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Key points

- **The solid economic performance continues into the fourth quarter of 2017 with particularly visible positive signals emanating from the property market**
 - **In Q3-2017 the economy expanded by 3.9% on an annual basis, bringing the 9M-2017 performance to 3.8%**
 - **Rating agencies continue to assign a positive outlook in their Cyprus ratings: DBRS was the latest agency to do so in December within its long-term sovereign rating of BB+**
 - **Fiscal performance continues solid despite upcoming elections:**
 - **The general government surplus is expected to outperform the 1% target for this year**
 - **The general government primary balance came to 4.8% of GDP in the first ten months of the year**
 - **Public debt is projected to drop below the 100% threshold in 2017 on early loan repayment by the Ministry of Finance to the Central Bank**
 - **NPEs remain the single largest vulnerability of the economy with banks lagging behind the Central Bank's restructuring targets for 2017 Q2**
- 1. The latest GDP estimate of Q3-2017 surpassed the most optimistic forecasts bringing the latest full year projection close to 4% in 2017**

The second and latest estimate of CYPSTAT about the seasonally adjusted Q3 GDP reading confirmed the flash estimate of 0.9% QoQ/3.9% YoY. This strong reading compares to 1.0% QoQ/3.9% YoY in Q2-2017 and 0.7% QoQ/3.7% YoY in Q1-2017, up from 1.3% QoQ/3.7% YoY in Q4-2016 vs. 0.8% QoQ/3.6% YoY in Q3-2016. Real GDP growth marked the 11th consecutive positive reading on a both quarterly and annual basis after a previous three-year recession. The GDP growth rate of Q3 is among the highest in EA-19 and EU-28, both on a quarterly and an annual basis (Figure 2 & 3) and, for a ninth consecutive quarter in a row, above that of EA-19 (Figure 1).

The output performance of the third quarter is now the highest during the post-Lehman period, bringing and surpassing analysts' expectations and international organizations full year initial and revised forecasts. This latest statistic signals that the economy has embarked on a faster growth path than previously envisaged.

CYSTAT also revised upward the national accounts of 2015 and 2016 in both nominal and real terms.¹ The revision showed that the economy rebounded much faster in 2015-16 than previously thought: the Statistical Service revised the GDP growth rate of FY2015 from 1.7% up to 2.0% and that of FY2016 from 2.8% up to 3%. As a result, the level of GDP in 2016 stood only 5% below that in 2011 and is expected to surpass the level of 2008 by the end of 2018 under the assumption of real GDP growth averaging 3.5% YoY in 2017-2018. Overall, the 9M 2017 YoY GDP growth reached 3.8%, which makes us optimistic that the full year GDP growth projection could even approximate 4% in 2017.

IMF brings its full year Cypriot GDP growth projections in 2017-2018 closer to reality, yet highlights downside risks for the medium-term outlook

The concluding statement of the most recent IMF mission to Cyprus in early October, which took place as part of the article IV report consultation and was endorsed by the IMF Board in mid-December², contained optimistic forward looking findings.³ The mission forecasts GDP growth to average 3.75% in 2017-2018. The growth is driven by private consumption, which mirrors the rise in disposable income and the improvement in economic conditions. Yet it also mirrors a weak payment discipline by a large fraction of borrowers. Growth is also driven by foreign financed investment in large construction projects. Strong foreign demand propels the sectors of tourism, construction and professional services. The IMF mission also warns of the ongoing contraction in domestic financial intermediation—reflecting deleveraging by banks. It also emphasizes that downside risks to growth in the medium-term could be sizeable, making the economy vulnerable to a sudden-stop of external financing.

The above optimistic growth forecasts of the IMF mission are new and were not present in the IMF's most recent flagship publication, the October World Economic Outlook (WEO). In the October WEO, the full year GDP growth in 2017 was projected at 3.4%, up from 2.5% last April (Table 2) and closer to reality. Yet, its GDP growth forecast of next year was very conservative. GDP growth was expected to ease to 2.6% in 2018, up from 2.3% in the April forecast. In the same publication, unemployment is forecasted to further decline from a projected 11.8% in 2017 to 10.7% in 2018. After staying in negative territory in 2016 at -1.0%, average inflation is projected to average at 0.8% in 2017 and stay subdued at 0.7% in 2018.

¹<http://www.cystat.gov.cy/mof/cystat/statistics.nsf/All/A875EF7C036ED39BC22581B10031AD93?OpenDocument&sub=1&sel=1&e=&print>

² <http://www.imf.org/en/News/Articles/2017/12/14/pr17494-imf-executive-board-concludes-2017-article-iv-consultation-with-cyprus>

³ <http://www.imf.org/en/News/Articles/2017/10/06/ms100617-cyprus-staff-concluding-statement-of-the-2017-article-iv-mission>

Table 1: IMF World Economic Outlook Forecasts for Cyprus

IMF WEO	2017		2018	
	April Forecast	October Forecast	April Forecast	October Forecast
GDP growth (%, YoY)	2.5	3.4	2.3	2.6
Consumer Prices (%, average)	1.5	0.8	1.4	0.7
Unemployment (% of Labour Force)	11.3	11.8	10.2	10.7
Current Account Deficit (% of GDP)	-2.5	-3.8	-2.5	-2.7

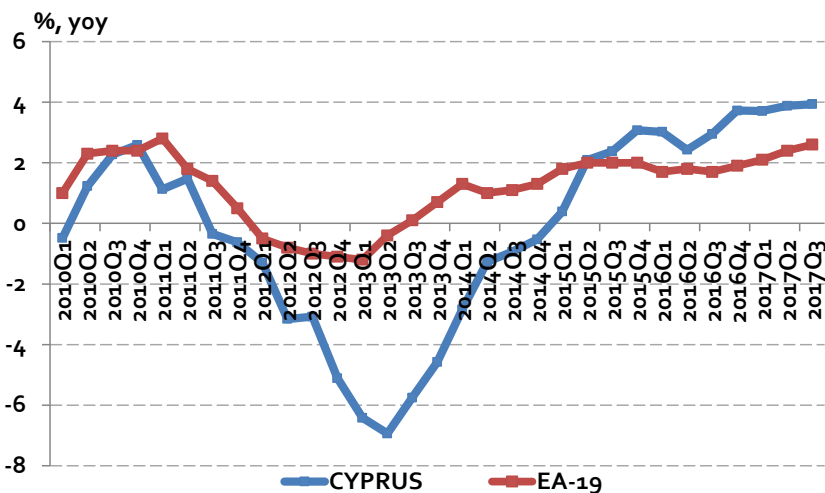
Source: IMF World Economic Outlook April & October 2017

Table 2: EU Commission Forecasts for Cyprus

IMF WEO	2017		2018	
	April Forecast	October Forecast	April Forecast	October Forecast
GDP growth (%, YoY)	2.5	3.5	2.3	2.9
Consumer Prices (%, average)	1.2	1.0	1.1	1.1
Unemployment (% of Labour Force)	11.7	11.0	10.6	10.0
Current Account Deficit (% of GDP)	-5.9	-5.4	-6.3	-6.2

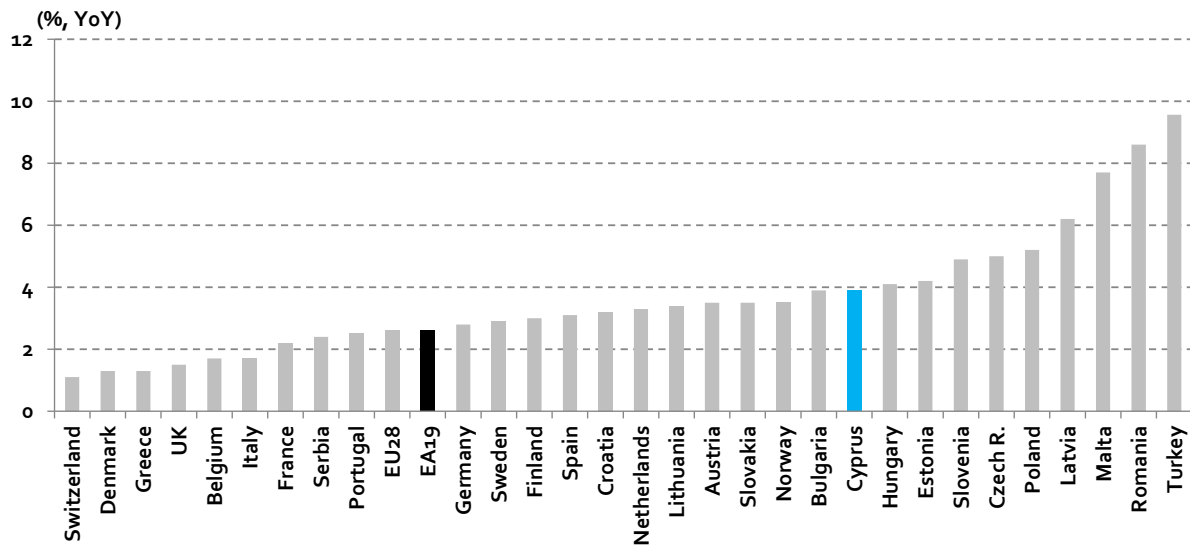
Source: EU Commission autumn forecasts October 2017

Figure 1: GDP growth (YoY) in Cyprus above that in EA19 since Q3-2015



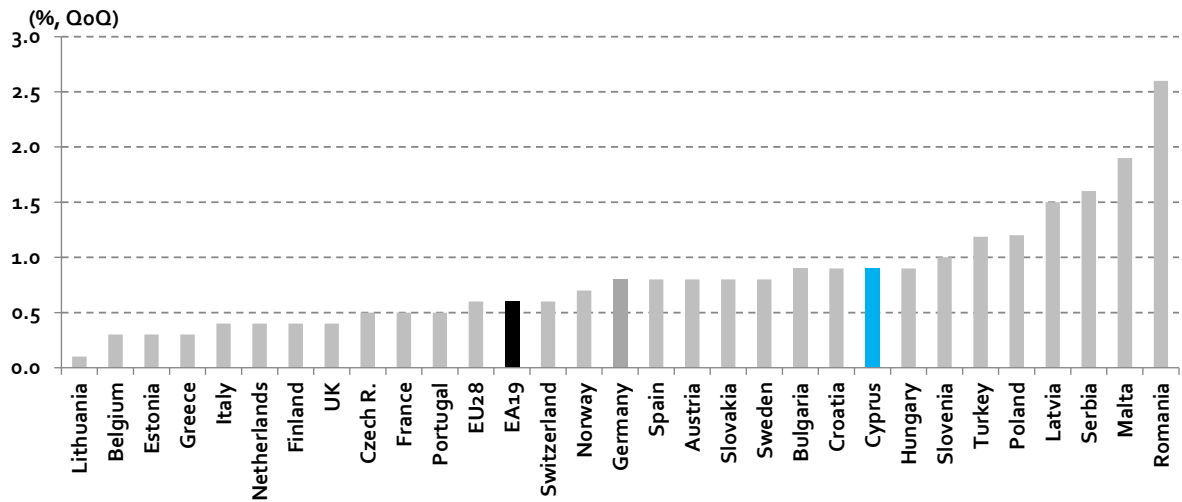
Source: Eurostat, CYSTAT, Eurobank Research

Figure 2: Third Quarter GDP growth (YoY) in Cyprus among the highest in EA19 & EU28



Source: Eurostat, CYSTAT, Eurobank Research

Figure 3: Third Quarter GDP growth (QoQ) in Cyprus above EA19 & EU28



Source: Eurostat, CYSTAT, Eurobank Research

2. Consumption remains in the driver's seat of the ongoing GDP growth rebound for yet another quarter in Q3-2017. The solid economic performance continues into the fourth quarter of 2017 with more visible signs of improvement from the property market

From a demand point of view, the consumption rebound continued into Q3-2017, making a +2.9ppts contribution to growth. Final consumption expanded by 0.2% QoQ /+2.8% YoY in Q3-2017 down from +0.9% QoQ/+3.4% YoY in Q2-2017, up from +0.3% QoQ/+3.0% YoY in Q1-2017, compared to +1.2% QoQ/+3.7% YoY in Q4-2016, vs. +0.9% QoQ/+1.4% YoY in Q3-2016. The consumption rebound is underpinned by a number of factors, namely the strong sentiment improvement mirroring the earlier lasting progress within the programme, a flourishing tourism sector, improved labor market conditions, further property market stabilization, the impact from the envisaged fiscal relaxation, and the further normalization of banking sector conditions.

As far as other growth components are concerned, higher imports of transportation equipment – likely due to ship & airplane purchases - weighed heavily on the imports side (imports: +7.6% YoY vs. exports: +8.5%YoY), trimming net exports' positive contribution (+1.0 ppts) in Q3. Finally, investment spending turned out higher than expected on an annual basis (+5.3% YoY, +0.6 ppts in Q3), thereby having a positive contribution to GDP growth.

On the supply side, GDP dynamics were shaped by the steady performance of key sectoral pillars of the economy. Output in the combined sectors of “wholesale and retail trade, transport, accommodation and food service activities,” expanded by +4.8% YoY in Q3-2017, unchanged compared to Q2-2017 and up from +4.5% YoY in Q1-2017, down from +5.6% YoY in Q4-2016 and +4.4% YoY in Q3-2016. The performance of these national accounts items reflects largely the contribution of the flourishing tourism industry. Tourist arrivals increased by +14.7% YoY in Jan-Aug2017. Similarly, tourism-revenues expanded by +15.3% YoY in Jan-July2017.

Manufacturing accelerated to 8.2% YoY in Q3-2017, up from +5.4% YoY in Q2-2017 vs. +6.2% YoY in Q1-2017 (up from +4.7% YoY in Q4-2016, +4.5% YoY in Q3-2016). In contrast, professional services slowed down to +3.5% YoY in Q3-2017 compared to +3.2% YoY in Q2-2017 vs. +3.3% YoY in Q1-2017 (down from +6.1% YoY in Q4-2016, +5.3% YoY in Q3-2016). Furthermore, construction accelerated its dynamic double-digit recovery, expanding by +27% YoY in Q3-2017 compared to 28% YoY in Q2-2017 vs. +30.7% YoY in Q1-2017, up from +18.7% YoY in Q4-2016 compared to 11.8% YoY in Q3-2016.

Financial Services is the exception to the upward momentum: They remained a drag on economic recovery, recording negative growth for a sixth quarter in a row. Nevertheless, the pace of contraction has slowed down in Q3 to the lowest pace since Q1-2016. Financial services contracted by -0.6% YoY in Q3-2017 compared to -1.9% YoY in Q2-2017, down in absolute terms from -3.5% YoY in Q1-2017, from -6.8% YoY in Q4-2016, and compared to -7.3% YoY in Q3-2016. The negative contribution to GDP growth by the financial sector

reflects largely the bank restructuring activities (debt to asset swaps), write-offs and the ongoing deleveraging.

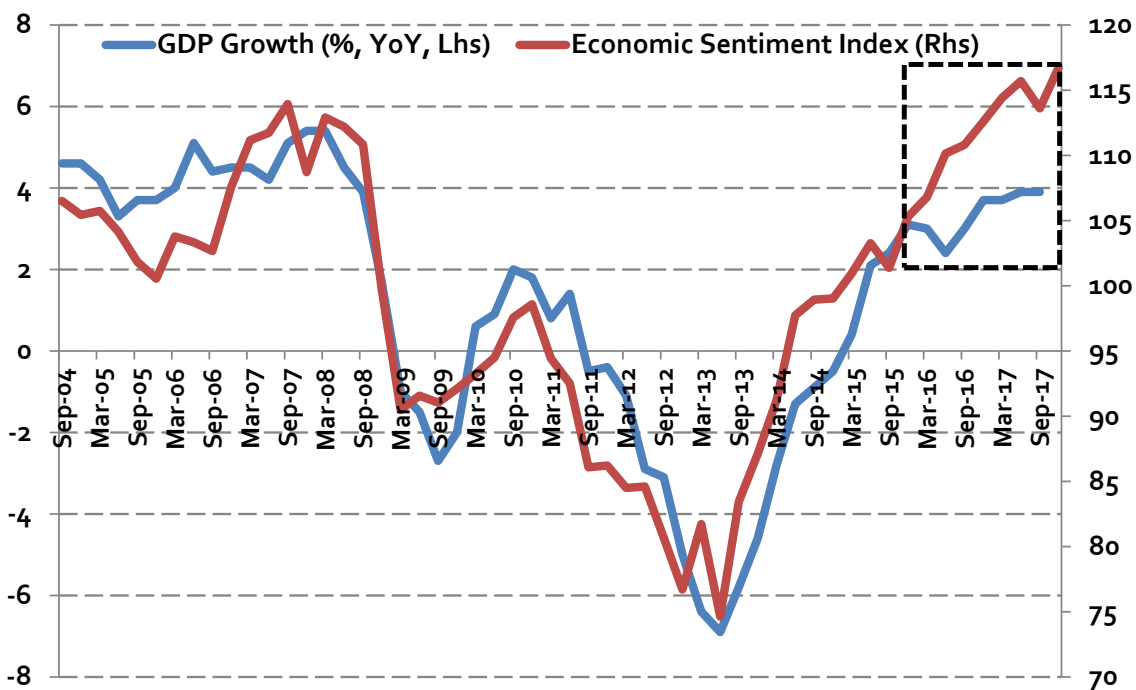
Economic activity continued its upward trend in Q4-2017. High frequency and leading indicators, particularly the consumer related ones, were performing very well. More specifically:

- **Sentiment:** After a temporary slump of the Economic Sentiment Index (ESI) in August 2017, the index rebounded strongly in September and further in October, reaching a new multi-month pre-Lehman period high. The improvement mirrors the lasting progress within the economic adjustment program as well as general optimism for the short-term prospects of the Cypriot economy.
- **Retail Trade:** Retail sales, except for motor vehicles and motorcycles, expanded in volume terms by +7.3% YoY in September, bringing the year performance to September at +5.5%. Similarly, retail sales in value terms expanded by +4.9% YoY in September, bringing the year performance to May at +5.1% YoY. Retail trade confidence was on a climbing trend throughout 2H in line with the strengthening of consumer and services' confidence.
- **Credit-card transactions:** The value of credit-card transactions expanded by 9.0% YoY by Cypriots and 20.5% YoY by foreigners in 10M2017 (JCC Payments Ltd).
- **Tourism:** The positive momentum in the tourism industry continued in 10M-2017. Tourist arrivals increased by +14.6% YoY in 10M-2017, up from +13.5% YoY in Q1-2017. The arrivals' monthly reading of October is the highest ever recorded for that month. Similarly, tourism revenues expanded by 12.9% YoY in Jan-Sep2017.
- **Industrial sector:** After expanding by 9.1% YoY in Q1-2017, industrial production on a calendar - not seasonally adjusted- terms, slowed down to 5.3% YoY in Q2 and rebounded to 7.2% YoY in Q3. After climbing last March to its highest pre-crisis level of June 2008 – the highest since April 2013, industrial confidence retreated to lower levels in Q2. As of Q3, industrial confidence has started rebounding as well.
- **Labor market:** Unemployment continued its downward trend in Q4-2017. The unemployment rate in seasonally adjusted terms declined further to 10.2% in October, down from 11.3% in May, 13.1% YoY in October 2016 and from its peak of 17.0% in October 2013.
- **Deposits:** Deposits growth continued to be in positive territory on an annual basis in Q4-2017. The annual rate of expansion slowed down to 3.4% YoY in October down from 7.1% YoY in March, up from +6.2% YoY in February and 6.0% YoY in January.

▪ **Property-market:**

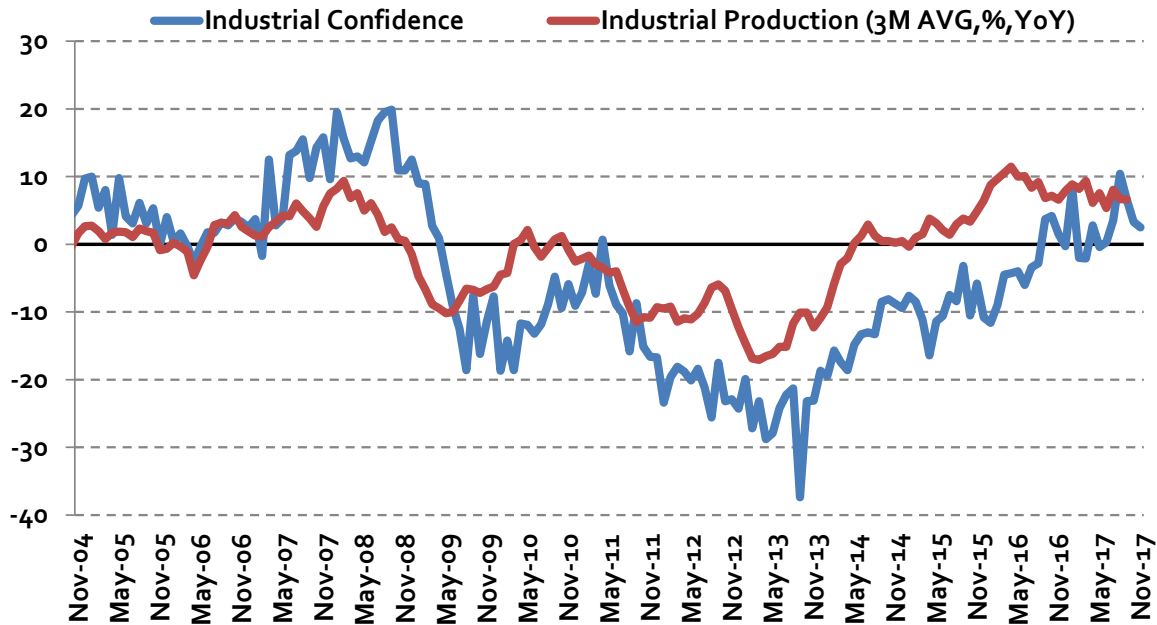
- **Construction:** The latest building permits release predisposes for a continuation in the construction output rebound. According to CYPSTAT, the total value of building permits issued in the first nine months of the year increased by 44.8% YoY, while the total area of building permits rose by 37.2% YoY. During the period January – September 2017, 4,281 building permits were issued, up from 3,901 in the corresponding period of the previous year.
- **Real estate transactions & prices:** The number of real-estate market sale contracts has risen by 20% YoY in 9M-2017 (from 3,610 to 3,012). The reading of 843 in June 2017 only, was a new multi-year monthly high of the last six years (Department of Lands and Surveys). Property prices were on an increasing path in Q2-2017. The Residential Property Price Index (RPPI) recorded its fourth quarterly increase and the second annual increase in Q2-2017 since 2009 (Central Bank of Cyprus). The House Price Index (HPI), another metric calculated and published by CYPSTAT, is in positive territory since Q4-2016. The HPI accelerated to +3.1% QoQ/+3.6% YoY in Q2-2017 up from -3.0% QoQ /+2.4% YoY in Q1-2017 and 0.8% QoQ/+3.3% YoY in Q4-2016.

Figure 4: Economic Sentiment & Economic Growth in Cyprus



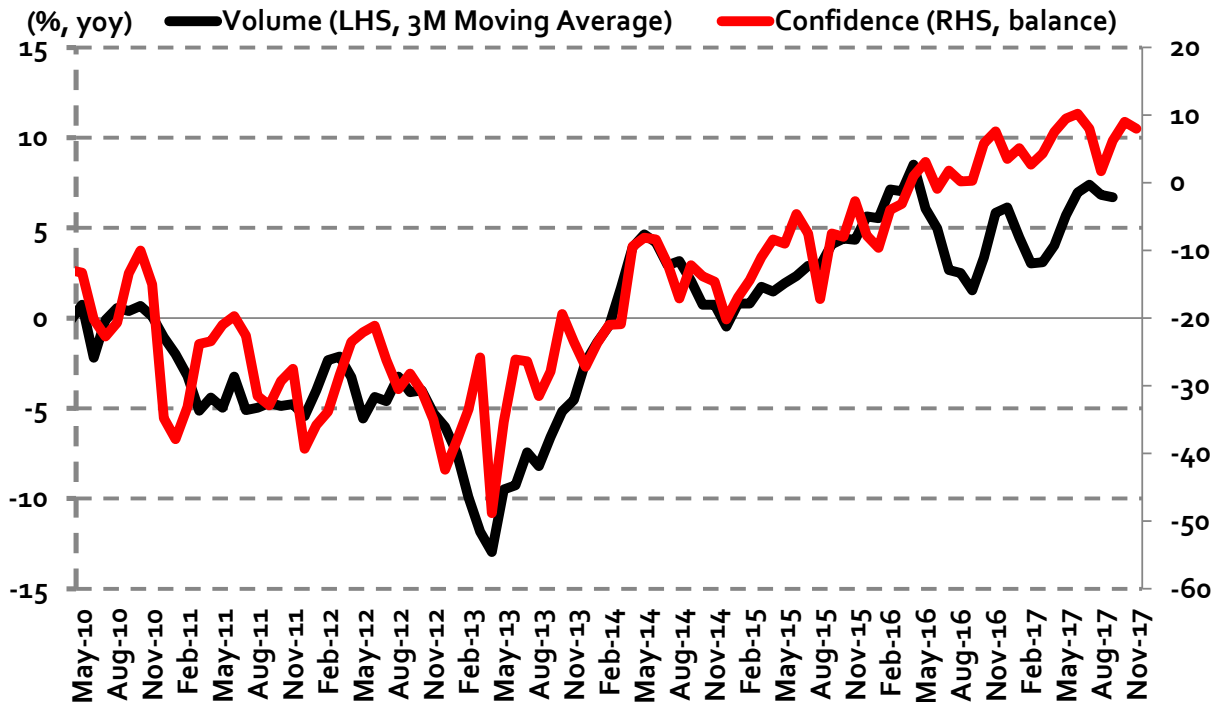
Source: Eurostat, CYPSTAT, Eurobank Research

Figure 5A: Industrial Production & Confidence in Cyprus



Source: Eurostat, CYSTAT, Eurobank Research

Figure 5B: Retail Trade & Confidence in Cyprus



Source: Eurostat, CYSTAT, Eurobank Research

3. Fiscal performance remains impressive for an election year

- The budget execution has surpassed the most optimistic expectations for an election year. According to the latest data, the general government recorded a surplus of 2.7% of GDP and a primary surplus of 4.8% of GDP in the first ten months of the year. Taking into account an additional expenditure of 2% of GDP in the supplementary budget of the Ministry of Finance by the end of this year, the budget is still projected to end in a surplus above 1% of GDP in FY2017, up from 0.4% of GDP in FY2016.
- On November 6, 2017, the Ministry of Finance repaid part of a 3.0% loan held by the Central Bank of Cyprus. This early repayment amounts to €614.9mn plus €6.3mn accrued interest and represents a projected reduction of 3.2 ppts in the General Government Debt-to-GDP ratio. As this transaction is to be funded without any additional debt issuance by the already existing cash surpluses of the Government, it is projected to bring the debt-to-GDP ratio further down to 98.4% of GDP at the end of 2017, compared to 107.8% at the end of 2016. More importantly, the projected cash reserves of the Government at year-end 2017 are estimated to fully cover the financing needs of 2018.
- Current fiscal experience continues the earlier credible fiscal path. Recall Cyprus performed an impressive fiscal adjustment in 2013-2014, which outperformed initial targets. A general government primary surplus of 2.6% of GDP in cash terms was already achieved in 2014, two years ahead of schedule vs. a primary deficit of -1.8% in 2013 and -2.9% in 2012. Accordingly, the general government deficit declined on a cash basis from -5.8% of GDP in 2012 and -4.9% of GDP in 2013 to only -0.2% of GDP in 2014, and to a balanced position in 2015 (not including the Co-operatives capital injection)

4. Non Performing Exposures (NPEs)

Despite the intense restructuring effort of the banks and the continuing decline in the stock of bad loans, NPEs remain the elephant in the room

Despite the intense restructuring efforts of the banks on their portfolios, the ratio of non-performing exposures to total exposures remains at relatively high levels. According to the data released by the Central Bank of Cyprus,⁴ the stock of non-performing exposures (NPEs) declined by €555mn in August relative to June, bringing the stock of NPEs down by 18% in the period between December 2014 to August 2017. The decline in NPEs reflects three main factors: (i) increased repayments, (ii) the migration of successful restructurings to performing loans after the completion of the observance period, and (iii) write-offs and settlements through immovable property exchange.

⁴ <https://www.centralbank.cy/el/announcements/aggregate-cyprus-banking-sector-data-non-performing-facilities-data-with-reference-date-31-august-2017>

Total loan exposures (performing plus non-performing) decreased by €923mn in August, which is a larger drop than the drop in their non-performing component alone. This is due to the on-going deleveraging. Still the ratio of NPEs (non-performing to total exposures) declined a bit, from 45.0% in June 2017 to 44.7% in August 2017, compared to 47.2% in December 2016.

Recall that according to the EBA conservative definition, a restructured NPE is still classified as an NPE for a probation period of at least 12 months, even if it is properly serviced without incurring new arrears. As a result, a large fraction of the restructured loans are still classified as NPEs (€8.8bn out of €12.5bn in August 2017). At the end of the second quarter of 2017, out of the 20,148 accumulated applications for restructuring, agreements with the borrowers had been concluded in 3,587 cases (17.8%), another 15,769 cases (78.3%) were carried forward in order to be examined during the next quarter, while the remaining 792 cases (3.9%) were rejected either by the bank or by the borrower.

By the end of Q2-2017, banks were lagging behind their restructuring targets. The Central Bank uses a set of four indicators to monitor the compliance of the banks in the NPEs restructuring process.⁵ In its press release,⁶ the Central Bank noted that there is an over-performance of the target for the first indicator (“Proposed sustainable solutions”), pointing to the huge effort that is being made in sustainable restructuring of loans in arrears over 90 days. Specifically, the target for this first indicator was set at 14.73% and the actual realization was 21.8%. However, a sizeable under-performance was observed in the second indicator (“Concluded sustainable solutions”) whose target was 15.13% and the actual realization was 10.42%. A smaller under-performance was observed in the third indicator (“Terms being-met Rate” or Loans that have been restructured since 1/1/2014 and do not present arrears or present arrears of less than 8 days) whose target was set at 71.91% and the actual realization was 68.21%. The biggest under-performance was observed in the fourth indicator (“Loans that presented arrears of 31-90 days at the beginning of the quarter but by the end of the quarter do not present any arrears”), which was 43.58% whereas the actual realization was 25.55%.

Overall, the NPE ratio remains extremely high and, as of June 2017, the ratio in Cyprus is the second highest in the Euro Area behind Greece⁷. It is important to note that the stock of NPEs is even larger when measured relative to the size of the economy. The NPEs as a percentage of GDP stood at 132.4% in December 2016, down from 155.1% in December 2014. This has not escaped the attention of the Central Bank of Cyprus, which noted there is a long road ahead, towards the eventual resolution of the NPE problem.⁸

⁵ https://www.centralbank.cy/images/media/redirectfile/Aggregate%20Targets%20publication%20template-Jun2017%20-%2017_10_2017.xls

⁶ <https://www.centralbank.cy/images/media/redirectfile/Commentary%20on%20results%20for%202017Q2greek.doc>

⁷ <https://www.eba.europa.eu/documents/10180/1981506/EBA+Dashboard+-+Q2+2017.pdf/a7736ea3-6054-4397-a2b7-d34493dbc168> (page 13)

⁸ https://www.bankingsupervision.europa.eu/press/interviews/date/2017/html/ssm.in171016_1.en.html

5. The probability of further ratings upgrades after Presidential elections has increased. Rating agencies assign a positive outlook on the long-term sovereign rating of Cyprus in their individual ratings.

On December 1st, DBRS changed its outlook (they call it “trend”) from stable to positive, yet confirmed the rating at BB (Low). According to DBRS’ rationale, the change in trend reflects the agency’s view that both Cyprus’ solid fiscal and economic performances are likely to be maintained, leading to a further decline in the General Government Debt-to-GDP ratio. DBRS now expects real GDP growth to average 3.7% for the FY2017 – compared to a previous forecast of less than 3% – and projected a growth of around 3% in 2018 and 2019. Accordingly, DBRS has revised the forecast for the fiscal surplus upwards to 1.0% of GDP in 2017 – from 0.2% – and to above 1.3% over the next two years. The stronger-than-expected growth developments and the partial early debt repayment have brought the government debt-to-GDP ratio down to below 100% in 2017. This would take place one year earlier than initially estimated in the government’s Stability Programme in April. At the same time, banks’ non-performing loans (NPLs) continue to decrease.

DBRS expects the political commitment for prudent fiscal and debt management to be maintained throughout the electoral cycle. According to DBRS, Cyprus benefits from a stable political environment and solid institutions. The government demonstrated strong commitment to the economic adjustment programme, exceeding fiscal targets and making important efforts to obtain legislative support for reforms. This commitment has been maintained since exiting the programme in March 2016. Despite delays in the outstanding reforms in Parliament due to the upcoming presidential election, DBRS expects after the election broad continuity on fiscal policy, on the debt management strategy, and on efforts to address banking sector vulnerabilities.

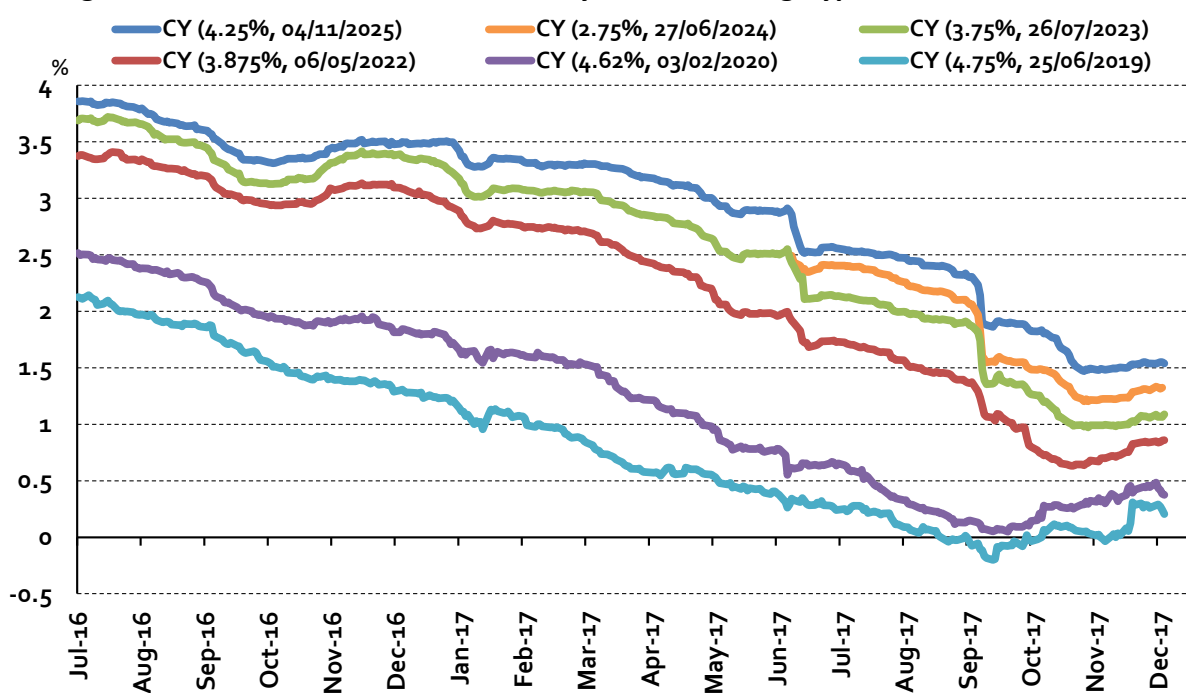
Earlier, on June 2, 2017, DBRS had already upgraded the long-term sovereign rating of Cyprus Republic by two notches (from B to BB low) with a stable outlook (trend). At that time, the DBRS rating decision - an upgrade by two notches - was more aggressive than anticipated. Hence today DBRS is no longer the rating agency that assigns the lowest rating.

Looking back, it seems that for autumn 2017 period, the round of reviews by the rating agencies has been concluded: S&P (September 15, 2017), Fitch (October 20, 2017), Moody’s (November 17, 2017), and DBRS (December 1, 2017). Specifically, on September 15th, in line with expectations, S&P affirmed the long-term sovereign rating of Cyprus at BB+ but, at the same time, it changed the outlook from stable to positive. On October 20th, Fitch upgraded the long-term sovereign rating of Cyprus by one notch from BB- to BB with a positive outlook. More recently, on November 17, Moody’s deferred its scheduled assessment, maintaining the rating of Cyprus at Ba3 with a positive outlook. In its annual report released on November 27th, Moody’s explained that Cyprus’s credit profile reflects recent improvements in the country’s economic resilience, robust growth momentum and strong fiscal performance. In Moody’s view, Cyprus faces credit challenges arising from its small and relatively undiversified economy, as well as high levels of government, banking and

household debt. The positive outlook on Cyprus's sovereign rating reflects Moody's view that improvements in economic resilience and fiscal strength are likely to be sustained.

Following the last round of assessments, there remains a slight divergence of views between the rating agencies on the sovereign rating of Cyprus (Table 3). The distance from government bond investment grade status is one notch for S&P (currently at BB+), two notches for Moody's (currently at Ba3), and three notches for Fitch (currently at BB) and DBRS (currently at BB Low) respectively. The lack of investment grade status prevents Cyprus from qualifying to join ECB's Quantitative Easing (QE) program. Earlier, when Cyprus was still in a Program, an ECB waiver allowed participation in QE. The Program and the waiver no longer exist.

Figure 6A: Annualized Yields to Maturity of outstanding Cypriot Government Bonds

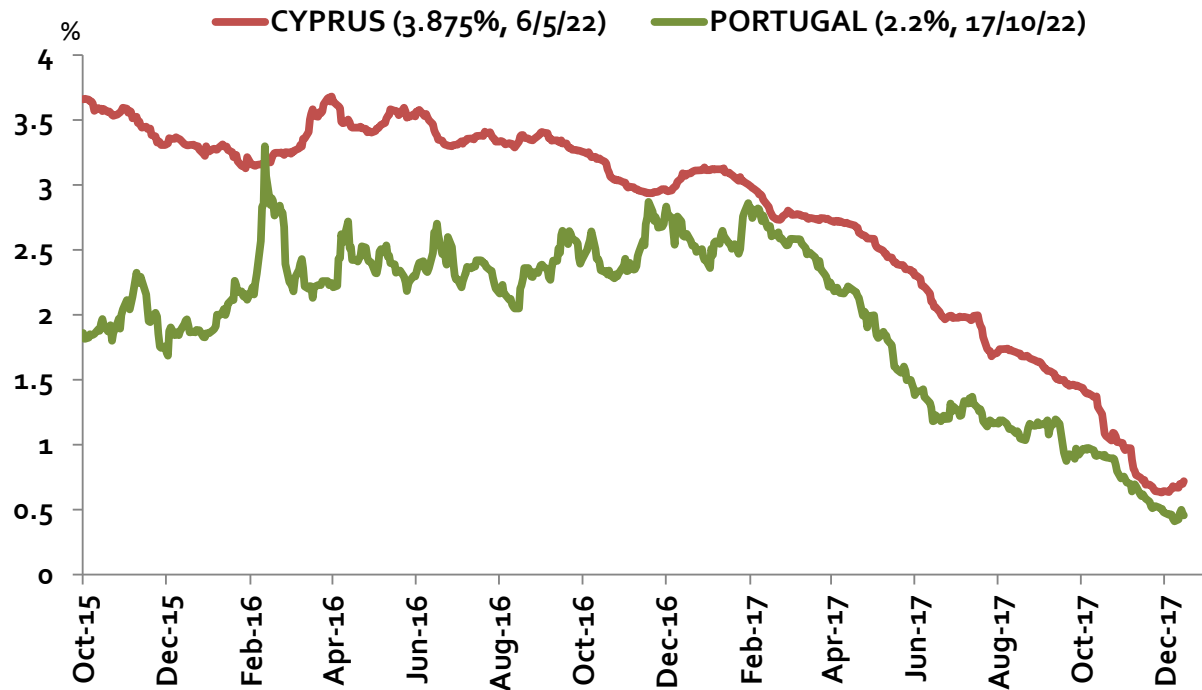


Source: Bloomberg, Eurobank Research

Note: The maturity of each bond declines as we move from left to right on the diagram. The first observation is on July 20, 2016 and the last observation is on December 15, 2017. On that date, the longest 04/11/2025 bond had a maturity of 8 years. At the other end, the shortest 25/06/2019 bond had a maturity of 18 months.

Despite not participating in ECB's QE, the medium-term Cypriot bond yields are on a declining trend since March 2016 (Figures 6A-6B). Cyprus enjoys uninterrupted access to international capital markets. In late June, Cyprus tapped international markets with a new 7Y-Eurobond for the second time after exiting from the Economic Adjustment Programme in March 2016. It was issued at the lowest cost ever achieved in a benchmark bond issuance.

**Figure 6B: Annualized Yields to Maturity of Government Bonds maturing in 2022:
Cyprus vs. Portugal**



Source: Bloomberg, Eurobank Research

Note: The Cypriot bond matures in May 2022 and the Portuguese about six months later, in October 2022. Thus on December 15, 2017 the Cypriot bond had an approximate maturity of 4.5 years and the Portuguese 5 years.

Table 3

Foreign Currency Long Term Sovereign Ratings of Cyprus

Moody's	S&P	Fitch	DBRS	Rating Description
Aaa	AAA	AAA	AAA	Prime
Aa1	AA+	AA+	AA High	High Grade
Aa2	AA	AA	AA	
Aa3	AA-	AA-	AA Low	
A1	A+	A+	A High	Upper Medium Grade
A2	A	A	A	
A3	A-	A-	A Low	

Baa1	BBB+	BBB+	BBB High	Lower Medium Grade
Baa2	BBB	BBB	BBB	
Baa3	BBB-	BBB-	BBB Low	
Ba1	BB+	BB+	BB High	Non-Investment Grade
Ba2	BB	BB	BB	
Ba3	BB-	BB-	BB Low	
B1	B+	B+	B High	
B2	B	B	B	
B3	B-	B-	B Low	
Caa1	CCC+	CCC+	CCC High	
Caa2	CCC	CCC	CCC	
Caa3	CCC-	CCC-	CCC Low	
Ca	CC	CC	CC High	
			CC	
			CC Low	
C	C	C	C High	
			C	
			C Low	
C	SD	DDD	D	Default
C	D	DD		
C	D	D		

Source: Rating Agencies

(Upgrade within the last review is marked with green color. Affirmation is marked with grey color)

6. Interpreting the latest Cypriot Economic News (October-December 2017)

The real economy continues to surprise positively

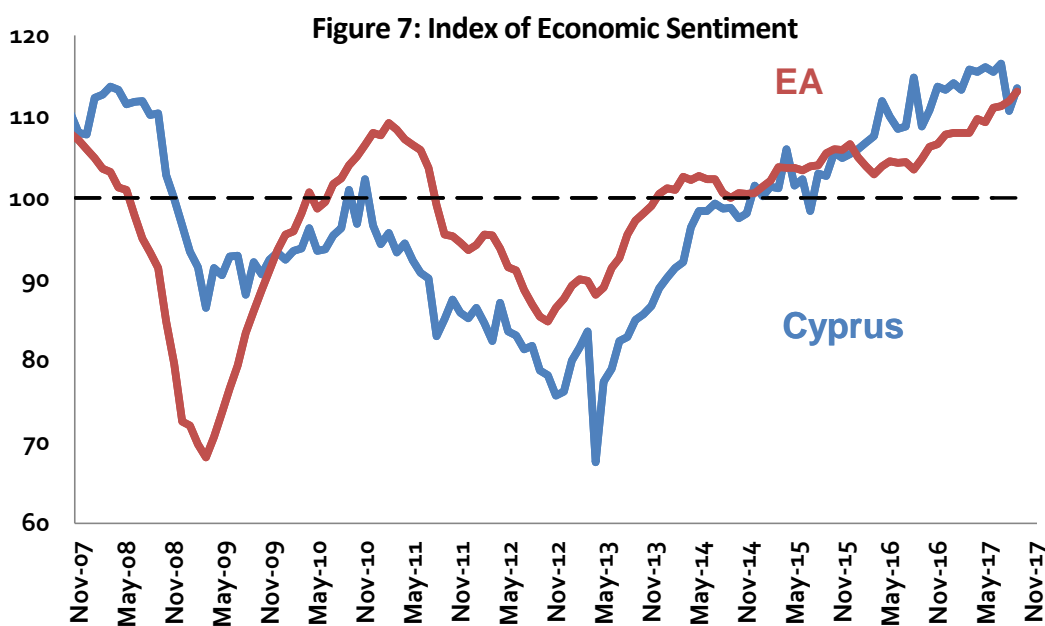
Economic Sentiment Index (ESI Index)

Confidence rebounds in October, reaching a new pre-Lehman period peak

The ESI Index rebounded further in October on top of the September rise, after a temporary slump in August. In more detail, ESI expanded further by 0.9 points to 118.8 in October, up from 113.5 in September, compared to 110.7 in August, reaching a new multi-month high. The more pronounced improvement in expectations came from the services and construction components, which expanded by 7.7 and 6 points respectively. All other components of the index - except that of the retail trade which retrenched back to the September levels - improved too. Consumer sentiment and industry improved by 3.1 and 0.8 points respectively.

The ESI index stands at a very high level – having reached a new pre-Lehman Brothers period peak (the previous pre-Lehman period peak stood at 117.3, which was recorded in August 2007). All in, the ESI Index stands above its long-term average, spurring optimism for the prospects of short-term economic activity. The improvement recorded in the past four years – a total of 47 points since the crisis period in April 2013 - is still the highest among all countries in EU-28 over the same sample period.

Sentiment improvement is one of the key drivers of the consumption rebound, which feeds into output growth. The sentiment improvement is illustrative of the progress of the Cypriot economy in the past three years within the economic adjustment program. This progress is evident in a number of areas, including but not limited to, restoring the health of the banking sector, a complete lift of capital controls, the rebalancing of public finances and the correction of all other macroeconomic imbalances.



Source: Eurostat, Eurobank Research

Consumer prices (HICP)

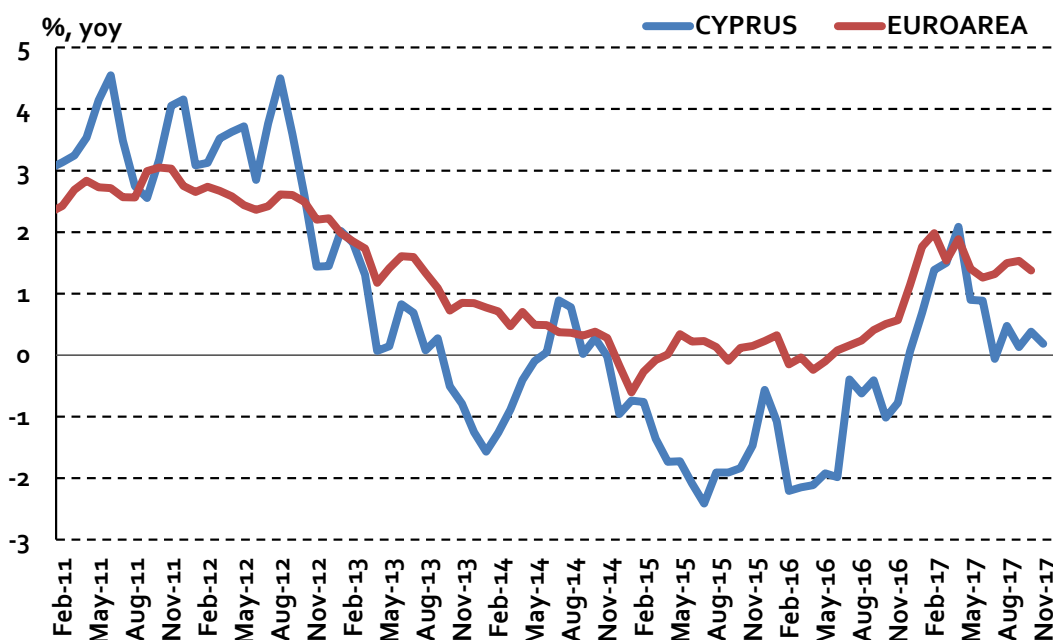
Further inflation moderation in the last months of 2017

Consumer prices, measured by HICP, have entered positive territory since December 2016, thus marking the end of the prolonged - four year- period of deflation, and subsequently started accelerating in the first quarter of 2017. Having jumped to a multi month high at +1.0% MoM/+2.1% YoY in April, compared to only +0.3% MoM/+0.1% YoY in last December, HICP moderated further in Q4. In turn, HICP came to -1.2% MoM/+0.2% YoY in November compared to -0.6% MoM/+0.4% YoY in October and -0.8% MoM/+0.1% YoY in September.

The biggest increases on an annual basis were observed in the categories of “*Transportation*” (-0.5% MoM/+2.6% YoY in November vs. +0.9% MoM/+2.0% YoY in October) and “*Utilities*” (+0.9% MoM/+2.1% YoY in November vs. +0.2% MoM/+2.0% YoY in October). The rise in “*utilities*” reflects the past pass through of world energy prices and the subsequent increase in the local electricity tariffs by the state-owned energy company. “*Restaurants & Hotels*” was the category with the sharpest monthly decline (-6.3% MoM/+1.3% YoY in November vs. -4.8% MoM/+3.1% YoY in October compared to -2.8% MoM/+3.6% YoY in September vs. +2.4% MoM/+3.1% YoY in August). The decline in “*restaurants & hotels*” most probably reflects the end of the increased demand for catering and accommodation services during high-season.

As of November, the rise of energy prices and prices of services accounted for 0.2ppts and 0.4ppts of HICP inflation respectively while volatile food (fruit and vegetables) and non-energy industrial goods subtracted another 0.2 ppts from the headline respectively. Overall, the average annual HICP declined to +0.2% YoY in Q3-2017 down from +1.3% YoY in Q2-2017 compared to +1.2% YoY in Q1-2017 up from -1.2% YoY in the 2016, -1.4% YoY in 2015 and -0.7% YoY in 2014.

Figure 8: HICP in Cyprus vs. EA-19



Source: Eurostat, Eurobank Research

Deposits & Loans

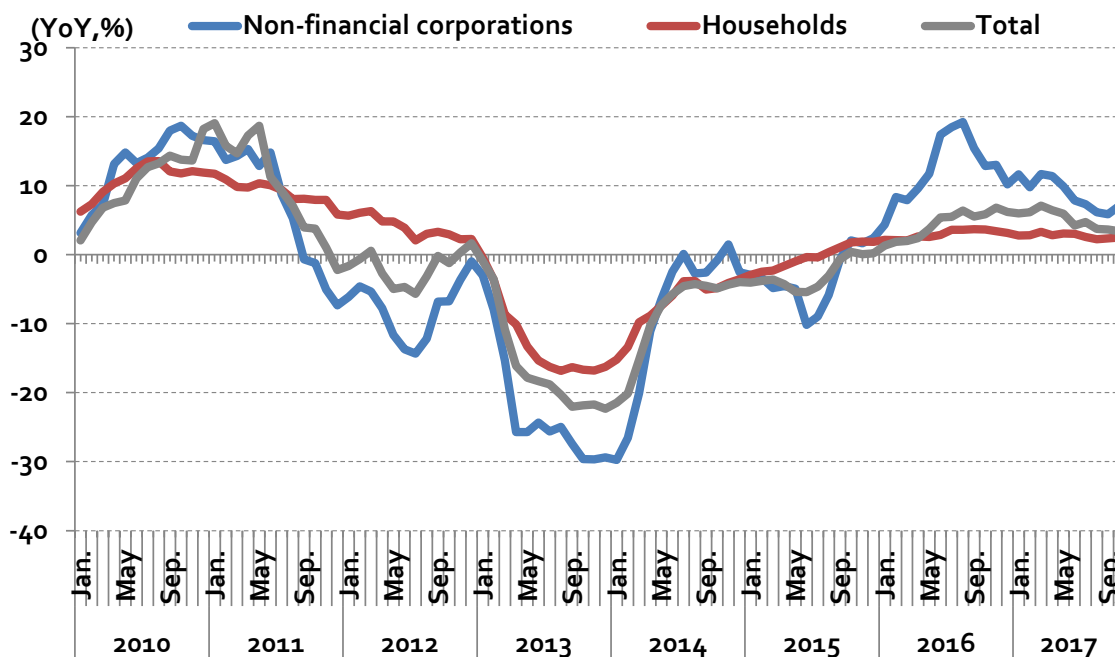
Deposit growth remained in positive territory on an annual basis in the first ten months of 2017

The Central Bank of Cyprus published on December 4th the Monetary and Financial Statistics (MFS) of October.⁹ From a flow point of view, total deposits recorded a net increase of €335.1mn in October on top of a net temporary decline of €164.9mn in September, up from a substantial net increases of €432.9 in August and €513.4 in July, compared to €332mn in March, and €148.9mn in January..

The annual rate of expansion-*which has been in positive territory since October 2015*- has slowed down to 3.4% YoY in October against 3.6% YoY in September, 4.2% YoY in June vs. 7.1% YoY in March, compared to 6.2% YoY in Dec2016 and only 0.2% YoY in Dec2015. The outstanding amount of total deposits has reached as of October the highest level in the post-MoU era. Total deposits stood at €49.5bn in October up from €49bn in September, €48.5bn in June, €49.6bn in March, compared to €49.0bn in December 2016 and €45.97bn in December 2015.¹⁰

Total loans in October exhibited a net decrease of €110.0mn, on top of a net decrease of €134.6mn in September and €107.0mn in August. The annual growth rate of contraction narrowed to -1.7% YoY in October compared to -1.8% YoY in September, -0.7% YoY in June which was the *lowest reading since April 2013*- and -5.0% YoY in March, compared to -10.7% YoY in December 2016 and only -3.4% YoY in December 2015. A substantial part of these repayments concern previous transfers of loans from non-resident MFIs and are not related to the domestic economic activity. The outstanding amount of loans reached €52.5bn in October down from €52.6bn in September compared to €54.3bn in June and €55.0bn in March compared to €55.3bn in December 2016 and €62.7bn in December 2015.

Figure 9: Annual growth of deposits



Source: Central Bank of Cyprus, Eurobank Research

⁹ <https://www.centralbank.cy/images/media/xls/2ndMFSNo2017eng.xls>

¹⁰ The Central Bank is using ECB methodology to calculate the annual growth with a special formula taking into account the monthly transactions

Residential Property Price Index (RPPI)-Q2-2017

The RPPI Index recorded in Q2-2017 the second increase on an annual basis since 2010

The Central Bank of Cyprus published in mid-November the residential property price index (RPPI) for Q2-2017. On a quarterly basis, the RPPI increased by +0.5% QoQ, recording the fourth consecutive quarterly rise since 2009 vs. -0.5% QoQ in Q2-2016 compared to -0.8% QoQ in Q1-2016. The quarterly rise reflects the combined effect of an increase in both flat apartments and house prices by 1.5% QoQ and +0.1% QoQ respectively. On an annual basis, the RPPI recorded the second increase since Q1-2010. The RPPI Index expanded by +1.5% YoY in Q1, showing the second such increase since 2008 (Figure 10B). This was up from +0.2% YoY in Q1-2017 up from -0.9% YoY in Q4-2016, -1.3% YoY in Q3-2016 compared to -1.7% YoY in Q2-2016, -1.6% YoY in Q1-2016, and smaller in absolute terms than -1.8% YoY in Q4-2015, -3.7% YoY in Q3-2015 and -5.0% YoY in Q2-2015.

Overall, the RPPI trajectory in the past quarters, in combination with other high frequency data from the construction industry and real estate transactions, point to a further stabilization of the real estate sector. According to CYSTAT, construction output expanded by a hefty +1.1% QoQ/+32.5% YoY in Q2-2017 compared to +13.5% QoQ/+45.6% YoY in Q1-2017 up from +8.6% QoQ/+18.4% YoY in Q4-2016.

Figure 10A: RPPI Index (2010Q1=100)

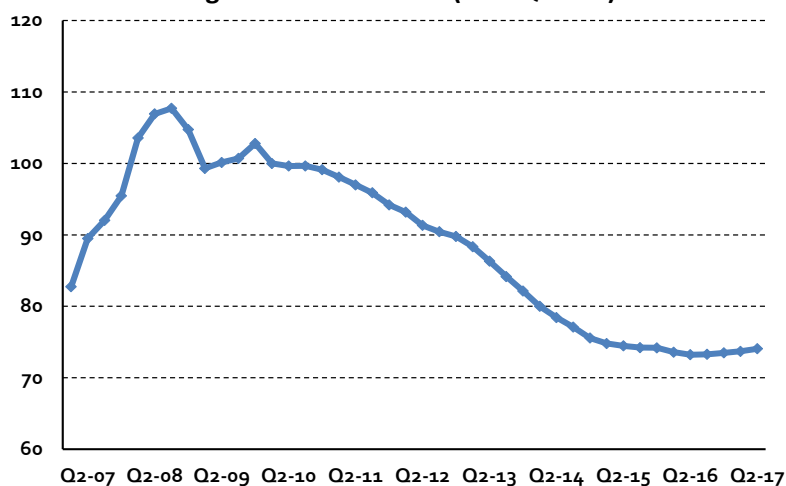
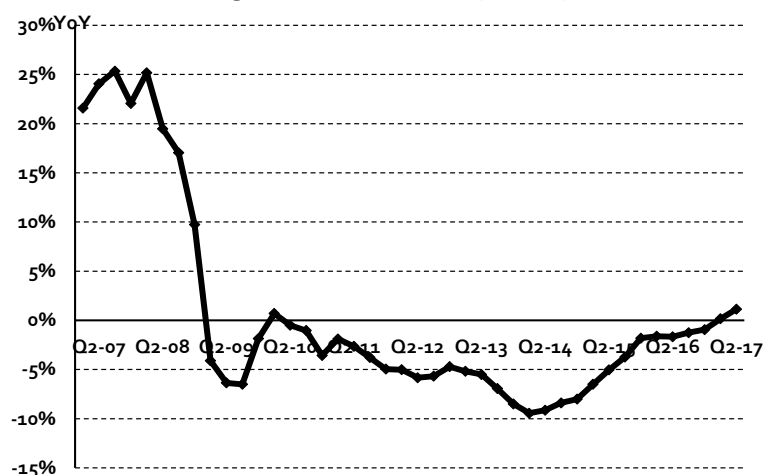


Figure 10B: RPPI Index (% YoY)



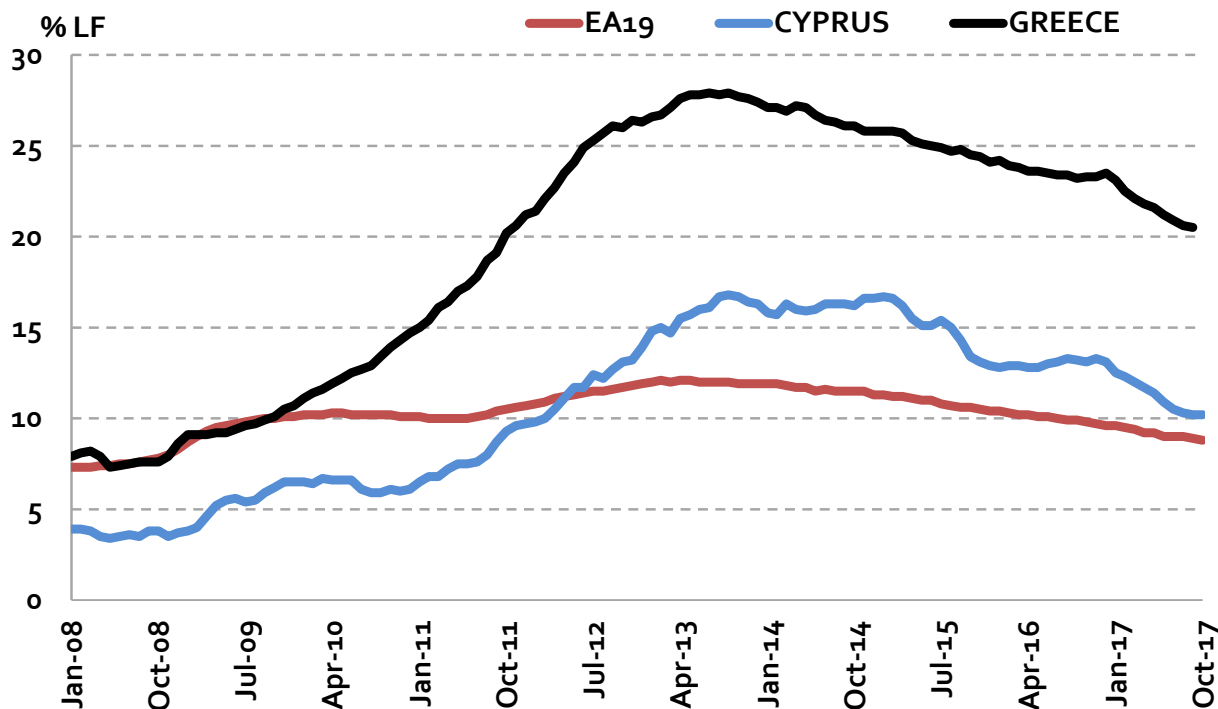
Source: Central Bank of Cyprus, Eurobank Research

Unemployment

Unemployment consolidates at multi-month lows in the first month of Q4

According to the latest Labor Force Survey (LFS), unemployment on a seasonally adjusted basis remained unchanged at 10.2% in October vs. September, yet it remained lower than 11.4% in May 2017, 13.1% in December 2016, 13.1% in October 2016, and 17% at its peak in October 2013. (See Figure 11). Overall, Cyprus recorded the highest unemployment decline in EU-28 in the first ten months of 2017, so that unemployment now stands close to that of Euroarea. In the previous year 2016, Cyprus had recorded the third highest decrease in unemployment in EU-28, behind Croatia and Spain. Despite the improving trend, unemployment in Cyprus is still the fifth largest in EU-28. Youth & Long-term unemployment are a source of concern and require more attention.

Figure 11: Unemployment rate



Source: Eurostat, Eurobank Research

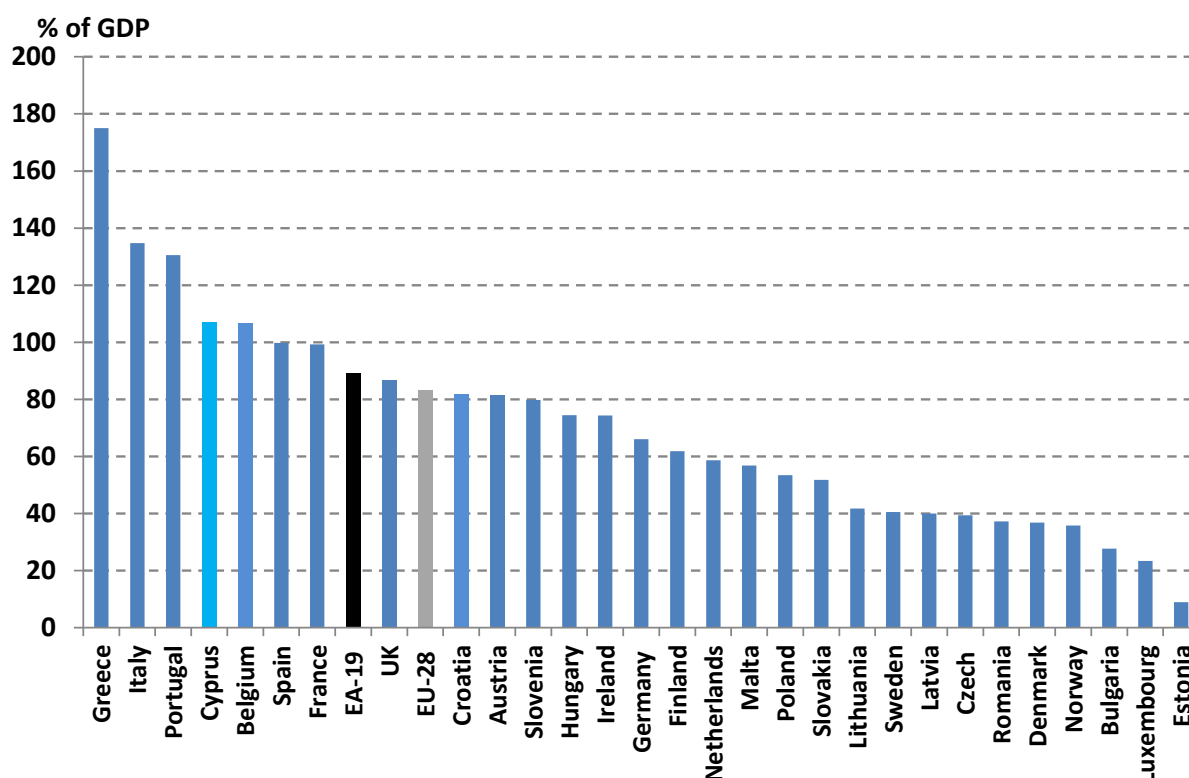
Q2-2017 General Government Deficit and Public Debt (ESA2010 terms)

Cyprus improves in the public indebtedness ratio in Eurostat ranking

On October 24, Eurostat announced the provisional data for the fiscal deficit and public debt in the second quarter of 2017.¹¹ In ESA2010 terms, Cyprus recorded a €138.4mn general government deficit in Q2-2017 which is approximately -2.9% of the GDP in the same quarter, switching from an earlier surplus of €200.9mn or 4.5% of the GDP in the same quarter in Q1-2017, compared to a Euro Area and EU-28 deficit of 0.7% respectively) in the same period. According to the latest Ministry of Finance data, the general government surplus in ESA2010 terms had reached €431.5mn or 2.7% of projected GDP in 10M-2017.

As a result, the general government debt remained flat as percentage of GDP at 107.6% of GDP or €19.8bn in Q2-2017, compared to €19.6bn in Q1-2017, down from €19.3bn or 107.8% in Q4-2016, compared to €19.1bn or 107.5% of GDP in Q1-2016. Cyprus’ ranking among EU-28 members remained relatively unchanged: The Cypriot government debt as a percentage of GDP is now the fourth highest, behind that of Greece (175.0%), Italy (134.7%), and Portugal (132.1%). The public debt of Cyprus is in the form of loans (36.2% of total) and debt securities (70.6% of total).

Figure 12: General Government Debt across EU-28 members in Q2-2017



Source: Eurostat, Eurobank Research

¹¹ <http://ec.europa.eu/eurostat/documents/2995521/8332661/2-24102017-AP-EN.pdf/ef03ad4f-b3ee-4ce4-99a0-fe38e8a1d32d>

January-October 2017 Budget execution

The budget was in surplus in the first ten months of 2017

The budget was in surplus during the first ten months of 2017. The consolidated government surplus increased to €431.5mn in 10M-2017, up from €71.7mn in 10M-2016. As a percentage of GDP, the consolidated government surplus came at +2.7% in 10M-2017, compared to +0.8% of GDP in 10M-2016. The primary surplus stood at +4.8% of GDP in 10M-2017 compared to +2.9% of GDP during the same period a year ago. Total revenues improved by +9.0% YoY, driven by double digit growth in indirect taxes. On the other hand, total expenditure remained relatively contained in an election year, expanding by +1.6% YoY driven by higher spending on procurement (+10.2% YoY), pensions (+2.6% YoY) and public wages (+3.5% YoY). On the other hand, spending items such as social security payments (+0.4% YoY) remained at low levels and while spending on current transfers (+0.4% YoY) and subsidies (-44.0% YoY) decreased.

Table 4: General Government Budget Execution

General Government Adjusted Budget Balance on cash basis (January-October 2017)		
in % GDP	January-October 2016	January-October 2017
I. Government Budget and SSF		
Total Revenue	29.0%	30.6%
Current revenue	28.8%	30.3%
Direct Taxes	9.0%	8.7%
Indirect Taxes	11.8%	12.8%
of which, VAT	7.1%	7.8%
Social security contributions	4.7%	5.0%
Non-tax revenue	3.5%	3.8%
Capital Revenue	0.0%	0.0%
Grants	0.2%	0.3%
Total Expenditure	28.6%	28.2%
Current expenditure	27.7%	27.3%
Wages and Salaries	7.3%	7.3%
Goods and services	1.6%	1.8%
Subsidies	0.5%	0.3%
Social Security payments	6.8%	6.6%
Pensions	2.5%	2.4%
Social Pensions	0.3%	0.3%
Current transfers	6.3%	6.1%
Non-allocated	0.1%	0.1%
Interest payments	2.3%	2.4%
Capital expenditure	1.0%	0.9%
Balance (I)	0.4%	2.5%
II. Other General Government Bodies		
including		
Local Authorities	0.0%	0.0%
Semi-public Entities	0.0%	0.0%
Other Entities	0.0%	0.0%
Balance (II)	0.1%	0.1%
III. ESA 2010 adjustments		
Balance (III)	0.3%	0.1%
III. General Government Balance		
Budget Balance (I+II+III)	0.8%	2.7%
Primary Balance (excl. interest)	2.9%	4.8%
Cyprus GDP (Mrd EURO-CYP)	17,901.4	18,717.0

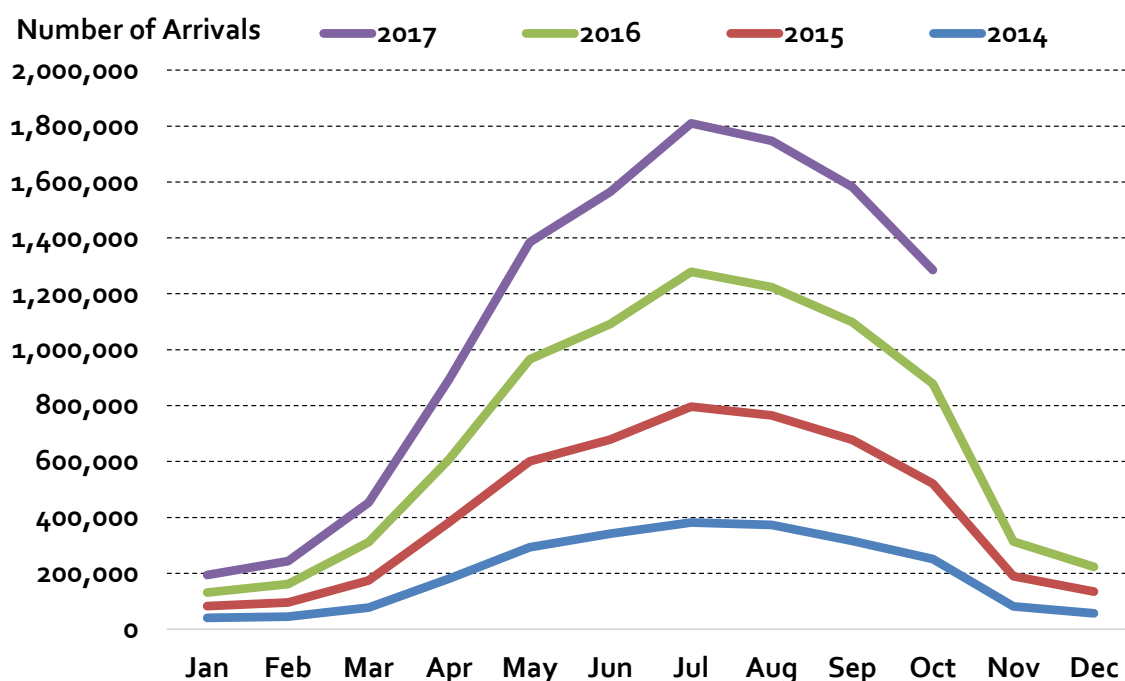
Source: Ministry of Finance, Eurobank Research

Tourism arrivals (January-October 2017) & revenues (January-September 2017)

Poised for another year of records in tourism arrivals

The positive momentum in the tourism sector continued into 10M-2017. Tourist arrivals increased by +14.6% YoY in 10M-2017 (3,408,473 vs. 2,974,412 see Figure 13). The highest increase was recorded in tourist arrivals from Israel (+80.8% YoY, 242,756), Germany (+60.0% YoY, 170,754), Poland (+38.1% YoY, 53,731 and Austria (+38.0% YoY, 38,462). Tourist arrivals from traditional and more sizeable markets such as Russia (+5.2% YoY, 703,446) and UK (+7.9% YoY, 1,174,358) fared relatively well. In a similar vein, tourism revenues expanded also robustly by +12.9% YoY in January-September 2017 to €2,2bn, up from €1,96bn compared to the same period last year. The expenditure per person for the month of September 2017 only reached €766.8, compared to €800.2 in the corresponding month of the previous year, recording a decrease of -4.2%. The expenditure per person/per day for September 2017 compared to July 2016 also recorded a decrease of -4.2%. This percentage decrease was smaller the corresponding percentage increase in tourist arrivals, hence revenues expanded.

Figure 13: Tourism Arrivals



Source: CYSTAT, Eurobank Research

Eurobank Cyprus Research

Economic Indicators	Description	Source	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
National Accounts															
Population	Number	Eurostat	722,893	733,067	744,013	757,916	776,333	796,930	819,140	839,751	862,011	865,878	858,000	847,008	848,319
GDP (%YoY)	Constant Prices	Eurostat	4.6	3.7	4.5	4.8	3.9	-1.8	1.3	0.3	-3.1	-5.9	-1.4	2.0	3.0
Households and NPISHs Final Consumption Expenditure (YoY%)	Constant Prices	Eurostat	7.2	3.5	4.4	10.2	7.9	-6.4	3.3	-0.7	-1.3	-5.9	0.7	2.6	3.3
General Government Final Consumption Expenditure (YoY%)	Constant Prices	Eurostat	1.2	2.8	7.0	3.3	5.7	6.4	1.2	2.1	-1.8	-8.1	-7.2	-2.8	-0.4
Gross Fixed Capital Formation (YoY%)	Constant Prices	Eurostat	4.7	6.9	21.0	7.8	8.8	-13.6	-2.6	-12.1	-20.5	-12.9	-17.5	13.6	35.0
Exports of Goods and Services (YoY%)	Constant Prices	Eurostat	2.3	2.1	1.3	5.3	-0.7	-4.1	4.5	5.6	-2.7	2.1	4.2	6.3	3.9
Imports of Goods and Services (YoY%)	Constant Prices	Eurostat	6.9	1.6	5.7	10.5	12.5	-15.0	8.0	-3.0	-4.4	-4.8	4.6	8.1	6.6
GDP	Current Prices, SA ,mil	Cyprus Statistical Service	13856.3	14822.3	15999.9	17511.6	19006.0	18673.5	19299.5	19731.1	19489.7	18140.5	17605.9	17742.0	18122.5
GDP (%YoY)	Current Prices, SA ,mil	Cyprus Statistical Service	7.9	7.0	8.0	9.5	8.5	-1.8	3.4	2.2	-1.2	-6.9	-3.0	0.8	2.1
Labour Market															
Unemployment Rate	% active population	Eurostat	4.6	5.3	4.6	3.9	3.7	5.4	6.3	7.9	11.9	15.9	16.1	15.0	13.0
Labor Productivity	Real, Per employee, % Change	Eurostat	0.6	0.1	2.6	0.4	0.3	-1.8	0.8	0.3	0.0	0.0	0.2	-0.2	0.1
Unit Labor Costs	Index, 2010=100	Eurostat	82.3	87.7	89.1	90.4	93.0	100.2	100.0	101.8	103.3	97.7	93.8	92.9	92.3
Unit Labour Cost Growth Total Economy	YoY%	Eurostat	1.6	6.5	1.6	1.5	2.9	7.7	-0.2	1.8	1.5	-5.4	-4.0	-0.9	-0.7
Short-term business statistics															
Economic Sentiment Index (ESI)	EoP, SA	EU Commission	106.3	99.8	108.1	108.4	97	93.8	97.1	85.7	76.6	89.6	102.7	106.7	113.3
Industry	EoP, SA	EU Commission	-36.4	-26.2	-31.8	-40.8	-39.2	-40.5	-46.7	-61.3	-43.9	-20.2	-10.0	-4.0	-0.4
Construction	EoP, SA	EU Commission	-4.4	-32.7	2.7	-7.9	-27.5	-38.8	-44	-51.5	-56.5	-54.5	-49.8	-30.3	-27.4
Retail trade	EoP, SA	EU Commission	3.3	5.2	0.7	11.2	-12.8	-22.5	-22.6	-29.0	-31.8	-19.1	-10.6	-1.6	8.5
European Commission Services Confidence Indicator Cyprus	EoP, SA	EU Commission	14.4	6.1	15	8.7	1.8	-3.6	3.6	-25.2	-40.7	-24.2	11.4	8.2	28.4
Industrial Production General Index	NSA	Cyprus Statistical Service	103.2	102.7	103.5	111.0	109.9	102.8	100.3	92.5	75.2	69.9	72.8	77.3	84.5
Industrial Production General (%YoY)	NSA	Cyprus Statistical Service	3.7	-0.5	0.8	7.2	-1.0	-6.5	-2.4	-7.8	-18.7	-7.0	-9.6	7.8	8.7
European Commission Capacity Utilization Cyprus SA	SA	Cyprus Statistical Service	70.0	72.6	66.8	71.3	69.4	63.0	63.9	58.1	53.7	50.8	54.5	61.1	59.6
Housing and Real Estate															
Building Permits	Number	Cyprus Statistical Service	8252.0	9098.0	9794.0	9521.0	8896.0	8950.0	8777.0	7506.0	7172.0	5341.0	4933.0	5014.0	5354.0
Value of permits	mil €	Cyprus Statistical Service	1994.6	2288.9	2473.4	2782.3	2904.6	2815.8	2639.5	2065.1	1632.3	1141.0	859.5	1071.4	1157.6
Area of permits	(Thousand Sqm)	Cyprus Statistical Service	3015.7	3417.0	3507.5	3612.8	3689.1	3136.5	2917.9	2253.0	1499.9	1044.8	784.9	881.1	1047.1
Dwelling Units	Number	Cyprus Statistical Service	15743.0	18770.0	18915.0	20486.0	20082.0	16688.0	14312.0	8839.0	5879.0	4141.0	2855.0	3197.0	2348.0
Personal/Household Sector															
Credit for Consumption	mil €	ECB MFIs Statistics		2,577	2,848	3,118	4,261	4,770	3,390	3,371	3,341	3,039	2,794	2,792	2,583
Lending for House Purchase	mil €	ECB MFIs Statistics		4,140	5,450	6,989	8,584	10,492	12,033	12,658	12,772	11,943	11,747	11,735	11,587
Other Lending Cyprus	mil €	ECB MFIs Statistics		5,645	5,676	6,111	6,366	5,600	7,381	7,855	8,025	7,558	7,433	7,099	6,736
Total MFI Loans to Non-MFIs Domestic Residents	Monetary & Financial Statistics	Central Bank of Cyprus		25,005	27,511	33,995	43,452	45,681	49,403	52,870	53,936	50,082	49,583	51,201	45,310
Gross Household Saving Rate	% of Gross Disposable Income	Eurostat	7.9	10.7	10.8	5.9	4.8	8.9	6.7	6.4	3.6	-3.3	-7.9	-5.7	N/A
International Trade & Balance of payments															
Current account balance (%GDP)	BMP6	Eurostat					-15.5	-7.7	-11.3	-4.1	-6.0	-4.9	-4.3	-2.9	-5.3
Current Account, Goods & Services Net Balance (%GDP)	BMP6	Eurostat					-12.8	-5.4	-7.3	-2.9	-1.5	1.8	2.1	0.3	0.0
Current Account, Primary Income Net Balance (%GDP)	BMP6	Eurostat					-2.5	-1.3	-3	0	-3	-4.7	-3.6	-0.3	-2.7
Current Account, Secondary Income Net Balance (%GDP)	BMP6	Eurostat					-0.3	-1.0	-1.0	-1.1	-1.4	-2.1	-2.8	-2.9	-2.6
Imports of Goods (%GDP)	BMP6	Eurostat					42.2	34.7	36.8	35.5	33.7	31.2	32	32	35.1
Exports of Goods (%GDP)	BMP6	Eurostat					12.0	13.1	13.9	15.3	15.6	15.0	16.0	14.1	13.6
Imports of Services (%GDP)	BMP6	Eurostat					20.7	19.4	20.7	20.4	21.3	25.7	28.1	28.9	28.0
Exports of Services (%GDP)	BMP6	Eurostat					38.1	35.7	36.3	37.6	37.9	43.7	46.2	47.2	49.5
Financial Account (%GDP)	BMP6	Eurostat					-18.5	-8.4	-8.6	-1.2	-2.1	-1.9	-7.1	2.0	-5.9
Government Finance & Debt															
General Government Deficit (-) or Surplus (+) (% GDP)	including Coops banks' recap	Cyprus Statistical Service	-3.7	-2.2	-1.0	3.2	0.9	-5.4	-4.7	-5.7	-5.6	-5.1	-8.8	-1.2	0.4
General Government Debt EDP Procedure (% GDP)		Cyprus Statistical Service	64.1	62.8	58.7	53.5	44.7	53.4	55.8	65.2	79.3	102.2	107.1	107.5	107.8
Prices															
CPI (%YoY)	Annual Average	Cyprus Statistical Service	2.3	2.6	2.5	2.4	4.7	0.3	2.4	3.3	2.4	-0.4	-1.4	-2.1	-1.4
Cyprus HICP All Items (% YoY)	Annual Average	Eurostat	1.9	2.0	2.2	2.2	4.4	0.2	2.6	3.5	3.1	0.4	-0.3	-1.5	-1.2
Tourism															
Tourist & Excursionist Arrivals	Number	Cyprus Statistical Service	2,349,007	2,470,057	2,400,919	2,416,075	2,403,744	2,141,187	2,172,993	2,392,223	2,464,903	2,405,387	2,441,231	2,659,400	3,186,531
Revenue From Tourism	mil €	Cyprus Statistical Service	1,678,419	1,718,302	1,755,252	1,858,106	1,792,787	1,493,246	1,549,801	1,749,306	1,927,600	2,082,400	2,023,400	2,112,100	2,363,400
Market Indicators															
10Y Gov Bond Yield Rate	%, EMU criterion series	Eurostat	6.3	4.1	4.3	4.6	4.6	4.6	4.6	7.0	7.0	6.0	6.0	3.9	3.6
Cyprus Stock Exchange Index	EoP, Composite Index		1012.27	1704.76	3900.39	4820.72	1101.42	1597.23	1055.21	295.94	114.86	103.31	85.70	67.75	66.40