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Review of 2018 & Prospects for 2019

In 2018, GDP growth in Cyprus stayed close to its cycle peak, surpassing earlier forecasts

- **Rating agencies offered the country investment grade status for the first time since 2011**
- **Access to international capital markets was maintained at favorable terms**
- **A new record in tourist arrivals, yet revenues per person on a declining trend**
- **Fiscal discipline maintained despite banking sector costs**
- **In banking, challenges remain yet the Gordian knot was cut with Hellenic Bank absorbing the healthy part of Cyprus Cooperative Bank and with NPEs declining substantially**
- **A property market recovery is fueled mainly by the "program citizenship through investment"**
- **Labor market improved further yet productivity growth remained subdued**

In 2019, robust but declining growth

- **Consumption growth expected to remain robust and support another year of expansion**
- **Downside risks have multiplied: High NPEs and high private sector indebtness, structural reform fatigue, adverse fiscal court decisions, a hard Brexit, trade tensions and declining world growth**

1. Overview

The past year was another solid year for Cyprus. Progress was achieved in most areas. First, the year was marked by the re-election of President Anastasiades thus ensuring policy continuity for the next five years. And second, all robust economic indicators show the recovery is broad-based, affecting most of the population.

The economic recovery has, in turn, benefited labor market conditions, bringing the rate of unemployment back to the lower Euro area levels. Traditional industries such as tourism, construction & real estate, professional services and shipping continued to be the locomotives of the Cypriot economy despite rising challenges.

After the revision of the national accounts data for 2016-2017 by CYSTAT it became clear the peak of the economic cycle is behind us. The country also demonstrated serious commitment to fiscal prudence despite inflated public expectations; and it continued having uninterrupted access to international markets at historically low rates. More importantly, all this progress was acknowledged by the major rating agencies, three of which awarded Cyprus with investment grade status for the first time in seven years.

If there were only one item to remember from the past year, this would be the orderly market exit of Cyprus Co-operative Bank (CCB), at the time the second largest bank in terms of assets. The CCB case had resembled a ticking time-bomb at the foundation of the Cypriot banking system, and was defused thanks to an initial aggressive intervention by the Single Supervisory Mechanism, the corresponding accumulated domestic policymaking experience with a banking crisis, a strong fiscal position and an empowered domestic banking system with adequate capital and liquidity. None of those characteristics were present during the crisis times of 2013.

More specifically,

i. **Output growth remained close to its post-Lehman high in 2018.** Real GDP growth expanded by 3.9% YoY in 2018, down from 4.2% YoY in 2017, compared to 4.8% YoY 2016, up from only 2.0% YoY in 2015, and after three years of recession and a cumulative drop of 10.1% over 2012-2014. This is third highest growth rate between Euro Area members (following Ireland and Malta) and is over two times the average 2018 Euro Area growth rate.

ii. **Consumption driven growth:** From a demand point of view, growth was primarily driven by final consumption for the first time in three years, which was being driven by the improvement of economic fundamentals. Total investment's contribution to growth was null in the past year, in contrast to the two earlier years. Despite the robust construction activity and inventories building, much lower shipping registration - lower by 2/3 compared to last year - was the main culprit behind it. The silver lining of lower shipping activity is their positive contribution to net exports for the first time in four years, which is channeled through a sharp slowdown in imports.

iii. **Economic activity is highly correlated with economic sentiment**, which is on an improving trend over the past four years. The Economic Sentiment Index (ESI) remained relatively flat at 115.3 compared to 115.7 in December 2017, up from 113.3 in December 2016 and 106.7 in December 2015. It has now reached levels very close to those of August 2008 (116.1), just prior to the Lehman Brothers international crisis. Yet in the first quarter of 2019 it declined a bit.

iv. **Prices on an upward trend**: In 2018 prices were in positive territory on an annual basis for a second consecutive year for the first time since 2013. The annual average HICP inched up to 0.8% YoY in 2018 compared to 0.7% YoY in 2017, up from -1.2% YoY in 2016, compared to -1.5% YoY in 2015. The rebound was driven by higher world energy prices on an annual basis and domestic catering and hotel services for most of the outgoing year. Despite the increase, Cyprus registered the second lowest inflation in EU-28 ahead of Ireland.

v. **Labor market conditions improved further in 2018**. The unemployment rate declined for a fourth consecutive year in a row coming down to single digits' territory and fully converging close to EA-19 levels. Unemployment declined from 15.0% in 2015 to 13.3% in 2016, further to 11.1% in 2017 and down to 8.4% in 2018. Cyprus recorded the *highest unemployment decline* (by 2.7ppts) in EU-28 in 2018. Yet, this level remains the fourth highest in EU-28 behind Greece, Spain, and France and at par with Croatia.

vi. **Fiscal discipline and prudence were maintained in 2018, despite the state support to the banking system and the rising public pressure for more spending**. Excluding the fiscal burden of the public support measures for the sale and orderly winding down of Cyprus Co-operative Bank (CCB) to Hellenic Bank, the general government recorded a surplus of 611,1mn on an accrual basis or 2.9% of GDP in 2018, up from a surplus of €344,2mn or 1.8% of GDP in 2017 compared to €58.9mn or 0.3% of GDP in 2016.

vii. **The state intervention in the banking system occurred at the expense of temporarily reversing the downward trend in public debt dynamics**. The one-off banking system state injection pushed the projected public debt to GDP ratio temporarily up to 104% of GDP in 2018 from 97.5% in 2017. This increase is not expected to reverse the overall downward trajectory of debt-to-GDP, provided fiscal policy remains prudent and nominal GDP growth remains robust. The public debt-to-GDP ratio is expected to decline to 97% in 2019 and further to 91% in 2020 and to 85% in 2021.

viii. **Uninterrupted access to the international markets**: Cyprus tapped international markets for a third time after exiting from the Economic Adjustment Programme in March 2016, with a new 10Y-Eurobond, issued at the lowest cost ever achieved in a benchmark bond issuance. Later in February 2019 it even managed to issue a 15-year bond.

ix. **Rating agencies assigned investment grade status acknowledging the significant improvement of macroeconomic fundamentals**: During the past year, all major rating agencies upgraded the sovereign rating of Cyprus by at least one notch. More importantly, as of late 2018, except for Moody's all other major rating agencies have rated Cyprus with investment grade.

x. **Despite volatility throughout the past year, the domestic banking sector is now healthier**
   a. *Cyprus registers the highest decline in NPEs in EU-28 during 2018*: The sizeable amount of NPEs removed from the banking sector as a result of the resolution of CCB and the creation of state management company allowed for an important -but one-off- decline in the NPEs ratio from 40% to currently much lower 30%.
   b. *Deposits decreased for the first time in three years in 2018.* The decline in deposits stems from the decline in the segment of the non-Euroarea residents

xi. **Tourism:** the industry registered another record year in arrivals in 2018, contributing to the GDP growth rebound of the Cypriot economy.

xii. **The property market is showing visible signs of revival, yet uneven across the island**
   a. Property prices are on the rise and in positive territory on an annual basis for the first time since 2009. Yet the rise is uneven and unequal among different areas in the island.
   b. Construction output rebounds strongly, expanding in double digit territory.

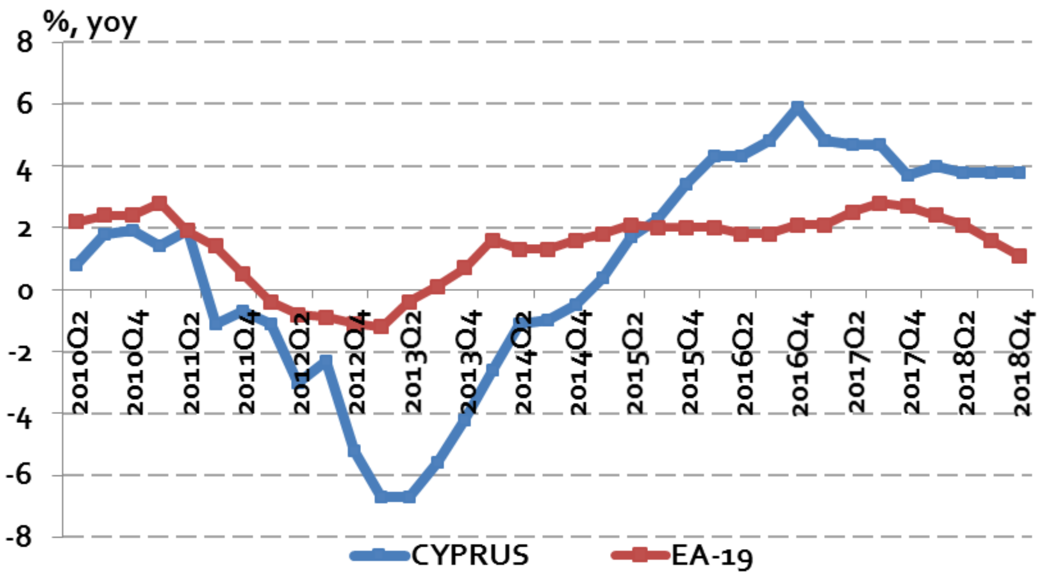
2. Growth prospects: Developments in Q4-2018 & outlook for 2019

2.1. Latest economic developments: the second GDP growth estimate for Q4-2018 – an inch lower compared to the flash CYSTAT estimate- confirmed that economic activity had a strong year finish

The second and latest estimate of CYSTAT on the seasonally adjusted Q4-2018 GDP-reading, trimmed by 0.1ppts off the flash, confirmed that economic activity remained strong in the last quarter of 2018. Real GDP expanded by 1.0% (down from 1.1% in the flash) on a quarterly basis, bringing the annual rate of expansion at 3.8% YoY in Q4-2018 on a seasonally adjusted basis, flat compared to Q3-2018 and Q2-2018, vs. 3.7% YoY in Q4-2017.

Real GDP growth marked the sixteenth consecutive positive reading on a both quarterly and annual basis after a previous three-year recession. The GDP growth rate of Q4-2018 is among the highest in EA-19 and EU-28, both on a quarterly and on an annual basis and, for a fourteenth consecutive quarter in a row, above that of EA-19 (Figure 1). This output performance is still among the highest during the post-Lehman period, surpassing analysts' expectations and international organizations' full year initial or revised forecasts. However, it marks the end of a period of buoyant growth and - ceteris paribus - suggests that the economic cycle peak is behind us.

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



Source: Eurostat, CYSTAT, Eurobank Research

From a demand side point of view, the main trends were the following:

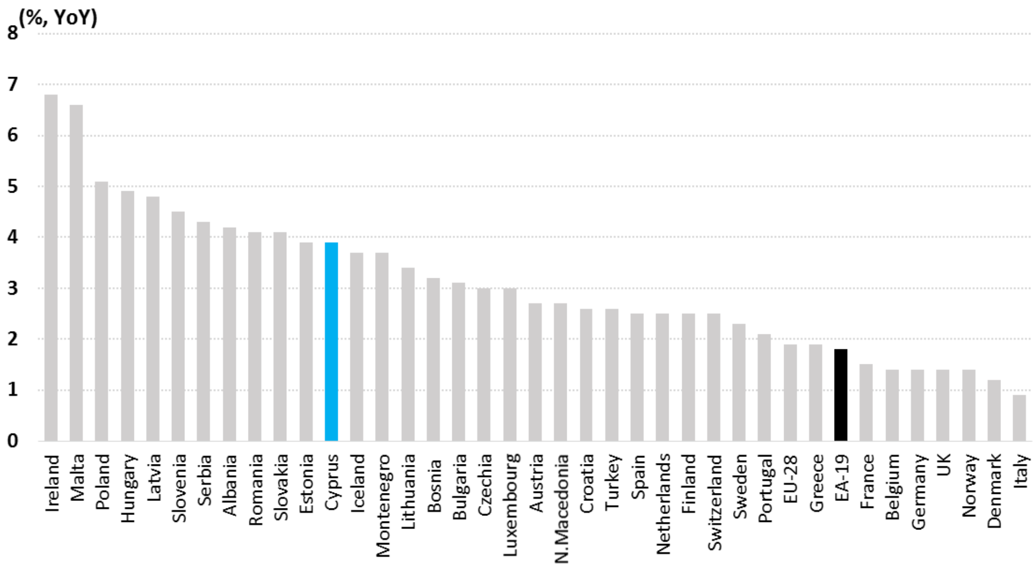
- Final consumption made the strongest contribution. Final consumption expanded by 2.7% QoQ/5.3% YoY in Q4-2018, which is the highest reading in the post-Lehman period, up from 1.0% QoQ/3.8% YoY in Q3-2018 compared to 1.0% QoQ/3.4% YoY in Q4-2017.

- Investments (-11.1% QoQ/-16.5% YoY in Q4) made a negative contribution to this quarter's GDP, being a lot less buoyant relative to previous quarters.
- The concomitant imports decline on an annual basis (-6.3% YoY in Q4 vs. 5.9% YoY in Q3), if combined with the mediocre exports performance (-0.9% YoY in Q4 vs. -7.2% YoY in Q3) resulted in net exports' contribution becoming positive, thus offsetting the negative contribution of investments.

2.2. In 2018, full year GDP growth remained close to its post Lehman period high

CYSTAT presented the finalized data of the national accounts for 2018 and announced the upward revision of the national accounts data for 2017 in both nominal and real terms. According to the finalized data,[1] real GDP expanded by 3.9% in FY2018 compared to 4.5% in 2017, 4.8% in 2016 and only 2.0% in 2015.

Figure 2: 2018 annual real GDP growth in Cyprus above EA19 growth



Source: Eurostat, Eurobank Research

The data revision[2] showed that in 2017 the economy had rebounded from the earlier recession even faster than previously thought: The real GDP growth rate of 2017 was further revised up to 4.5% from 4.2%, against an initial announcement of 3.7%. As a result, the level of GDP in 2017 in constant prices already stood 0.5% above the level of 2008 and 3.8% above the level of 2012. Therefore, after the revisions and factoring in the performance of

[1] GDP for the year 2018 is provisionally estimated at €20.730,9mn at current prices compared to €19.648,7mn in 2017 and €20.290,2mn at volume measures (Reference year 2010 - chain linking method)

[2] Earlier on, the Statistical Service had revised the real GDP growth rate of FY2016 to 4.8% compared to 3.4% in the second estimate and only 3% initially announced. http://www.cystat.gov.cy/mof/cystat/statistics.nsf/All/E99702C8D4AB3B9CC225830100351BD0?OpenDocument&sub=1&sel=1&e=&print

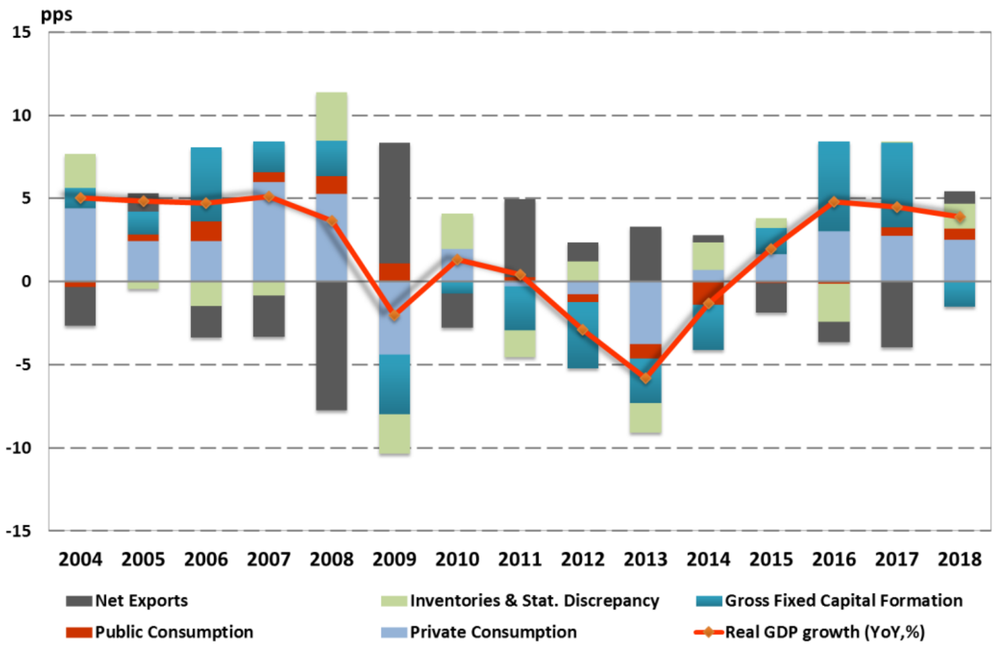
the past year, the level of GDP in 2018 now stands 4.4% above the 2008 level and 7.8% above the 2012 level.

The FY2018 real GDP growth rate still stands very close to the post-Lehman period high, recorded in 2016. From a cross-country perspective, the real GDP growth rate of Cyprus is among the highest in Europe. It is the seventh highest growth rate among Euro Area members (behind Ireland, Malta, Latvia, Slovenia, Slovakia and Estonia) and 2.5 times the average 2018 growth rate in the Euro Area (Figure 2). The full year output reading vindicated our earlier forecasts and expectations that the solid performance of the Cypriot economy would continue and upside risks to the consensus forecasts existed because of the outstanding investments performance.

2.3. Demand side growth components: Investments had their lowest contribution to GDP growth compared to the two earlier years, while consumption remained strong

From a demand point of view, final consumption dynamics were strong for yet another year. The final consumption rebound relative to the earlier recession continued into 2018, making a combined +3.2ppts contribution to GDP growth (Figure 3). The contribution of final consumption consists of the contribution of public consumption (0.7ppts in FY2018 vs. 0.5ppts in FY2017 vs. -0.1ppts in FY2016), which was positive for a second year in a row the first time since 2009, and that of private consumption (2.5ppts in FY2018 vs. 2.7ppts in FY2017). Private consumption expanded by 3.7% YoY in 2018, down from 4.1% YoY in 2017 and 4.5% YoY in 2016. Public consumption expanded by 4.3% YoY in FY2018, up from 3.1% YoY in in 2017, switching from -0.8% YoY in 2016.

Figure 3: Final consumption was the main driver of GDP growth in 2018



Source: CYSTAT, Eurobank Research

The consumption rally is underpinned by a number of factors, which all boil down to the rise of disposable incomes and the propensity to consume, namely: The sustained 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 fiscal relaxation after the graduation from the programme and the acceleration of public consumption in 2H-2018.

As far as the other growth components are concerned, there are two points to make. First, total investments' had their lowest contribution in three years. Notwithstanding the performance of inventories building, investment spending in constant prices was lower on an annual basis. Having recorded two consecutive years of buoyant growth by 41.8% YoY in 2016 and 29.0% YoY in 2017, gross fixed capital formation declined by -7.1% YoY in 2018. As a result, the contribution of gross fixed capital formation became negative at -1.5ppts in 2018, down from 5.1ppts in 2017 and 5.6ppts in 2016. The negative contribution of gross fixed capital formation is fully offset by the positive one coming from inventories building,[3] so that the contribution of total investments or gross capital formation becomes nil.

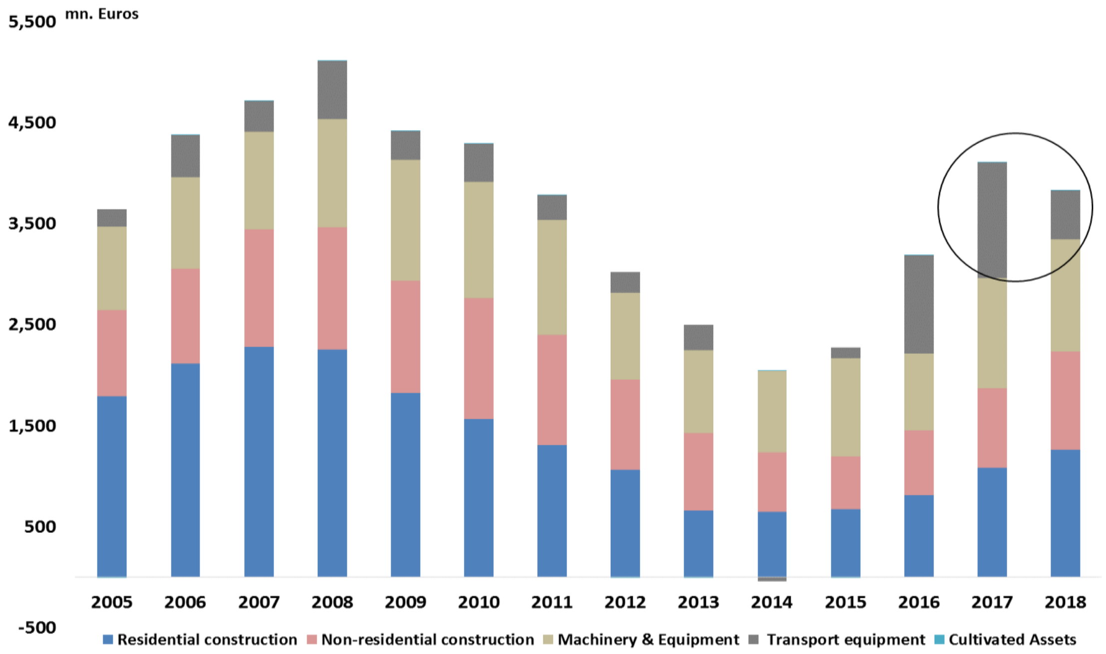
Looking deeper into the component statistics of investments, we conclude that this extraordinary outcome was driven by lower investments in transportation equipment, the latter most probably due to lower registration activity of ships (Figure 4). Investments in transport equipment (at current prices), which comprises of motor vehicles, ships and aircrafts, declined to €501.9mn in 2018, down from €1,187.9mn in 2017, lower by -57.7% YoY. The share of the aforementioned category in gross fixed capital formation was less than half on an annual basis in 2018 vs. a year ago (12.5% in 2018 vs. 28.1% in 2017, down from 31.0% in 2016, (Table 1). The performance of the two other key categories which refer to construction- both residential (+13.7% YoY) and other buildings (+25.8% YoY)-was very supportive to investments.

Table 1: The composition of Investments *(% of Total)*

	2013	2014	2015	2016	2017	2018
Residential	28.7	35.1	32.3	27.6	28.7	36.6
Non-Residential	28.9	26.8	20.9	17.8	16.9	22.7
Machinery & Equipment	32.7	39.9	42.1	23.3	26.0	28.0
Transport Equipment	9.9	-2.0	4.9	31.0	28.1	12.5
Cultivated Assets & Livestock	-0.2	0.2	-0.1	0.3	0.2	0.2
Total Total (€mn., *current prices)*	100 2,562.5	100 2,052.4	100 2,302.5	100 3,264.0	100 4,220.1	100 4,024.3

[3] and the statistical discrepancy, which is calculated as a residual

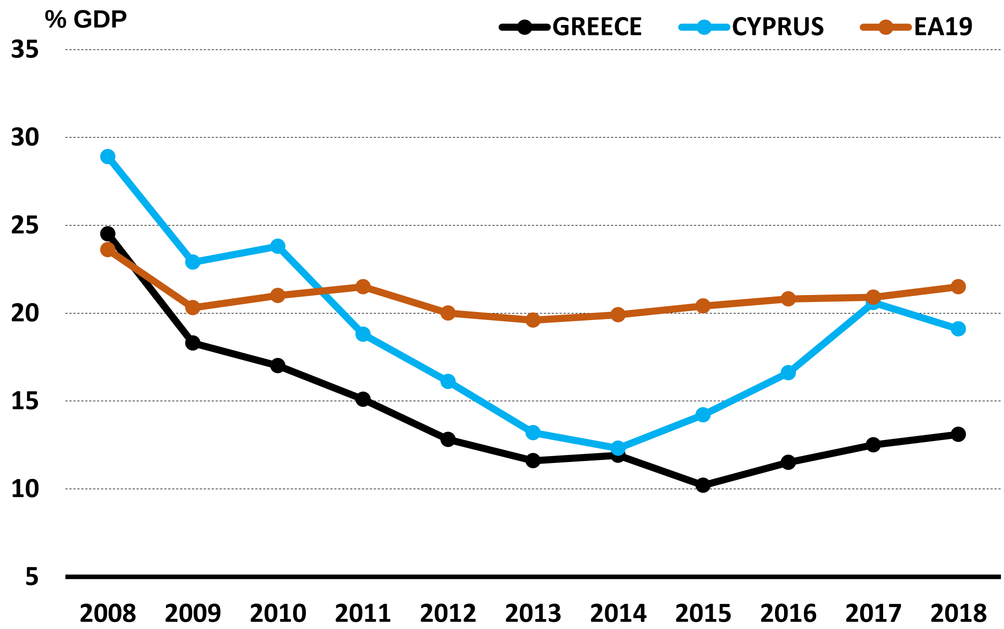
Figure 4: Gross fixed capital formation by type, 2005-2018



Source: CYSTAT, Eurobank Research

Overall, the ratio of total investments to GDP declined to 19.1% in 2018 down from 20.6% in 2017 - close to the EA19 average - up from 16.6% in 2016 and only 12.3% in 2014, 13.2% in 2013 and a pre-crisis high at 28.9% in 2008 (Figure 5).

Figure 5: Investments to GDP ratio



Source: Eurostat, Eurobank Research

The negative 2018 investments' performance was partially offset by the net exports' positive contribution, a trend we had witnessed again in 2014. The contribution of net exports amounted to 0.7ppts. In 2018 we actually witnessed a combined effect from both exports expanding by 3.3% YoY, and imports remaining contained at +2.0% YoY. The slowdown in export activity reflects a sizeable increase in the exports of goods' volume (+23.5% YoY in FY2018 vs. 0.3% YoY in FY2017). On top, exports of services failed to impress (-2.0% YoY in FY2018 vs. 7.6% YoY in FY2017) driven by lower activity in the sectors of gaming and financial services as a result of regulatory changes, while the record high tourist arrivals have not translated into a sizeable increase in revenues.

On the supply side, GDP dynamics were shaped by the steady performance of key sectoral pillars of the economy. Output in the sector entitled "wholesale and retail trade, transport, accommodation and food service activities" expanded by 4.8% YoY in 2018, *making a combined contribution of 1.1 ppts in 2018*, down from 6.5% YoY in 2017. The performance of these national accounts items reflects largely the robust private consumption dynamics and is being reinforced by the performance of the flourishing tourism industry, primarily in the summer months.

Construction accelerated its dynamic double-digit expansion, expanding by 24.7% YoY in 2018 compared to 27.5% YoY in 2017 and 16.6% YoY in 2017. Thus, the contribution of construction *increased to 1.4ppts in 2018* up from 1.3ppts and only 0.7ppts in 2016. In addition, the output in the sectors, entitled "Professional, scientific and technical activities; administrative and support service activities" which summarize the performance of the vibrant professional services sector, remained broadly stable at 6.4% YoY in 2018 compared to 6.6% in 2017.

Manufacturing, on the other hand, slowed to 5.6% YoY in 2018 down from 8.5% YoY in 2017.

Similarly, Financial Services continue to be a major exception to the upward momentum: They remained a drag on economic recovery, recording negative growth on an annual basis for a third year in a row. Financial services contracted by -5.5% YoY in 2018, down from -6.9% YoY in 2017 and -1.8% YoY in 2016. The negative contribution to GDP growth by the financial sector (-0.4ppts in 2018) reflects largely the bank restructuring activities (debt to asset swaps), write-offs and the ongoing deleveraging. Financial services have been in negative territory since Q3-2016. Nevertheless, the pace of contraction has slowed down in the last quarters.

2.4. Low labor productivity is a source of concern for the medium-term prospects

Real GDP growth can be decomposed into three underlying components of variation: Employment growth, labor utilization (labor hours/person employed) growth and growth in labor productivity (GDP/per hour worked). The results for the period 2007-2018 are presented in the following table.

Table 2: Decomposition of real GDP growth (YoY, %)

	Real GDP growth	Employment growth (# Employed)	Growth in Hours/ Person Employed	Labor Productivity growth (per Hour worked)
2007	*5.1%*	*4.4%*	*1.6%*	*-0.9%*
2008	*3.7%*	*3.5%*	*1.1%*	*-1.0%*
2009	*-2.0%*	*0.0%*	*-0.7%*	*-1.4%*
2010	*1.3%*	*0.5%*	*-0.7%*	*1.6%*
2011	*0.4%*	*0.0%*	*-0.8%*	*1.2%*
2012	*-2.9%*	*-3.2%*	*-0.4%*	*0.7%*
2013	*-5.8%*	*-5.9%*	*-1.6%*	*1.8%*
2014	*-1.3%*	*-1.8%*	*-0.5%*	*1.0%*
2015	*2.0%*	*1.5%*	*-0.1%*	*0.5%*
2016	*4.8%*	*4.6%*	*0.1%*	*0.1%*
2017	*4.5%*	*4.3%*	*-0.2%*	*0.4%*
2018	*3.9%*	*4.0%*	*-0.4%*	*0.2%*

Source: Eurostat, Eurobank Research

As shown in Table 2 above, the role of employment growth was pivotal in explaining the rebound and acceleration of real GDP growth in Cyprus in the period 2015-2018. The table shows employment growth has had the largest positive contribution to real GDP growth consistently from 2015 to 2018. The number of employed increased by 4.0% in 2018 (down from 4.3% in 2017 and 4.5% in 2016). At the same time, hours worked per employee have slightly declined. They declined by -0.4% in 2018, down from -0.2% in 2017 and 0.1% in 2016. Finally, labor productivity, defined by GDP/per hour worked, remained virtually stagnant throughout the 2015-2018 period. It increased by only 0.2% in 2018, down from 0.4% in 2017, 0.1% in 2016 and 0.5% in 2015.

Low labor productivity growth is a source of concern for the medium-term growth prospects of the Cypriot economy. Given that consistent employment gains cannot be easily sustained for a prolonged period, without productivity growth the high growth rates we have seen may disappear in the medium term. The key to addressing productivity expansion is to accelerate structural reforms (in goods markets, the public sector, etc.). Moreover, in order to boost total growth in the long-term, complementary strategies would be needed to attract more high quality human capital and to address the problem of the ageing population.

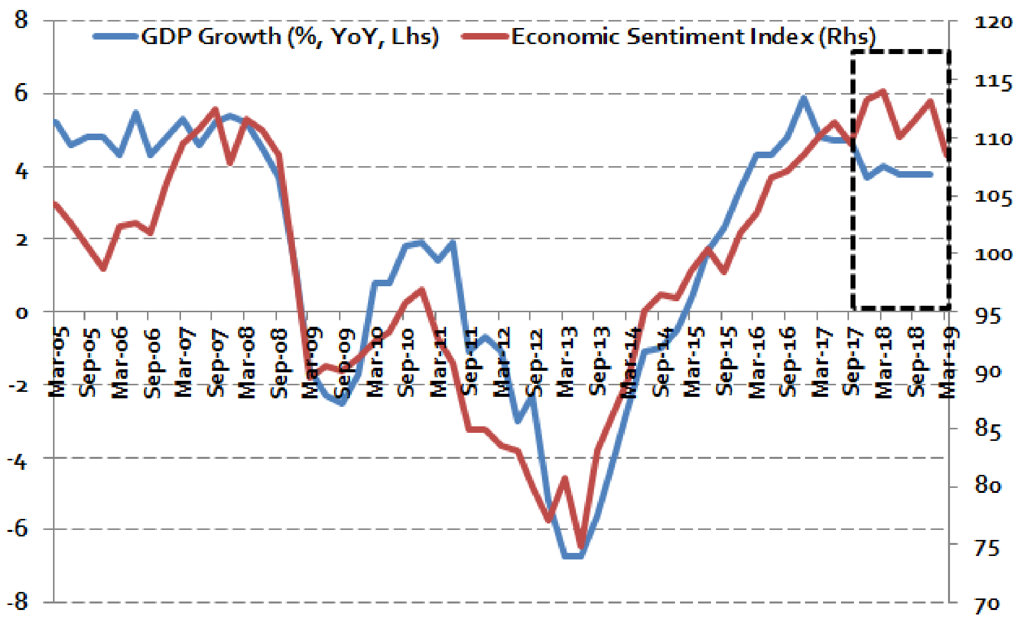
2.5. Should we worry about the slight decline in Economic Sentiment in Q1-2019?

Figure 6a shows a slight decline in the index of economic sentiment (ESI) in the first quarter of 2019. The figure also shows its movements are highly correlated with the movements of economic growth. Hence the question: Is the recent slight decline in sentiment a red flag for growth?

Economic sentiment does provide a warning signal for future growth, yet the relationship is not one-to-one. A drop in sentiment does not always forecast a drop in GDP growth. For example, the earlier sentiment slump in May-June of the past year – an extraordinary event likely related to the negative news surrounding the resolution of Cyprus Cooperative Bank (CCB), was not followed by a GDP slowdown in Q2- or Q3-2018. The cumulative decline of the ESI index in the first three months of 2019 seems to be comparable to that event, namely it seems to be driven by external factors unrelated to domestic economic events.

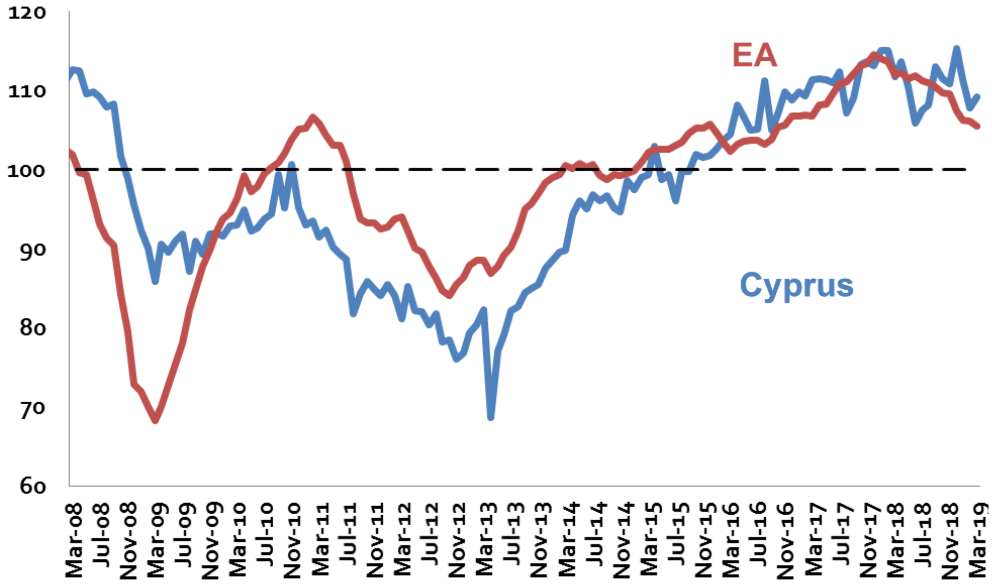
In our view, the decline in economic sentiment in the first quarter of 2019 likely reflects rising global uncertainties and trade disputes. To some extent, it is also correlated and synchronized with the ESI index declining trajectory in the full Euro Area (Figure 6b). It follows that if global uncertainties and trade disputes subside in the 2H-2019, we would expect some sentiment normalization as well. If not, then the impact on the short-term prospects of domestic economic activity would become more pronounced. Cyprus, a small and open economy, cannot go unscathed in case the world environment loses its growth momentum. We will be looking for further evidence in the direction of rising global uncertainties in the next few months.

Figure 6a: Economic Sentiment & Economic Growth in Cyprus



Source: CYSTAT, Eurobank Research

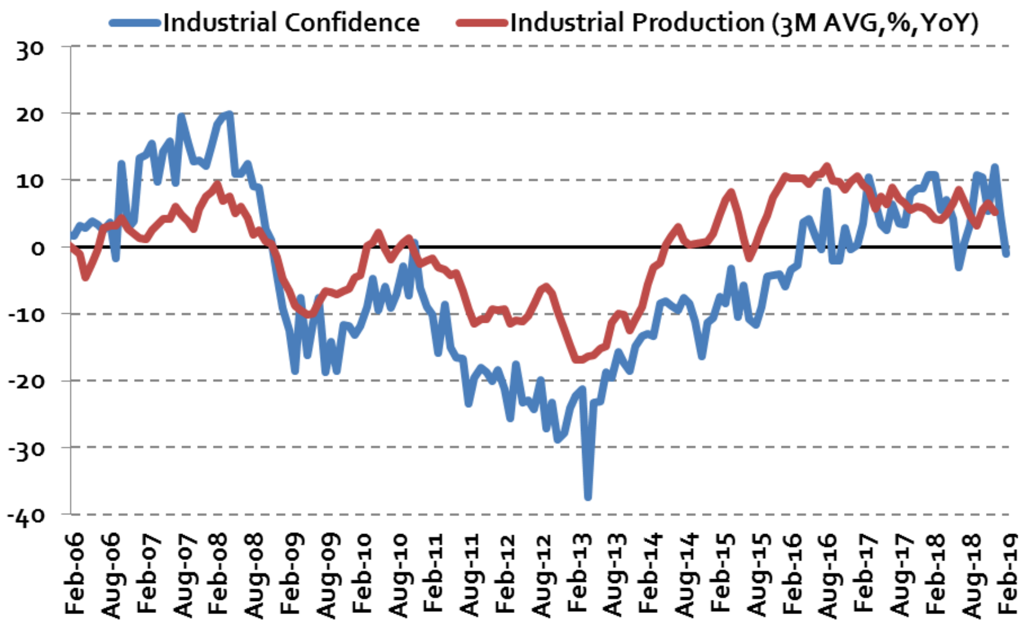
Figure 6b: Economic Sentiment in Cyprus vs. Euroarea



Source: Eurostat, Eurobank Research

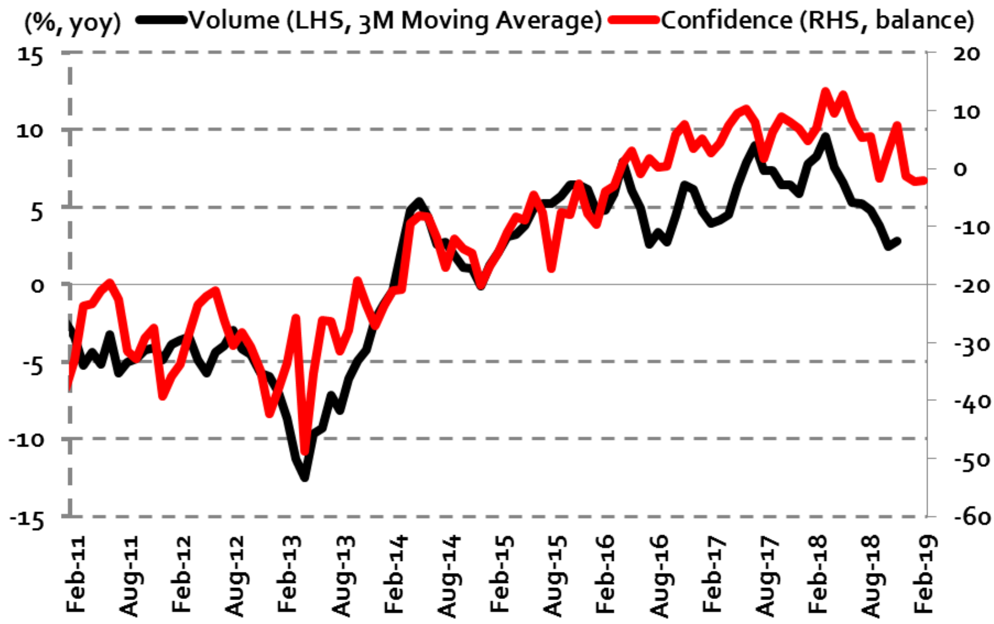
Elsewhere, high frequency leading indicators were performing relatively well in Q1-2019, yet visible signs that that we may have seen the peak of the economic cycle are slowly creeping up (Figure 7a-7b).

Figure 7a: Industrial Production & Confidence in Cyprus



Source: Eurostat, CYSTAT, Eurobank Research

Figure 7b: Retail Trade & Confidence in Cyprus



Source: Eurostat, CYSTAT, Eurobank Research

2.6. International organizations increasingly recognize downside global risks in their 2019-2020 economic forecasts for Cyprus

2.6.1. In its Winter 2019 forecast, the EU Commission downgraded its 2019-2020 growth forecasts for Cyprus

The EU Commission downgraded the GDP growth forecasts for the Cypriot economy in its Winter-forecasts, published in February 2019 (Table 3). The EU Commission now sees Cyprus expanding at 3.3% in 2019, down from 3.5% in the Autumn-forecasts, unchanged from 3.3% in the earlier Spring-forecasts, up from 2.8% in the previous Winter-forecasts, and up from 2.7% in the previous Autumn-forecasts. GDP growth is now forecasted to decelerate to 2.7% in 2020 vs. 2.9% in the Autumn-forecasts.

The growth momentum is supported by solid private consumption, the latter driven by the boost in confidence and disposable incomes following further employment gains and higher wages. Public consumption is also expected to grow amid rising wages and employment in the public sector. In addition, Investment should make a positive contribution on the back of strong construction activity.

The EU Commission also underlined the risks from a forecasted less favorable external environment in 2019-2020. Slowing growth in the Euro Area and persistent uncertainties in major trading partners weigh on Cyprus' outlook and increase downside risks.

Table 3: EU Commission Forecasts for Cyprus

	2018		2019	
	Spring Forecast	Autumn/Winter Forecast	Spring Forecast	Autumn/Winter Forecast
GDP growth (%, YoY)	3.6	3.9/3.8	3.3	3.5/3.3
Consumer Prices (%, average)	0.7	1.3/0.8	1.2	1.3/0.7
Unemployment (% of Labour Force)	9.0	8.2	7.1	6.3
Current Account Deficit (% of GDP)	-9.0	-9.3	-9.7	-9.5

Source: EU Commission forecasts, Spring 2018-Autumn 2017-Winter 2019

2.6.2. In the conclusion of the sixth post-programme surveillance mission, Troika warned about increasing external headwinds to the economic outlook and urged Cypriot authorities to step up structural reforms

In late March, ESM published a statement on the occasion of the conclusion of the sixth post-programme surveillance mission to Cyprus. The mission comprised of staff of the European Commission, the ECB and the ESM which visited Cyprus in mid to late March.

The major conclusion of the mission was that although Cyprus expanded strongly by 3.8% in 2018 - driven by tourism and recovering domestic demand, it now faces increasing external headwinds and important national vulnerabilities. From that point of view, the growth momentum is expected to ease in 2019 on the back of a weaker external environment. These challenges are further compounded by key vulnerabilities of the Cypriot economy, notably the still very high levels of NPLs plus high private, public and external debt in a context of low productivity growth and high dependency on foreign capital flows.

In the fiscal domain, the mission's statement identified as the main outlook risks those related to the fiscal impact of the healthcare reform and the outcome of court rulings on past measures, which had been taken in order to reign in the public sector wage bill.

In the banking sector, the mission's conclusion called for a rigorous implementation of the amended foreclosure and insolvency frameworks in order to continue with NPLs resolution.

Overall, the Troika urged the Cypriot authorities to take advantage of the prevailing favorable economic conditions in order to step up the pace of structural reforms and boost potential growth.

2.6.3. The IMF mission's statement at the conclusion of the third post-program monitoring (PPM) discussions called for mitigation of vulnerabilities amid gathering headwinds

The statement of the IMF mission[4] at the conclusion of the third post-program monitoring (PPM) discussions called on Cyprus to mitigate the main vulnerabilities the economy is confronted with, as headwinds are threatening sustained economic growth. The mission acknowledged that economic growth has been strong - supported by construction, tourism and professional services - unemployment has declined further, while the underlying budget remains in a large surplus.

The IMF identified three key vulnerabilities: 1) reducing NPLs and strengthening bank profitability 2) avoiding procyclical fiscal policy and maintaining debt sustainability 3) strengthening structural reforms. It also stressed those domestic vulnerabilities could be exacerbated in the event of weaker than expected growth in Europe, or a hard Brexit.

On the banking sector, the IMF called for steadfast implementation of the amended legislative framework on foreclosures including e-auctions to address the troubled legacy assets. It also stressed the need to enhance the governance and supervisory framework for the recently-established asset management company. On the public finances, the IMF said spending growth should be firmly maintained at a pace below that of medium-term nominal GDP growth and cyclical and windfall revenues should be saved, to ensure a neutral fiscal policy stance, build up buffers, and anchor public debt on a firmly downward path. Finally, on strengthening structural reforms, the IMF prioritized the ongoing judicial reform which would help address the legacy of the crisis and improve the investment climate.

Table 4: IMF World Economic Outlook Forecasts for Cyprus

IMF WEO	2018		2019	
	Apr 2018 WEO Forecast	Oct 2018 WEO Forecast	Apr 2018 WEO Forecast	Oct 2018 WEO Forecast
GDP growth (%, YoY)	3.6	4.0	3.0	4.2
Consumer Prices (%, average)	0.4	0.2	1.6	1.0
Unemployment (% of Labour Force)	10.0	9.5	9.1	8.0
Current Account Deficit (% of GDP)	-4.1	-3.1	-4.6	-5.2

Source: IMF World Economic Outlook April 2018 & June 2018

The IMF now sees GDP growth reaching a still-robust 3.0-3.5% in 2019–20, from 3.9% in 2018, led by foreign direct investment. The above growth forecasts represent a newer and

[4] https://www.imf.org/en/News/Articles/2019/03/27/mcs032819-cyprus-staff-concluding-statement-of-the-third-post-program-monitoring-mission

less optimistic assessment. They were not present in the IMF's earlier flagship publication, namely the October World Economic Outlook (WEO) or the Executive Board statement on the occasion of the conclusion of the Article IV consultation with Cyprus in last December. [5] At that time, the Executive Board had assessed the near-term outlook as favorable, expecting GDP growth to remain at around 4.2% in 2018–19, supported by the services sector and largely foreign-financed investments.

The IMF flagship publication in October had upgraded its forecasts to reflect the ones prescribed earlier in the second post-program staff monitoring report of June[6] (Table 4). In terms of the macro-outlook of 2018-2019, the WEO forecasted GDP growth inching up to 4% in 2018 and 4.2% in 2019. The average inflation projection in 2018 was raised to 0.8% in an illustration of upside price pressures throughout the year so far, up from 0.2% in the June monitoring report, while it is further seen at 1% in 2019. Unemployment was seen to decline from a projected 9.5% in 2018 down to 8% in 2019. The current account was seen as widening from 3.1% of GDP in 2018 to 5.2% in 2019.

2.7. Growth Outlook 2019: Healthy but slowing

The precise growth picture for next year is somewhat mixed. As already mentioned in the previous Quarterly Economic Monitors, the economy has past its cyclical peak. GDP growth dynamics peaked in 2017, moved lower in 2018 and now are decelerating towards more sustainable levels in 2019-2020. The primary question is not whether current year's GDP growth rate is going to be higher or lower relative to the growth of 2018. The question is how big the slowdown will be. Given the progress recorded so far in the previous years, we expect the slowdown not be a sharp one.

We anticipate the main trends for this year to be:

- **Healthy final consumption dynamics**. Having expanded robustly in the last three years, we anticipate final consumption to grow at a healthy speed. That would be the combined effect of two factors. First, it would be based on the assumption that public consumption remains equally strong compared to last year on higher employment and wages. Second, private consumption is expected to be relatively less strong but still very sound. It will receive support from sustained sentiment improvement, reflecting the turn-around of the economy in the past three years, from a tight labor market as unemployment has reached single-digit levels and from the protracted impact on disposable incomes. The latter originates first from earlier fiscal relaxation, reflecting the abolishment of the property tax and the levy on personal tax and second, from inflated expectations for wage increases driven by the improvement in macroeconomic environment.

[5] https://www.imf.org/en/News/Articles/2018/11/30/pr18448-cyprus-imf-executive-board-concludes-2018-article-iv-consultation
[6] https://www.imf.org/~/media/Files/Publications/CR/2018/cr18153.ashx

- **Investments continue expanding, yet their contribution to GDP growth arithmetic remains uncertain**. Investment is a very critical component for the GDP growth dynamics in 2019 and a key source of uncertainty of the forecast. In contrast to other economies, it is very difficult to make a precise forecast for Cyprus because of the importance of the shipping industry in shaping up total investment. The value of ships registered and unregistered is volatile and is disproportionally large for the small size of the economy, thus making a huge difference in the performance of the investment statistics.

  Despite the shipping volatility, total investments have been expanding on average by 17.3% YoY in 2015-2018, driven by buoyant construction activity.[7] The “citizenship through investment” program had a pivotal contribution to this. Investments are broadly expected to register a lower, yet still relatively strong expansion rate in 2019, as there are still many construction projects in the pipeline. Yet the uncertainty about the shipping registration activity contribution could either neutralize or exacerbate that impact.

- **The contribution of net exports is going to be challenged in a volatile and unfavorable world economic environment**. Exports, particularly the tourism sector, are going to be under pressure because of the rise of competition from neighboring countries and the slowdown in the Euro Area.

Factoring in all the above, our baseline scenario is for GDP growth to remain robust around 3.3% in 2019. Risks and challenges to our forecast view do exist.

- On the upside, risks originate from a positive surprise on the volatile investment.
- On the downside, risks stem from:
  - High NPEs ratio & high private indebtness: Even though a big chunk of NPEs has been removed from the banking sector balance sheet, those have remained in the broader economy. Lack of speed in their reduction or further delays in the implementation of the “ESTIA” plan may induce moral hazard and undermine confidence in the financial sector.
  - Reforms fatigue: There is a substantial unfinished reforms agenda, in which the government needs to demonstrate more willingness to take action. Cyprus seems to be missing an opportunity at today’s good times to fix its investment climate and increase its growth potential.
  - Risks to macroeconomic policy: Backtracking from prudent macroeconomic policies could result either from the fiscal risks from the court decisions or the lack of majority in Parliament.
  - Hard Brexit: Cyprus is among the EU countries with significant trade ties with UK.
  - Political risks of a geopolitical event in the Eastern Mediterranean sea.

[7] The relevant number is 19.4% for gross capital formation, that is to say if inventories and statistical discrepancy is includedde19.4% YoY

3. Main economic events of 2018 in detail

In this section, we present in more detail the main economic events of the outgoing year.

3.1. Cyprus regained investment grade status for the first time since 2011

In September 2018, 2.5 years after its exit from the economic adjustment program in late March 2016, Cyprus regained its investment grade status for the first time in the post-Lehman era.

On September 14, 2018, **S&P** was the first rating agency to **upgrade** the long-term sovereign rating of Cyprus in the post-Lehman era by one notch from BB+ **to BBB- with a stable outlook**. According to S&P, the decision reflects three main views. First, it is based on the assumption that the Cypriot economy will continue to grow at a solid pace on average by 3.25% (4% in 2018 and by 3% on average in 2019-2021) throughout the forecast horizon until 2021, supporting a further reduction in the debt burden. Second, S&P praised the recent government measures to reduce the volume of NPEs via financial support and legislative changes, which have improved the banking system's health and are likely to facilitate further recovery efforts. Finally, S&P assessed that any additional financial state support to the banking sector will only moderately affect the sovereign balance sheet. The stable outlook balances the view of Cyprus' strong growth prospects against its still highly leveraged public and private balance sheets. S&P could consider raising the ratings of Cyprus over the next two years if the economy deleveraged significantly.

On October 19th, **Fitch** became the second rating agency to **upgrade** the long-term sovereign rating of Cyprus in the post-Lehman era by one notch from BB+ **to BBB- with a stable outlook**. According to Fitch, the decision reflects the expectation that Cyprus will maintain its prudent fiscal policy which, along with the buoyant revenues, will maintain a high fiscal surplus at 2.4% and 2.2% of GDP in 2019 and 2020 respectively, compared with 3.1% and 2.9% targeted in the 2019 Draft Budgetary Plan. Accordingly, the public debt to GDP ratio will remain on a firm downward trajectory, despite a one-off expected increase to 104.4% in 2018. Moreover, the rating agency acknowledged the decisive action to address the legacy issues of the banking system, both in the area of strengthening the regulatory framework as well as the carve-out of the CCB NPEs (ca. €5.7bn).

On November 23th, **DBRS** became the third rating agency to upgrade the long-term sovereign rating of Cyprus to investment grade status in the post-Lehman era. More specifically, DBRS upgraded the long-term sovereign rating by two notches from **BB low** to **BBB low** with a stable outlook (they call it "trend"). The upgrade decision was driven by the material reduction of NPEs, which reflects the stepped up efforts of both the government and banks to reduce NPEs. Moreover, the rating upgrade is also driven by the solid performance of the Cypriot economy, one of the strongest growth rates in the Euro-area. According to the DBRS, risks to the ratings are broadly balanced. The ratings could come under upward pressure from sustained healthy economic growth and a sound fiscal position as well as progress in reducing private sector debt and banking system NPEs. On the other hand, the ratings could come under negative pressure in a period of significantly weak growth, combined with large fiscal imbalances or materialization of large contingent liabilities.

Earlier, on July 27, **Moody's** had **upgraded** the long-term sovereign rating of Cyprus by one notch from Ba3 **to Ba2 with a stable outlook**. According to Moody's, the decision for the upgrade reflected two main drivers: First, the ongoing recovery of Cyprus' banking system through the liquidation process of Cyprus Cooperative Bank (CCB), and second, the positive fundamental trend of the government's balance sheet, which is based on a robust nominal growth and a primary surplus, irrespective of the one-off increase related to the recent CCB transaction. The stable outlook on Cyprus's Ba2 ratings balances Cyprus's strong fiscal dynamics against pressures for higher public expenditure. It also reflects uncertainty around the extent to which new legal tools will enable a material decline in the banking system's non-performing loan (NPL) ratio. Moody's would consider changing the outlook to positive and eventually upgrading the rating if macroeconomic conditions and actions of the Cypriot government would lead to a significant decline in the government debt stock and in the stock of non-performing loans in the domestic banking sector. Downward pressure that could lead to a negative outlook and eventually to a downgrade of the rating could develop if growth or fiscal policy decisions were to cause a reversal of the supportive fundamental debt trend. A failure to translate recent legislative actions and interventions in the banking sector into a significant decline in the non-performing loan ratio would also be credit negative.

Overall, all major rating agencies (FITCH, DBRS, Moody's and now S&P) upgraded their long-term sovereign rating of Cyprus in 2018, awarding at least one notch in their respective rankings. Following the last round of assessments, there still remains a **slight divergence** of views between the rating agencies on the sovereign rating of Cyprus (Table 5). Moody's is the only agency among the four major ones which classifies Cyprus two notches below investment grade status.

In the following table we present the sovereign rating review calendar of 2019.

Table 5: Sovereign Rating Review Calendar 2019

Fitch	April 12th	October 11th
S&P	March 8th	September 6th
Moody's	March 29th	September 20th
DBRS	May 17th	November 15th

Table 6
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 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)

On March 29th, Moody's became *the second* agency in a row to postpone the scheduled sovereign rating assessment of Cyprus. Recall, that Standard & Poor's postponed its own on March 9th. This is not the first time rating agencies do. For instance, Moody's had done the exact same thing in February 2018. Nevertheless, it was widely expected that Moody's would upgrade the sovereign rating of Cyprus by at least one notch. In the press release, Moody's cited that that it had completed a periodic review of sovereign issuers which includes Cyprus. However, it clarified that the review did not involve a rating committee, and its publication does not announce a credit rating action and is not an indication of whether or not a credit rating action is likely in the near future.

According to Moody's, the credit profile of Cyprus is supported by the country's moderate economic strength, which reflects the country's 2% medium- to long-term growth potential and balances the country's high wealth levels against its small size and relatively undiversified economy. Cyprus's high institutional strength reflects both the effectiveness of domestic institutions and the fact that the country defaulted on private-sector obligations in 2013; Its moderate fiscal strength, takes account of the country's high debt burden as well as its affordable debt-servicing burden; and its high susceptibility to event risk is driven by the still-substantial risks that persist in the banking sector given high levels of NPEs.

3.2. Cyprus maintained access to international capital markets at favorable terms in 2018-early 2019

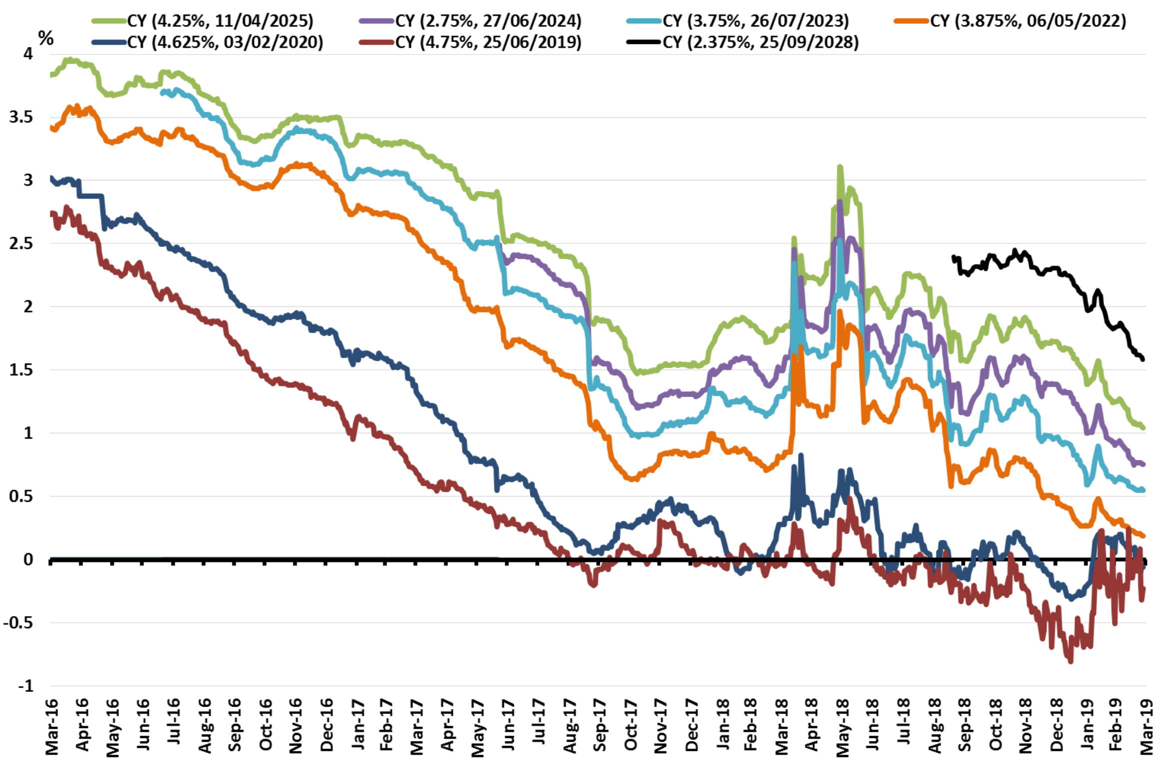
Cyprus enjoys uninterrupted access to international capital markets. In mid-September 2018, it tapped international markets with a new 10Y-Eurobond for the third time after exiting from the Economic Adjustment Programme in March 2016. It was issued at the lowest cost ever achieved in a benchmark bond issuance. In that tender, the Public Debt Management Office (PDMO) sold an offered amount of €1.5bn instead of the €1bn initially planned of 10-year government bonds. JP Morgan, Morgan Stanley and SG CIB were appointed by the Cypriot government as joint lead managers. The issue was heavily over-subscribed with total bids amounting to €5.5bn. Following the competitive bids, the average accepted price was at 99.686 and the corresponding yield at 2.40%. The latter yield compares with an initial guidance of 2.6%. The issue matures on June 27, 2028 and bears a 2.375% fixed annual coupon.

Subsequently, in late February 2019, the Public Debt Management Office (PDMO) sold an offered amount of €1bn of 15-year government bonds for the first time in its history. Citi, Goldman Sachs and HSBC were appointed by the Cypriot government as joint lead managers. The issue was heavily over-subscribed with total bids amounting to €8.1bn. Following the competitive bids, the average accepted price was at 99.903 and the corresponding yield at 2.758%. The latter yield compares with an initial guidance of 3.008%. The issue matures on February 26, 2034 and bears a 2.75% fixed annual coupon. Part of the proceeds of the issue will be utilized to repay two installments of €312.5mn of the bi-lateral loan with Russia. The total gross borrowing needs of Cyprus amount to €1.6bn or 7.3% of projected GDP in 2019.

Until mid-September, the lack of investment grade status prevented 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. Following the upgrade, the ECB announced that the Cypriot bonds became eligible and that it has started buying Cypriot bonds within the framework of the Quantitative Easing program. The press release added that "*the Eurosystem's pace of purchase in Cypriot government bonds will take the specific market liquidity situation of the Cypriot government bond market into account in calibrating a gradual and measured increase in Eurosystem holdings towards Cyprus's share in the ECB capital key*". The Quantitative Easing Program ended at the end of December for all of the Euro Area. Yet in the future the ECB would be able to keep appropriate amounts of Cypriot and other Euro Area bonds it originally bought by refreshing its buying at the maturity of those bonds.

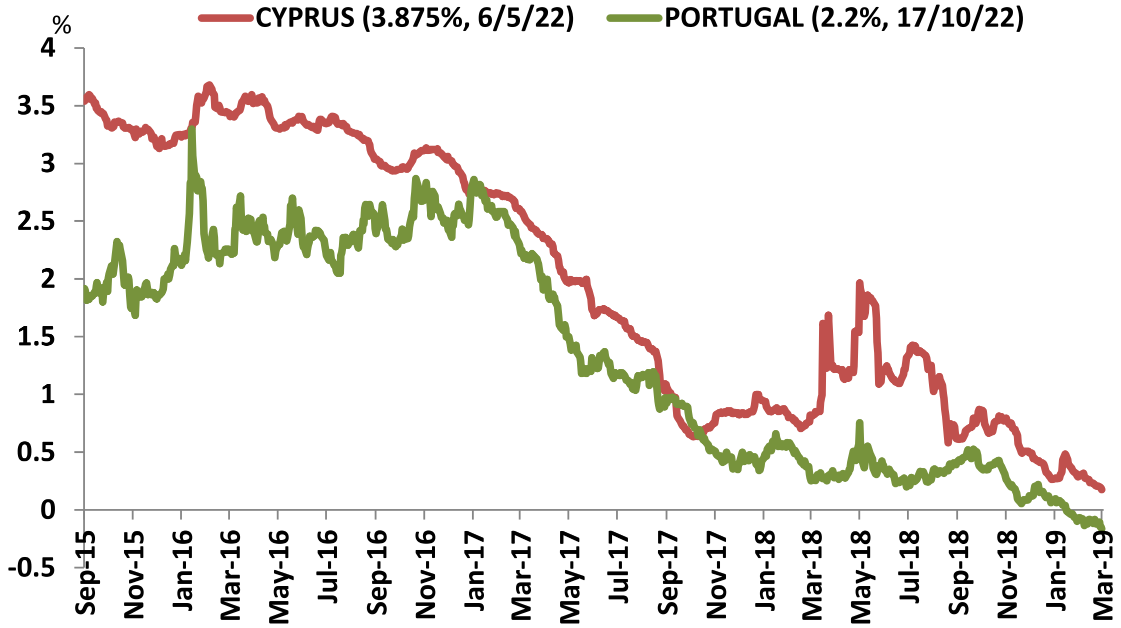
Despite not participating in ECB's QE, the medium-term Cypriot bond yields were on a declining trend since March 2016, which was interrupted for six months by market fears for the CCB resolution. Yet upon the parliamentary approval of the state guarantees for the asset protection scheme attached to the CCB assets acquired by of Hellenic Bank and the revamping of the foreclosure and repossession frameworks in early to mid-July, government yields declined sharply (Figures 8a-8b).

Figure 8a: Annualized Yields to Maturity of outstanding Cypriot Government Bonds



Source: Bloomberg, Eurobank Research

Figure 8b: 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.

3.3. Cyprus banking: The Gordian knot is cut but challenges remain

During 2018 the domestic banking sector map was redesigned. The rapidly evolving case of the Cyprus Co-operative Bank (CCB), the second largest bank in terms of assets in the domestic market at the time, dominated the agenda throughout the past year and its impact is expected to keep our attention in the medium-term.

The privatization process of CCB, initiated by the government in late March 2018, resulted in its ultimate liquidation. The liquidation involved the acquisition of its performing assets by Hellenic Bank and the transfer of NPEs to a state-owned entity, which was set up for that purpose. On top, the Cypriot government introduced the "ESTIA" subsidy scheme to help vulnerable groups of borrowers, while the insolvency and foreclosures frameworks were further reformed for the first time since 2014-2015.

3.3.1 Cyprus recorded the highest decrease in NPEs among EU-28 in 2018

The resolution of CCB was a game changer in the battle to address the thorny issue of NPEs. The sizeable amount of removed NPEs (€5.6bn) from the banking sector reflecting the carve out of the Cyprus Cooperative Bank (CCB) bad loans- allowed for an important -but one-off-decline in the NPEs ratio further down to the level of 30% in September 2018. Please also note that the aforementioned official Central Bank statistics for the NPEs as of June 2018 have already mirrored the Bank of Cyprus (BOCY) securitization transaction with Apollo (€2.8bn)-to be approved by SSM by late 2018 or early 2019.

According to latest data released by the Central Bank of Cyprus, the stock of non-performing exposures (NPEs) posted a minor increase by €10mn in November on top of a small increase by €87mn in October, compared to a sizeable drop of €5.6bn in September, after registering minor decreases of €15mn in August and €10mn in July and a large decrease of €3.3bn in June. Over the longer period from December 2014 to November 2018 the stock of NPEs is down by 59.3% (from €27.3bn in December 2014 to €11.1bn in November 2018).

At the same time deleveraging of the banking sector continues. Having decreased by €6.6bn from €41.3bn in June 2018 to €34.6bn in September 2018, loan exposures (performing plus non-performing) expanded by €42mn in November, which is a higher increase than the rise in their non-performing component alone. Despite the loans rise, the ratio of NPEs (non-performing to total exposures) remained flat at 31.8% in November vs. the previous two months, down from 40.3% in June 2018. Yet the ratio is much lower than the 43.7% in December 2017, 47.2% in December 2016, 45.8% in December 2015 and 47.8% in December 2014 (Figure 9).

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 (€4.9bn out of €7.1bn in November 2018).

NPEs remain the elephant in the room, an issue we have consistently highlighted in all our previous reports. As of June 2018, the ratio in Cyprus is the second highest in the Euro Area behind Greece. Moreover, the stock of NPEs appears bigger when measured relative to the size of the economy. As of November 2018, the NPEs as a percentage of 2018 GDP stood at 53.6% - below the 100% threshold - compared to 104.7% in December 2017- down from 128.8% in December 2016, compared to 150.3% in December 2015 and 155.2% in December 2014.

Following the carving-out of NPEs from the banking sector, the new country challenge is how to handle them at the level of the established management company. Smooth handling necessitates the implementation of a transparent, professional, efficient and publicly accountable governance framework. The success of this management company is crucial not only for the recoverability of the NPEs – that would minimize the cost to the taxpayer – but also because failure to deliver could induce moral hazard in the rest of the system.

3.3.2 Further progress on the issue of NPEs relies on the implementation of the amended insolvency and foreclosures framework and the ESTIA scheme

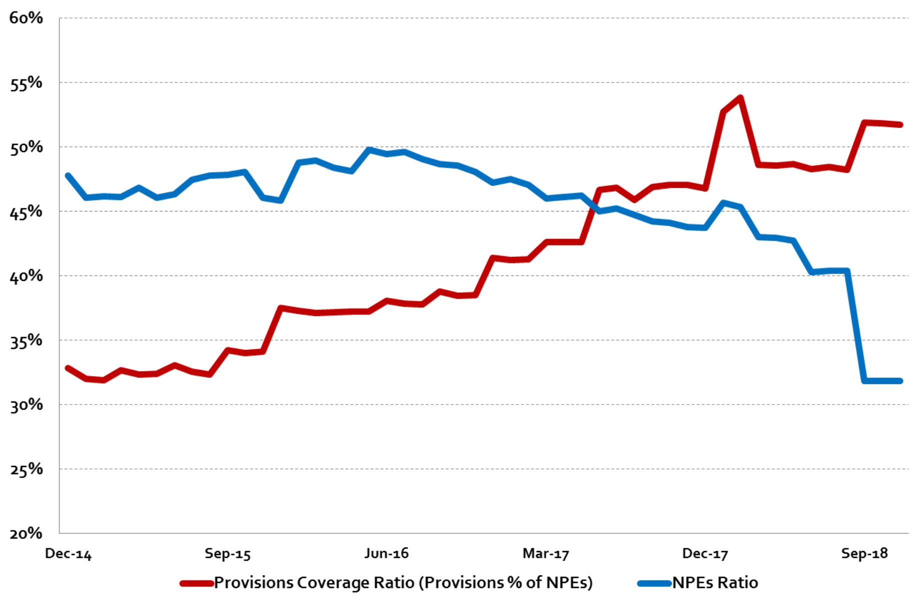
Further progress on the NPEs issue hinges upon two more game-changing factors: 1) the implementation of the reformed insolvency and foreclosures frameworks, and 2) the government-subsidized ESTIA plan. Regarding the first item, the adoption of the new insolvency and foreclosures laws by the parliament without any amendments has created optimism that the new framework will empower banks to pursue strategic defaulters more efficiently than previously. Regarding the second item, the government has drafted and made public the so-called ESTIA plan,[8] a subsidy scheme introduced to help vulnerable groups of distressed borrowers.[9]

The ESTIA scheme incentivizes both creditors (the banks) and debtors (borrowers) to come into an agreement on restructuring the non-performing mortgage loans for primary residence. The lender is required to offer a restructuring of the loan to eligible borrowers. The bank undertakes the responsibility to restructure the mortgage loan and forgive the loss coming from the difference between the market price and the book value of the collateral. Then, eligible borrowers – households and micro companies would receive a government subsidy equal to one third of their monthly installment, provided that their restructured mortgage loans are secured against their primary residence and they resume servicing the other two thirds of their monthly payment. If the borrower stops servicing its loan, it is foreseen that the bank initiates the foreclosure of the property.

Earlier, on December 3rd, the European Commission approved the "ESTIA" plan,[10] concluding that the scheme is well-targeted, is limited in time and scope and would not create undue distortions to competition, the latter required by the EU state aid rules. The scheme, which has an annual budget of around €33mn, sets strict eligibility criteria in terms of the value of the primary residence (a maximum value of €350,000) and income of the borrower to ensure it is targeted at those in need. The revised version of the scheme ties eligible borrowers' income upon their marital status and the number of their family members. As a result, the scheme foresees a ceiling of €20,000 for singles, €35,000 for a married couple, €45,000 for a married couple with one sibling, €50,000 for a married couple with two siblings, €55,000 for a married couple with three siblings and €60,000 for a married couple with four children or more. More importantly, the net other assets of the eligible borrowers cannot exceed 80% of the market value of the primary residency (instead of 120% in the previous version of ESTIA) or the absolute amount of €250,000.

[8] http://mof.gov.cy/assets/modules/wnp/articles/201807/427/docs/estia_021118_en.pdf
[9] http://mof.gov.cy/assets/modules/wnp/articles/201807/427/docs/estia_scheme_31_10_2018_final.pdf
[10] http://europa.eu/rapid/press-release_MEX-18-6649_en.htm

Figure 9: Banking Sector Provisions Coverage & NPE ratio



Source: Central Bank of Cyprus, Eurobank Research

Despite the Commission approval, the announced criteria of eligibility for ESTIA have been heavily criticized publicly as overly generous and inducing moral hazard. The endorsement of the scheme was subject to a heated debate among political parties in the parliament, in which the ruling party (DISI) doesn't hold parliamentary majority. Ultimately the parliament endorsed the plan under the condition that the releases of the funds would be subject to the approval of the committee on budgetary and financial affairs on an annual basis.

In late January of this year, the parliamentary committee on budgetary and financial affairs approved the release of the funds designated for the ESTIA government plan in 2019. The decision was taken by a majority vote. The ruling party Democratic Party Rally (DISI), Democratic Party (DIKO) and Solidarity Move voted in favor while the opposition parties of Progressive Party of Working People (AKEL), Movement of Social Democrats (EDEK) and Movement of Ecologists — Citizens` Cooperation voted against.

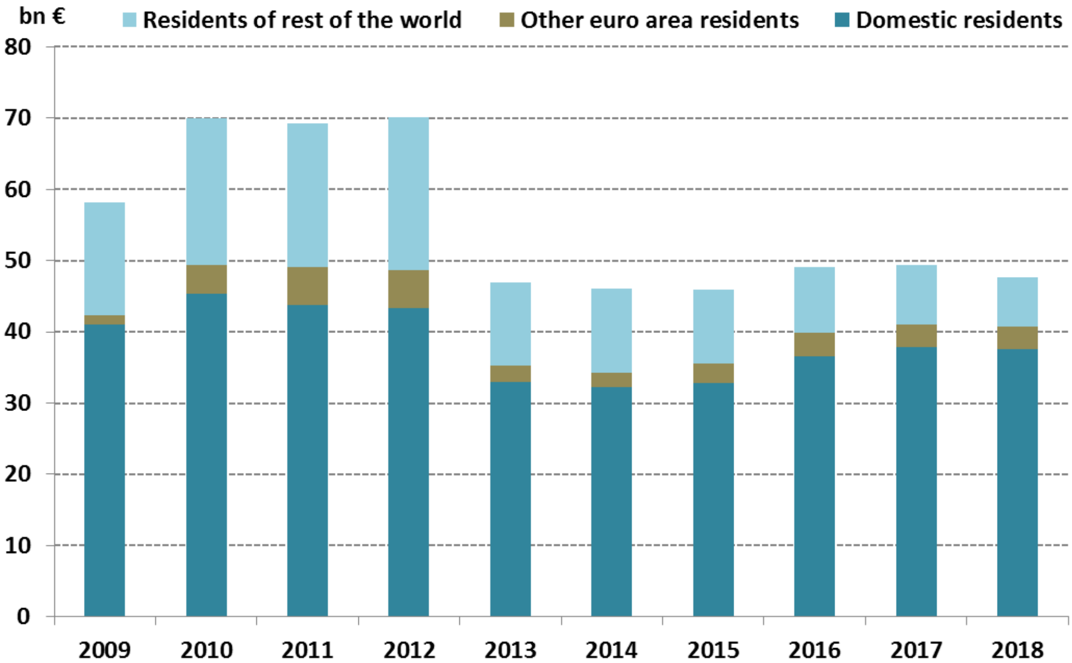
According to news media, at the time of the writing in late March, the implementation of the scheme has encountered further delays as the MoU draft between the banks and the state was under the scrutiny of the Legal Service and an online platform to collect the applications was still under construction.

3.3.3 Bank deposits recorded a decrease in 2018 for the first time in three years

Having expanded for two years in a row, bank deposits declined in 2018. Total deposits reached €47.9bn in December up from €47.5bn in November compared to €47.8bn in October up from €47.4bn in September, against €49.4bn in December 2017, compared to €49.0bn in December 2016 and €45.97bn in December 2015 (Figure 10).

From a flow point of view, total deposits recorded a net increase of 392.7mn in December, up from a net decrease of €272.7mn in November, up from a net increase of €299.7mn in October, on top of a net decrease of €230.4mn in September, against a net decrease of 176.3mn in August, on top of a substantial net increase of 796.4mn in July. The annual rate of expansion in deposits - which has been in positive territory since October2015 with the exception of only one month in March2018 –climbed again at 3.8% YoY in December up from 3.4% YoY in November down from 3.8% YoY in October-September, 3.1% YoY in Dec2017, compared to 6.2% YoY in Dec2016 and only 0.2% YoY in Dec2015..

Figure 10: Banking Sector Deposits



Source: Central Bank of Cyprus, Eurobank Research

Total loans in December exhibited a small net increase of €166.8mn in December up from a net increase of €40.2mn in November compared to a substantial net decrease of €976.5mn in October on top of a net decrease of €5.2mn in September, a net decrease of €187.2mn in August, and a net decrease of €74.7mn in July. The annual growth rate of contraction came at -2.6% YoY in December down from -3.0% YoY in November and October, up from -0.6% YoY in September, compared to - 1.7% YoY in December 2017 and -10.7% YoY in December 2016. The outstanding amount of loans reached €39.2bn in December compared to €39.9bn in November, virtually unchanged from October, up from €39.6bn in September, €45.9bn in August compared to €46.2bn in July vs. €51.4bn in December 2017 and €55.3bn in December 2016.

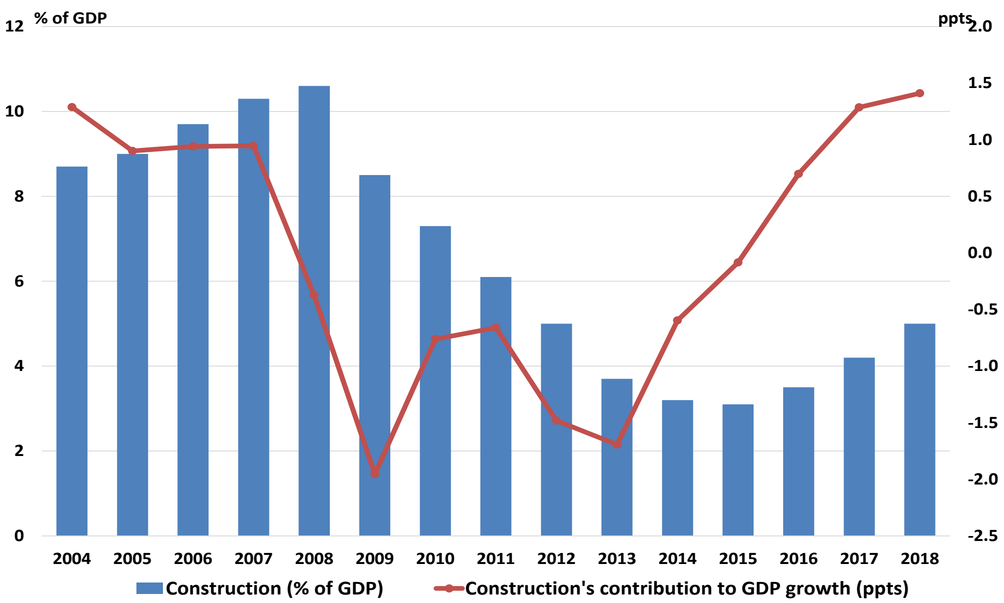
Overall, the deposits decline was orchestrated by the decline in the segment of the non-residents deposits. Out of the €1.5bn decline in total deposits, €1.4bn is explained by the withdrawals of non-residents. In contrast, the resolution of Cyprus Co-operative Bank (CCB) one of the key developments in the past year have changed the banking sector map. The government liquidity injection of €2bn in the banking system and the stabilization of depositors' sentiment after the absorption of the CCB's performing assets by Hellenic Bank coupled with the ongoing deleveraging process have allowed for an improvement in the domestic liquidity conditions. According to the latest available SSM data, the Cypriot Banking system enjoys the second highest liquidity coverage ratio – behind Slovenia-among Euro area members. The relevant ratio stood at 305.67% in Q3-2018 compared to above the euro area average of 140.93% and more than two times higher than the Basel III required threshold.

3.4. Cyprus' property market recovery is underpinned by the program citizenship through investment

Construction

Construction output has been expanding with double digits throughout 2018. On average, construction output was running at 17.7% YoY in 9M-2018 compared to 32.3% YoY in 9M-2017, up from 17.3% YoY in 9M-2016 and a negative performance of -2.9% YoY in 9M-2015. The latest building permits release predisposes for a continuation in the construction output rebound. According to CYSTAT, the total value of building permits issued in FY2018 (Jan-Nov) increased by 20.1% YoY, while the total area of building permits rose by 17.1% YoY. During last year, 5,929 building permits were issued, up from 5,291 in the corresponding period of the previous year.

Figure 11: Construction sector's share in GDP on the rise in 2016-2018



Source: CYSTAT, Eurostat, Eurobank Research

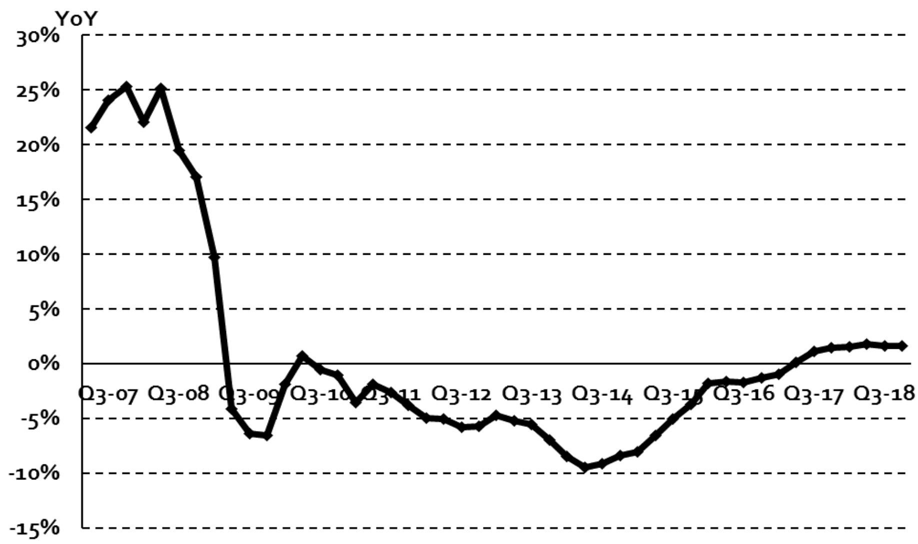
The share of the construction sector's adding value to GDP has been on the rise in the last three years reversing earlier trends. The construction adding value to GDP climbed from 3.1% in 2015- a multiyear low- to 5% in 2018. Meanwhile, the contribution of the construction sector to GDP growth has grown from negative in 2013-2015 to positive in 2016-2018 (Figure 11). The contribution of the construction activity to GDP growth amounted to 1.4ppts in 2018 up from -0.1ppts in 2015.

Real estate transactions & prices

The number of real-estate market sale contracts has risen by 24% YoY in FY2017 (from 3,610 to 8,734). The reading of 1,537 in December 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 positive path throughout the first three quarters of 2018. The Residential Property Price Index (RPPI)-published by Central Bank of Cyprus- recorded its ninth quarterly increase and the seventh annual increase in Q3-2018 for the first time since 2008 (Figures 12a-12b).

Figure 12a: RPPI Index: Property prices expansion rate in positive territory

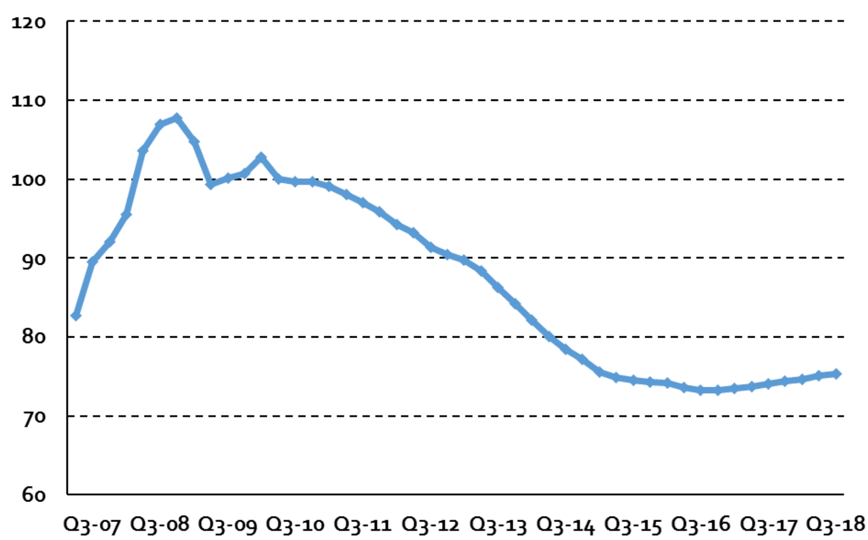


On a quarterly basis, the RPPI increased by 0.3% QoQ, remaining unchanged compared to the previous quarter, compared to 0.6% QoQ in Q1-2018, 0.4% QoQ in Q4-2017, 0.4% QoQ in Q3-2017. The quarterly rise reflects the combined effect of an increase in flat apartments' prices by 1.2% QoQ and house prices staying flat. The sub-indices of residential property prices by district have increased across the board, with the exception of Paphos, which recorded a marginal decrease of 0.2% on a quarterly basis.

On an annual basis, the RPPI Index expanded by 1.6% YoY in Q3-2018 vs. 1.7% YoY in Q2-2018 compared to 1.8% YoY in Q1-2018. This was up from 1.5% YoY in Q4-2017, 1.4% YoY in

Q3-2017, 1.1% YoY in Q2-2017 up from 0.2% YoY in Q1-2017, -0.9% YoY in Q4-2016 compared to -1.3% YoY in Q3-2016, -1.7% YoY in Q2-2016, and smaller in absolute terms than -1.6% YoY in Q1-2016, -1.8% YoY in Q4-2015 and -3.7% YoY in Q3-2015. All residential prices district sub-indices (Famagusta, Nicosia, Larnaca, Limassol) have recorded increases on an annual basis, with the exception of Paphos where prices recorded a small decline (-0.4% YoY). The largest annual increase in house prices was recorded in Famagusta (4.6%) and in apartment prices in Limassol (6.1%).

Figure 12b: RPPI Index: Property prices on the rise



Source: CYSTAT

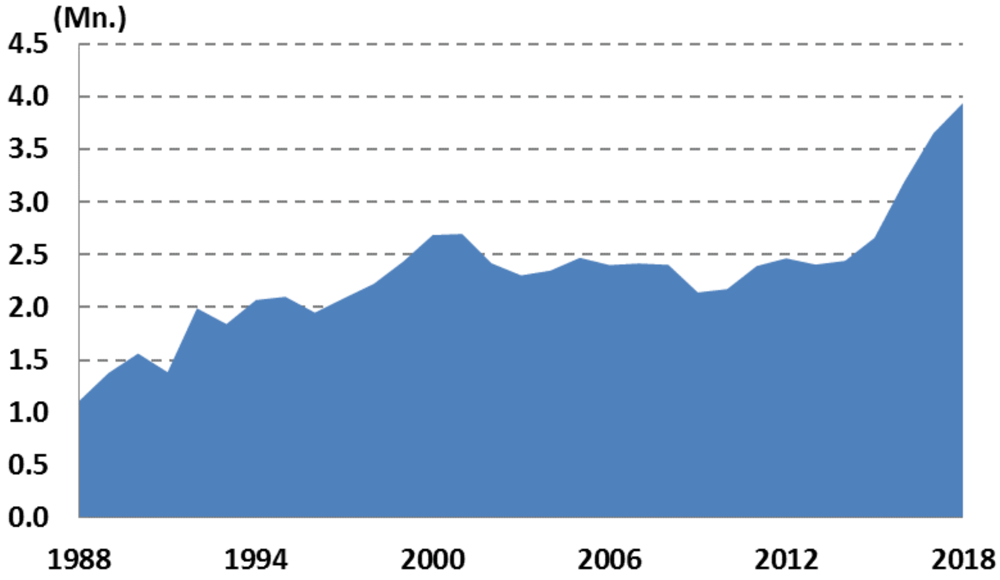
More importantly, the Central Bank attributed the significant increase in apartment prices in Limassol to the increased demand mainly in coastal areas, in part, due to the transactions made in within the framework of Citizenship by investment program. The Central Bank highlighted that despite the general moderate price increases, the dynamics of price increases, especially in Limassol, underlines the need for close monitoring of developments and vigilance.

The House Price Index (HPI), a quarterly index calculated and published by CYSTAT which measures the change in the average prices of residential dwellings on a transactions basis, is in positive territory since Q4-2016. The HPI expanded on an annual basis by +0.2% QoQ/+1.7% YoY in Q3-2018, up from +0.6% QoQ/+1.2% YoY in Q2-2018, down from -1.8% QoQ/+3.7% YoY in Q1-2018 compared to +2.7% QoQ/+2.4% YoY in Q4-2017 vs. -0.3% QoQ/+0.6% YoY in Q3-2017. The Cypriot reading-although lagging behind that of EA-19 (+1.6% QoQ/+4.3% YoY) in this quarter-still bodes well with the ongoing rebound in the property market.

3.5. Cyprus reached a new record in tourist arrivals, yet revenues per person are on a declining trend

The number of tourist arrivals increased by 7.8% YoY in FY-2018 (3,938,625 vs. 3,652,073 in the same period last year, Figure 13). Tourist arrivals from Eastern Europe countries such as Poland (+58.0% YoY) and Ukraine (+44.5% YoY) and Nordic countries such as Finland (+26.5% YoY) and Sweden (+12.5% YoY) recorded a hefty increase. Tourist arrivals from some traditional markets such as Germany (+0.2% YoY), Greece (+9.8% YoY), Israel (-11.2% YoY), and UK (+5.9% YoY) had a mediocre performance in 2018. In addition, tourist arrivals from niche markets such as Russia (-5.0% YoY) were weak while tourist arrivals from Switzerland, a new niche tourist market for Cyprus has been growing fast in 2018 (+29.0% YoY).

Figure 13: Tourist arrivals 1988-2018



Source: CYSTAT

Accordingly, tourism revenues expanded by +2.7% YoY in FY2018 to reach €2,710.6mn, up from €2,639.8mn the same period last year. However, the corresponding statistics for expenditure per person are on a declining trend. The expenditure per person for 2018 reached €688,22 compared to €722,62 in the previous year, recording a decrease of 4.8%. In fact, the expenditure per person/per day for the period of January – December 2018 compared to the period of January – December 2017 also recorded a decrease of 1.7% (from €76,07 to €74,81). There are a number of reasons to explain this declining trend not only limited to the changing decomposition of tourist arrivals shifting markets with lower income and purchasing power (e.g. Eastern Europe) and the disruption of the traditional tourist product from new digital platforms of the sharing economy (e.g. Airbnb)

Overall, the tourism industry has been among the key sectors behind the GDP growth rebound of the Cypriot economy in 2016-2018. Looking ahead, tourism, a key driving force behind the acceleration in services exports in the past years, is expected to soften. Tourism will be increasingly confronted with increasing competition from the re-opening of neighbor markets, where safety concerns are abating, and the lower purchasing power of their traditional tourists markets (predominantly British and Russian) as a result of their currency depreciations.

On the flipside, even though it is soon to tell, the latest statistics point to the opposite. The positive momentum in the tourism sector continued into the first two months of 2019. Tourist arrivals expanded by 5.7% YoY in January-February 2019 to 187.5 thousand, up from 177.3 thousand in the same period a year earlier. This sets a new record as it was the highest volume of tourist arrivals ever recorded in Cyprus during the first two months of the year.

3.6. Cyprus maintained fiscal discipline despite banking sector related fiscal costs. Budget over-performance gives rise to spending pressures while fiscal risks from negative court decisions are looming

In 2018 the budget execution surpassed the most optimistic expectations for yet another year. According to the preliminary fiscal results released by CYSTAT, the general government recorded a €1.050,9mn deficit in 2018 compared to a €344,2mn surplus in 2017. As a percentage of GDP, the general government deficit stood at -5.1% in 2018 vs. a 1.8% surplus in 2017. The aforementioned fiscal results reflect the impact of the public support measures for the sale and orderly winding down of Cyprus Co-operative Bank (CCB) to Hellenic Bank in Q3-2018. Excluding the fiscal burden of CCB, the general government recorded a surplus of 611,1mn or 2.9% of GDP in 2018, the highest since 2008 the year Cyprus entered Euro area (Figure 14). The primary surplus stood at -2.5% of GDP in 2018 compared to +4.3% of GDP in 2017.

Total revenues improved by +7.4% YoY, driven by double digit growth in net VAT revenues collection (+12.3% YoY) and social security contributions (+7.8% YoY). The only item which registered a decrease was property taxes (-21.6% YoY). On the other hand, total expenditure-notwithstanding the negative result of the CCB sale -remained relatively contained, expanding by +4.1% YoY driven by higher spending on public wages (+3.0% YoY), social benefits (+3.4% YoY) and current transfers (+2.2% YoY). On the other hand, spending items such as interest payments (+2.5% YoY) were subdued and capital investment (-4.5% YoY) decreased. The aforementioned performance is even more impressive despite the lower Central Bank dividend by about 0.2 ppts of GDP relative to last year, and despite the gradual withdrawal as of July 1, 2018 of the public sector wage cuts and their estimated fiscal impact of about 0.1 ppt.

The state intervention in the banking system occurred at the expense of temporarily reversing the downward trend in public debt dynamics. The one-off banking system state injection pushed the projected public debt to GDP ratio temporarily up to 102.5% of GDP in 2018 from a 95.7% of revised GDP in 2017 (from 96.1% previously). This increase is not expected to reverse the overall downward trajectory of debt-to-GDP, provided fiscal policy remains prudent and nominal GDP growth remains robust. The public debt-to-GDP ratio is expected to decline to 97% in 2019 and further to 91% in 2020 and to 85% in 2021.

For year 2019 the EU Commission has already approved the Draft Budget Plan (DBP) plan[11] as being in line with the provisions of the Stability and Growth Pact (EU Commission opinion on DBP).[12] The budget of 2019 targets a general government primary surplus of 5.6% and headline surplus of 3.1% of GDP. Total revenue is expected to expand by 3.9% YoY. This growth is lower than the projected nominal rate of GDP growth hence revenues are expected to decline as a percentage of GDP to 39.4% from a projected 39.7% in 2018. The revenue growth is driven mainly by the continued cyclical improvement of the economy plus the already legislated tax increases on labor (legislated rises in social security contributions and the introduction of compulsory health insurance contributions), which are estimated to increase revenues by 0.4% of GDP. Despite the envisaged labor tax increases, the EU Commission claims labor tax revenue in Cyprus is still expected to remain below the corresponding EU-28 average.

In 2019 total expenditures are forecasted to increase by 3.3% YoY - below the revenues rate of increase and the rate of nominal GDP increase. Hence as a percentage of GDP, expenditures are expected to decline to 36.3% from a projected 36.9% in 2018. The gradual withdrawal of public sector's wage cuts and the introduction of the ESTIA subsidy plan are the main discretionary initiatives introduced in the budget of 2019. The first one was legislated in June 2018 and is estimated to cost about 0.2% of GDP on an annual basis in 2019-2023. The second is estimated to cost around 0.1% of GDP on an annual basis in 2019. However, according to news media reports, the fiscal over-performance and the need to achieve political consensus on the implemented fiscal policies has given rise to spending pressures.

Fiscal pressures are evident in a fiscal package of €100mn of additional discretionary spending, agreed according to news media between the ruling party DHSY and DHKO, the third largest party in the parliament. The fiscal package contains measures targeting vulnerable groups such as low income pensioners (an additional €50 per month for each pensioner, resulting in €23mn spending increase), an "ESTIA 2" subsidy scheme for eligible borrowers who service their debts (€30mn spending increase) and the reduction of the fuels consumption tax (€45mn loss in revenue). The fuels consumption tax has been chosen to replace the planned taxation reform of defense withholding tax on interest. The defense withholding tax on interest rate was originally planned to be reduced from 30% to 17% as of 1st January 2019 and was estimated to have a fiscal cost of approximately €45mn.

Finally, at the time of the writing, more fiscal risks were looming from the negative outcome of court rulings on past measures to contain the public sector bill. Only recently, the administrative court declared null and void the 2012 legislation which had imposed cuts on the pensions and wages of public sector employees, ordering the government to retroactively compensate the affected individuals. In its ruling, the administrative court stated that the 2012 legislation violated Article 23 regarding the right to property, protected by the constitution. In response, the government has vowed to file an appeal, promote

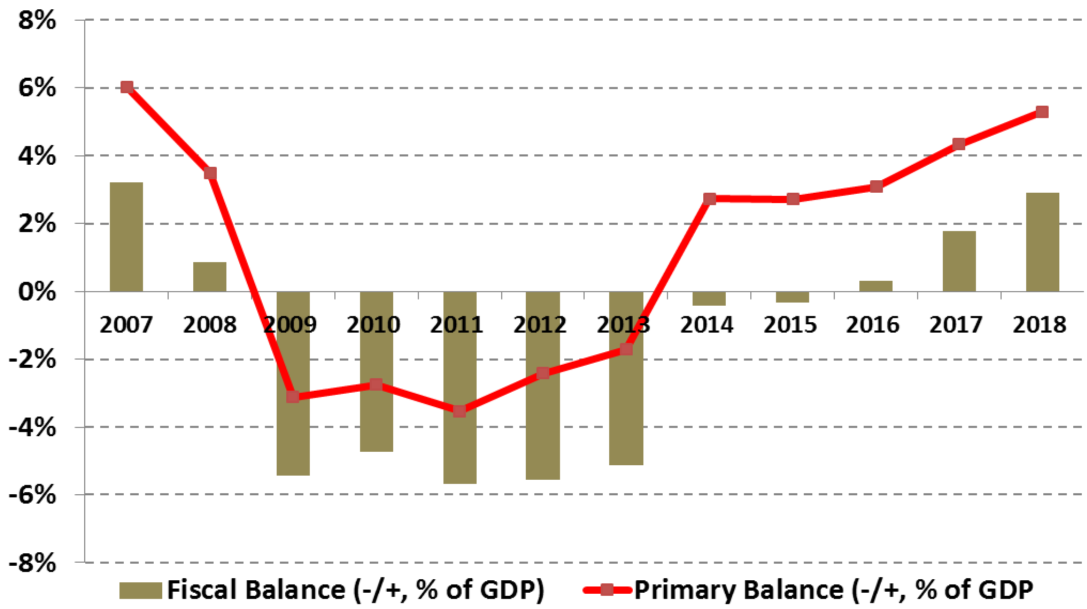
[11] http://mof.gov.cy/assets/modules/wnp/articles/201810/438/docs/draft_budgetary_plan_2019.pdf
[12] https://ec.europa.eu/info/sites/info/files/economy-finance/c-2018-8012-cy_en_.pdf

constitutional changes or cite EU regulations amongst other measures if the Supreme Court validates the administrative court decision. Although the case is still rapidly evolving and uncertainties are high, according to news media citing sources in the Ministry of Finance, the fiscal cost could amount to €1.2bn.

Overall, current fiscal policy continues the earlier credible fiscal path. In 2019 the government would broadly be running a balanced budget for a sixth consecutive year in a row.

Figure 14 shows Cyprus performed an impressive fiscal adjustment in 2013-2014, which outperformed initial targets. A general government primary surplus of 2.7% of GDP was already achieved in 2014, two years ahead of schedule vs. a primary deficit of -1.7% in 2013, -2.4% in 2012 and -3.5% in 2011. Accordingly, the general government deficit[13] declined from -5.1% of GDP in 2013) to only -0.4% of GDP in 2014 (and -0.3% of GDP in 2015) and switched to a surplus of 0.3% of GDP in 2016 and 1.8% of GDP in 2017.

Figure 14: The fiscal surplus is expected to reach its highest level since 2008



Source: CYSTAT, Eurobank Research

[13] The fiscal metrics don't account for the capital injection in the Co-operatives which amounted €1.5bn in 2014 and €175mn in 2015.

Table 7
Time line of Events in Cyprus: 2008-2019

Jan 1st, 2008	Cyprus enters EMU
Feb 17th, 2008	First Round of Presidential Elections in Cyprus
Feb 24th, 2008	Run off round between DISY candidate Kasoulidis and AKEL candidate Christofias. Christofias elected President with 53.36% of the vote
Jan 13th, 2011	Moody's places Cyprus on negative watch for the first time
Jan 17th, 2011	Fitch places Cyprus on negative watch for the first time
Feb 24th, 2011	Moody's downgrade to A2
Mar 30th, 2011	S&P downgrade to A-
May 16th, 2011	Moody's places Cyprus on negative watch again
May 31st, 2011	First Fitch downgrade to A-
July 11th, 2011	Ammunitions explosions in Naval Base Mari. 50% of the power generation capacity is destroyed
July 27th, 2011	Moody's downgrade to Baa1
Oct 27th, 2011	EU leaders summit decision on 50% haircut on Greek public debt
Aug 10th, 2011	Fitch downgrade to BBB
Nov 4th, 2011	Moody's downgrade to Baa3
Dec 16th, 2011	Fitch places Cyprus on negative watch again
Jan 13th, 2012	S&P downgrade to BB+, the first rating agency to rank Cyprus below investment grade
Jan 27th, 2012	Fitch downgrade to BBB-
Mar 13th, 2012	Moody's downgrade to below investment grade (Ba1)
May 3th, 2012	Panicos Dimitriades took office as the new Central Bank governor to replace Orphanides
Jun 13th, 2012	Moody's downgrade to Ba3
Jun 25th, 2012	FITCH downgrade to BB+, below investment grade
Jun 25th, 2012	Cyprus application to ESM
Jul 1st, 2012	Begins Cyprus Presidency of the European Union Council
Jul 25th, 2012	Troika submitted the terms of the bail-out program for Cyprus. The Cypriot government expressed disagreement over those terms and continued negotiations with Troika
Sep27th, 2012	Central Bank of Cyprus commissions PIMCO to carry out the an independent due diligence exercise
Nov16th,2012	Moody's downgrade to B3
Nov21st, 2012	FITCH downgrade to BB-
Nov22nd, 2012	Statement on the European Commission website on behalf of Troika claims progress towards agreement on key policies of a macroeconomic adjustment program
Nov 30th, 2012	Christofias administration announced agreement reached with Troika on bail-out terms with only the financial sector package pending
Dec 13th, 2012	Euro-Group statement took notice of the progress made at the staff level
Jan 10th, 2013	Moody's downgrade to Caa3
Jan 25th, 2013	FITCH downgrade to B
Feb 17th, 2013	First Round of Presidential Elections in Cyprus
Feb 24th, 2013	Run off round between DISY candidate Anastasiades and AKEL candidate Mallas. Anastasiades elected President with 57.48% of the vote
Feb 28th, 2013	Anastasiades administration is sworn in
Mar 15-16th,2013	First Euro-Group: agreement to impose a levy on all (insured &uninsured) depositors (6.7%<100,000 9.9>100,000 to collect €5.8bn) in all banks- Capital controls imposed
Mar 19th,2013	Parliament rejects the bank levy bill, part of the bail-out agreement conditionalities, with a majority of 36 MPs against, 19MPs abstained, 1 absent
Mar25th,2013	Second Euro-Group: agreement to bail-in the uninsured depositors of Laiki and Bank of Cyprus only, resolve Laiki and fold the good bank into Bank of Cyprus. Program money will not be utilized to recapitalize the domestic banking sector except for a provision of 1.5bn for Co-operative sector.
Mar 26th,2013	Fitch places Cyprus on negative watch again
Apr 2-3rd,2013	Michalis Sarris resigns from the post of Minister of Finance; Harris Georgiades appointed Minister.
Apr 24th,2013	ESM Board of Directors grants stability support to Cyprus
May 13th,2013	ESM disbursement of €2bn in cash
Jun 3th,2013	FITCH downgrade to B-
Jun 26th,2013	ESM disbursement of €1bn in cash
Jun 28th,2013	Interim report of the Independent Commission on the future of the Cypriot banking sector
Jul 9th-15th, 2013	ESM disbursement of €600mn & €100mn in cash

Jul 30th, 2013	Bank of Cyprus exit from resolution status, recapitalized with 47.5% conversion of uninsured deposits to equity
July 31th, 2013	Staff teams from the Troika visited Nicosia during July 17-31 for the 1st quarterly review
Aug 8th, 2013	Ministry of Finance announcement on a capital restrictions roadmap removal in agreement with official lenders
Sep 5th, 2013	IMF appoints a resident representative in Cyprus
Sep 10th,2013	General Meeting of the new shareholders in Bank of Cyprus convenes to elect a new Board of Directors
Sep 12th,2013	Cyprus and Russia agreement on the restructuring of the 2011 bilateral €5bn loan
Sep 16th,2013	IMF Completes First Review Under EFF Arrangement and Approves €84.7 Million Disbursement
Sep 27th,2013	ESM disbursement of 1.5bn in floating rate notes
Nov 7th,2013	Staff teams from the Troika visited Nicosia during October 29-November 7 for the 2nd quarterly review
Dec15th-19th,2013	ESM disbursement of 350mn &100mn in cash
Dec20th,2013	IMF Completes Second Review Under EFF Arrangement for Cyprus and Approves €83.5 mn Disbursement
Feb 11th,2014	Staff teams from the Troika visited Nicosia during January 29-February 11 for the 3rd quarterly review
Mar10th-11th, 2014	Panicos Dimitriades resigns from Governor-Chrystalla Georghadji announced as successor
Mar 28th, 2014	IMF Completes Third Review Under the EFF and Approves €83.3mn Disbursement
Apr4th,2014	ESM disbursement of 150mn in cash
Apr 25th,2014	S&P upgrade to B
May 17th,2014	Staff teams from the Troika visited Nicosia during May 6-17 for the 4th quarterly review
Jun 30th,2014	IMF Completes Fourth Review Under the EFF for Cyprus and Approves €84mn Disbursement
Jul 25th,2014	Staff teams from the Troika visited Nicosia during July 15-24 for the 5th quarterly review
Jul 29th,2014	Successful €1bn rights issue of Bank of Cyprus with the participation of EBRD and Wilbur Ross
Sept 6th,2014	The Parliament endorsed the foreclosure bills with a majority of 47 votes and 7 against
Oct 24th,2014	S&P upgrade to B+
Oct 25th,2014	IMF Executive Board Concludes the 2014 annual Article IV Consultation with Cyprus
Oct 26th,2014	Announcement of the comprehensive SSM assessment results of four systemic Cyprus banks
Nov 14th,2014	Moody's downgrade to B3
Feb 6th,2015	Staff teams from the Troika visited Nicosia during January 27-February 6 for the quarterly review (no staff level agreement was reached given the suspension of an effective application of the foreclosures framework)
Apr 06th,2015	Full lift of capital controls
Apr 18th,2015	The Parliament endorsed the insolvency framework bills with a majority of 33 votes and 23 against
Apr 26th,2015	Election of Mustafa Akinci in the post of Turkish-Cypriot leader
May 20th, 2015	Based on the recent Troika visit in the island staff-level agreement has been reached on policies that could serve as a basis for completion of the pending reviews.
Jun 19th,2015	IMF Completes Fifth, Sixth & Seventh Reviews of Cyprus' EFF and Approves €278.4 mn Disbursement
Jul 27th,2015	Staff teams from the Troika visited Nicosia during July 14-24 for the 8th quarterly review
Aug 15th,2015	CYSTAT announced the flash estimate of Q2-2015 which showed the second positive QoQ growth
Sep8th,2015	S&P upgrade to BB-
Sep23rd,2015	IMF Completes Eighth Review of Cyprus' EFF and Approves €126mn Disbursement
Sep 25th,2015	S&P upgrade to BB-
Oct10th,2015	ESM disbursement of €500mn in cash
Oct23th,2015	FITCH upgrade to B+
Nov15th,2015	Moody's upgrade to B1
Nov16th,2015	Staff teams from the Troika visited Nicosia during November 3-13 for the 9th quarterly review
Jan27th,2016	IMF Completes Ninth Review of Cyprus' EFF and Approves €126.3mn Disbursement
Mar7th, 2016	Ministry of Finance asks IMF for the early termination of EFF arrangement & Euro-Group supports Cyprus graduation from the economic adjustment program. The last prior action of the completion of the review (CYTA corporatization) was not satisfied
May22nd, 2016	Parliamentary elections: The ruling right-wing party DHSY gained 37.6% (18 seats), the main opposition left-wing party AKEL gained 25.7% (16 seats), and DHKO gained 14.5% (9 seats)
Sep16th, 2016	S&P upgrade to BB
Sep30th, 2016	Draft Budget Plan submitted to the Parliament
Oct 17th, 2016	Draft Budget Plan of 2017 submitted to EU Council of Ministers
Oct21st, 2016	FITCH upgrade to BB-
Oct 25th, 2016	EU Commission sends a letter to the Cypriot Minister of Finance expressing its concern over a significant fiscal relaxation of the fiscal stance next year
Oct 27th, 2016	The Cypriot Minister of Finance replies to the EU Commission rebutting its arguments on fiscal relaxation and the calculation of the output gap in the case of Cyprus
Nov 11th, 2016	Moody's affirmed sovereign long-term rating at B1 but changed the outlook from stable to positive

Nov 15th, 2016	EU Commission adopts an official opinion on the Cypriot budget of 2017 assessing that it is at risk of non-compliance with the requirements of the SGP
Dec 6th, 2016	Eurogroup agrees with the EU Commission assessment and welcomes the commitments of Cyprus, in such circumstances, to implement the measures necessary to ensure that the 2017 budget will be compliant with the rules of the preventive arm of the SGP
Dec 7th, 2016	Parliament approved the Budget of 2017 with 28 votes for and 25 against
Dec 18th, 2016	Municipal elections
Mar17, 2017	S&P affirmed the long-term sovereign rating of Cyprus at BB+ with a positive outlook
June 2nd, 2017	DBRS upgraded the long-term sovereign rating of Cyprus Republic by two notches (from B to BB low) with a stable outlook (trend)
June 11th, 2017	Cyprus tapped international markets with a new 7Y-Eurobond for the second time after exiting the economic adjustment program at a yield of 2.8%
July 28th, 2017	Moody's upgraded the long-term sovereign rating of Cyprus by one notch from B1 to Ba3 with a positive outlook
Sep 15th, 2017	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
Oct 20th, 2017	Fitch upgraded the long-term sovereign rating of Cyprus by one notch from BB- to BB with a positive outlook
Nov 6th, 2017	The Ministry of Finance repaid part of a loan held by the Central Bank of Cyprus bringing the public debt to GDP ratio down to 98.4%-below 100% for the first time since 2012- in 2017
Dec 13th, 2017	Parliament approved the Budget of 2018 with 30 votes for and 25 against
Dec 14th, 2017	IMF Executive Board Concludes 2017 Article IV Consultation with Cyprus
Jan 28th, 2018	First round of Presidential elections: the incumbent President Anastasiades backed by DHSY received 35.5%, Mr. Mallas backed by AKEL received 30.25%, and Mr. Papadopoulos supported by a coalition of centrist parties received 25.75%. Further behind came the ELAM candidate with 5.6% and the Citizen's Alliance leader Mr. Lillikas with 5.6% of the vote. The voter's turn out stood at 71.9% a historic low for Presidential elections
Feb 4th, 2018	Second round of Presidential elections: Nikos Anastasiades received 55.9% of the vote and was re-elected President for another five year term. The runner up Stavros Mallas received 44.01%. The voter's turn-out in the second round stood at 73.97%
Feb 7th, 2018	Moody's affirmed the long-term sovereign rating of Cyprus at Ba3 with a positive outlook
Feb 12th, 2018	Italian oil & gas company ENI announced a "promising" gas discovery in Cyprus' Block 6, noting that the discovery confirms the extension of the "Zohr like" play in Cyprus' Exclusive Economic Zone (EEZ).
Mar 16th, 2018	S&P affirmed the long-term sovereign rating of Cyprus at BB+ with a positive outlook
Mar 16th, 2018	CYSTAT announced the provisional national accounts data for FY2017. Real GDP growth recorded the highest reading in the post-Lehman Brothers era
Mar 19th, 2018	The Co-operative Central Bank announced that it resumes the process to attract private investors in shareholder's capital and reduce state ownership. The bids process has two options, either for the fully licensed bank entity, or all or part of CCB's assets and liabilities
Mar23th ,2018	Statement by the staff of the European Commission and the ECB following the fourth post-programme surveillance (PPS) mission to Cyprus
April 4th,2018	Cyprus issued a number of 15-20Y government bonds of total nominal value of €2.35bn at market terms with the right for early redemption. Thereafter, the government placed a deposit of €2.5bn in the Cyprus Cooperative Bank (CCB) and took in exchange €7.6bn in collateral for the deposit, which comprises of all non-performing loans from the bank's portfolio, equity participation of the CCB in various private and cooperative societies, and a number of real estate properties in both the southern and the northern parts of Cyprus
April 19th, 2018	Speaking to a joint meeting of the parliamentary committees of Finance and Expenditure Control, the Minister of Finance, Harris Georgiadis said the scenario involving a merger of the performing part of the CCB with another commercial banks seems to be preferred by the SSM, adding that mounting capital needs due to the change of assumptions render the option to acquire the whole banking entity through a capital raise more remote
April 20th, 2018	Fitch upgraded the long-term sovereign rating of Cyprus by one notch from BB to BB+ with a positive outlook
April 24th, 2018	Having received the approval of ECB and SSM, the Cooperative Cyprus Bank (CCB) announced the extension of the deadline for submission of binding bids to mid-May from end-April. According to unnamed sources in the news media, "the privatization process is going well, interest is significant and serious"
May 14th, 2018	The Cooperative Cyprus Bank (CCB) announced that it has received two bids as part of its privatization process launched in March. According to news media, Hellenic Bank and Apollo Global Management submitted binding offers
May 23th, 2018	The European Commission announced its 2018 country-specific recommendations (CSRs) for Cyprus, setting out its economic policy guidance for Member States for the next 12 -18 months

May 25th, 2018	DBRS upgraded the long-term sovereign rating of Cyprus Republic by one notch (from BB low to BB) with a positive outlook (trend)
June 18th, 2018	The Cabinet approved in principle a deal on the CCB following the offer submitted by the Hellenic Bank but subject to the submission of the plan regarding the shareholding structure
June 19th, 2018	EU Commission approves aid under EU rules for financing the orderly market exit of CCB under national law, involving sale of some parts to Hellenic Bank
June 21th, 2018	ESM warned in its 2017 annual chapter report for Cyprus that "the high NPLs remains a key vulnerability for banks, which suggests the need for a reform in the insolvency and foreclosure framework and poses a risk for the economy going forward,"
June 25th, 2018	Hellenic Bank announced that it signed with the Cyprus Cooperative Bank (CCB) a business transfer agreement, allowing it to acquire CCB's performing assets
June 28th, 2018	The Cabinet approved legislation aimed at enhancing the legal framework to facilitate the reduction of NPEs
June 29th, 2018	The Central Bank announced that customer deposits below €100,000 will be guaranteed even in a remote scenario of a liquidation of the CCB
July 3rd, 2018	The Cabinet approved the "ESTIA" scheme aimed at addressing the high volume of non - performing loans in the banking sector, by supporting vulnerable borrowers. The Cabinet also approved the Finance Minister's proposal to set up an entity that will undertake the management of CCB's NPEs.
July 8th, 2018	The parliament endorsed four bills and one draft regulation aimed at enhancing the legal framework to facilitate the reduction of NPEs. The Parliament also approved the state guarantees granted by the Ministry of Finance to the Hellenic Bank for the absorption of the CCB
July 10th, 2018	An inquiry committee which will look into all the facts surrounding and leading to the predicament Cyprus' cooperative credit system has found itself in, was sworn in at the Legal Service's offices
July 18th, 2018	The Public Debt Management Office (PDMO) has announced the issuance of 5 government bonds for a total nominal amount of €3,19bn maturing between 5 to 53 months with private placement towards the CCB
July 27th, 2018	Moody's upgraded the long-term sovereign rating of Cyprus by one notch from Ba3 to Ba2 with a stable outlook
Aug 23th, 2018	The shareholders of the Hellenic Bank approved an equity capital increase of €150mn required to complete the acquisition of CCB bank assets
Aug 31st, 2018	An extraordinary annual general meeting of the CCB approved a series of resolutions that will transform the bank to a state-owned asset management company setting up a subsidiary company, the Cyprus Asset Management Company (KEDIPES) that will manage the CCB's NPLs
Sep 3th, 2018	Hellenic Bank announced that it completed the acquisition of performing assets and liabilities of the CCB
Sep 10th, 2018	CYSTAT presented the finalized data of the national accounts for 2016 and revised upward the national accounts of 2017 in both nominal and real terms
Sep 14th, 2018	S&P became the first rating agency to upgrade the long-term sovereign rating of Cyprus in the post-Lehman era by one notch from BB+ to BBB (investment grade) with a stable outlook
Sep 18th, 2018	Cyprus tapped international markets for €1bn with a new 10Y benchmark bond at 2.40%, the lowest yield ever achieved
Sep 27th, 2018	ECB announced that it had started purchasing government bonds again as part of its QE program. ECB added that the pace of purchase in Cypriot government bonds will take the specific market liquidity situation of the Cypriot government bond market into account in calibrating a gradual and measured increase in Eurosystem holdings towards Cyprus's share in the ECB capital key
Oct 15th, 2018	Central Bank announced that there was a significant decrease of €3.284 million in NPEs
Oct 19th, 2018	Fitch became the second rating agency to upgrade the long-term sovereign rating of Cyprus to investment grade in the post-Lehman era by one notch from BB+ to BBB- with a stable outlook
Nov 16th, 2018	Exploration on the ExxonMobil and Qatar Petroleum began exploration in block 10 of Cyprus' Exclusive Economic Zone
Nov 23th, 2018	DBRS upgraded the long-term sovereign rating of Cyprus Republic by one notch to investment grade, from BB low to BBB low, with a stable outlook (trend)
Dec 3rd, 2018	The European Commission approved the ESTIA scheme concluding that the scheme is well-targeted, is limited in time and scope and would not create undue distortions to competition, the latter required by the EU state aid rules
Dec 17th, 2018	Parliament approved the Budget of 2019 with 30 votes for and 24 against
Dec 17th, 2018	According to a report by the European Banking Authority (EBA), Cyprus recorded the largest decrease among EU countries in NPLs between June 2017 and June 2018
Jan 2nd, 2019	DBRS: Cypriot government debt securities account for only 4% of €2.1 trillion public sector asset holdings of the ECB portfolio at the end of 2018
Jan 11th, 2019	Cyprus ranked first among EU member states regarding the absorption of EU Regional Development Fund for

	a second year in 2018 and sixth concerning its absorption capacity from all EU funds
Jan 11th, 2019	Central Bank announced that there was a significant decrease of €5.613 million in NPEs which reflects the removal of CCB bad loans from its balance sheet and the transfer to the state management company (KEDIPES)
Feb 14th, 2019	Cabinet approved changes in Cyprus Investment Program
Feb 28th, 2019	ExxonMobil and Cyprus government announced a discovery of a natural gas resource of approximately 5 to 8 trillion cubic feet in offshore block 10, at the Glaucus-1 well
March 6th, 2019	The report of the Committee of Inquiry on the failure of the CCB was made public. In the report, the Minister of Finance is cited as the person bearing the heaviest responsibility for the failure of CCB
March 15th, 2019	In statements to the press, the Minister of Finance Harris Georgiadis has announced his decision to leave the Ministry at the end of the year.
March 28th, 2019	The President of the Republic Nicos Anastasiades appointed Constantinos Herodotou as Governor of the Central Bank (CBC) of Cyprus.

Eurobank Cyprus Research

Economic Indicators	Description	Source	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
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	854,802	864,823
GDP (%YoY)	Constant Prices	Eurostat	5.0	4.9	4.7	5.1	3.7	-2.0	1.3	0.4	-2.9	-5.8	-1.3	2.0	4.8	4.5	3.9
Households and NPISHs Final Consumption Expenditure (YoY%)	Constant Prices	Eurostat	7.2	3.9	3.9	9.7	8.2	-6.5	3.0	-0.5	-1.2	-5.7	1.0	2.4	4.5	4.1	3.7
General Government Final Consumption Expenditure (YoY%)	Constant Prices	Eurostat	-1.8	2.3	7.2	3.4	6.4	6.3	-0.3	1.5	-2.5	-4.8	-7.5	-0.5	-0.8	3.1	4.3
Gross Fixed Capital Formation (YoY%)	Constant Prices	Eurostat	5.8	6.5	20.9	7.5	8.4	-13.6	-2.9	-11.9	-20.4	-16.6	-19.0	13.8	41.8	29.0	-7.1
Exports of Goods and Services (YoY%)	Constant Prices	Eurostat	3.2	3.1	2.3	5.4	-0.6	-4.7	4.5	5.7	-2.7	2.1	4.3	5.2	4.6	6.0	3.3
Imports of Goods and Services (YoY%)	Constant Prices	Eurostat	7.4	1.0	5.7	9.6	13.0	-15.3	7.8	-3.2	-4.7	-4.0	3.6	8.4	6.6	12.2	2.0
GDP	Current Prices, SA ,mil	Cyprus Statistical Service	13938.0	15039.3	16263.8	17591.0	19006.2	18673.5	19299.5	19731.0	19489.7	18140.5	17610.0	17746.0	18490.2	19648.7	20730.9
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	-2.9	0.8	4.2	6.3	5.5
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	11.1	8.4
Labor Productivity	Real, Per employee, % Change	Eurostat	1.0	1.2	2.8	0.6	0.1	-2.0	0.9	0.4	0.3	0.1	0.5	0.5	0.2	0.2	-0.1
Labor Productivity	Real, Per hour worked, % Change	Eurostat	3.0	2.9	3.6	-0.9	-1.0	-1.4	1.6	1.2	0.7	1.8	1.0	0.5	0.1	0.4	0.2
Unit Labor Costs	Index, 2010=100	Eurostat	83.2	87.7	88.9	90.0	92.8	100.2	100.0	101.7	103.1	97.4	93.5	91.9	90.7	91.2	91.5
Unit Labour Cost Growth Total Economy	YoY%	Eurostat	1.1	5.4	1.4	1.2	3.1	7.9	-0.2	1.7	1.4	-5.5	-4.0	-1.7	-1.4	0.6	0.3
Short-term business statistics																	
Economic Sentiment Index (ESI)	EoP, SA	EU Commission	106.3	98.4	106.4	106.9	95.8	92.6	95.8	84.8	76.3	88.5	100.2	103.9	113.3	115.7	115.3
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	8.7	11.9
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	-24.3	-11.3
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	10.0	1.5
Services	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	36.5	44.3
Industrial Production General Index	NSA	Eurostat	135.0	135.7	136.3	142.8	149.2	135.3	132.9	122.6	110.6	95.7	95.1	100	109.3	117.1	123.4
Industrial Production General (%YoY)	NSA	Eurostat	1.5	0.9	0.6	4.5	4.1	-9.1	-1.8	-7.6	-9.9	-13.5	-0.6	5.2	9.2	7.5	5.2
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	5728.0	6408.0
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	1047.1	1719.8	1297.7
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	1157.6	1542.7	1338.4
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	3649.0	4939.0	6201.0
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	2,486	1,813
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	11,187	8,718
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	6,274	3,030
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	43,116	30,877
Total deposits of Non-MFIs held with MFIs Domestic Residents	Monetary & Financial Statistics	Central Bank of Cyprus		24,874	27,401	32,294	39,462	41,012	45,379	43,748	43,317	32,973	32,283	32,868	36,586	37,807	37,599
Gross Household Saving Rate	% of Gross Disposable Income	Eurostat	8.7	11.5	11.6	6.2	5.0	9.2	6.5	6.4	3.7	-1.8	-6.2	-4.5	-3.2	-3.1	N/A
International Trade & Balance of payments																	
Current account balance (%GDP)	BMP6	Eurostat, IMF (2018)					-15.5	-7.7	-11.3	-4.1	-6.0	-4.9	-4.3	-1.5	-5.1	-8.4	-4.1
Current Account, Goods & Services Net Balance (%GDP)	BMP6	Eurostat, IMF (2018)					-12.8	-5.4	-7.3	-2.9	-1.5	1.8	2.0	0.8	-0.6	-3.5	-2.0
Current Account, Primary Income Net Balance (%GDP)	BMP6	Eurostat, IMF (2018)					-2.5	-1.3	-3.0	0.0	-3.0	-4.7	-3.6	0.6	-2.0	-2.7	-2.2
Current Account, Secondary Income Net Balance (%GDP)	BMP6	Eurostat, IMF (2018)					-0.3	-1.0	-1.0	-1.1	-1.4	-2.1	-2.7	-2.9	-2.4	-2.1	-1.9
Imports of Goods (%GDP)	BMP6	Eurostat, IMF (2018)					42.2	34.7	36.8	35.5	33.6	31.2	31.9	33.0	35.1	37.7	34.3
Exports of Goods (%GDP)	BMP6	Eurostat, IMF (2018)					12	13.1	13.9	15.3	15.6	15.0	15.9	16.2	14.1	13.4	13.3
Imports of Services (%GDP)	BMP6	Eurostat, IMF (2018)					20.7	19.4	20.7	20.4	21.3	25.7	28.1	30.8	30.1	30.9	30.7
Exports of Services (%GDP)	BMP6	Eurostat, IMF (2018)					38.1	35.7	36.3	37.6	37.8	43.7	46.1	48.3	50.5	51.7	51.9
Financial Account (%GDP)	BMP6	Eurostat, IMF (2018)					-18.5	-8.4	-8.6	-1.2	-2.1	-1.9	-7.1	-1.6	-4.7	-5.6	-3.6
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	-9.0	-1.3	0.3	1.8	-5.1
General Government Debt EDP Procedure (% GDP)		Cyprus Statistical Service	64.8	63.4	59.3	54.0	45.6	54.3	56.8	66.2	80.1	103.1	108.0	108.0	105.5	95.7	102.5
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	0.5	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	0.7	0.8
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	3,652,073	3,938,625
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	2,639,100	2,639,800
Market Indicators																	
10Y Gov Bond Yield Rate	%, EMU criterion series	Eurostat	5.8	5.2	4.1	4.5	4.6	4.6	4.6	5.8	7.0	6.5	6.0	4.5	3.8	2.6	2.2
Cyprus Stock Exchange Index	EoP, Composite Index	Bloomberg	1012.27	1704.76	3900.39	4820.72	1101.42	1597.23	1055.21	295.94	114.86	103.31	85.70	67.75	66.41	69.50	66.77