bond issues of the Republic of Cyprus. In April 2023, the total order book for the EMTN issuance was above EUR 12.1 bn and the investor coverage ratio stood at 12.1 times reflecting investor's confidence in Cyprus economy.

The said 10-year EMTN issuance was the first sustainable bond issued by the Republic of Cyprus, with the reoffer yield priced at 4.219% and coupon yield at 4.125%.

An exception was the month of April 2020, during which the bond coverage ratio recorded a significant decrease. This was an isolated case that happened due to the uncertainty that was preceded from the first wave of the pandemic and the time-waited for EU decisions to address the economic impact of the Covid-19 pandemic.

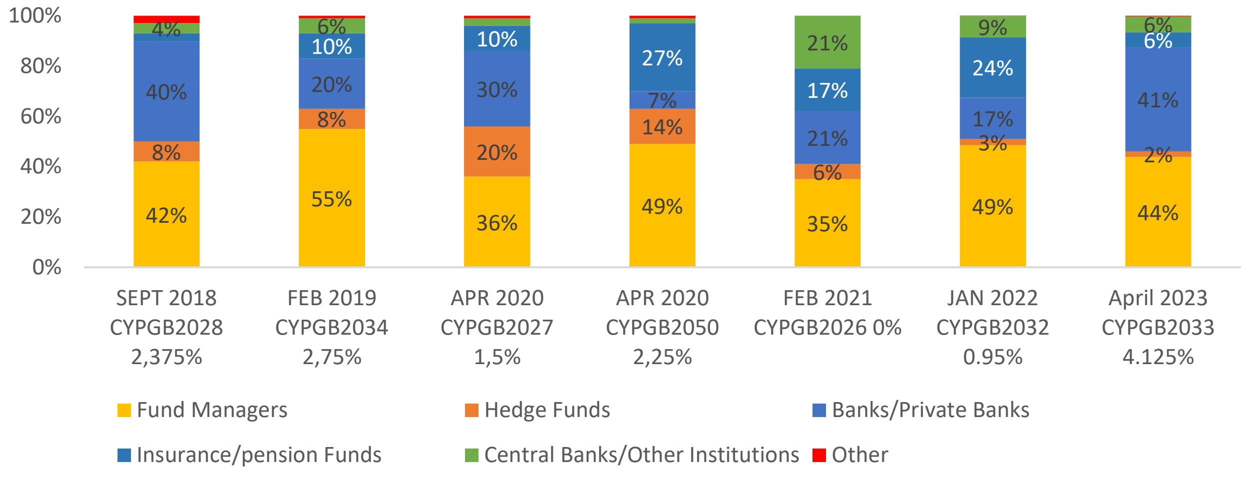
Figure 10: Orderbook size



(Source: PDMO)

The distribution of investors by type shows a significant improvement in recent years, reflecting the improvement of the credit rating of the Republic of Cyprus, namely the restoration of its credit rating to investment grade by S&P in September 2018 and also by other Agencies in subsequent upgrade ratings. As shown in Figure 11 below, the increased share of the Hedge Funds in May's 2015 issue was followed by a significant contraction of this type of investors, especially since 2021, with the majority of them in the final distribution in the primary market coming from Fund Managers and Banks/Private Banks. At the last EMTN issuance, the majority of investors again were Fund Managers and Banks/Private Banks followed by Central Banks/ state institutions and by Insurance / Pension Funds.

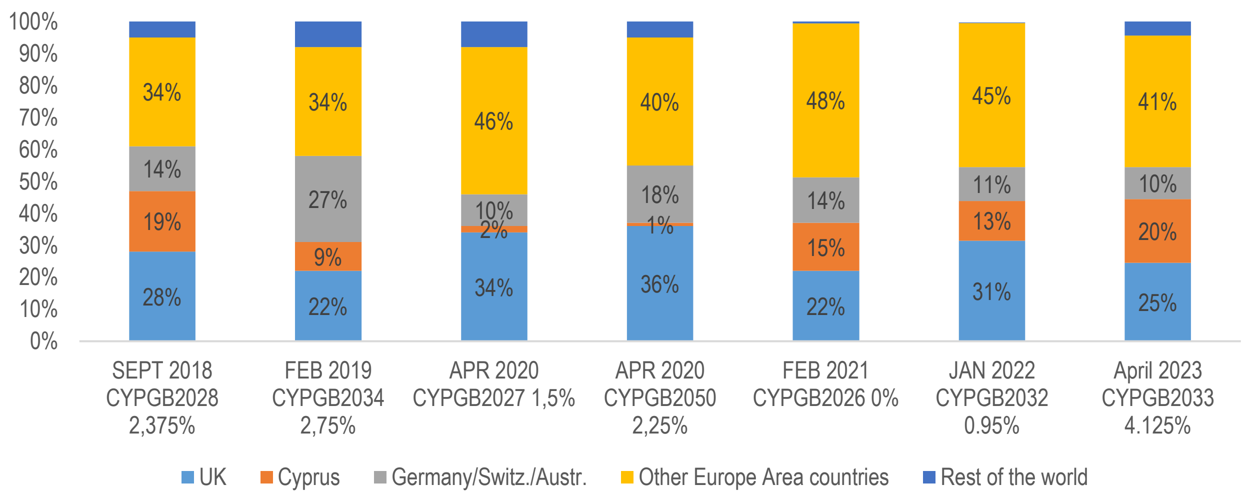
Figure 11: Investor allocation by type in the primary market (EMTN)



(Source: PDMO)
Note: This figure does not illustrate all the EMTN issuances.

Figure 12 below, illustrates the distribution of investors by geography for selected EMTN issuances during the period 2015 to 2023.The distribution of investors by geography shows a more balanced distribution between UK and Europe investors. However, investors from UK continue to play a significant role in the development of the orderbook at every EMTN issuance. Concluding, in all the last issuances an extended investor base by geography has been achieved across Europe with Cypriot investors having an important share on the final allocation. Specifically, at the last issuance, the majority of the international investors originated from the UK and Nordic countries whilst the participation from Cypriot investors reached 20%. It is noted that a number of orders have been placed by new investors reflecting the increasingly importance of green, social and sustainability bonds to the global fixed income markets.

Figure 12: Investor allocation by geography in the primary market (EMTN)



(Source: PDMO)
Note: This figure does not illustrate all the EMTN issuances.

VI. Strategic Framework 2024-2026

A. Selected issuance strategy

The main financing tool for the aforementioned strategic period will be the international bond issuances, given the large size of the aforementioned market, as well as due to the expectation of better borrowing rates, in order to continue with the progress made on the strategic targets of debt management over the past years.

These bonds are issued under English Law and listing may occur in more than one stock exchange. The method of issuance is through syndication.

All other available instruments will complement the international bond issuances. Domestic bonds, issued under Cyprus law and listed at the Cyprus Stock Exchange will be used to a lesser extent should opportunities arise. Additionally, the retail segment of the domestic market will be tapped in regular intervals through retail bonds. In the short-term spectrum, Treasury Bills and potentially Commercial Papers will be used, giving priority to Treasury Bills which are issued through auctions. Finally, non-market financing will be pursued from supranational institutions for long-term financing either for new projects mainly associated to the green transition and digital transformation or for ongoing projects.

The specific features of the newly assumed debt will be chosen in accordance with the guidelines set on risk management, development and expansion of the market and investor base, and under the condition that risk mitigation generally precedes cost minimization.

B. Guidelines and strategic objectives

B1: Risk mitigation

Refinancing risk

Although the debt maturity profile has smoothed and is within comfortable levels, thanks to the successful implementation of the previous debt management strategies, efforts towards the same direction will also continue under the new strategy 2024-2026 given the global uncertainty in the economy including geopolitical developments, prolonged prevalence of strong inflationary pressures and exposure to physical climate risk. These actions will help us to maintain a fairly balanced redemption schedule as well as an ample average remaining maturity profile, in order to keep the refinancing risk at low levels. Nonetheless, the international bonds issued at a minimum benchmark size by small-scale issuers, such as the Republic of Cyprus, according to international best practice (at EUR 1 bn as a general rule), cause rather sizeable remaining maturity peaks. Targets are set as follows:

(i) Target: Maintaining average remaining maturity of marketable debt to 7 years minimum.

Rationale: The reasoning for maintaining remaining maturity levels greater than 7 years is to enable the State to proceed with redesigning its strategy, if that be required, in order to ensure that borrowing is contained within acceptable and manageable risk levels. High concentration of debt with a medium-term horizon could undermine the objective of the public debt management especially given the high level of uncertainty that currently exists in public finances due to the unforeseeable economic consequences from the continuation of Russia-Ukraine war, the EU sanctions effects to Russia combined with UK and USA sanctions which seems likely to continue and also from the exposure, as all countries, to physical climate risks which may pose additional obstacles in the future creating negative economic, financial and social effects.

(ii) Target: The outstanding short-term debt, with initial issuance maturity up to 12 months, will not exceed 2% of the cumulative government debt for each of the years 2024, 2025 and 2026.

Rationale: Preserving short term debt within these levels ensures the minimization of refinancing cost and contains interest rate risk, particularly in times of strong interest rate volatility. At the same time, there should be sufficient room left for long term issuances in order to improve liquidity of Eurobond issuances and develop the long-term yield curve.

Principles/Actions: Regular auctions will be pursued, preceded by the publication of an auction calendar.

(iii) Target: Maintaining adequate liquid funds to cover financing needs of the next 6-9 months, focusing on the maximum limit of 9 months for the period 2024 to 2026.

Rationale: Substantial prudential liquidity allows more room for executing main financing operations in case of any unfavorable conditions disrupt or delay market access.

Principles/Actions: Cash management may be utilized to minimize the cost of carry.

(iv) Target: The maturity of issuances will be chosen so that the annual gross financing needs do not exceed 10% of the respective GDP for the years up to 2030.

Rationale: The target aims to ensure that financing needs are comfortably met under normal market conditions. According to the IMF risk assessment framework countries with gross financing needs up to 15% of GDP are assessed as ‘low scrutiny’. A prudent limit of 10% is set for the case of Cyprus, to account for the lower liquidity in the market which can exacerbate investor behavior in times of market stress. It is noted that in recent issuances a growing investor base has been presented with high bid to cover ratio indicating the possibility of the State to proceed with an issuance volume of more than 10% of GDP.

Principles/Actions: Liability management transactions may be applied in order to comply with the target of the strategy.

(v) Target: The difference between the average interest rate on public debt and the nominal GDP growth rate of the economy will maintain at negative values for the years 2024, 2025 and 2026

Rationale: The target aims to ensure that the refinancing risk of the outstanding public debt will be maintained at the lowest level, the fiscal cost will be sustained at low levels and in general to eliminate risks to debt sustainability. Although, theoretical models do not provide clear cut and sufficient conclusions with respect to the sign and size of the interest rate-growth differential on government debt (i-g), the above target is set for the case of Cyprus, to account for the relatively elevated stock of public debt that raises Cyprus's vulnerability to interest rates, especially under the current level of the increasing interest rate environment. It is noted that maintaining negative interest rate-growth differential on government debt helps to stabilize debt in the long term, however debt dynamics in the near term depend also on the primary budget balance.

Principles/Actions: Amendment of the target of liquid funds may be applied in order to comply with the target of the strategy.

Interest rate risk

Following the borrowing of official loans under the EU-IMF Adjustment Programme in the period 2013-2016, the share of debt carrying floating interest rates increased significantly. While total floating rate debt has been following a declining path approaching 31% at the end of August 2023 given the early repayment of the IMF loan in February 2020, the floating rate debt is set to substantially decline as of 2025 onwards. This is expected to occur through the redemption of ESM loans that carry floating interest rate and through the assumption of the undertaking of new long-term project loans with fixed interest rate (numerator effect).

Target: Debt carrying floating interest rates should not exceed 30% of outstanding debt in the period 2024 to 2026.

Rationale: This target aims at reducing fluctuations of interest paid on an annual basis due to floating interest rates. The share of debt with floating interest rate concerns mostly the ESM loans. Furthermore, this target aims to improve the forecasts of public finances and evidently government cash reserves. With respect to projects financed by loans, priority will be given to those carrying fixed interest rates within the next three-year horizon given also the high current interest rate environment and the possibility of a further increase in the short-term.

Principles/Actions: The use of derivatives will be assessed and may be applied to ensure compliance of the debt structure with the strategy. Priority will be given to fixed-interest loans in order to contribute positively to the target set under the strategy.

Foreign exchange risk

Cyprus has not issued long term marketable debt in foreign currency to date, with the exception of the IMF loan which has been prepaid in 2020. The fact is that the euro market is sufficiently large and diverse covering Cyprus' financing needs.

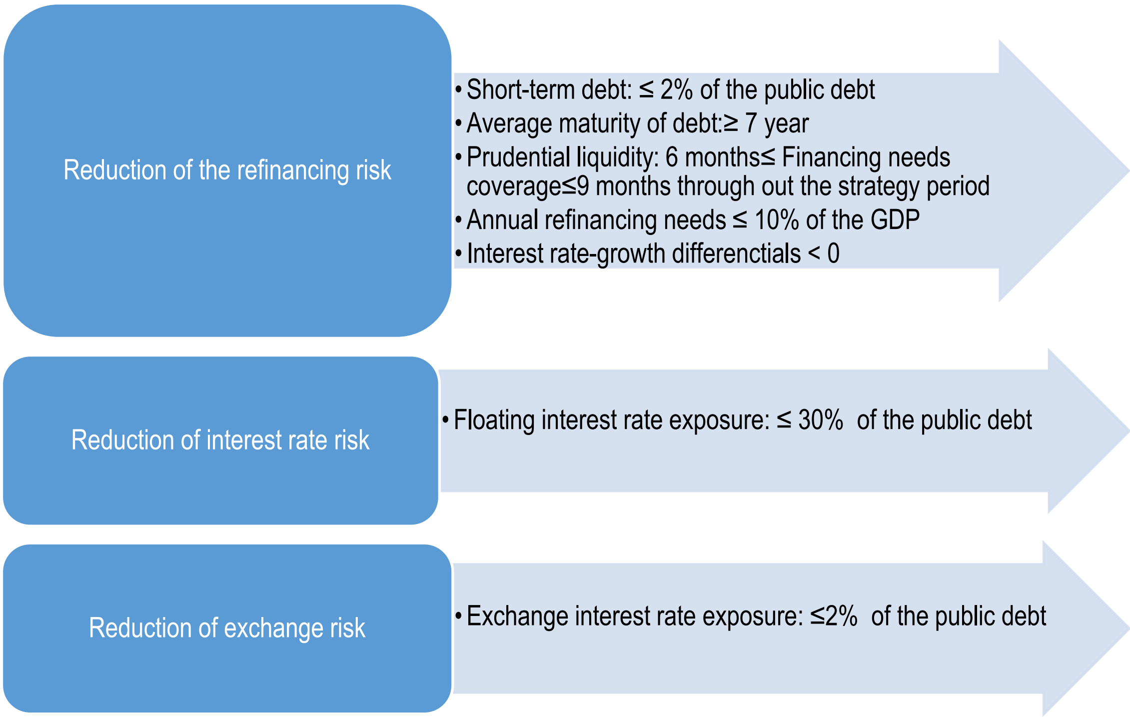
Target: Debt denominated in foreign currency should not exceed 2% of outstanding debt.

Rationale: While opportunities in foreign currencies may arise from time to time, these should be evaluated in relation to the development of the government securities market, mitigation of exchange risk and the objective of cost minimization.

Principles/Actions: The use of derivatives will be assessed and may be applied to ensure compliance of the debt structure with the strategy.

The strategic targets serve as benchmarks and are a management tool for the government to steer its risk tolerance with respect to refinancing and market risk. An overview of the key risk benchmarks is illustrated in Figure 13.

Figure 13: Key risk benchmarks for debt management 2024-2026



B2: Development of government securities market

Primary market

Background: The Cypriot sovereign debt market is naturally constrained by its small size therefore primary market activity is vital in maintaining the functioning of the market. However, market fragmentation has been reduced post economic crisis with the concentration of financing needs in single benchmark international bonds and absence from domestic bond issuances.

Target: The completion and extension of sovereign yield curve with international investors benchmark bond issuances.

Rationale: Significant improvement has been achieved in building up the sovereign yield curve which has been extended up to a 30-year tenor. However, the whole process for further enhancement was interrupted, since last year, due to the tightening monetary policy by the ECB to tackle soaring inflation. Given the high interest rate environment which is expected to sustain for some period, our efforts are concentrated on the medium part of the curve, so that, at any time point there are enough available pricing points to evaluate possible issuing opportunities.

Principles/Actions: Communication of general financing plans to the market and transparency, predictability and consistency of actions to the extent permitted by market conditions and major current economic developments. Regular, benchmark-sized, issuance under the same instrument, the EMTN Programme. In this way, consistency of issuance characteristics in terms of currency and interest rate type is maintained.

Secondary market

Background: The promotion of a vibrant secondary market for government securities has proved to be one of the more difficult aspects of government securities market development. Successful development of the secondary market requires a number of actions such as active participation of many different groups, including investors, providers of trading and settlement infrastructure and intermediaries.

In the context of developing the government securities market, a primary dealer system based on best effort basis has been adopted by the PDMO and it seems that the efficiency of the secondary market for government bonds has increased during the last few years. The bank group comprises of eight international banks with terms of reference, among others, to support a well-functioning market for the Cyprus government securities and display a good code of conduct in the clearing and settlement of trades, provide information about prices in the secondary markets, development via their marketing strategy new client investment in Cyprus Government securities and make them accessible to investors.

Following the formation of a bank group to support the Cyprus government bond market, the management of relations with the financial institutions has become more formal. Additionally, with the introduction of MTS, an electronic trading platform, towards the end of 2019 secondary market transactions began to take place, thus enabling primary dealers to trade electronically and enhancing transparency and efficiency in the Eurobond market.

Target: A more liquid and transparent secondary market.

Rationale: A functioning secondary market, within the limitations of a small issuer, will strengthen demand in the primary market.

Principles/Actions:

i. A group of market-making banks acting as dealers in the secondary market, will initially be maintained within an underlying operational infrastructure on a voluntary basis. The performance of the banks will be evaluated and properly communicated. The assessment will take place during the strategy period in order to evaluate whether conditions are mature enough to proceed to a full primary dealership system.

ii. The investor support in the secondary market trading will be a driver for primary market allocation.

iii. Transparency in the processes and decisions, clear communication of privileges and obligations on behalf of the banks. Timely communication for the appraisal of the banks' activities.

B3: Investor relations

Background: Given the small and relatively infrequent debt issuances of Cyprus, when compared to the rest of the Eurozone, with the exception of the year 2020 when the Government issued six EMTN, due to the high uncertainty surrounding the development of the Covid-19 pandemic, there is a need to counterbalance with actions that enhance visibility and presence in the market. Efforts to increase visibility will continue to intensify with regular roadshows in core and peripheral European financial centers, after a short-period of break, due to the Covid-19 pandemic, in order to expand further its list of investor entities. In addition, investor communication takes place through teleconferencing and through the PDMO's website, as well as through regular publications involving information on public debt management and economic developments in Cyprus.

Target: A larger, more diversified and less correlated pool of investors.

Principles/Actions:

i. Maintaining a regular communication with existing investors whilst intensifying efforts to bring in new investors, in order to expand the investors base and the geographical distribution. Efforts for swift responses to opportunities with new investors as a result of credit rating or market changes will be aimed at. Overall, as broad an investor base as possible will be targeted.

ii. Communication with investors through:
   - Regular publication of reports and statistics about the Cypriot economy and on debt management developments with the aim of facilitating the information spread on a regular basis (see Box)
   - Roadshows and meetings with investors on a regular basis
   - Participation of the PDMO in main international conferences and fora
   - Maintenance of the stand-alone website and of a mailing list which investors can subscribe to.

Box: Disclosure of information to market participants

All publications are prepared by the Public Debt Management Office with the aim of maintaining information flow towards the investor community and international financial institutions. All publications are posted on the PDMO website.

Medium Term Public Debt Management Strategy
Designed on a three-to-five-year basis, provides the outline of government policy for financing and public debt related matters, projected gross financing needs and the desired cost-risk outcome of the debt portfolio. It is approved by the Council of Ministers through submission by the Minister of Finance.

Annual Funding Plan
For every fiscal year, the PDMO prepares an Annual Funding Plan which covers the projected accumulated borrowing needs of the Republic of Cyprus.

Annual Public Debt Management Report
Communicated by the Minister of Finance to the Budget and Finance Committee of the Parliament, it includes the following:

- Developments in Cypriot and eurozone capital markets
- Debt structure
- Debt operations of the year in review
- Risk management and risk indicators
- Review of annual actions and operations towards MTDS targets

Auction Calendar
Calendar for monthly Treasury Bill auctions published twice in a year.

Quarterly debt bulletin
Overview of the quarterly debt management operations, auction results, secondary market yield developments and presentation of the main debt statistics, compared to previous quarters.

Quarterly statistics
Lists concerning the central government debt by instrument and the maturity profile.

Bi-annual risk indicators
Time series of main indicators for refinancing, currency and interest rate risk.

Newsletter on economic developments
Main events and data on all recent developments in the macro economy, banking, fiscal and public debt management of Cyprus. Published at least quarterly.

Investor Presentation
Published frequently, it includes the latest information and forecasts on the macro economy, public finances, financial sector and public debt management.

Offering Circular
The PDMO is updating the Offering Circular, which is a part of the EMTN legal documents and includes important provisions about the EMTN programme as well as information and data of the Republic of Cyprus and economy.

C. Comparison with the MTDS 2023-2025

The main pillars for MTDS 2024-2026 remain the same as those of the previous strategy, as their consistent implementation has obviously contributed to achieving the objective of public debt management. However, the chosen strategy for the period 2024-2026 corresponds and is based on the benchmarks achieved during the previous period, taking also into account the current market conditions as well as a number of challenges, such as the geopolitical developments, the high interest rate environments, the management of PDMO cash balances and the effects of climate change in years to come, on the tourism sector and in general in the whole economy.

For the refinancing risk a retention guideline with five quantitative targets were set. The target for the short-term debt has been reduced by 1pp, compared to the existing strategy, and should not exceed 2% of the total outstanding debt for the period 2024-2026. The second quantitative target, concerns the average remaining maturity of marketable debt. In view of the fact that the main source of financing for the upcoming years will be the international bond market through the issuance of EMTN, sustaining the average remaining maturity of the marketable debt at not less than 7 years, acquires special importance within the context of high interest rate environment in combination with the next quantitative indicator that refers to the reduction of the gross financing needs at below 10% of GDP by the end of 2030. The fourth quantitative target, which is one of the most important indicators for the reduction of the refinancing risk, in view also of the continuation of the Russia-Ukraine war for an unknown period as well as the ongoing monetary policy tightening process, is to retain cash reserves at a satisfactory level, however at lower level as it is in the existing strategy, covering the financial needs of the next 6 - 9 months (with more emphasis to 9 months). The reason that the target is reduced to 6-9 months, is attributed to the accumulation of high cash balances resulting from better-than-expected fiscal performance during the last two years and to the fact that based on the latest projections the Gross Financing Needs for the period under review are within manageable levels despite the uncertainty in the global economy and the ongoing monetary tightening policy. In addition, the target about interest rate-growth differential which has been incorporated in the existing MTDS to eliminate, among other factors, the risks on debt sustainability, will remain in the new MTDS.

The guideline for the development of the public debt market includes two objectives, which were also incorporated in the MTDS 2023-2025. The first objective concerns the development of the primary market for government securities and the second objective focuses on the development of the secondary market with higher liquidity and transparency. In the field of the secondary market, the intended efforts will concern the continuation of the evaluation of the work carried out by the group of international banks in order to increase the efficiency of the secondary market and the evaluation of the operation of the electronic trading platform for Cypriot government bonds and its contribution in the increase of the liquidity of the bonds issued by the Republic of Cyprus.

In general, the guidelines on investor relations remain the same. PDMO will continue to seek regular contact with existing investors, while trying to find new investors in order to achieve a more diversified and a less correlated investment base contributing to further reduction of transaction costs. It is noted that through the inaugural 10-year sustainability bond issued in 2023, the investor base has been further broadened.

D. Potential risks in the implementation of the Strategy

Although the credit rating developments for the Republic of Cyprus were positive during the year 2023, with three Credit Rating Agencies upgrading the sovereign bond rating of Cyprus (of which two of them by one notch and one of them by two notches) and the other CRA affirming the sovereign bond rating of Cyprus and changing the outlook from stable to positive, uncertainty in the global economy remains high. If the war's effects will lead in materially weaker economic growth prospects or fiscal consolidation interrupting the downward path of the public debt, then a negative rating action would be a possible scenario. It is worth noting that any change in the outlook and/or investment rating category or even non-investment rating will have an equivalent impact on the cost of borrowing of the Republic of Cyprus.

In addition, a possible increase in the annual gross financing needs due to the continuation of the Russia-Ukraine war, impacts of EU sanctions, and UK/USA sanctions, and inflationary pressures on Cypriot economy as well as any possible fiscal pressures, due to physical climate risks, may affect the amount of capital borrowed from international markets and borrowing within an acceptable and manageable risk framework. However, the strong cash position of the Government could curb to some extent these risks. Consequently, this may necessitate the raising of funds from the domestic market with probably higher borrowing costs and with a negative impact on effective demand and purchasing power.

Although it seems unlikely to have a material negative impact at this stage, the possibility of a prolonged period of strong inflationary pressures and the impact of the war on the external environment, may affect the cost of borrowing and therefore the cost of servicing the public debt.

VII. Final provisions

The PDMO may deviate from the Strategy, with the approval of the Minister of Finance, if significant market conditions or economic developments render it a necessary or appropriate action. Although the Strategy allows for some flexibility, accountability and transparency of action and decision-making will be pursued at the same time.

With the adoption of the Strategy for 2024-2026, the MTDS 2023-2025 becomes void.

Annual Financing Plan 2023

Financing Instrument	Initial AFP_2023 (Nov. 2022) Upper borrowing limit	Actual borrowing (as at the end of Sept.2023)
Domestic 3-month Treasury Bills	€300 mn	€35 mn
Euro Medium Term Notes (EMTN)	€1000 mn	€1000 mn
Domestic Retail Bonds	€40 mn	€13 mn
Loans from Supranational Institutions (EIB, EBRD, CEB)	€180 mn	€123 mn
Total approved maximum borrowing amount in Jan. ~ Dec. 2023	**€1520 mn**	**€1171 mn**

Notes

- EIB = European Investment Bank, EBRD = European Bank for Reconstruction and Development, CEB = Council of Europe Development Bank.
- The 3-months Treasury Bills are encounter in a 3-months roll-over base.
- Any amounts that are expected to be received, as a grant, under RRF were not included in the above table.