Is the Banking Stress over in Cyprus?

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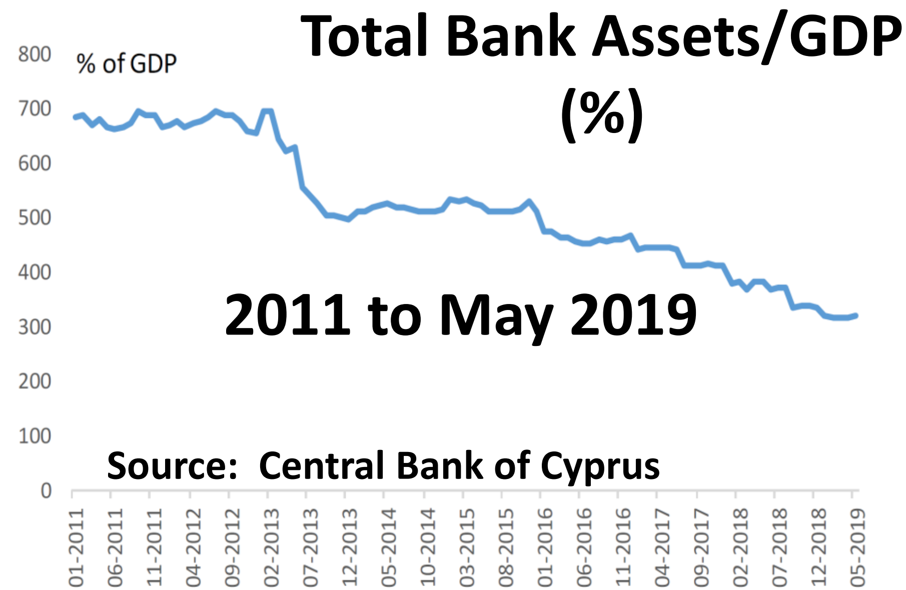
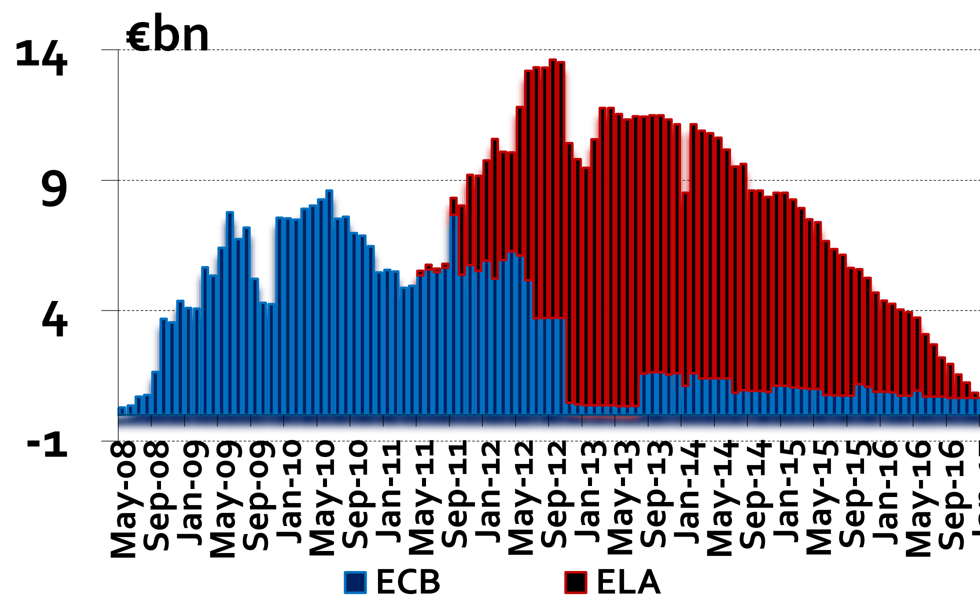
The Economist EVENTS

Post-crisis drastic changes in the financial sector

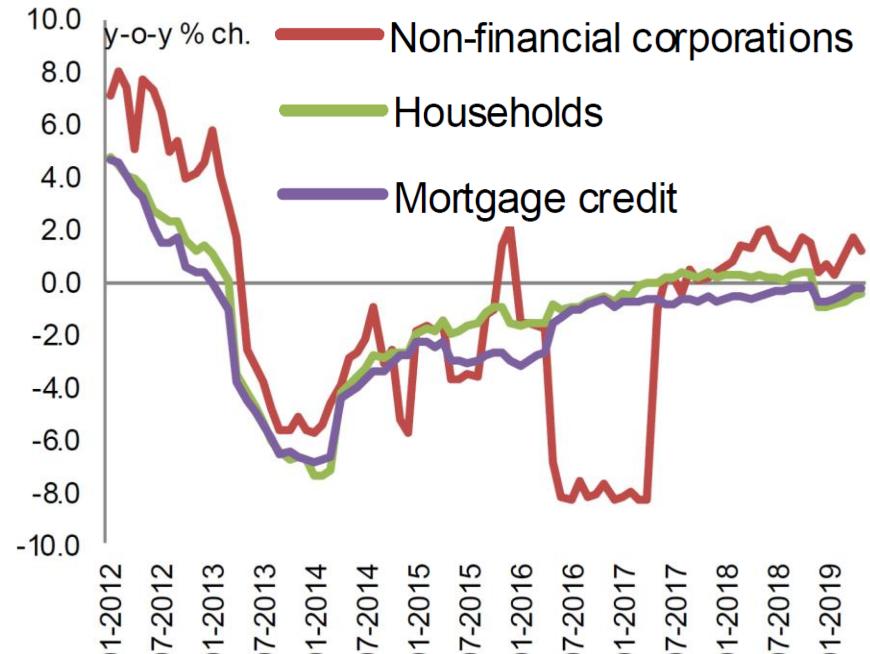
- Crisis erupted in 2013 with a €9bn bail-in, restructuring of CPB & BoC, and capital controls
- Cooperative banks were allowed to continue with €1.5bn infusion plus subsequent support
- Deleveraging after the 2013 crisis, from Assets = 7XGDP to 3XGDP
- Dependence of banks on the Eurosystem is gone by 2017
- Eventually Cooperatives were liquidated in 2018, healthy part in Hellenic Bank
- Now BoC & Hellenic Bank own ~70% of total loans & deposits

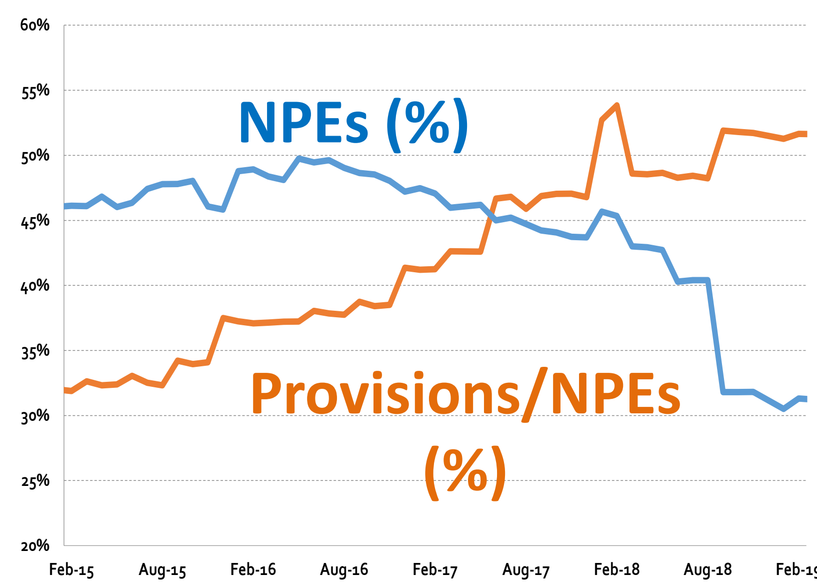




The crisis is over, the stress remains

- Credit growth negative despite the rapid expansion of GDP since 2016
- Only corporate credit growth positive but close to zero
- NPEs, the second highest in Europe, began declining in 2018 to ~30% (€10.3bn) thanks to one-off:
  - Helix 1, a securitization by the bank of Cyprus (€2.7bn)
  - The liquidation of CCB and transfer of NPEs to ΚΕΠΙΔΕΣ
- Target NPE reduction to single digits in 2020, thanks to BoC Helix 2
- Provisions do rise to more normal levels of ~50%





The rough banking ride continues

- **NPEs remain high**, particularly in the construction sector
  - ESTIA Plan had a cool reception in Sept 2019
  - Questions on effectiveness of Insolvency & Repossession framework as populist July 2019 revisions by Parliament are now pending in the Supreme Court – if not reversed, they would help strategic defaulters (see EU Commission Paper 114, Oct 2019)
- **Difficult to contain bank costs** in Cyprus: Inflexible labor contracts
  - Cost-to-income ratios rise (to 60% in 2018 from 40% in 2014)
- **Future profitability under pressure** (as for all European banks)
  - Regulations become more restrictive (AML, Basel IV, MREL, etc.)
  - Possible competition from Big-tech → need to invest in Technology
  - Net Interest margins decline and fee income under pressure (e.g. GDPR)
  - Negative interest rates cannot be easily passed on to customers
  - Economy at risk of slowdown as wage demands rise, past wage freeze in question (at the Supreme Court); excesses in tower construction together with the selling-passport business may lead to collapse in the sector; plus while securitizations get rid of bank NPEs, the NPEs do stay in the economy.

When will the Banking Stress be over in Cyprus?

- The banking stress will be over if
  - Economy continues to grow, avoiding an accident
  - Populist politics take a back seat
- Yet the rough ride will continue as new challenges emerge, most of which are common to all European banks
- Good performance by regulators thus far

Thank you for your attention!

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