MEDIUM TERM PUBLIC DEBT MANAGEMENT STRATEGY

2015-2019

Republic of Cyprus

Ministry of Finance

Public Debt Management Office

23 December 2014

Contents

Executive summary

This is the second medium-term public debt management strategy (MTDS) of Cyprus since the enactment of the Public Debt Management Law in December 2012.

The present MTDS covers the five-year period 2015-2019. Consequently, this Strategy is intended to operate and it reflects the aspiration of functioning as a bridge between the official funding (IMF/ ESM) period (which ends by March 2016) and the post-Programme period, commencing in April 2016.

The drafting of this MTDS document has benefited and relied to a great extent on the IMF – World Bank Revised Public Debt Management Guidelines as well as on the relevant Stockholm Principles (Guiding Principles for Managing Sovereign Risk and High Levels of Public Debt).

The guidelines of this MTDS as well as of the resulting Annual Financing Programmes (AFP) are the following four: (i) Smoothening out the maturity profile of marketable debt; (ii) Risk mitigation through increased cash reserves and management of foreign exchange and interest rate risk; (iii) Development of the government securities market; and (iv) Minimisation of medium-term cost of public debt.

The present MTDS is expected to function in a macro-economic environment which is more favourable than initially projected, though under certain challenges. Cyprus's economy reflects a shallower recession than initial forecasts whereas fiscal targets have been met with considerable over-performance. The contraction of real GDP will continue over 2014 whereas a modest and gradual recovery is expected to start in 2015.

There exist a number of risk factors and challenges, though manageable: In particular, building economic confidence following the restructuring of the financial system, may be slow and the period of tight credit supply may be prolonged affecting investment and outlook. Structural reforms provided for in the economic adjustment programme, might face resistance. Moreover, a possible realization of contingent fiscal liabilities resulting from a limited number of government guarantees may take place, though to an absolutely manageable extent which is already reflected in the State Budget incorporating a current annual provision of EUR 50 million.

Although the average term to maturity of debt is projected to exceed 8,5 years the current debt maturity profile shows a concentration of maturities in the years 2015-2020, which gives rise to a high refinancing risk in the first post-Programme period. In order to mitigate these risks it would be advisable to maintain low annual maturities during the first post-Programme years to moderate the need of market-based issuance and maintain a smooth maturity profile.

At end December 2014 the interest rate structure is projected to be 55% fixed-rate debt and 45% floating-rate debt. It is worth-noting, however, that the largest share of existing debt with variable interest rates relates to official loans by the ESM and the IMF, whilst further bank loans carry low margins over base rates. The average time to refixing is projected to be 1,9 years.

The interest rate and foreign exchange risks in the post-Programme period will be mitigated through increased cash reserves and management of foreign exchange and interest rate risk. The existence of an increased cash reserve level, will reduce liquidity risk and will materially improve market perception for the risks facing the Republic thus reducing borrowing costs. In this context, cash reserves are targeted to increase from €200 million to €500 million by December 2015.

For selecting the proper MTDS for Cyprus, under current conditions, four alternative strategies have been assessed under four different interest rate and exchange rate scenarios. In this analysis framework, the MTDS Analytical Tool (AT) has been employed. Cost-risk analysis is particularly insightful when evaluated with the AT. It is of paramount importance, however, to stress from the very beginning that the decision-making mechanism for selecting the proper MTDS entails a heavy weight of mindful judgment over and above the AT results. The outcome of this analysis has led us to the selection of a strategy which gives particular emphasis on the public debt maturity extension. Under the selected debt management strategy, borrowing in the post-Programme period is mainly undertaken in long-term foreign-law bonds. In the domestic market the share of Treasury Bills will gradually be reduced over time, making room for the issuance of government bonds under domestic law.

The selected strategy is consistent with the overall aim of reducing the existing aggregate debt portfolio refinancing risk. At the same time, its cost impact in terms of the implied interest rate, is within the framework outlined in the Guidelines and it does not indicate a severe impact on debt sustainability. In addition, the marketable debt risk indicators improve considerably. In particular, this strategy follows the Guidelines of 2015-2019 and leads to the goals set out in the MTDS. The debt profile is smoothened as there is little concentration of future repayments following the end of the strategy period. An element of the selected strategy is the creation of a cushion of liquidity in its early stage. This important element, seems to be contributing to the management of refinancing risk most effectively than alternative options. Furthermore, the selected debt management strategy avoids any accumulation of market risks, particularly of foreign exchange rate or floating interest rate risk. At the same time the adopted strategy facilitates the development of domestic primary and secondary market by moving gradually from Treasury Bills to a higher share of domestic bonds.

It is a common place that even the most carefully designed strategies, cannot deliver the expected results if sufficient attention is not paid to the quality of the implementing mechanism. To this end, specific steps will be taken to improve and strengthen the organizational structure of the PDMO. In addition, improvements in the internal controls of the PDMO will also be considered. Through this process, potential operational risks are expected to be identified and managed. In the same context, the Information Technology infrastructure of the PDMO will be assessed and modernized. The importance of strengthening the relations with investors has already been acknowledged and an investor's relations function is being established within the PDMO. Last but not least, the market intelligence function will also be enhanced via the allocation of more resources in following and analyzing market developments and financial innovation.

In sum, this MTDS reflects all planned actions that have to be taken in a concerted manner in order to achieve stable market access combined with fiscally sustainable cost of borrowing, under acceptable levels of financial risks.

The Annual Financing Programme (AFP) will thus be designed and implemented on the basis of and in compliance with the above-mentioned selected MTDS.

1. Introduction

The Medium Term Debt Management Strategy (MTDS) is a policy statement detailing the direction and actions of public debt management during the period 2015-2019. The purpose of the strategy is threefold:

- The strategic guidelines for government financing are set and explained
- A framework for quantitative and qualitative targets as well as the use of analytical tools facilitating the strategic decision making is put in place
- A framework for the development of an effective investors relations strategy and a market intelligence function is set

The strategy is intended to be a working policy document and is updated at least once annually, on a rolling basis.

Legal framework

Public debt management in Cyprus is regulated under the Public Debt Management Laws 2012-2013 (the Law). As per the Law, the medium term debt management strategy covers a horizon of 3 to 5 years and is prepared and updated at least once a year or a rolling basis by the Public Debt Management Office (PDMO). The MTDS is submitted for approval to the Council of Ministers by the Minister of Finance after informing the Budget and Finance Committee of the parliament. The approval by the Council of Ministers is made by end October of the year preceding the first year of the strategy. Following the final approval the borrowing and other debt management operations are subject to and enforced on the basis of the strategy. This is formalized in the Annual Financing Programme for each calendar year.

Objective of debt management

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

Scope of the strategy

The analysis covers the debt of budgetary central government, which makes up about 99% of the general government debt. Indirectly the risk of explicit contingent liabilities, i.e. guarantees, is covered via their impact on fiscal financing needs.

Reading instructions

The document structure begins by defining the guidelines and targets that will apply to public debt management over the years 2015-2019. Then in Chapter 3 and 4, conditions and assumptions for the debt management strategy are described. Chapter 5 describes the discussion and analysis leading to the selected debt management strategy and forms the basis for the Guidelines of the current strategy. Chapter 6 describes specific initiatives undertaken by the PDMO to achieve stable market access.

2. Guidelines for 2015-2019

Based on the debt management objectives, analysis and discussions lead to strategic decisions guiding the debt management in the medium term. The strategic decisions take the form of guidelines and reflect the desired balance between expected costs and risks.

The focal point of the guidelines and, thus, of the MTDS, is the reduction of risks to acceptable levels in the immediate post-Programme period, a target that takes precedence over pure cost minimization.

The guidelines that will drive the strategy and the design of the Annual Financing Programme are the following:

- Smoothening of maturity profile of public debt and extension of maturity of marketable debt;
- Risk mitigation through increased cash reserves and management of foreign exchange and interest rate risk;
- Development of the government securities market;
- Minimisation of marketable debt borrowing costs, without compromising the above guidelines.

The guidelines translate into more concrete actions and, where the goal permits, into quantitative targets in the form of ranges or directions. These are outlined in Table 1. The rationale and background driving the guidelines is analysed in Section 5 "Analysis and discussions".

Table 1: Overview of guidelines, actions and targets

Guidelines	Actions/Quantitative targets
Smoothening of maturity profile of public debt and extension of maturity of marketable debt	• Average remaining maturity of marketable debt: not less than 3 years The debt profile with regards refinancing aspects is envisaged to be composed as follows: • Short term debt between 1- 5% of total debt stock or up to €750 million which ever is lowest. Short term debt is the debt of an original maturity up to 12 months. • Long term debt at least 95% of total debt stock and respecting the maturity limits: o Long term debt maturities 2015: about €1300 million o Long term debt maturities 2016-2018: up to €1750 million o Long term debt maturities of 2019 and thereafter: up to €2200 million Long term debt is any debt with original maturity of 1 year or longer.
Risk mitigation ➢ Increase of total liquid funds of the Budgetary Central Government ➢ Management of foreign exchange and interest rate risk	• Total liquid funds end of 2015: €1 billion, of which designated cash reserves €500 million • Total liquid funds 2016-2019: €1 billion, of which designated cash reserves €500 million (to be reevaluated on an annual basis) The debt profile with regards to market risk aspects is envisaged to be composed as follows: • Marketable debt foreign exchange exposure: not more than 5% of total debt stock ; total debt foreign exchange exposure: not more than 10% of total debt stock • Marketable debt floating interest rate exposure: not more than 5% of total debt stock ; total debt floating

	interest rate exposure: not more than 60% of total debt stock
Development of the government securities market	• Improvement of the efficiency of the government securities markets • Introduction of regular auctions and issuance calendar in the Treasury Bills market • Building of long term international bond yield curve • Introduction of domestic bond (initially for short maturities)
Minimisation of marketable debt borrowing costs	• Improved investor relations • Regular provision of information to investors • Expansion of the investor base

3. Conditions and assumptions for the strategy

3.1. Baseline macroeconomic assumptions and risk factors

3.1.1. Macroeconomic and fiscal situation and outlook

The economic performance so far has been better than anticipated. The Cyprus macroeconomic framework reflects a shallower recession than past forecasts while fiscal consolidation has progressed exceeding original targets. Throughout 2013 and 2014 there has been continuous fiscal overperformance. Important structural reforms have been implemented such as the Fiscal Responsibility and Budget Systems Law and the modernization and rationalization of the welfare system. Additionally, first signs of improvement in unemployment have appeared recently. In October the major domestic banks successfully passed their AQR-stress tests satisfying fully the necessary assessment and criteria. One bank which was identified as having a small capital deficit vis-á-vis the threshold has in the meantime been fully recapitalised by private sources. As from November 2014 the four major banks of the domestic system are under the supervision of the European Central Bank.

The first five Troika review missions were concluded positively. The implementation of the Economic Adjustment Programme remained on track whereby fiscal targets have been met with considerable over-performance, reflecting better than projected revenue results and prudent budget execution.

The primary fiscal balance is projected to turn positive by the end of 2014, enabling the fiscal deficit to fall below the excessive deficit threshold of 3% and improve gradually to 4,0% in 2019. Public debt to GDP is projected to follow a downward trend to below 100% of GDP by 2019, expressed in the revised ESA2010 terms. Despite the improvements some challenges remain with the contraction of real GDP continuing over 2014 whereas a modest and gradual recovery is expected to start in 2015. Output is projected to grow by 0,4% in 2015 and expand at a moderate pace thereafter reaching 2,1% in 2019.

3.1.2. Potential risk factors

There exist potential risk factors that may have an impact on borrowing costs, credit ratings and stable market access. The return of confidence following recapitalization and restructuring of the banking sector may take time and the period of tight credit supply may also be prolonged. Structural reforms, as in the case of the privatization schedule, may face resistance and therefore this risk has to be stated, despite not being the baseline expectation. Moreover, a possible

realization of contingent fiscal liabilities resulting from government guarantees may take place. This source of risk is analysed in Subsection 3.1.3 "Contingent liabilities". In this context, regaining sufficient and uninterrupted market access must be ensured .

3.1.3 Contingent liabilities

The Public Debt Management Law provides that the Public Debt Management Office is assigned with the responsibility to keep a complete, accurate and updated record of government guarantees and on a regular basis (at least once a year) follow up and assess the financial risk resulting from outstanding government guarantees. The PDMO is responsible also to assess the financial risk resulting from newly proposed government guarantees, before they are issued. Contingent liabilities in the form of government guarantees, express the explicit commitment of the Republic of Cyprus to guarantee the fulfillment of financial obligations for which the guarantee is issued. The said government guarantees are provided to both legal entities and private individuals.

The outstanding amount of government guarantees at end July 2014 was €3,073 billion or about 19 percent of GDP, as compared to €3,125 billion at end March 2014. The said guarantees by group of beneficiaries are presented in Table 2 below. It is worth noting that a 100% of the guarantees portfolio is denominated in Euro.

As can be seen from Table 2, below, the main beneficiaries of guarantees are the Bank of Cyprus (BoC) and the EFSF that account for €1,3 billion (42% of the portfolio). The remaining guarantees of €1,8 billion (58% of the portfolio) have been extended to public corporate bodies, local authorities, natural persons, non-for-profit organizations, semi-government organizations and private corporations.

Table 2: Grouped frequency distribution table by beneficiary (by amount and percentage) at end July 2014

Category of Beneficiary	**Total Outstanding loans (in € million)**	**Percentage Frequency**
Public corporate bodies[1/]	1.236	40,22
Financial Institutions[2/]	1.000	32,54
Local authorities[3/]	334	10,87
International organisations[4/]	288	9,37
Natural persons	182	5,92
Companies with share capital participation by the government, other than financial institutions[5/]	24	0,78
Companies	7	0,23
Not-for-profit organisations[6/]	2	0,07
Total	3.073	100,00

1/ Refers to Sewerage Boards (€0,7 billion), Electricity Authority of Cyprus (€0,5 billion) etc
2/ Refers to Bank of Cyprus (€1 billion)
3/ Refers to Municipalities and Community Boards
4/ Refers to European Financial Stability Facility
5/Refers to Cyprus Airways Ltd (€24 million)
6/ Refers to Satirical Theatre

A description of the various groups of beneficiaries of government guarantees is presented in Appendix 2.

Even though the government adopted a relevant guarantee scheme since December 2013 and stands ready to provide additional government guarantees in line with EU state aid rules, for a total amount of up to €2,9 billion, for the issuance of bank bonds that can be used as collateral against liquidity, if it becomes necessary to safeguard the financial stability of the Cypriot economy, no such guarantees were requested up to date. The issue of any guarantee under this scheme, will also be subject to a risk-assessment analysis by the PDMO.

The total *unaudited* called guaranteed amount as of end September 2014 is €84 million. Out of this amount the PDMO estimates that the government may be required to pay up to €50 million until the end of 2015. The remaining amount (i.e. €34 million) of guarantees is expected to be paid by the government in the following years (2016-2017). It should be clarified that once a guarantee has been called, it does not mean that the government has to pay this claim immediately. The relevant procedure implies that the guarantee is payable after exhausting all legal measures against the principal debtor or if a court decision has been issued against the principal debtor. Furthermore, before the Government pays any amount, the individual called loan balances under guarantee have to be audited by the Treasury Department.

In the same context, the Government includes a provision for an amount of €50 million in annual budgets regarding additional guarantees that might be called, i.e. for meeting the potentially resulting expenditure from such guarantees. This provision is consequently incorporated in the annual financing requirements.

Given that contingent liabilities might adversely affect both the liquidity position of the State and the effective implementation of the MTDS, the government paid particular attention to the improvement of the risk-assessment mechanism by enhancing the legal framework which assigns the relevant powers to the PDMO and by strengthening the capacity of the PDMO through the appointment of additional staff.

3.1.4. Financing needs and sources of funding

Financing needs

The bulk of the financing needs is made up by medium-long term amortisations. The government budget deficit diminishes in volume whilst in 2018 it turns positive, thus contributing to a reduction in financing needs. At the same time however, financing needs assume full use of Programme buffers. This is a purely technical assumption for the purposes of the MTDS and is expected to be reavaluated positively over 2015 following fiscal overperformance, successful comprehensive assessment of banks and a revised macroeconomic outlook. The source for the financing needs over the programming period is the 5th review of the Economic Adjustment Programme for Cyprus.

Sources of funding

The potential sources of financing over the 5-year period covered by the MTDS include both official and market creditors. Official sources are the European Stability Mechanism and the International Monetary Fund. The market sources can be further broken down into (a) foreign government securities and (b) domestic government securities, with the differentiation among the two lying in the issuance law and investors' origin but not in currency, and (c) issuance in foreign currency presuming thereby foreign law *and* foreign investors.

An overview of the market instruments of the Republic of Cyprus is presented in Table 3.

Table 3: Characteristics of borrowing market instruments

Security	Maturity	Interest rate type	Currency	Legal Jurisdiction
Treasury Bills	up to 12 months	zero coupon	EUR	Cyprus
Euro Commercial Papers	up to 12 months	zero coupon	EUR or other	UK
Domestic Retail Bonds	6 years	step-up structure	EUR	Cyprus
Domestic Bonds	more than 12 months	Fixed, floating, Indexed, zero coupon	EUR	Cyprus
Euro Medium Term Notes	more than 12 months	Fixed, floating, Indexed, zero coupon	EUR or other	UK

The domestic investor base is heavily dominated by the domestic credit institutions[1] with holdings of approx. 77% of domestic bonds (excluding the bank recapitalization bond). The non-bank holdings are attributed mainly to insurance companies and pension & provident funds. The domestic investor base is homogenous and its behavior relates highly to the developments in the domestic banking sector.

The foreign investor base is currently mainly asset management and hedge fund investors. During the last ETMN issuance in June 2014 the majority of investors were Fund Managers (51%) and Hedge Funds (27%). Geographically it was concentrated in the UK (54%); 23% of the bond was purchased by other European investors, excluding domestic ones, while 14,5% of the issue was covered by domestic investors. An increasing participation of banks, real money and more asset management investors can be expected with the gradual improvement in the sovereign credit rating.

3.2. Medium term financing assumptions

It is important to note that a technical assumption is made that the full outstanding €10 billion ESM-IMF Programme will be utilized by Q1-2016. This does not exclude that financing needs even *beyond* Q1-2016 may also be covered should fiscal overperformance continue at the current trend. However, until Q1-2016 market issuance is possible for liability management purposes *while* covering main financing needs from official funding. Furthermore, a share of new market issuances of 2015 will be diverted towards the enhancement of existing cash reserves. Thus, it is expected that debt issuances during the remaining duration of the Programme will be largely but not entirely debt-neutral.

The working assumptions of the MTDS with regards to fiscal deficits and privatisation proceeds are those forecast under the Programme. With regards to privatisation revenue in particular, €500 million reduce financing needs in each of 2015 and 2016. Furthermore, the impact of contingent liabilities is embedded within the fiscal needs and amounts to €50 million annually, as explained further in Subsection 3.1.3.

[1] This comprises of about 14 institutions of either local banks or subsidiaries of foreign banks. A number of branches of foreign banks and representative offices within the domestic banking sector are not in fact involved in Cyprus government domestic securities.

Pricing assumptions

The long term borrowing cost has been computed based on the German Bunds forward curve plus a credit (and liquidity) risk premium which decreases towards the end of the strategy period. The domestic market borrowing cost has been calculated based on a premium over the foreign borrowing cost. The interest rates of ESM loans were taken from own ESM estimations based on market data and Programme assumptions as of June 2014.. The interest rate of other variable-rate loans was projected according to the Euribor forward rates. All pricing assumptions are sensitive to global and country specific developments in fixed income and currency markets.

3.3. Sovereign credit rating and rating outlook

The current Republic of Cyprus credit ratings are the following: DBRS: B (low) with stable outlook; Fitch Ratings: B- with positive outlook; Moody's Investors Service: Baa3 with stable outlook; Standard & Poor's: B+ with stable outlook;

Since the start of the Economic Adjustment Programme, the Republic was upgraded between 3 to 4 notches by the aforesaid credit rating agencies. These were the first positive actions since 2010 from a rating perspective and were significant in terms of changing the negative trend. The potential is generally encouraging towards further upgrades albeit existing risk factors in the strategy period.

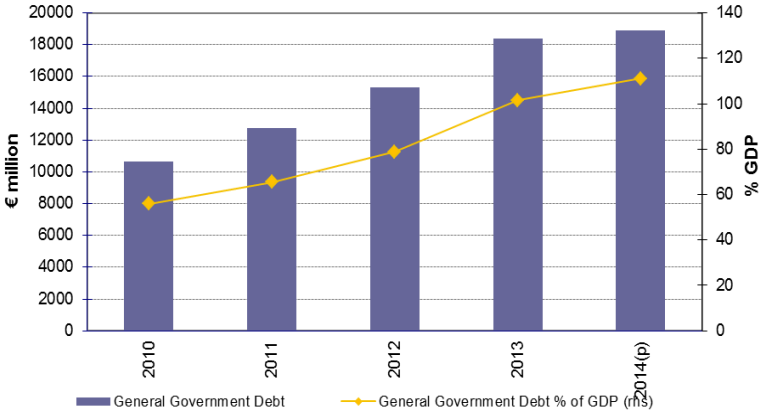
While market views and rating developments may not always coincide the credit rating will generally keep its role in terms of investors' risk and pricing guidance, and is useful in peer comparisons. It is expected that a gradual rating improvement should have an enhancing impact both on the structure of the investor base as well as to the overall market demand of Cyprus government bonds. This should in turn translate, ceteris paribus, into a lower cost.

4. Stock and structure of existing debt portfolio

4.1. Stock and composition of existing portfolio

Cyprus experienced a sharp worsening of the public debt situation over the crisis due to fiscal loosening, financial sector recapitalization and negative growth rates. The debt stock at end 2013 stood at €18,4 billion and is projected to reach €18,9 billion by end 2014 , the start of the MTDS programming period.

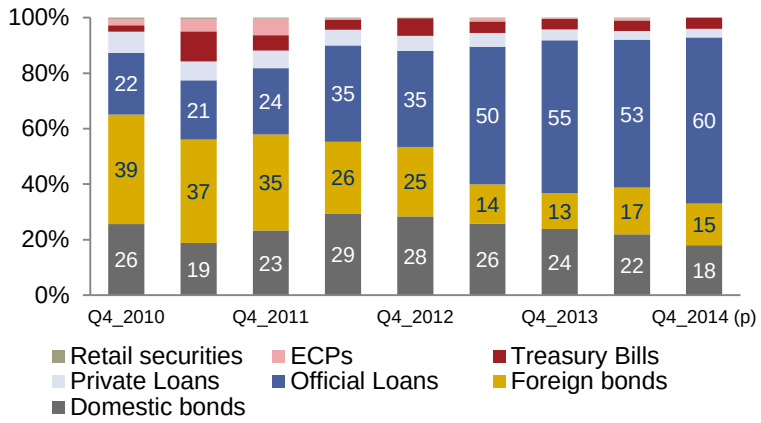
Figure 1: Public debt evolution



The full stock of debt is presented in Appendix I.

The current debt structure is dominated by non-marketable debt in the form of loans by supranational organisations (mainly ESM, IMF, EIB) as well as other governments and the Central Bank. The fall in the domestic bond share is only mitigated by the bank recapitalization bond (6% of debt) as otherwise no significant issuance activity has been undertaken in the domestic market since 2009. The foreign bond share has been on a falling trend since 2012. However signs in this segment are more encouraging since in June there was an initial return to the market with the first significant international issuance in nearly 4 years.

Figure 2: Projected debt composition by instrument, end 2014



Box: Main characteristics of the loans by the European Stability Mechanism and the International Monetary Fund

The outstanding financing Programme with the IMF is an Extended Fund Facility. The approved mount is SDR 891 million which correspond, at the time of the Facility approval, to €1032 million. This amount is equal to 563% of Cyprus' quota at the IMF.

The Special Drawing Rights (SDR) is an international reserve asset whose value is based on a basket of four currencies. Itself is not a currency but forms the means by which the holders can obtain access to currencies of the IMF members.

Each tranche by the IMF for Cyprus is repaid in equal installments between 4,5 and 10 years as per the rules of the Extended Fund Facility. The interest rate is floating and stepwise increasing the longer the debt is outstanding and the higher the amount borrowed. Furthermore, servicing of the IMF loans in interest and principal is in SDRs so that this debt carries foreign exchange risk until its full settlement.

The available financing by the ESM has been set for the remainder of the €10 billion, i.e. at €8968 million. The weighted average maturity of these loans has been agreed at 15 years, while the maximum maturity has been set at 20 years. The various tranches are actually projected to fall due between 2024 and 2033.

The interest rate results from combining the estimated borrowing cost of the ESM with the country-specific funding mix as of June 2014 (such funding mix being dependent to country's disbursement and redemption path), and incorporating margin and fees payable. ESM's borrowing cost estimations themselves are derived using a market based estimate of future money market interest rates in the euro-area, adding an estimated spread. The current (2014) interest rate is about 1% but this is projected to increase to a long term level beyond 2,5%.

4.2. Costs and risks of existing portfolio

The weighted average cost of outstanding debt is expected to be 2,9 % at end 2014 which is the lowest level since end 2010. The cost has benefited significantly from the low interest rate of ESM-IMF loans, albeit this at a semi-fixed/semi-variable nature, and the low base rates of the Euribor. Notwithstanding this, the market cost of Treasury Bills and foreign bonds, the only market instruments issued recently, has been the highest in the Eurozone.

Refinancing risk

At end 2014 the average term to maturity of debt is expected to be at a historic high of 8,5 years (preliminary estimation). This is a natural result of the long term official loans with the average maturity of the ESM loans at 15 years.

Although in average terms the maturity structure is clearly improving the current debt maturity profile shows a concentration of maturities in the years 2015-2020. In fact, about 40% of debt falls due within 5 years.

Figure 3: Average term to maturity, end 2014

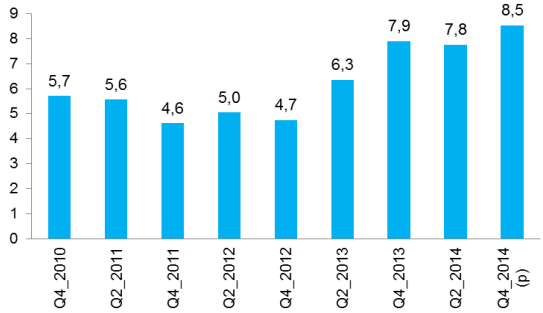
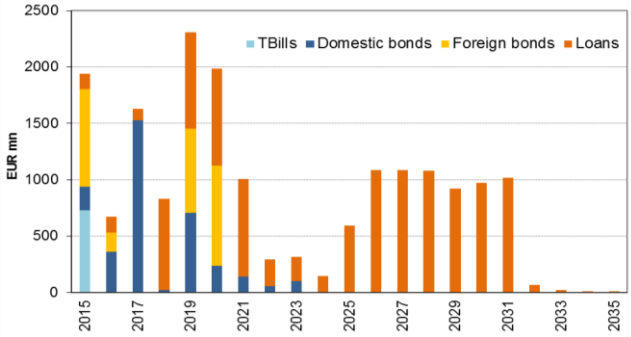


Figure 4: Debt maturity profile, end 2014



Interest and Currency risk

At end December 2014 the interest rate structure is projected to be 55% fixed-rate debt and 45% floating-rate debt as shown in Figure 5.

A further split of variable-rate debt (Figure 6) indicates that the largest share relates to official loans by the ESM and the IMF, whilst further bank loans carry low margins over base rates. The average time to refixing is projected to be 2,2 years.

Figure 5: Interest composition of debt, end 2014

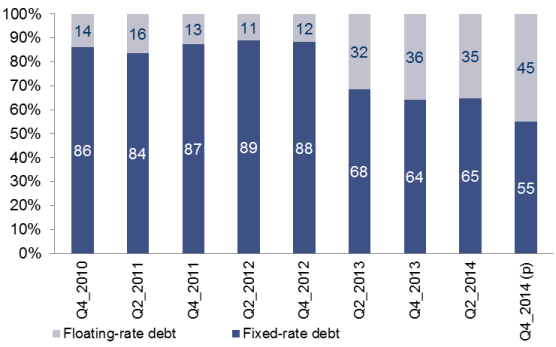
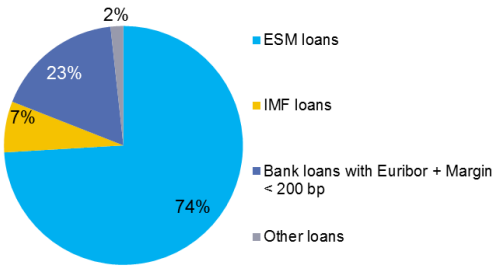
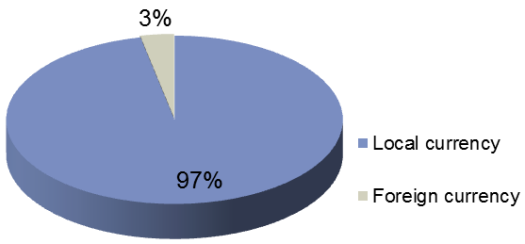


Figure 6: Breakdown of floating interest rate debt



The currency risk in the existing portfolio is limited since about 3% of outstanding debt is denominated in foreign currency, which in fact, is exclusively the SDR basket of currencies of which the domestic currency (EUR) forms a major component.

Figure 7: Currency composition of debt, end 2014



5. Analysis and discussion

This section outlines the guidelines but more importantly the underlying situation which was the motivation for the guideline as well as how the core actions and quantitative benchmarks contribute towards addressing the issues.

5.1. Smoothening of debt maturity profile and extension of marketable debt maturity

The potential risks of the post Programme period with the economy still adjusting from the financial and economic crisis, are expected to remain during the first years after the exit from the Programme. In order to mitigate potential risks and secure comfortable access to the capital markets it would be beneficial to maintain low maturities during the first post Programme years to moderate market based issuance and after that period maintain a smooth maturity profile. Low debt maturities in the first post Programme years will reduce the refinancing risk and will provide the necessary financing room in case funding needs are higher than projected or if market conditions become adverse. The existence of a smooth maturity structure in the later years will similarly reduce the rollover risk and project an image of stability and normality.

The level of short term debt on any given year will be heavily influenced by the overall debt maturities of the following year. Given the general direction of increasing the share of domestic bond issuances over Treasury Bills the range of short term debt is envisaged to range between 1%-5% of total debt stock. In order to account for variations in debt stock and not to compromise the containment of refinancing risk , outstanding short term debt during the programming period shall remain within €750 million.

Consequently medium and long term debt is expected to be at least 95% of outstanding debt. At the same time, debt redemptions should be managed by, inter alia, not violating any upper limits in medium-long term maturities. Medium/long-term maturities for 2015 are set at about €1300 million. For the years 2016-2018 the projected target is that these maturities will not exceed annually €1750 million. For the year 2019 onwards this target is raised to a maximum of €2200 million annually. Restricting the medium/long term annual maturities does not necessarily imply an increase in the short term borrowing. Maintaining a rational amount of medium/long term maturities, may be achieved by issuing longer-term bonds or by exchanging outstanding medium-term bonds for longer-term bonds. These targets are based on the current forecast of borrowing needs and may be revised if the borrowing requirement changes substantially. For safeguarding a rational balance between medium/long-term maturities and short term borrowing, the average remaining maturity of marketable debt is targeted not to fall below 3 years by the end of the period (2019).

5.2. Mitigation of Potential Risks

The potential risks and uncertainty of the post-Programme period will be mitigated through increased levels of liquid funds and containment of foreign exchange and interest rate risk.

The government liquid funds are made up of (i) funds to cover cash flow needs, set by a decision of Council of Ministers to a minimum of €500 million and (ii) cash reserves, currently at €200 million. The existence of an increased cash reserve level, higher than today's amount will reduce liquidity risk and will materially improve market perception for the risks facing the Republic thus reducing borrowing costs. Cash reserves are targeted to increase to €500 million by the year end 2015 and thereafter will be reevaluated on an annual basis. This will bring total liquid funds to €1 billion at end 2015, which covers most of the total financing needs of the year 2016.

Moreover, the amount of €1 billion is projected to be adequate to cover the fiscal deficit and short term debt repayments for a period of at least three months for the remaining strategy years. Beyond these cash holdings the available cash will fluctuate depending on total financing needs in the following three months.

It should be noted that while the strategic choice of maintaining high cash holdings is important for the reduction of liquidity risk it is accompanied by significant fiscal costs. It should thus be monitored closely and combined with an efficient investment policy of excess liquidity to mitigate its cost impact.

As the IMF funding is denominated in a basket of currencies the foreign exchange risk has increased in the last few years. However currency risk exposure in the portfolio remains low and, as shown in Section 5.6, under stress scenarios there is a limited impact of the currency shock on overall debt service costs. Moreover given the potential diversification of investor base associated with issuance in non-Euro currencies this risk can be justified, albeit in a limited manner, due to its positive attributes on liquidity and refinancing risk. It is thus envisaged that marketable debt issuances in foreign currency will not accumulate to more than 5% of the outstanding debt which corresponds to total foreign currency exposure in marketable and official debt not exceeding 10% of total debt stock by the end of the strategy period. This benchmark target allows some room for flexibility in the market activity while still focusing on euro issuances.

Although most floating rate debt has currently highly favorable terms the possibility of the associated costs increasing is quite high since interest rates at the moment are at historically low points and a rise in base interest rates in the medium term is almost certain. Importantly, floating rate debt already makes up a significant share of (45%) of the debt portfolio and is expected to reach 55% by the end of the strategy period even though, as explained earlier, it corresponds to low-margin, official debt. While it is preferable to have fixed interest profile for certainty of debt service payments it may be possible to reach new investors and achieve longer maturities by offering floating interest rate structures. A range of up to 5% marketable debt exposure to floating interest rates is thus considered appropriate to balance the associated risk while allowing some borrowing flexibility. This translates to a total of up to 60% of total debt stock being under variable interest rates when accounting for both official and market sources.

While this target share is significant it is important to highlight that most of the variable debt is relatively low risk as the majority relates to the ESM loans which are funded on a pool of fixed rate

instruments that would only generate an increase in borrowing cost gradually over time. With the gradual repayment of official loans of IMF and ESM starting in 2017, the level of floating rate debt will subside as in parallel more fixed rate instruments are issued.

In order to avoid increasing foreign exchange rate and interest rate risk the Public Debt Management Office will focus on fixed rate euro denominated issuances during the first post-Programme years while closely monitoring market conditions and possible opportunities. This practice will be reevaluated towards the end of the MTDS period.

5.3. Development of government securities market

The existence of a developed liquid securities market is essential both to maintain stable market access and to reduce costs. This objective can be achieved through the reduction of the liquidity premium, the increase in the investor universe and the creation of a more robust price discovery mechanism. The lack of a well-functioning market increases borrowing costs for the Republic and is an impediment to the development of a liquid domestic money market.

The development of a well-functioning securities market is a gradual process which is expected to take some years to complete. This process will begin with developing the short term part of the market and graduating to a fully functioning long term securities market towards the end of the programing period.

A specific characteristic of the Cyprus government bond market (both domestic and international) is the relatively shallow liquidity which results in high liquidity premiums during new issues and reduces the available investor pool. This is an issue that the PDMO sees as central to the reduction of costs and plans to improve upon within the reference period as described below.

It is necessary, as a first step in this process, to create a well-functioning Treasury Bills market with frequent auctions at pre-set dates and a published auction calendar. The T-Bill market, in conjunction with steps to develop a liquid market for medium to long term bonds will ensure an acceptable level of liquidity.

The PDMO will take a number of actions for the building up of a long-term yield curve by issuing euro denominated medium to long-term instruments in the international markets.

During the MTDS period the PDMO will re-introduce domestic bonds in an effort to restore the domestic government bonds market. The existence of a domestic bond market will act as a complement (and not a replacement) of the international bond market. The existence of such a market is necessary as it will provide a more stable investor base segment as well as opportunities for investor and instrument diversification. Currently the domestic investor base is heavily dominated by the domestic credit institutions who hold the large majority of outstanding bonds. A further strategic objective will be to diversify the domestic investor base to include a more diversified set of investors with different investment preferences and investment horizons.

The final strategic target towards the end of the period will be the establishment of a well-functioning long term bond market through the introductions of the most appropriate market structures (e.g. Primary Dealers). Without a well-functioning and liquid bond market issue and other risk premiums will remain high while access to the market will always be constrained relative to peers who have a developed bond market. The existence of a bond market also provides a number of other ancillary benefits for the economy as it is crucial to the development of the capital markets as a whole in order

to complement bank financing. Also it enables the introduction of other products including repurchase agreements (repos) and other instruments that can help improve risk management and financial stability. The infrastructure needed to develop such a market (informational, legal and institutional) has benefits for the entire financial system.

5.4. Minimisation of marketable debt borrowing cost

The PDMO aims to minimise borrowing costs in order to improve both fiscal performance and the sustainability of public debt to the largest extent possible subject to the risk parameters as defined in the Guidelines 2015-2019. Borrowing cost minimisation is targeted to be achieved through improved investor relations, expansion of the investor base and significant improvement of the fundamental mechanics of the Republic's debt markets.

A well-diversified investor base will lead to a better price discovery mechanism as more investors are involved and increased demand will by itself drive costs lower. The existence of a non-homogenous investor base (e.g. only domestic banks) will reduce the possibility of all investors abandoning the market at the same time and thus reduce refinancing risks.

Good investor relations are important as beyond the obvious positive effects of attracting new investors a well-informed investor base is less volatile and is more confident in dealing with the borrower as there is more certainty about the risks involved with the relevant investment.

These qualitative factors should translate into quantitative reductions of borrowing costs through better pricing and the reduction of risk premiums which in the case of the Republic of Cyprus represent a significant part of the spreads to peer countries.

5.5. Stylized quantitative analysis

For the achievement of the medium term goals a borrowing strategy following and adhering to the general guidelines is necessary. In order to understand the mechanics of various borrowing options and for the expansion and deepening of analysis the IMF-World Bank jointly developed MTDS tool was used. Under the tool four alternative strategies were constructed with the purpose of examining stylized situations to help reach general meaningful conclusions. It is important to stretch that these are only few of the many possible strategies but these four were selected to highlight the major alternative choices in the strategies.

For the case of Cyprus no particular strategy can be described as the baseline one, given the nearly full financing from the Programme since Q2-2013, following the exclusion of the country from international capital markets in mid 2011. Hence all four strategies can be considered as equally new to Cypriot public debt management. All strategies assume financing of all needs, except the short term debt, in 2015 and Q1-2016 from the Programme sources as well as absorption of the full Programme financing of €10 billion. However, given the efforts to re-establish regular presence in the market the strategies test also debt-neutral market issuance during the Programme period i.e. whereby proceeds are to be used entirely for debt buybacks. This fits within the guidelines of smoothening the debt maturity profile.

The four strategies under examination are the following:

Strategy 1: cost reduction. This implies market financing in the post-Programme period in the form of short term debt or government bonds of maximum 3 year tenor. The mix external-domestic is equal with financing being in the form of bonds and bills respectively.

Strategy 2: maturity extension. Under this strategy the market financing in the post-Programme period is undertaken in long term foreign-law bonds, whilst in the domestic market the share of Treasury Bills diminishes and a shift to domestic bonds takes place.

Strategy 3: investor base diversification. This strategy is identical in all parameters as Strategy 2, however half of the external market financing is undertaken in foreign rather than domestic currency. The foreign currency chosen is the USD.

Strategy 4: domestic debt market development. This option presumes a stronger presence in the domestic rather than the external market, which was stipulated in all three previous strategies. Hence, issuances lie in domestic securities, moving composition from Treasury Bills to 3-year and then to 5-year domestic bonds. No external market financing is undertaken.

The strategies were subject to interest rate and exchange rate shocks under four scenaria.

- *Scenario 1: interest rate shock*. Short term interest rates rise by 1,50%, long term rates by 3,00% whilst ESM and IMF loans interest rate by 0,25% and 0,5% respectively, given their semi-variable nature. Euribor rates for other floating interest debt increase by 1,50%. This is a permanent shock applied to the whole 5-year period.

- *Scenario 2: severe interest rate shock.* Short term and long term market rates increase twice as much as Scenario 1, while the ESM and IMF loans' interest rate rise by 0,5% and 1,0% respectively. Euribor rates increase by 2,50%. This is a permanent shock applied to the whole 5-year period.

- *Scenario 3: depreciation of domestic currency*. An exchange rate depreciation of 10% of the EUR against the USD as well as to the other currencies composing the SDR basket is applied in the final year 2019. In order to arrive to the shock magnitude of 10%, the standard deviation of historical exchange rate EUR-USD was calculated. The shock was then computed as twice as large as the historic standard deviation.

- *Scenario 4: combination shock.* This is a shock to both the interest and exchange rate parameters, combining Scenario 1 and Scenario 3.

5.6. Cost-risk analysis under different strategies

The cost-risk analysis is particularly insightful examined using the MTDS tool output. It is important to highlight however, that the tool captures a broad analysis but its purpose is not the full borrowing modeling, not that the latter is, in fact, possible. The results are to be interpreted with cautiousness since the analysis is made on an indicative basis and it should not be understood that the illustrated results will be the actual cost and risk outcome.

In the stylised analysis the average cost increases under all strategies. The alternative strategies' cost impact ranges between 3,4% and 4,0% at the end of the programming period up from 2,9% at the start of the programming period. At the same time the maturity indicators worsen by end 2019, with the average maturity falling from 7,7 years to a range between 5,5 and 7,3 years. The trend in the cost and maturity indicators is inevitable given the return to post-Programme full market financing and the approaching of the official loans' maturity period.

The indicators of interest rate refixing of total debt (ATR: Average Time to Refix and debt refixing within 1 yr) are largely skewed by the floating rate loans of ESM-IMF, as explained in Box 1. Hence the indicators on marketable debt refixing were introduced. Similarly while the Average Time to

Maturity (ATM) indicators of the whole portfolio are core risk statistics, the consideration of ATM of marketable debt is at least equally important in the strategy choice. The range of the interest rate risk is quite large among the alternative strategies. Under Strategy 1 the interest rate risk actually increases over the current risk level, whilst Strategy 4 results in a slight improvement. Under Strategies 3 and 4 there is a considerable improvement of the interest rate risk over the existing one.

A characteristic which performs very similarly across all strategies is the composition of fixed-rate and floating-rate debt. The floating rate debt results from official long loans of the ESM, IMF and EIB/CEDB and with low margins over base rates or even in a semi-variable format. This is expectable given that the strategies, within the framework of the guidelines, do not involve any floating rate market instruments.

The foreign exchange risk is stable across all strategies with the exception of Strategy 3 (investor diversification) which captures the broadening of the investor base at the expense of higher foreign exchange risk.

An overview of cost-risk indicators under the alternative strategies is presented in the following table.

Table 4: Cost-risk indicators under alternative strategies

Risk Indicators		2014	As at end FY2019			
		Current	S1	S2	S3	S4
Implied interest rate (%)		2,9	3,4	3,9	4,0	3,6
Refinancing risk	ATM Total Portfolio (years)	7,5	5,5	7,2	7,3	6,4
	ATM marketable debt (years)	2,7	1,4	6,3	6,5	2,8
Interest rate risk	ATR (years)	1,9	1,1	2,9	2,9	1,5
	ATR Marketable Debt (years)	2,2	1,1	6,1	6,2	2,5
	Debt refixing in 1yr (% of total)	64,0	80,8	64,2	65,1	72,6
	Marketable Debt refixing in 1yr (% of total)	19,3	18,9	3,9	3,9	7,4
	Fixed rate debt (% of total)	53,1	41,5	43,1	42,1	38,3
FX risk	FX debt as % of total	3,2%	5,4%	5,2%	18,8%	4,9%

Strategy 1 is, together with S4, the most beneficial in terms of cost but ranks worst as regards maturity and interest rate risk. While the cost benefit is on average about 0,4% over the other strategies and thus non-negligible its risk indicators are considerably poorer.

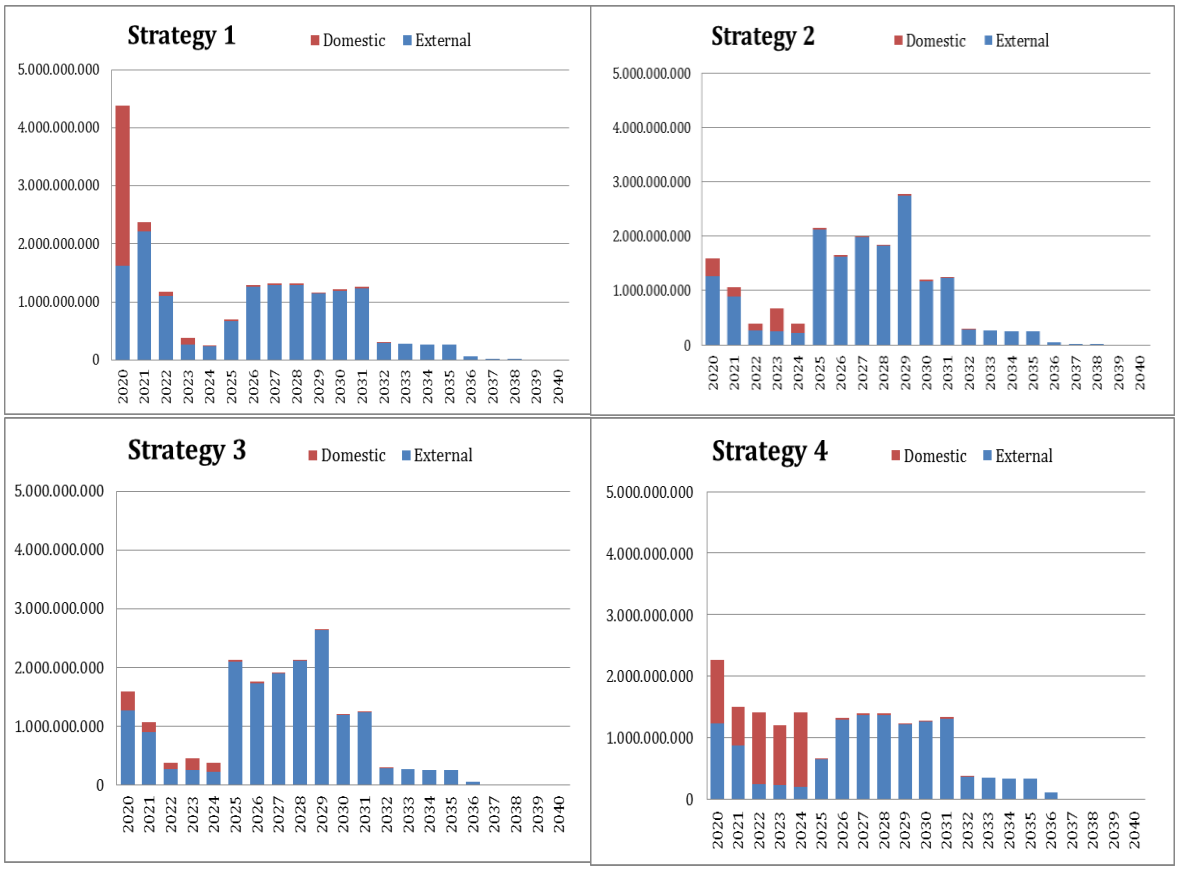
Strategy 2 presents a more favourable combination of the cost-risk outcome. The cost lies rather high within the strategy outcomes. At the same time the risk indicators are the most favourable among all strategies, with no particular risk indicator lagging behind that of any other strategy.

Strategy 3 is found to be costlier than all other strategies and involving a considerable increase in the FX risk. The other risk parameters which concern average maturity and interest rate risk are identical with S2 and better than S1 and S4.

Strategy 4 performs well in terms of cost as its average cost is together with S1 the lowest, but its risk indicators rank average among the four strategies. In particular whilst cost is contained low the newly issued marketable debt has generally shorter tenors as it is issued in the still developing domestic bond market.

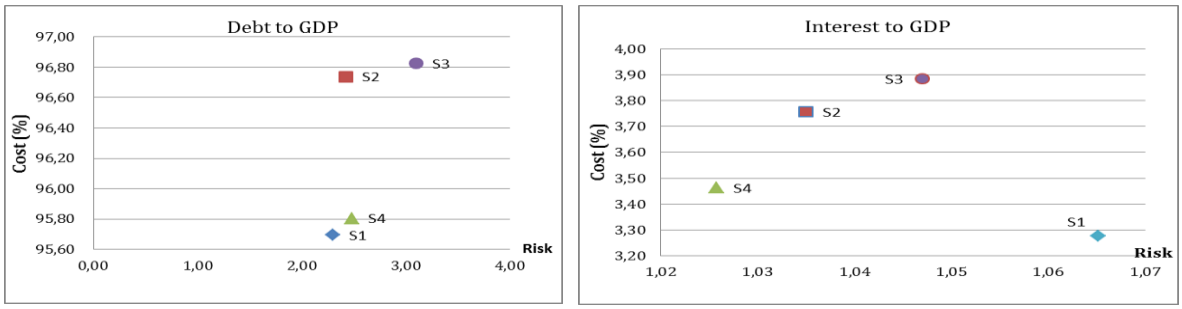
The maturity profile under each strategy provides particularly important information given that refinancing risk being the main source of vulnerability in the debt portfolio. Strategy 1 results in an extremely risky refinancing profile which cannot be confidently considered viable even under favourable market conditions. Strategy 2 and 3 perform equally well in this respect with maturities in the 5-year period after the end of the strategy (2020-2024) contained within manageable levels. Strategy 4 initially results in a concentration of maturities albeit following a more equally distributed maturity afterwards.

Figure 8: Projected maturity profile at end 2019 (EUR)



The performance of strategies under shock scenarios is shown in Figure 9. The graphs show the risk defined as the maximum change in each of the cost indicators of the baseline scenario under the four shock scenarios. The X-axis shows the highest nominal cost outcome under the shock scenarios.

Figure 9: Strategy performance under shock scenarios



As regards Debt to GDP Strategies 2 and 3 perform worst under a shock as this indicator increases quite sharply when stressed. This is natural to expect since S3 involves borrowing in a foreign currency and S2 comprises a larger share of borrowing under long term debt hence absorbing more cost. For the Debt to GDP ratio S1 and S4 perform very similarly. In terms of interest to GDP S1 reacts most sensitively under the shock scenarios but its cost impact is the least adverse. In absolute terms S2 and S3 result in a higher cost and rank average on shock resiliency. S4 results in a "better" outcome with milder combined cost and risk reactions over all other strategies.

5.7. Selection of strategy

The performance of the four strategies was assessed in both risk and cost aspects with risk implications generally overweighing against cost advantages. Considering the overall cost-risk trade off Strategy 2 was selected to be pursued in the medium term.

Strategy 2 follows the principles and leads to the goals set out in the Guidelines 2015-2019. The debt profile is smoothened as there is little concentration of future repayments following the end of the strategy period. This strategy, a component of which is the creation of a cushion of liquidity in its early stage, seems to be contributing to the management of refinancing risk most effectively among the stylized examined options.

Moreover, Strategy 2 does not lead to any accumulation in the exposure to market risks, in the form of either foreign exchange or floating interest rate risks. This complies with the generally conservative stance of the Guidelines as regards those risk aspects which have a volatile cost on the government debt servicing.

At the same time Strategy 2 promotes the development of domestic primary and secondary market by moving gradually from Treasury Bills to a higher share of domestic bonds while allowing enough scope for actions in the foreign market and thus the promotion and expansion of work with investors and the international markets.

In sum, this strategy is consistent with the overall aim of reducing the existing aggregate debt portfolio refinancing risk since it leads to a more favourable debt maturity profile than the current one and that of any other strategy. Its cost impact in terms of the implied interest rate, is within the framework outlined in the guidelines and it does not indicate a severe impact on debt sustainability. Importantly, the interest rate risk indicators perform robustly among the four strategies and the foreign exchange exposure is kept at a very low level. The marketable debt risk indicators, which effectively represent that section of debt that the strategy can control over the period, improve considerably as regards the average maturity, the average time to refix and the redemptions within 12 months, highlighting the merits of this strategy.

For the selection of a strategy it was deemed more pragmatic to place a higher weight on the baseline cost-risk indicators and less on the shock scenarios. This is due to the fact that this deterministic

scenario analysis does not account for the *probability* of a shock scenario occurring, although it can not be suggested either that any of the examined shocks have a low probability of realisation. Despite the limitations in the shock analysis the sensitivity of the borrowing strategy under alternative scenarios for market rates is relevant and can not be neglected in the choice of an appropriate strategy.

With that in consideration, the stress results show that Strategy 2 does not react excessively under market shocks. The stress impact is deemed acceptable within the desired cost-risk framework both as regards debt to GDP and interest to GDP indicators. In fact, in absolute numbers the cost-risk outcome under the stress situation is not even excessively high compared to the other strategies under examination.

It is important to highlight that the MTDS tool is only part of the motivation for the strategy and not an exclusive means of decision making. While its outcome is highly useful, the stylised results have been critically examined and adjusted with judgement to reach into the final conclusion as to which direction to follow.

6. Institutional Arrangements and Implementation Issues

The debt management strategy is designed on an annual basis by the PDMO and it is provisionally approved by the Minister who notifies the Budget and Finance Committee of the Parliament. The strategy is finally approved by the Council of Ministers. The PDMO is the responsible agency for drafting and, once approved by the Council of Ministers, for implementing this strategy.

The PDMO is in the process of improving and implementing the design of the organizational structure, introducing an appropriate IT system, and enhancing the investor relations and market intelligence function, through institutional arrangements.

Infrastructure

Regarding the organizational structure of the PDMO, steps will be taken into consideration to improve and strengthen the existing structure of the PDMO. Furthermore, the internal controls will also be considered and will be reevaluated and reassessed. Through this process risks will be identified and a framework for these policies will be set.

The Information Technology infrastructure is also under construction. Having considered the PDMO's own specificities and constraints the appropriate IT solution will be sought after.

Investor relations and market intelligence

The need to strengthen the relationship with investors will also be taken into account by establishing an investor relations function. This function will be developed by focusing on a number of important principles which are:

- Consistency and accuracy of information
- Timely availability of information
- The existence of a communications strategy

The communications strategy -among other things- will include a number of communication channels and actions that will be used to disseminate information to market participants presented in the table below:

Table 5: Improving actions in market communication

Existing	Future

• Web page with dedicated investors relations area
• Publication and distribution via webpage and mailing list of:
  ➢ Quarterly debt bulletins
  ➢ Annual debt report
  ➢ Newsletter
• Ad-hoc meetings and conference calls with investors
	• Regular non-deal road shows
	• Regular global calls with investors
	• Publication of Medium Term Debt Strategy
	• Publication of auction calendar and results
	• Upgrade of Reuters and/or Bloomberg page

The above represents an expansion from a mostly ex-post market communication to a more forward looking, proactive approach to investors and other market participants. A separate all-round communication strategy will be designed with the help of external advisors and implemented in the near future to formalize and integrate all the above mentioned actions for the achievement of the best possible benefits.

The market intelligence function will also be developed further during the period with the allocation of more resources in following and analyzing developments in the markets. This will help the PDMO to have a better understanding of the environment it operates in and allow it to be able to respond better and faster to changes to market conditions while it will also facilitate the development of more proactive rather than reactive policies.

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23 December 2014

Appendix 1: Public debt stock

	4th Quarter 2013	1st Quarter 2014	2nd Quarter 2014	3rd Quarter 2014
A. DOMESTIC	**7.118,4**	**6.864,8**	**6.898,2**	**5.925,3**
I. LONG-TERM	**4.432,7**	**4.188,2**	**4.190,3**	**4.129,3**
1. Domestic Government Bonds	**2.412,6**	**2.168,6**	**2.163,7**	**2.163,7**
- Deposit Money Banks	1.832,6	1.649,6	1.645,9	1.645,9
- Private Sector	580,0	519,0	517,8	517,8
2. Retail Securities	**26,7**	**26,2**	**33,2**	**49,2**
3. Loans	**1.993,4**	**1.993,4**	**1.993,4**	**1.916,4**
- Central Bank	1.350,8	1.350,8	1.350,8	1.297,0
- Loan No.6362 (School Committees)	439,9	439,9	439,9	416,7
- Local Authorities Loans	126,2	126,2	126,2	126,2
- Semi-government organisations	76,6	76,6	76,6	76,6
II. SHORT-TERM	**2.685,7**	**2.676,6**	**2.707,9**	**1796,0**
1. Treasury Bills	**698,5**	**689,4**	**720,7**	**704,7**
- Deposit Money Banks	307,0	297,4	332,1	307,0
- Private Sector	391,5	392,0	388,6	397,7
2. Financial Sector's Recapitalisation	**1.987,2**	**1.987,2**	**1.987,2**	**1.091,3**
B. FOREIGN	**11.365,7**	**11.383,2**	**12.451,5**	**12.467,8**
1. Long-term Loans	**8.627,0**	**8.627,9**	**8.846,5**	**9.547,1**
- Budgetary Central Government	8.468,6	8.469,4	8.826,2	9.526,7
of which IMF Loans	248,9	249,7	336,2	437,4
ESM Loans	4.600,0	4.600,0	4.750,0	5.350,0
of which financial sector recapitalisation	1.500,0	1.500,0	1.500,0	1.500,0
Other			130,9	130,9
- Local Authorities Loans	128,7	128,7		
- Semi-government organisations	29,8	29,8	20,3	20,3
2. Medium-term Securities (E.M.T.N.)	**2.403,7**	**2.403,7**	**3.168,7**	**2668.7**
3. Short-term Securities (E.C.P.)	**51,9**	**99,6**	**184,3**	**0,0**
4. EFSF	**283,1**	**252,0**	**252,0**	**252,0**
C. CONSOLIDATED GENERAL GOVERNMENT DEBT	**18.484,1**	**18.247,9**	**19.349,5**	**18.393,0**

Appendix 2 : Government Guarantees

Guarantees provided to legal entities

The value of the outstanding government guarantees of legal entities is €2,891 billion or about 94 percent of the total value of €3,073 billion. The distribution of the said amount by beneficiary indicates that the largest categories of beneficiaries enjoying government guarantees are: (a) the public corporate bodies (€1,236 billion) and (b) the companies with share capital participation (€1,024 billion). The analysis of the beneficiaries comprising the group of legal entities is presented below.

Public Corporate Bodies

The beneficiaries comprising the said category are the Sewerage Boards, the Electricity Authority of Cyprus (EAC), the Cyprus State Fairs Authority, the Cyprus Broadcasting Corporation, the Cyprus Sports Organisation, the Cyprus Olympic Committee, the Central Slaughter-House Board and the Cyprus Theatrical Organisation.

The value of the outstanding government guarantees for loans of the said category is €1,236 billion of which €0,7 billion relates to Sewerage Boards, €0,5 billion relates to the EAC and the remaining amount refers to other beneficiaries belonging to the category of public corporates bodies.

The purposes of the guarantees to Sewerage Boards are either for facilitating the funding of their infrastructure or for the construction of sewerage systems, while the purposes of the guarantees for loans provided to the EAC are to improve its capital position in order to cover its general needs including the EAC generation expansion plant, the upgrade of the transmission systems and the development of the transmission and distribution systems.

Financial Institutions

The guarantees provided to the Bank of Cyprus Ltd for an amount of €1,0 billion (initially granted to ex Cyprus Popular [Laiki] Bank and later transferred to the Bank of Cyprus) were intended to facilitate the issuance of debt instruments eligible to be used as collateral for liquidity purposes. The said guarantees were transferred to Bank of Cyprus Ltd in 2013.

Local Authorities

The beneficiaries comprising the said category are the Municipalities and Community Boards of the Republic of Cyprus. The value of the outstanding government guarantees for loans of the said category is €334 million, of which €319 million refers to guarantees provided to the Municipalities and €15 million concerns guarantees provided to the Community Boards. The purposes of the guarantees provided to Municipalities are either for securing funding for road construction works, for parking places or for improvements of infrastructure, while the purposes of the guarantees provided to Community Boards are either for the rehabilitation of road transportation, for the construction of pedestrian roads or for the improvements of community infrastructure.

International Organisations

The beneficiary comprising the said category is the European Financial Stability Facility (EFSF). The value of the outstanding government guarantees for loans of the said beneficiary is €288 million. The purpose of the guarantees provided to EFSF is to secure the issuance of bonds by EFSF, so as to address the European sovereign debt crisis and preserve the financial stability in Europe by providing financial assistance to Eurozone states in case of economic difficulty.

Companies with share capital participation by the state, other than financial institutions

The beneficiary comprising the said category are the Cyprus Airways Ltd. The value of the outstanding government guarantees for loans of the said category is €24 million which concerns guarantees provided to Cyprus Airways Ltd. The purpose of the guarantees for loans to Cyprus Airways Ltd were to refinance its existing indebtedness and to improve its working capital.

Companies

The beneficiaries comprising the said category are local companies of different business sectors of the economy. The value of the outstanding government guarantees for loans of the said category is €7 million. The purposes of the guarantees for loans provided to the said companies are for the improvement of working capital and for the enhancement of business activities.

Not-for-profit organisations

The only beneficiary comprising the said category is the Satirical Theatre. The value of the outstanding government guarantees for loans of the said beneficiary is €2 million. The purpose of the guarantees for loans provided to the said beneficiary is for the completion of the construction of the cultural center of Vladimiros Kaukaridis.

Government Guarantees provided to natural persons

The value of the outstanding government guarantees of natural persons is €182 million or about 6 percent of the total value of €3,073 billion. The purposes of the guarantees for loans provided to natural persons are mainly for housing (72 percent) and business (26 percent) funding. Table 3 below presents the distribution of loans under government guarantees granted to natural persons by type of guarantee program at end July 2014.

Table: Frequency distribution table by type of program for natural persons (by amount and percentage) at end July 2014

Programs/ Schemes of Government Guarantees	Total outstanding loans , € million	fi (%)
Housing loans	131,7	72,30
Agricultural loans	0,91	0,50
Consumer loans	1,23	0,67
Student loans	0,03	0,02
Business loans	48,04	26,36
Other loans	0,28	0,15
Total loans	182,19	100,00