

The Post Pandemic Economic & Financial Landscape in Cyprus

Η ΕΠΟΜΕΝΗ ΠΕΝΤΑΕΤΙΑ: ΤΡΑΠΕΖΙΚΗ ΚΡΙΣΗ Η Ή ΕΥΚΑΙΡΙΑ;

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Τη συζήτηση θα συντονίζει ο

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Τέως Υπουργός Οικονομικών



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The Post Pandemic Economic & Financial Landscape in Cyprus

- I. Real economy under stress, yet policy reaction was large and swift across the globe and in Cyprus**
- II. Monetary and financial conditions are expected to remain accommodative [Interest rates and inflation predicted to remain low], yet uncertainty exists**
- III. Multiple challenges for banks ahead both in Europe and in Cyprus**

I. The economy of Cyprus

- ❑ The 2019 recession was a bit below the average in the Euro Area, as the service economy proved resilient, thanks, *inter alia*, to strong fiscal support
- ❑ Is a return to the 2016-2019 golden period possible? Forecasters seem to think so, starting in 2021 with 4% growth, but risks exist:
 - How soon will tourism activity return to its pre-pandemic levels?
 - Rating agencies: No signs of outlook revision, yet after the pandemic what?
 - What will be the impact of Brexit, given the close links with the UK?
 - Will US-Russia Geopolitics stay neutral vis-à-vis the Cyprus service sector?
 - Which is the new investment booster? (The passport-related investment program is gone. It delivered c. €5bn cumulatively in 2013-19)
 - Will labor productivity growth eventually gain steam?
 - Can Cyprus use efficiently the EU-Recovery funds allocated?
 - Are the banks stable? Or we may see SSM intervening again?
 - Will the May elections deliver a stable parliament, able to proceed with required tough decisions on bank collateral liquidations? on future fiscal discipline?
 - Post-covid, can fiscal policy remain prudent?
 - High public & private sector debt: Will they take a toll on the medium and long-term growth potential?

Gross Domestic Product, annual variation in %

Source: Focus Economics

	2019	2020	2021	2022	2023	2024	2025
Euro Area	1.3	-6.8	4.4	4.0	2.1	1.7	1.4
Austria	1.4	-7.4	3.6	3.6	1.9	1.7	1.5
Belgium	1.7	-6.2	4.1	3.9	2.0	1.5	1.0
Cyprus	3.1	-6.1	4.1	4.3	3.5	2.7	2.0
Estonia	5.0	-3.0	3.2	3.9	3.3	3.0	2.6
Finland	1.1	-3.1	2.7	2.2	1.7	1.4	1.1
France	1.5	-8.3	5.7	3.9	2.2	1.8	1.4
Germany	0.6	-5.0	3.7	3.6	1.9	1.6	1.4
Greece	1.6	-9.5	3.8	5.6	3.2	2.5	1.9
Ireland	5.6	2.1	4.4	4.2	3.4	3.2	2.9
Italy	0.3	-9.0	4.6	3.8	1.7	1.2	0.8
Latvia	2.1	-3.6	3.8	4.2	3.7	3.2	2.7
Lithuania	4.3	-0.9	3.1	3.5	3.1	2.7	2.4
Luxembourg	2.3	-2.7	4.4	3.7	3.2	2.8	2.4
Malta	5.3	-7.9	5.6	4.5	3.2	3.1	3.0
Netherlands	1.7	-4.3	2.9	3.0	2.3	1.8	1.4
Portugal	2.2	-8.3	4.5	4.4	2.1	1.8	1.4
Slovakia	2.3	-6.0	4.8	4.3	3.7	3.2	2.7
Slovenia	3.2	-6.7	4.8	3.7	3.1	2.6	2.2
Spain	2.0	-11.0	5.5	5.7	2.5	2.1	1.6



GDP per capita, EUR

Source: Focus Economics	2019	2020	2021	2022	2023	2024	2025
Euro Area	35,467	33,242	35,053	36,965	38,128	39,275	40,420
Austria	44,879	41,894	44,116	46,068	47,610	49,085	50,539
Belgium	41,568	38,571	40,543	42,162	43,559	44,926	46,295
Cyprus	25,442	23,136	24,132	25,265	26,275	27,158	27,992
Estonia	21,217	20,284	21,383	22,687	23,987	25,233	26,499
Finland	43,595	42,456	43,896	45,528	47,036	48,399	49,780
France	37,440	35,014	36,496	38,183	39,586	40,912	42,230
Germany	41,577	39,961	42,076	44,284	45,677	47,085	48,503
Greece	17,101	15,312	16,249	17,405	18,151	18,892	19,637
Ireland	71,929	72,486	75,130	78,644	82,260	85,526	88,714
Italy	29,645	26,990	28,765	30,172	30,940	31,595	31,941
Latvia	15,866	15,151	16,102	16,636	17,911	19,046	20,187
Lithuania	17,535	17,588	18,466	19,665	20,781	21,945	23,122
Luxembourg	103,446	98,516	101,592	104,648	107,100	109,931	112,656
Malta	27,251	24,651	26,336	27,623	28,837	30,149	31,391
Netherlands	47,023	45,614	47,570	49,441	50,942	52,501	54,051
Portugal	20,757	19,296	20,331	21,429	22,162	22,813	23,469
Slovakia	17,279	16,305	17,439	18,613	19,540	20,360	21,115
Slovenia	23,401	21,786	23,197	24,576	25,704	26,716	27,727
Spain	26,777	24,090	25,607	27,262	28,178	29,140	30,102



Unemployment, % of active population

Source: Focus Economics

	2019	2020	2021	2022	2023	2024	2025
Euro Area	7.6	8.0	9.1	8.4	8.1	7.9	7.7
Austria	4.5	5.4	5.7	5.1	4.8	4.5	4.3
Belgium	5.4	5.5	7.0	6.6	6.4	6.3	6.1
Cyprus	7.0	7.9	8.1	7.1	6.6	6.1	5.7
Estonia	4.4	6.9	7.6	6.5	6.0	5.7	5.4
Finland	6.7	7.8	7.9	7.3	7.2	7.0	6.9
France	8.5	8.2	9.7	9.1	9.0	8.9	8.7
Germany	5.0	5.9	6.1	5.6	5.5	5.3	5.2
Greece	17.3	16.7	17.6	16.0	14.8	13.9	13.1
Ireland	5.0	6.0	8.8	6.6	5.6	5.4	5.2
Italy	9.9	9.2	10.9	10.3	10.0	9.7	9.4
Latvia	6.3	8.2	8.3	7.3	6.8	6.4	6.0
Lithuania	6.3	8.8	9.0	7.9	7.6	7.2	6.9
Luxembourg	5.4	6.3	6.4	6.0	5.7	5.5	5.3
Malta	3.6	4.3	4.4	4.1	4.0	3.9	-
Netherlands	3.4	3.8	5.3	5.0	4.8	4.6	4.4
Portugal	6.9	7.0	8.1	7.0	6.7	6.6	6.4
Slovakia	5.8	6.9	7.6	6.9	6.4	6.1	5.8
Slovenia	4.5	4.9	5.6	5.3	5.4	5.6	5.7
Spain	14.1	15.5	17.0	15.7	14.9	14.0	13.2



Fiscal Balance, % of GDP

Source: Focus Economics

	2019	2020	2021	2022	2023	2024	2025
Euro Area	-0.6	-9.1	-6.2	-3.8	-2.9	-2.3	-1.7
Austria	0.7	-9.7	-5.9	-2.8	-1.4	-0.5	0.4
Belgium	-1.9	-9.7	-6.4	-4.9	-2.9	-2.1	-1.2
Cyprus	1.5	-5.5	-2.8	-1.8	-0.5	0.0	0.4
Estonia	0.1	-6.2	-4.8	-3.1	-1.9	-1.0	-0.1
Finland	-1.0	-6.6	-4.1	-2.7	-1.9	-1.6	-1.2
France	-3.0	-10.8	-7.4	-5.1	-4.3	-3.6	-2.9
Germany	1.5	-6.0	-4.3	-1.7	-0.7	-0.1	0.6
Greece	1.5	-9.2	-6.3	-3.6	-1.4	-1.0	-0.6
Ireland	0.5	-5.9	-4.7	-2.5	-1.9	-1.6	-1.3
Italy	-1.6	-11.1	-7.8	-5.2	-3.6	-3.1	-2.5
Latvia	-0.6	-6.6	-4.4	-2.4	-1.4	-0.8	-0.3
Lithuania	0.3	-7.8	-5.4	-3.1	-2.3	-1.4	-0.6
Luxembourg	2.4	-5.8	-1.4	-0.4	-0.2	0.1	0.5
Malta	0.5	-8.5	-5.3	-3.5	-3.0	-2.5	-
Netherlands	1.7	-6.8	-4.9	-2.7	-1.9	-1.2	-0.5
Portugal	0.1	-7.9	-4.6	-2.7	-1.7	-1.0	-0.3
Slovakia	-1.4	-8.5	-6.1	-4.4	-3.5	-2.8	-2.1
Slovenia	0.5	-8.5	-4.7	-3.0	-2.2	-1.5	-0.9
Spain	-2.9	-12.1	-8.4	-5.8	-4.5	-3.6	-2.6

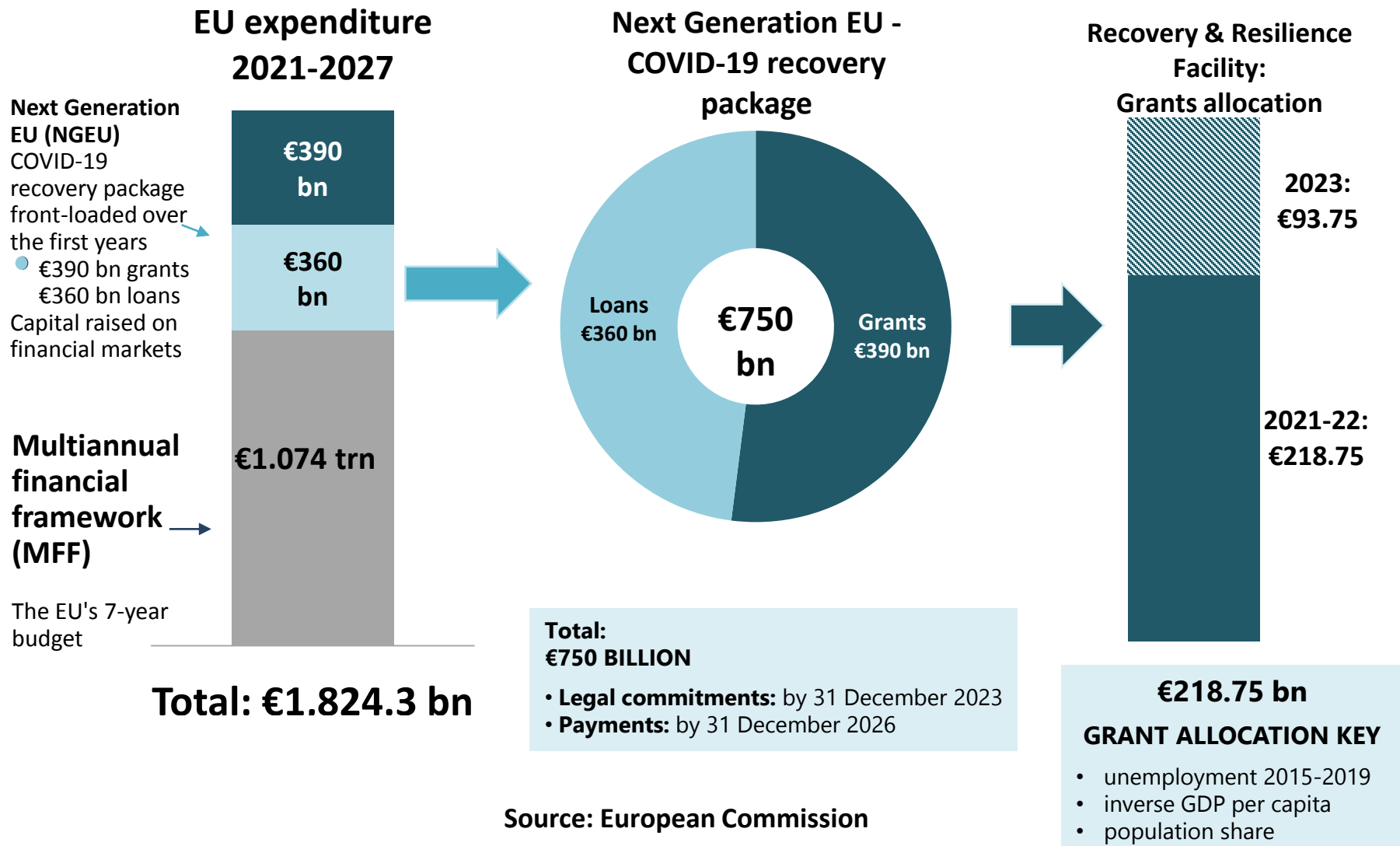


Public Debt, % of GDP

Source: Focus Economics	2019	2020	2021	2022	2023	2024	2025
Euro Area	84.0	100.7	101.4	99.9	97.8	96.2	-
Austria	70.5	85.5	87.3	85.9	82.8	79.9	76.9
Belgium	98.1	114.9	115.8	115.1	112.5	109.7	107.0
Cyprus	94.0	112.6	109.3	103.6	98.8	94.4	90.1
Estonia	8.4	16.5	21.0	23.2	23.1	22.9	22.6
Finland	59.3	69.0	70.9	71.0	70.1	69.7	69.3
France	98.1	118.4	118.7	118.4	118.1	117.8	117.4
Germany	59.6	71.0	71.9	69.6	67.7	65.6	63.6
Greece	181	207	204	194	185	179	173
Ireland	57.4	61.9	63.6	62.5	60.6	58.9	57.3
Italy	135	158	159	157	155	154	152
Latvia	36.9	45.8	48.1	47.6	45.0	42.7	40.4
Lithuania	35.9	46.4	49.9	49.3	47.1	45.2	43.3
Luxembourg	22.0	26.1	28.1	28.4	27.6	26.5	25.3
Malta	42.6	55.1	58.0	58.3	56.2	54.1	-
Netherlands	48.7	58.4	60.6	60.5	60.9	60.6	60.4
Portugal	117	133	131	127	124	121	118
Slovakia	48.5	61.0	63.2	63.0	62.6	61.9	61.2
Slovenia	65.6	79.6	78.8	77.6	76.5	74.5	72.6
Spain	95.5	119.1	119.7	117.8	115.7	113.6	111.6



I. The EU Recovery Fund



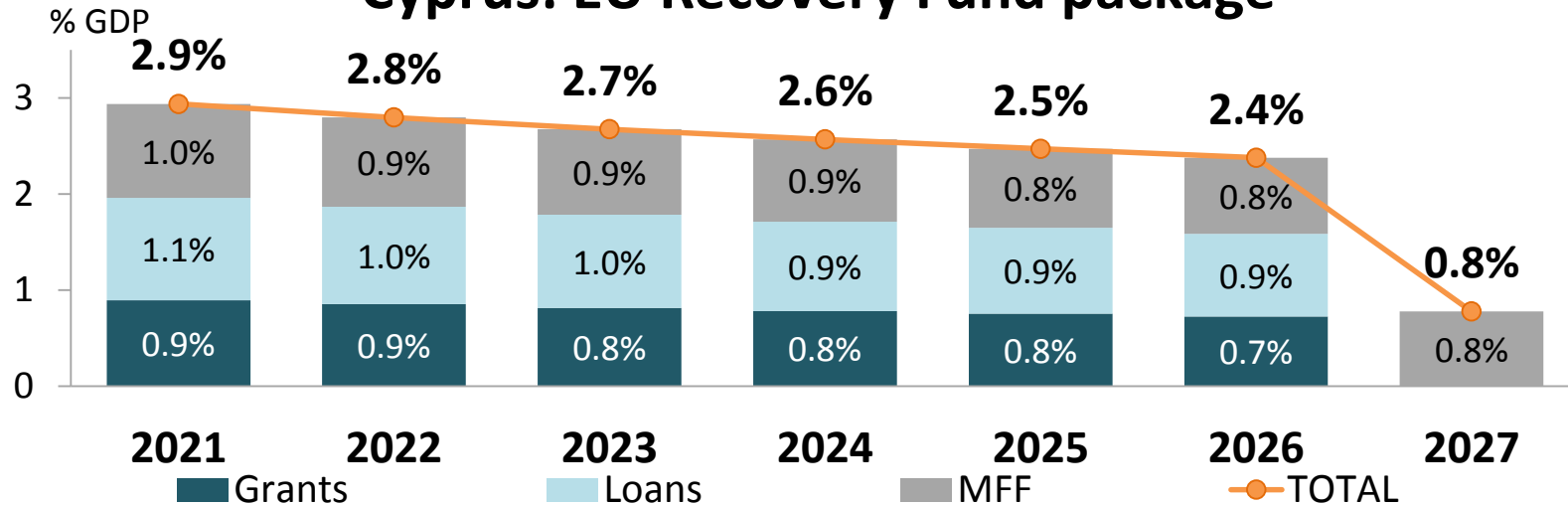
I. A big opportunity & challenge for Cyprus

MFF
Total
€1.5 bn

Loans
Total
€1.4 bn

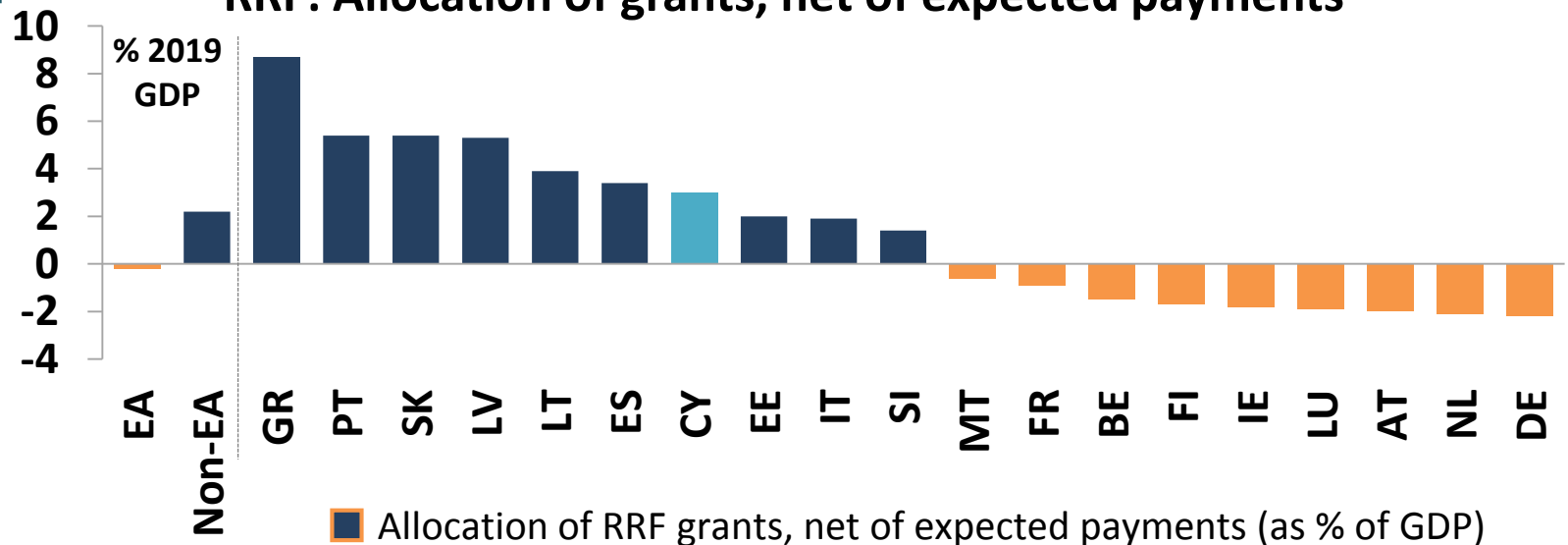
Grants
Total
€1.2 bn

Cyprus: EU Recovery Fund package



*All calculations are based on the assumption of a stable rate of disbursements each year

RRF: Allocation of grants, net of expected payments

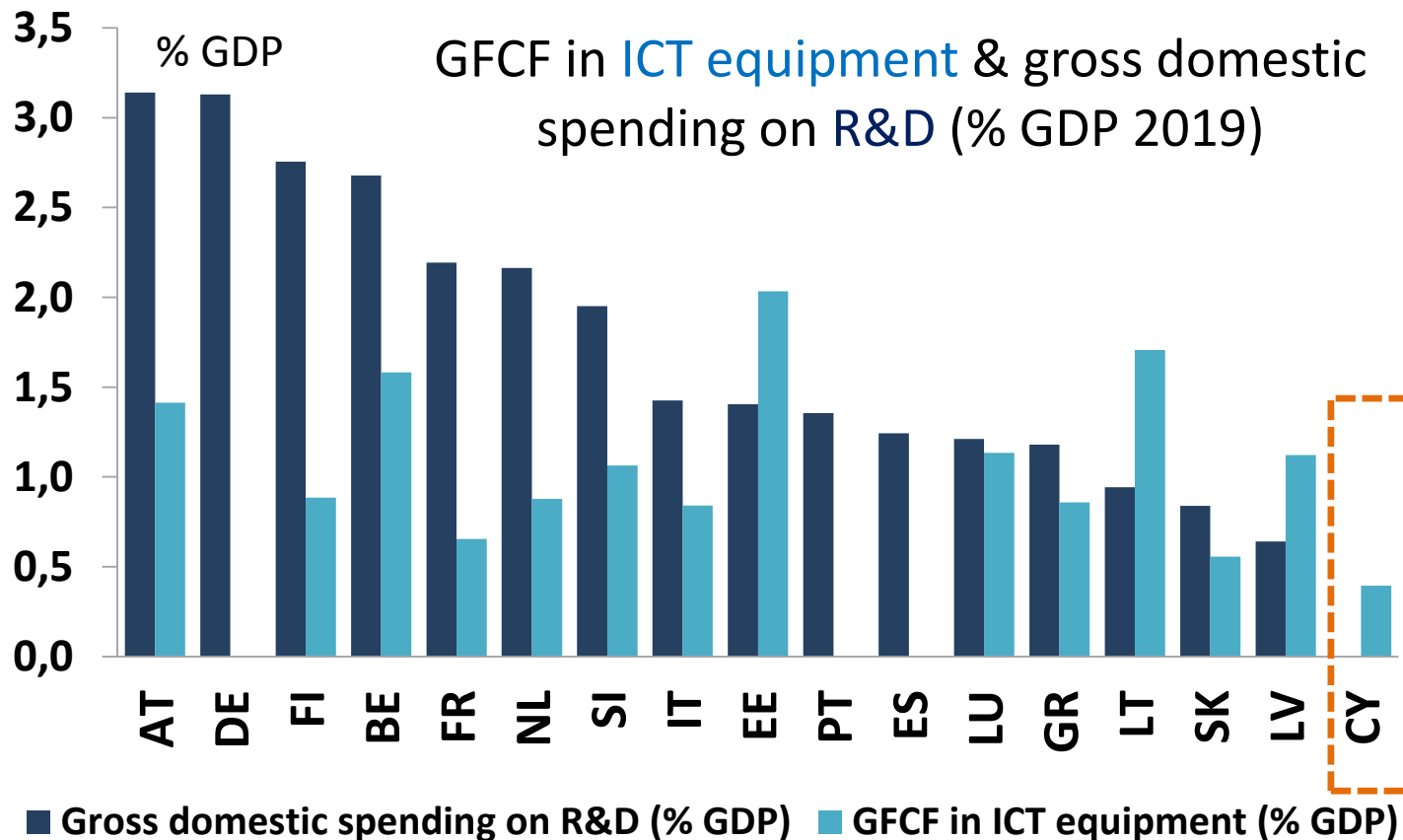


Allocation of RRF grants, net of expected payments (as % of GDP)

I. What is the smart allocation of the funds?

Closing the efficiency gap with the EU

- How can productivity increase permanently?
- One answer: Investment in R&D, ICT, education



Source: Eurostat, OECD



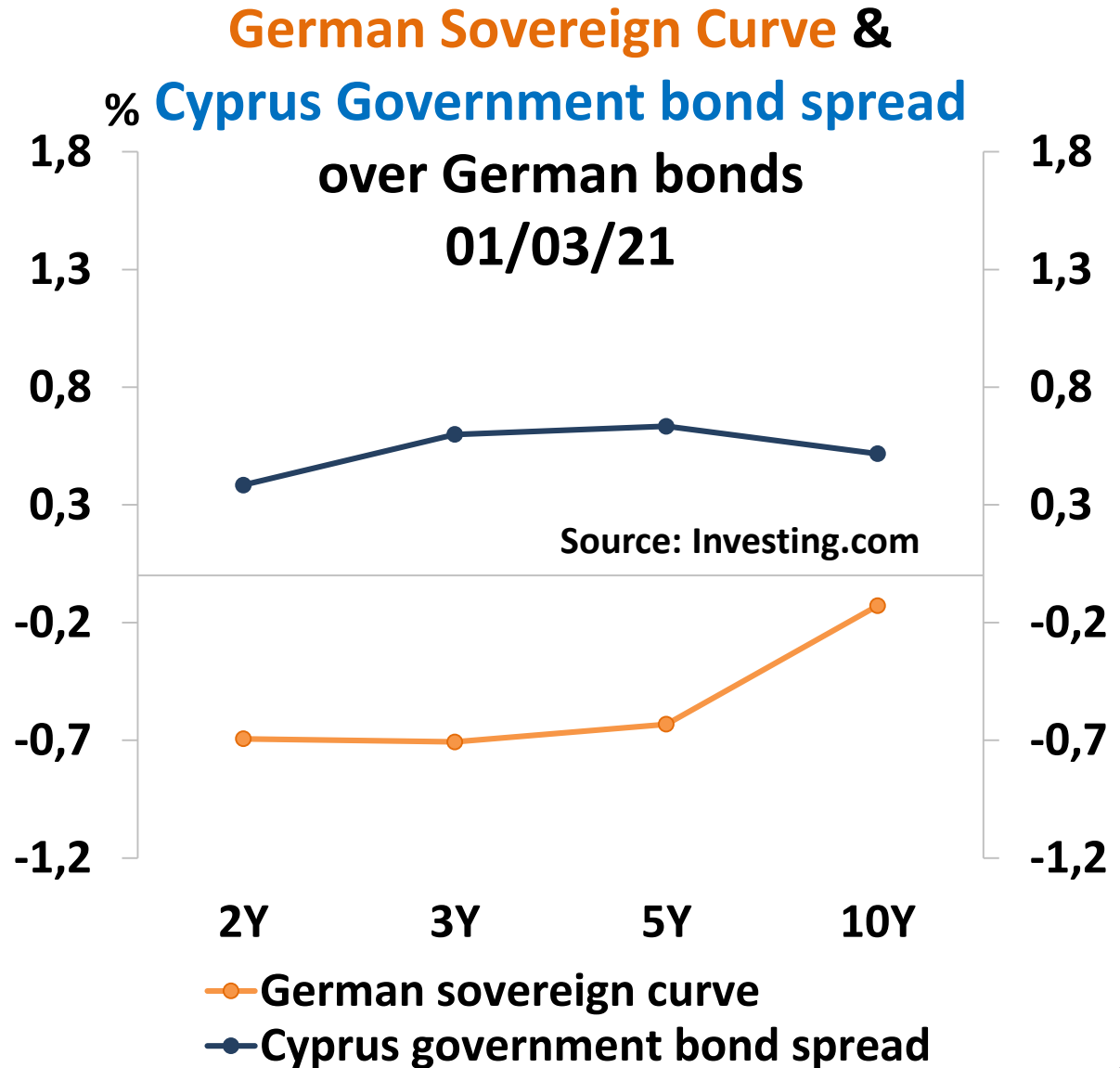
- I. Real economy under stress, yet policy reaction was large and swift across the globe
- II. Monetary and financial conditions are expected to remain accommodative [Interest rates and inflation predicted to remain low], yet uncertainty exists
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II. Interest rates are key variables

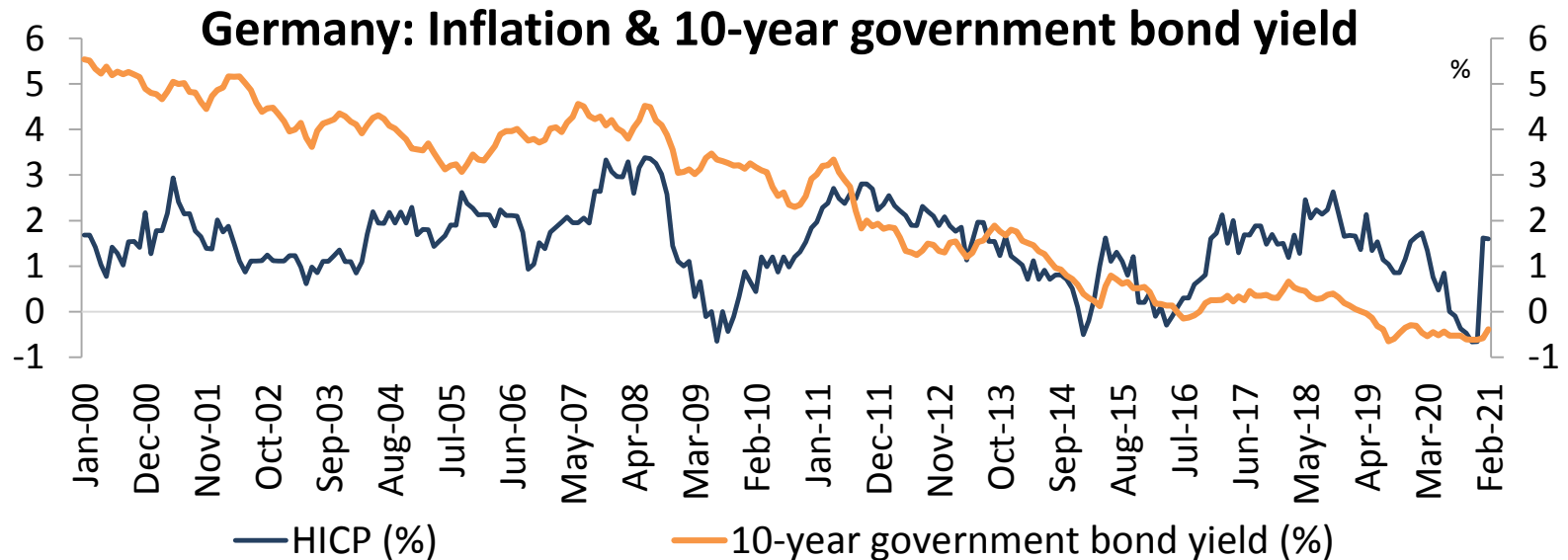
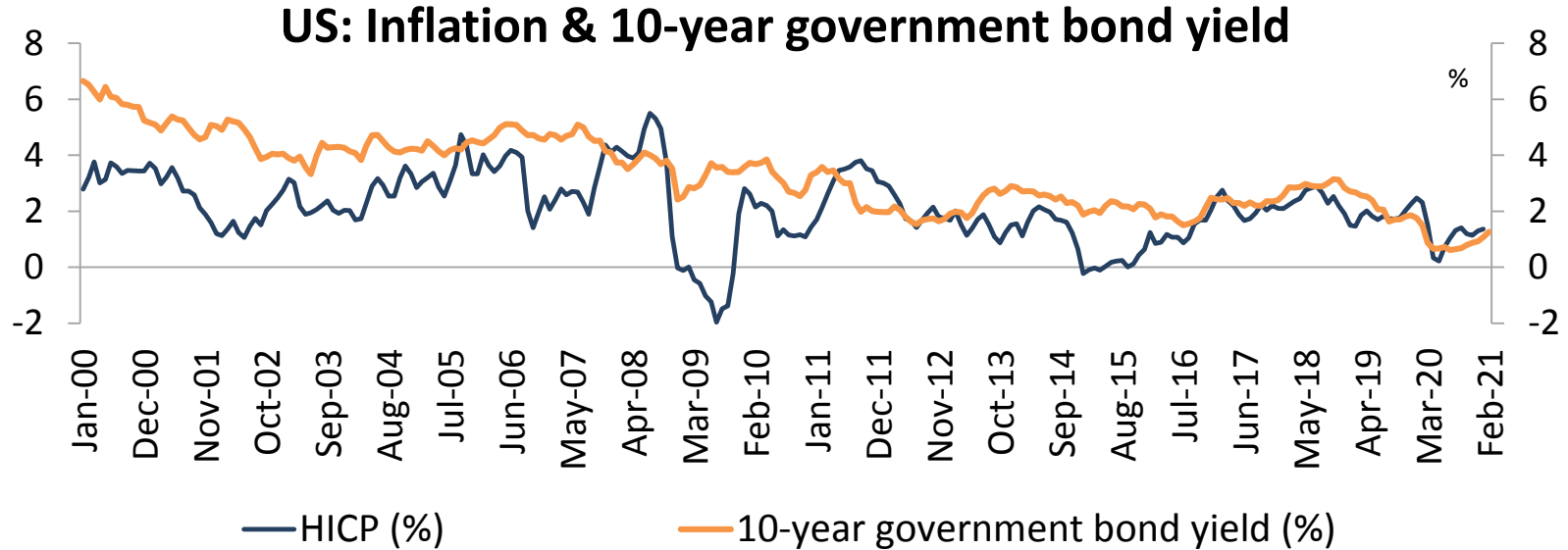
- ❑ **Bank profitability depends on the level of interest rates.**
 - Banks' net interest income (NII) is the most important source of income
 - NII is higher in environments of higher interest rates, as they generate higher spreads between lending and deposit rates
- ❑ **Yet higher rates on government bonds imply higher servicing costs and fiscal pressure.**
- ❑ **Despite the optimistic forecasts, globally, interest rates will not stay low forever.**
 - The questions is when will they rise?
 - A rise in inflation will be a likely trigger
 - We will see the increase in the US being copied in Europe
- ❑ **Stock markets may be over-priced today**

II. The financial sector, expansionary monetary policy & negative risk-free rates in Europe

- ❑ Expansionary monetary policy (PEPP) since March 2020
- ❑ Negative risk-free rates
- ❑ Spreads vs. Germany declined
- ❑ QE in Cyprus too



II. Early signs of reflation – CBs flexibility has increased



Inflation, annual average variation of consumer prices in %

Source: Focus Economics

	2019	2020	2021	2022	2023	2024	2025
Euro Area	1.2	0.3	0.9	1.3	1.4	1.6	1.7
Austria	1.5	1.4	1.6	1.7	1.8	1.9	2.0
Belgium	1.3	0.4	1.3	1.5	1.7	1.8	1.9
Cyprus	0.6	-1.1	0.9	1.2	1.4	1.6	1.7
Estonia	2.3	-0.6	1.3	2.1	2.1	2.2	2.3
Finland	1.1	0.4	1.1	1.4	1.7	1.8	1.8
France	1.3	0.5	0.9	1.2	1.4	1.5	1.7
Germany	1.4	0.4	1.3	1.5	1.5	1.6	1.7
Greece	0.5	-1.3	0.2	0.9	1.2	1.3	1.5
Ireland	0.9	-0.5	0.7	1.2	1.6	1.8	2.1
Italy	0.6	-0.1	0.5	0.9	1.1	1.2	1.3
Latvia	2.8	0.1	1.4	2.1	2.1	2.2	2.2
Lithuania	2.2	1.1	1.8	2.3	2.3	2.2	2.2
Luxembourg	1.7	0.0	1.1	1.3	1.5	1.6	1.7
Malta	1.5	0.8	1.3	1.6	1.6	1.7	1.7
Netherlands	2.7	1.1	1.3	1.4	1.5	1.6	1.7
Portugal	0.3	-0.1	0.6	1.1	1.3	1.5	1.6
Slovakia	2.8	2.0	1.6	1.9	2.0	2.0	2.1
Slovenia	1.7	-0.3	1.1	1.6	1.7	1.8	1.8
Spain	0.8	-0.3	0.7	1.1	1.4	1.6	1.9



10-Year Bond Yield, %

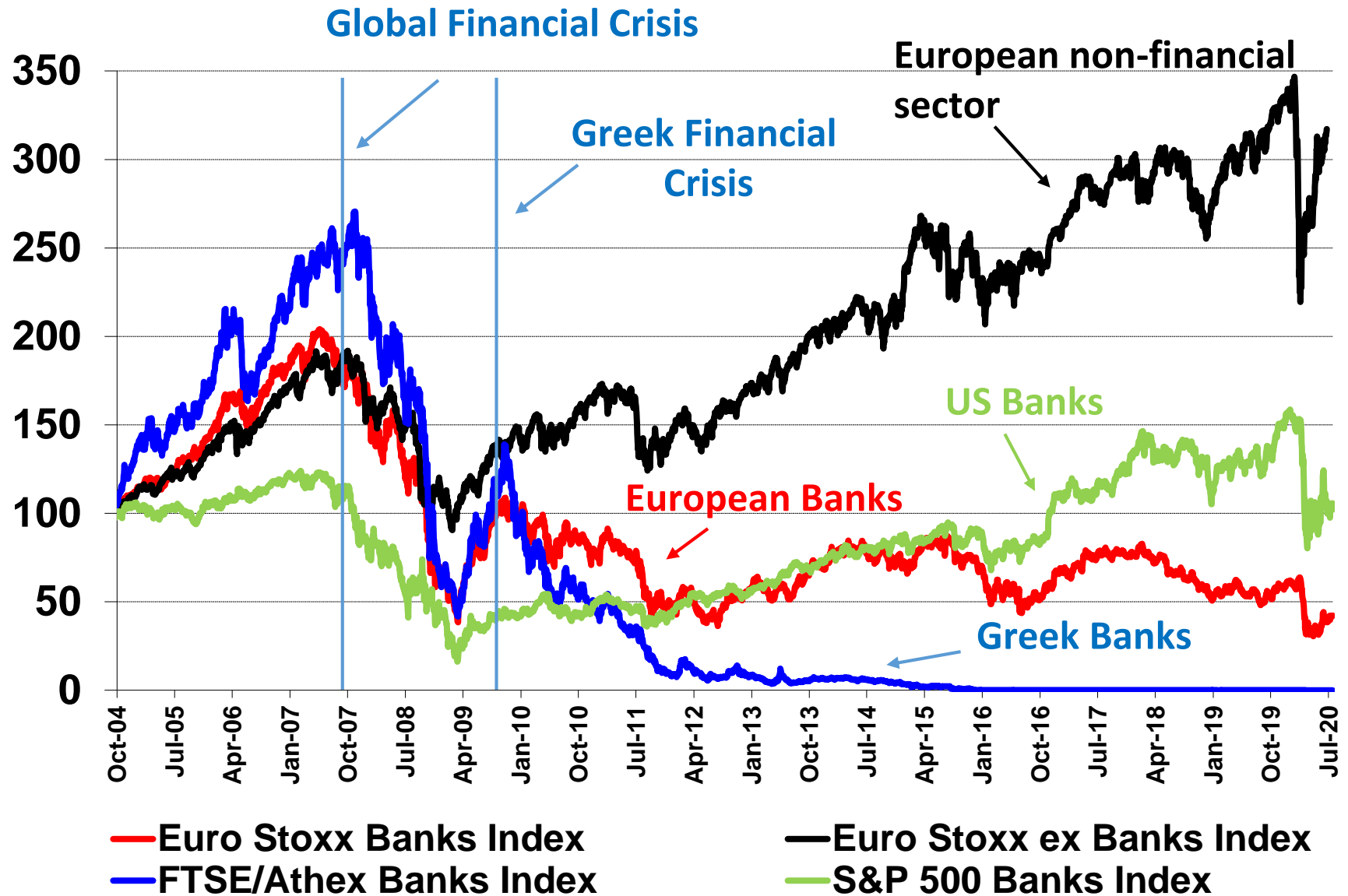
Source: Focus Economics	2019	2020	2021	2022	2023	2024	2025
Euro Area	0.25	-0.25	0.05	0.30	0.61	0.88	-
Austria	0.03	-0.50	-0.13	0.06	0.44	0.74	1.04
Belgium	0.10	-0.38	0.03	0.29	0.60	0.84	1.08
Cyprus	0.57	0.19	-	-	-	-	-
Finland	0.05	-0.40	-0.12	0.20	0.56	0.91	-
France	0.12	-0.34	-0.07	0.19	0.42	0.64	0.87
Germany	-0.19	-0.58	-0.32	-0.11	0.23	0.55	0.87
Greece	1.48	0.63	1.07	1.56	2.10	2.54	2.99
Ireland	-0.09	-0.48	0.02	0.20	0.68	1.09	-
Italy	1.31	0.52	0.87	1.17	1.45	1.73	2.00
Latvia	0.16	-0.29	-	-	-	-	-
Lithuania	0.43	0.04	-	-	-	-	-
Luxembourg	-0.23	-0.55	-0.23	0.05	0.27	0.37	0.47
Malta	0.40	0.27	0.74	0.89	1.23	1.58	1.94
Netherlands	-0.06	-0.55	-0.27	-0.07	0.29	0.60	0.91
Portugal	0.45	0.06	0.33	0.59	0.87	1.10	-
Slovakia	0.13	-0.52	-0.01	0.39	0.67	0.75	-
Slovenia	0.02	-0.23	-	-	-	-	-
Spain	0.46	0.04	0.31	0.63	0.87	1.05	1.23





- I. Real economy under stress, yet policy reaction was large and swift across the globe**
- II. Monetary and financial conditions are expected to remain accommodative [Interest rates and inflation predicted to remain low], yet uncertainty exists**
- III. Multiple challenges for banks ahead both in Europe and in Cyprus, starting from a healthier base**

III. Banks across the globe have underperformed



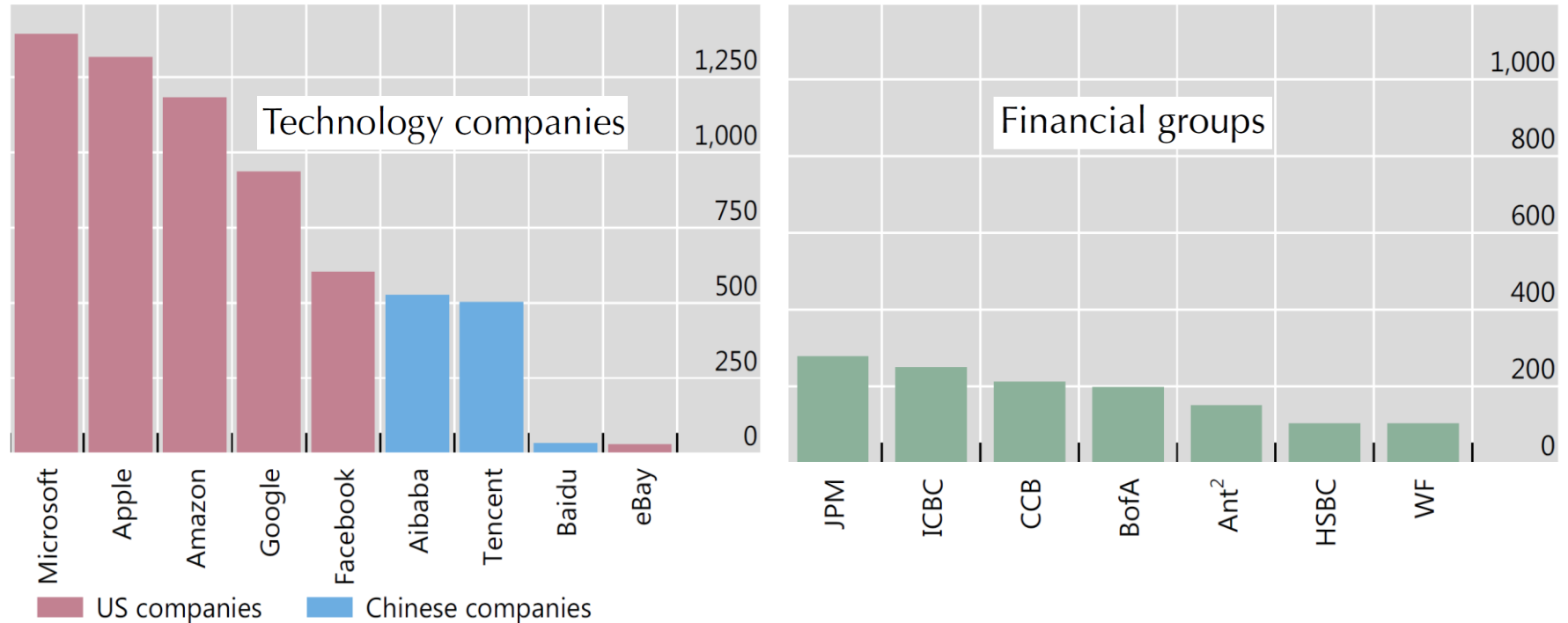
III. Pressures on European & Cypriot bank profitability

Common global pressures on banks:

- 1) The low interest rate environment
- 2) Competition from Big Tech & Tech Fin
- 3) Stricter regulation

III. Big Techs overwhelm Big Banks

Market capitalisation of BigTech, major financial groups (US\$ billions)



Notes: Ant = Ant Financial; BofA = Bank of America; CCB = China Construction Bank; ICBC = Industrial and Commercial Bank of China; JPM = JPMorgan Chase; WF = Wells Fargo. 1) Stock market capitalization, 7 May 2020. 2) The estimated value of Ant Financial was derived from the amount raised in the company's 2018 funding rounds times the stakes sold.

Sources: Refinitiv Eikon; company reports.

Source: Elena Carletti, Stijn Claessens, Antonio Fatas and Xavier Vives, CEPR and IESE Banking Initiative, 2020, "The Bank Business Model in the Post Covid-19 World"

III. Stricter bank regulation over time

- ❑ **Covid-19 brought relaxed regulatory policy toward banks**
 - Required min CET1↓
 - Easier NPE classification
- ❑ **Regulatory policy likely to revert to a strict stance, the moment herd immunity is achieved, and economies shed the crisis**
 - Lagarde is likely to continue with loose monetary policy but the same seems unlikely for regulatory policy
- ❑ **Since 2013, European banks were hit by regulatory demands originating from both Basel III and the Banking Union**
 - Basel III brought stricter capital requirements (in Pillar I and Pillar II) plus liquidity requirements with annual SREP exercises
 - Basel IV is coming 2023
 - The Banking Union brought , IFRS-9, MREL, the bail-in principle, a possible deposit insurance rule on minimum NPEs

III. Pressures on local bank profitability

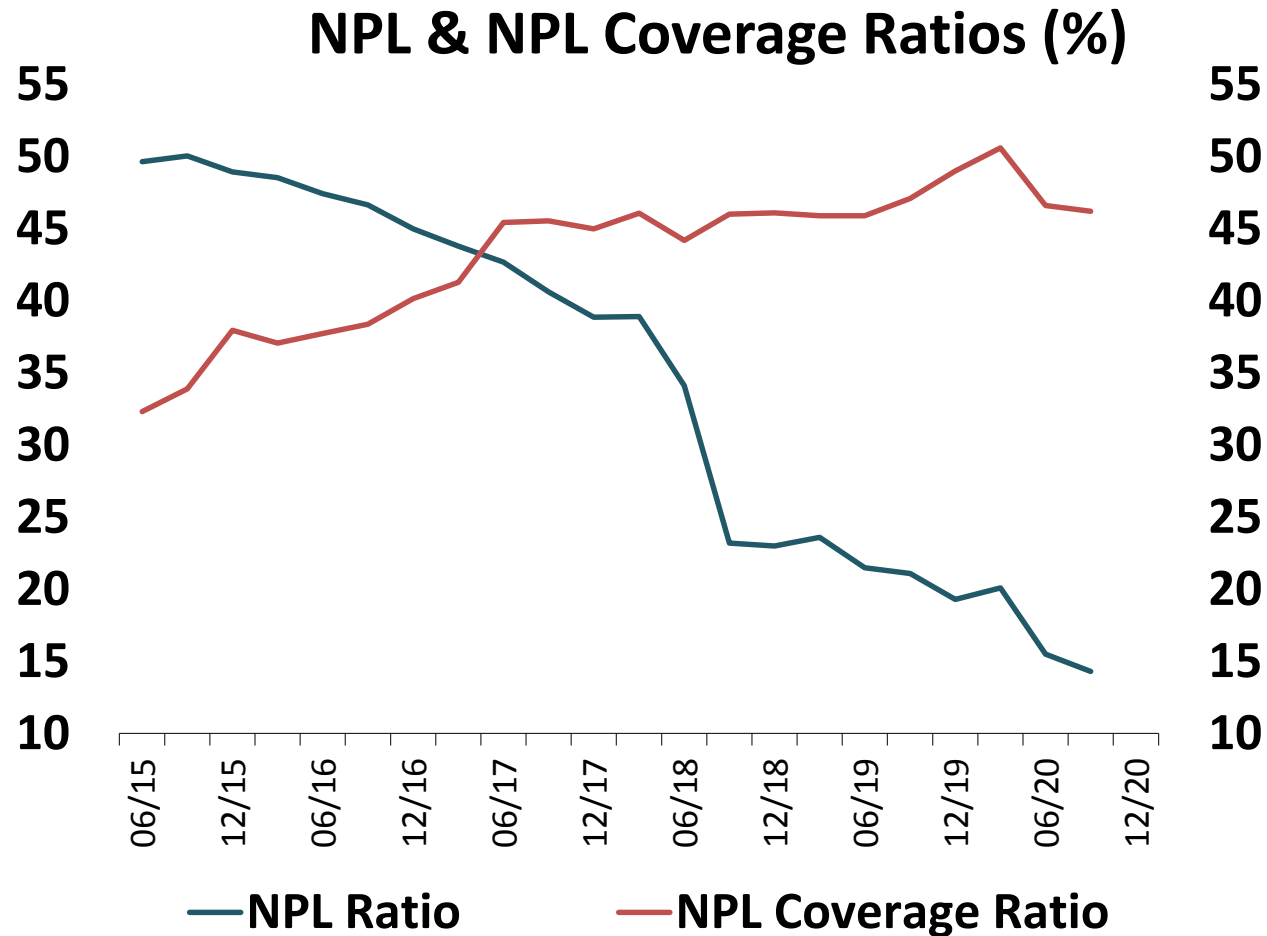
Local extra pressures:

- ❑ Personnel costs inflexible, cost to income ratio from 40% in 2014, to 60% in 2018, 70% in 2019
- ❑ Digitization of economy → higher short-run costs
- ❑ Reduction in NPEs reduces interest income
- ❑ High economic growth does not necessarily translate into high credit growth, as the 2016-2019 period has shown
- ❑ Value of collateral is in question as strategic defaulters, coupled with populist politics in Parliament, seem to prevail. ESTIA plan was unsuccessful

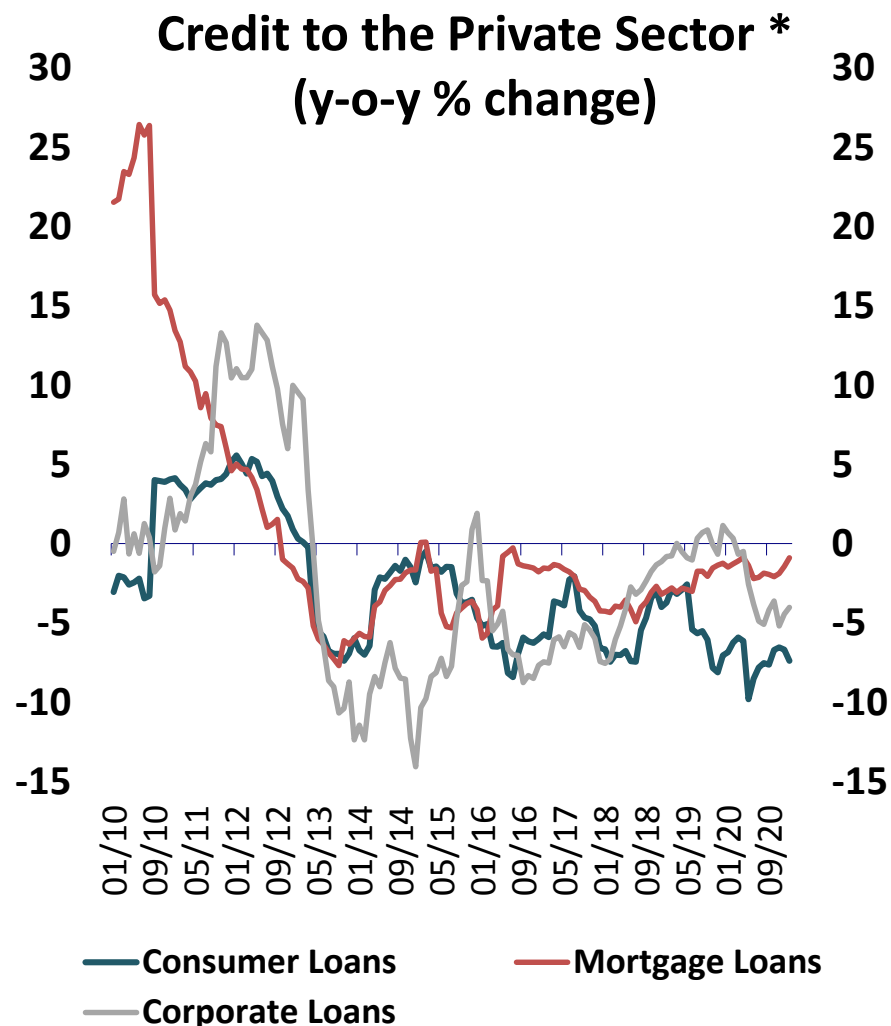
III. Cypriot Banks: Risks and challenges ahead

- ❑ Banking system was restructured and de-leveraged after the 2013 crisis and is in a healthier position today
- ❑ The banks' Achilles heel today is the cliff effect due to the ending of the COVID-19 moratoria
- ❑ High usage of moratoria, c. €11 bn, or half of performing loans, the highest in Europe
- ❑ Banks have been in a survival & restructuring mode since 2013, yet after NPEs are minimized, they need to realign their strategy and search for high risk-adjusted ROA
- ❑ Yet the environment remains difficult: The NPE problem may leave the banks but would remain in the economy

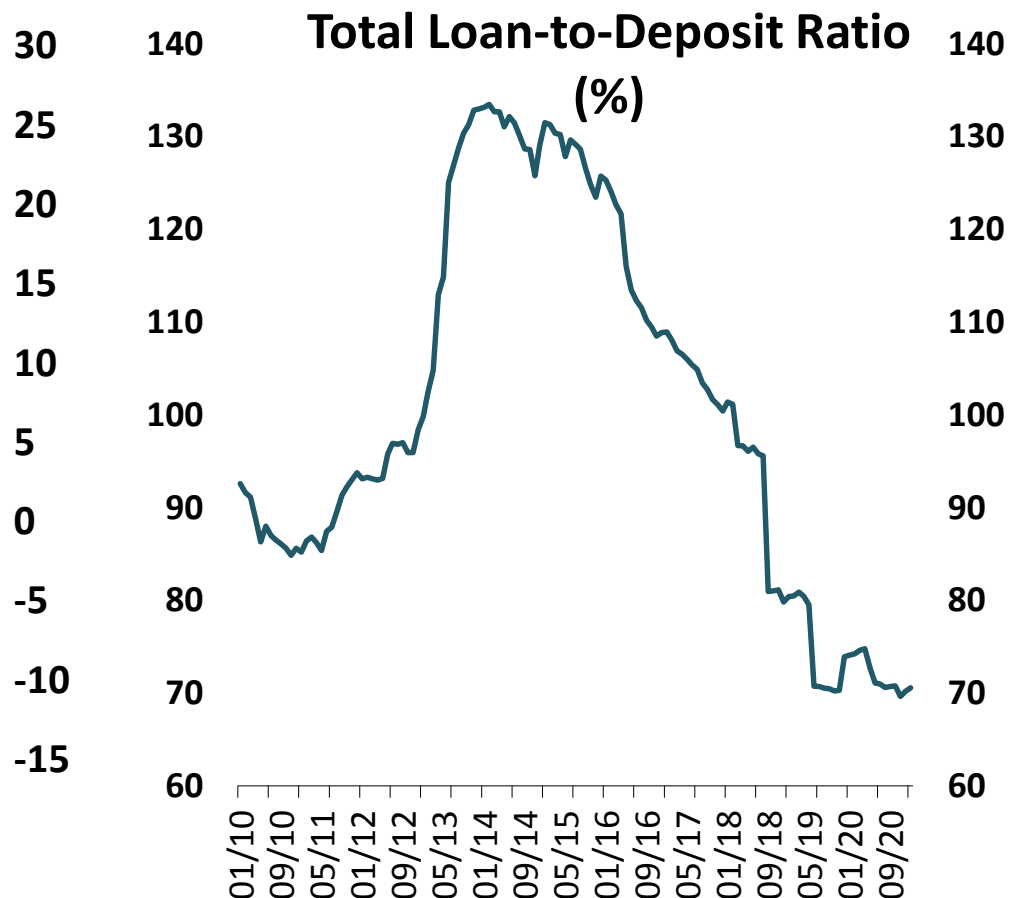
III. Cyprus banking system: Restarting from a healthier basis



III. Cyprus banking system: Confidence restored & liquidity position further strengthened



* adjusted for NPL sales and the transfer of Cyprus Cooperative Bank's loans to the Cyprus Asset Management Company, NBG estimates



III. Cypriot Banks, December 2019

Group Level – December 2019 (€mn.)	Cyprus	Hellenic	Eurobank	RCB	Astrobank	Alphabank	Total
1. Assets	21,123	16,308	6,304	4,705	2,266	2,601	53,307
2. Risk Weighted Assets (RWAs)	12,890	5,039	1,934	2,188	1,368	1,752	25,171
3. Gross Loans	12,822	7,244	2,097	3,569	1,158	2,107	28,997
4. Non-Performing Exposures (NPEs)	3,879	2,276	71	28	548	1,139	7,951
NPEs over Gross Loans (%)	30.3%	31.4%	3.4%	0.7%	42%	54.1%	27.4%
5. Total Provisions	2,096	1,265	46	13	301	610	4,331
Coverage rate (Provisions/NPE)	54%	55.6%	65.5%	46.4%	54.9%	53.5%	54.7%
Provisions for IFRS-9 stage 3 loans	1,960	1,223	44	12	247	447	3,933
6. Pre-Provision Income (PPI)	241	131	69	37	31	16	515
Net Interest Income	344	301	78	97	46	59	925
Net Fee & Commission Income	150	57	26	7	14	9	263
7. Tangible Equity	2,040	1,028	478	457	171	280	4,470
8. Regulatory Capital CET1	1,909	1,007	486	460	174	289	4,325
CET1 / RWAs (%)	14.8%	20%	25.1%	21%	12.7%	16.5%	17.2%
Fully loaded (for IFRS-9) CET1 / RWAs (%)	13.1%	19.5%	25.1%	21%	12.2%	14.2%	16.1%
Capital Cushion = Rows (8) + (5) – (4)	126	-4	461	445	-73	-240	715
Texas Ratio = Rows (4) / [(8) + (5)] (%)	96.9%	100.1%	13.3%	5.9%	115.3%	126.7%	91.9%

III. Bank of Cyprus, December 2020

❑ BoC Helix2 securitization brought down NPEs from €3.9bn to €1.8bn or 16% NPE ratio

❑ Even if nothing gets repaid from the new NPEs plus collateral value is zero, BoC survives with CET1 of €1bn or 10% CET1 ratio

❑ Covid-19 moratorium is a risk

Group Level – December 2020 (€mn.)	Cyprus	Cyprus post Helix 2 (pro forma basis)
1. Assets	21,514	21,472
2. Risk Weighted Assets (RWAs)	11,635	11,380
3. Gross Loans	12,261	10,907
4. Non-Performing Exposures (NPEs)	3,086	1,760
NPEs over Gross Loans (%)	25.2%	16.1%
5. Total Provisions	1,902	1,033
Coverage rate (Provisions/NPE)	61.6%	58.6%
Provisions for IFRS-9 stage 3 loans	1,731	878
6. Pre-Provision Income (PPI)	197	n/a
Net Interest Income	330	n/a
Net Fee & Commission Income	144	n/a
7. Tangible Equity	1,787	1,697
8. Regulatory Capital CET1	1,723	1,730
CET1 / RWAs (%)	14.8%	15.2%
Fully loaded (for IFRS-9) CET1 / RWAs (%)	12.9%	13.3%
Capital Cushion = Rows (8) + (5) – (4)	539	1,003
Texas Ratio = Rows (4) / [(8) + (5)] (%)	85.1%	63.7%

Note: Pro-forma and Preliminary Group Financial Results for the year ended 31 December 2020, published on 24 February 2021. The data in the right column are adjusted for NPLs sales (Project Helix 2, Portfolios A and B) of €1.3 bn based on the data as of 31 December 2020.

Conclusion

A year and a half ago, in an Economist conference I was saying:

- ❑ *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*

Relative to the pre-covid-19 period, I would now say:

- ❑ **The banks are in a healthier position, but the economy is not the domestic politics are worse**
- ❑ **Yet I am optimistic Cyprus will manage to overcome the stress one more time**

Thank you for your attention!

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