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Conclusion of ESM programme for Cyprus: an overview

European Stability Mechanism

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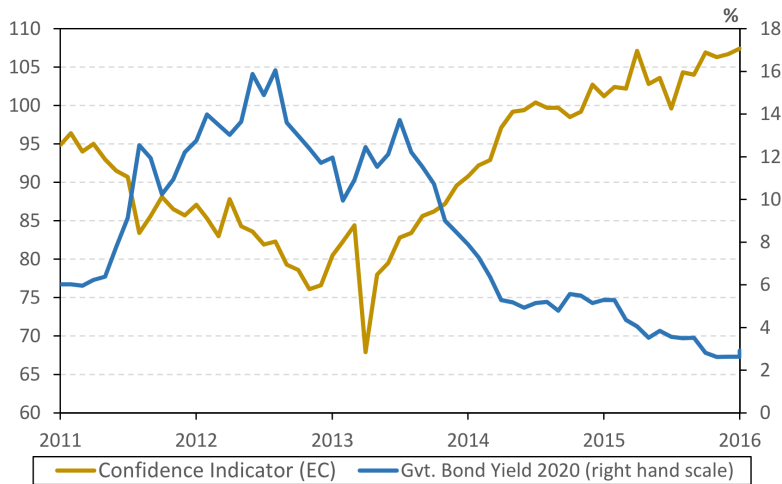
Conclusion of ESM programme for Cyprus: an overview

31 March 2016

Cyprus's clean exit possible thanks to strong commitment to reforms

- Three years of extensive reforms and ESM/IMF support have delivered **economic recovery**
- **Financial sector** was restructured, downsized and recapitalised
- **Macroeconomic imbalances** were corrected, **debt sustainability** achieved
- **Market access** was restored

Cyprus's 2020 bond yield and confidence indicator



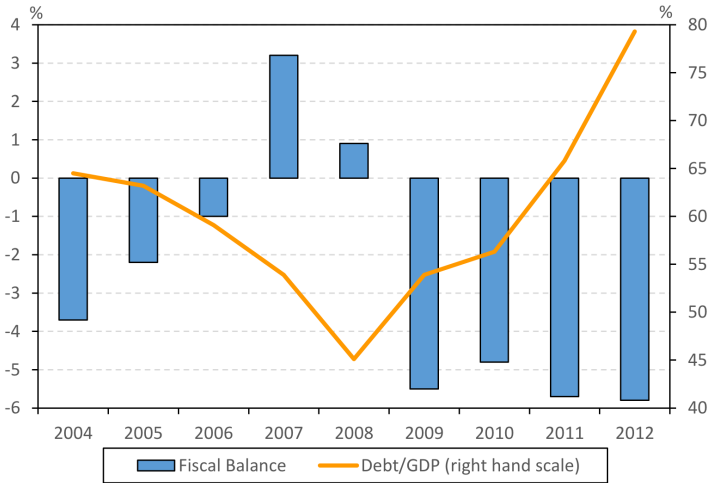
Confidence Indicator: overall economic sentiment derived from 5 indicators: industry (weight 40%), services (weight 30%), consumer (20%), construction (5%) and retail trade (5%). Source: European Commission

Source: European Commission, Bloomberg

The origins of Cyprus's crisis

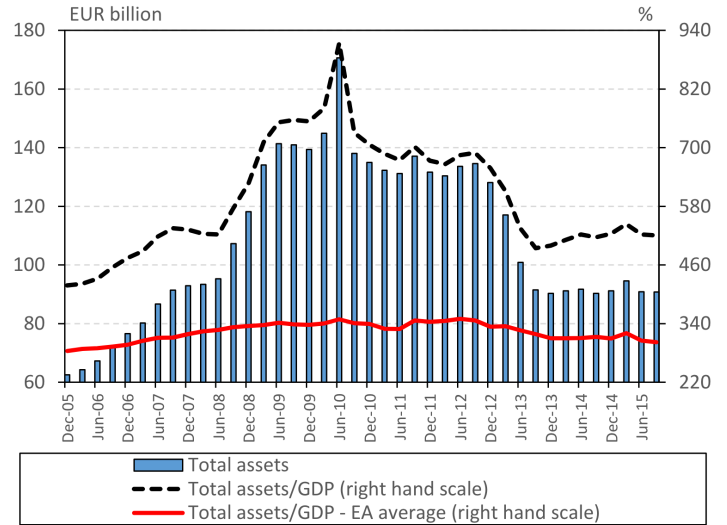
- Rapid expansion of financial sector after EU accession (2004) and adoption of euro (2008)
- Banking sector became oversized, with very poor lending practices, weak supervision, and concentrated exposure to Greece
- Macro and fiscal imbalances led to loss of market access

Fiscal imbalances



Source: European Commission

Oversized banking sector

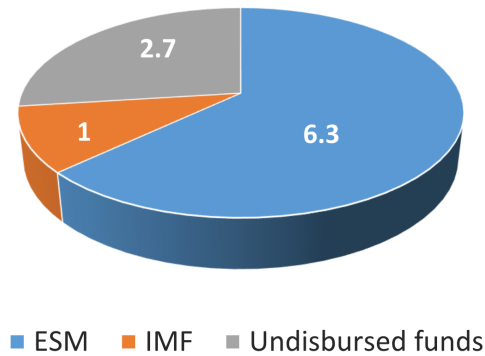


Source: ECB, Eurostat, ESM calculations

Financial assistance

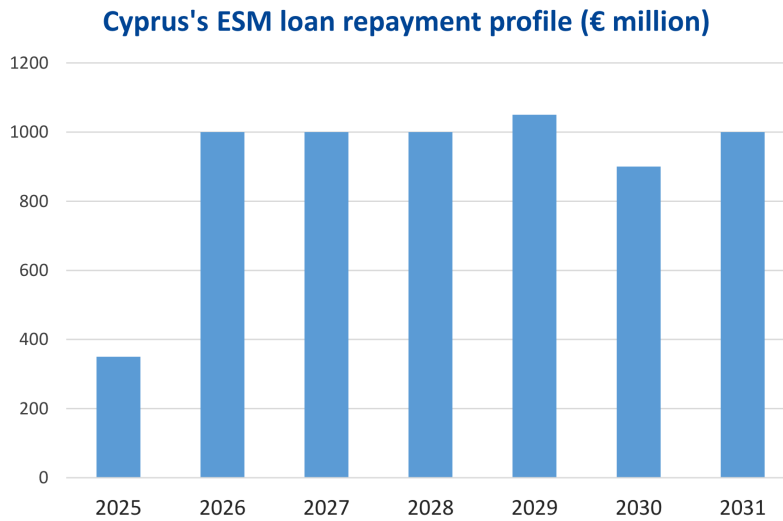
- Cyprus financial assistance programme agreed by ESM and IMF in April/May 2013
- Initial programme amount: up to €10 billion; €6.3 billion was disbursed by ESM and around €1 billion by IMF
- ESM loan disbursements from May 2013 to October 2015

Breakdown of total financial assistance for Cyprus (€ billion)



Financial assistance

- The ESM disbursed a total of **€6.3 billion** to Cyprus
- Loans included €1.5 billion for **recapitalisation of the Cooperative Central Bank Ltd**
- Repayment of loan principal starts in **2025**, ends in **2031**
- Weighted average maturity of ESM loans: **14.9 years**



Key objectives of the adjustment programme

Macro Fiscal

- Correcting the excessive government deficit
- Increasing the efficiency of the public sector

Financial sector

- Downsizing, recapitalising and restructuring of the banking sector
- Modernising legal, foreclosure and insolvency frameworks
- Strengthening supervisory environment

Structural

- Carrying out labour market reforms
- Removing obstacles in the services market
- Implementing privatisation programme

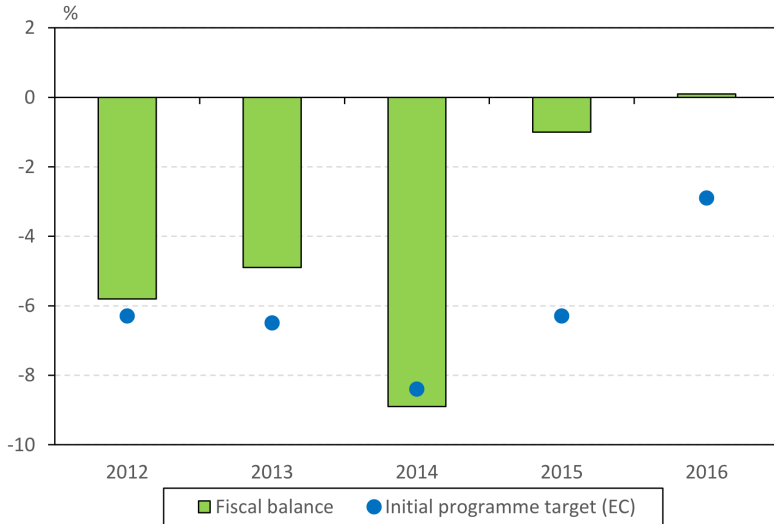
Programme success

- Cyprus's decision of a 'clean' exit is supported by the Institutions
- Programme achievements:
 - **Economic prospects improved:** to 1.6% growth in 2015 from -5.9% recession in 2013
 - **Unemployment** is gradually declining
 - **Fiscal adjustment** outperformed initial targets: public deficit declined to 1% in 2015 from 5.8% in 2012
 - **Liquidity and capital position** of the banking system restored
 - **NPLs** have peaked and are declining
 - **Market access** was restored
 - More than €1 billion **cash buffer** provides strong cushion

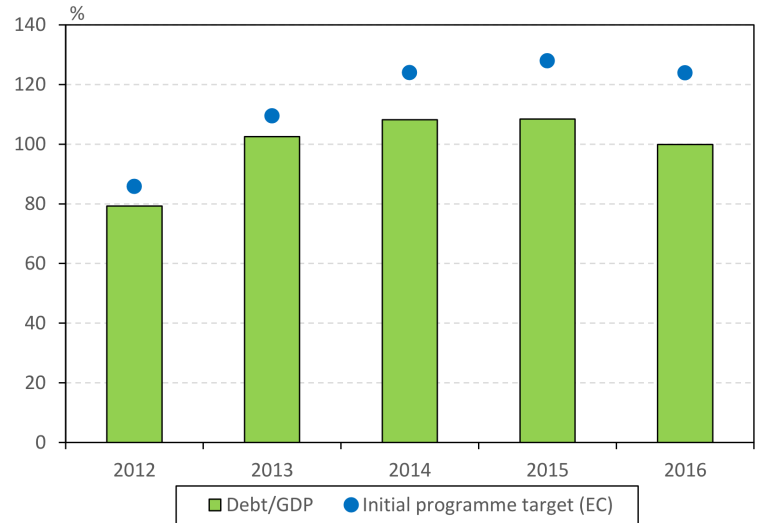
Fiscal adjustment helped to rebuild confidence

- Fiscal performance helped to regain market access
- After a deficit of almost 6% of GDP in 2012, the budget balance is expected to be slightly positive in 2016
- Government debt is now declining

Fiscal balance (% of GDP)



Debt/GDP (%)

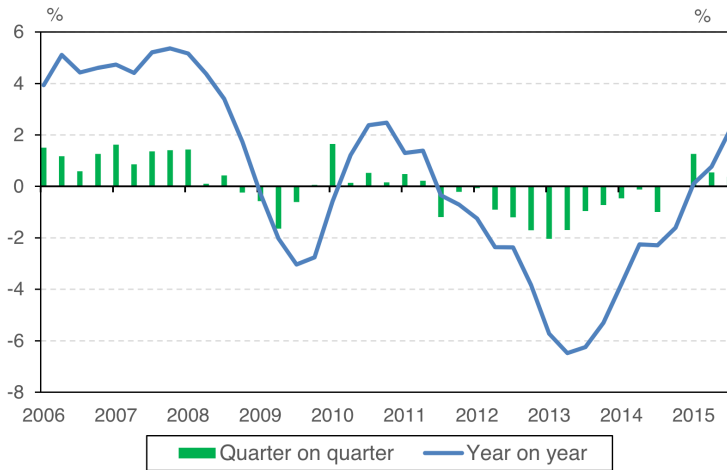


Source: European Commission

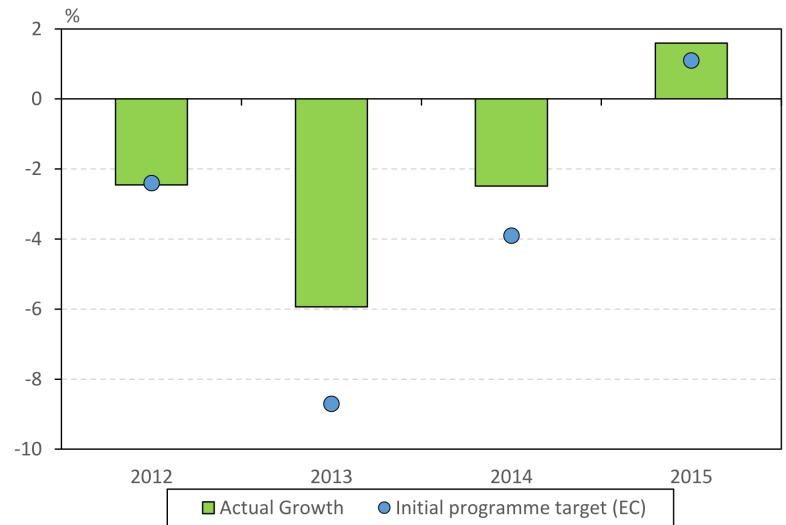
Growth is better than expected

- GDP is expanding: real GDP has grown for three quarters in a row and leading indicators point to a continuation of the recovery
- Program implementation led to a smaller recession and to a faster recovery than initially expected

GDP growth (%)



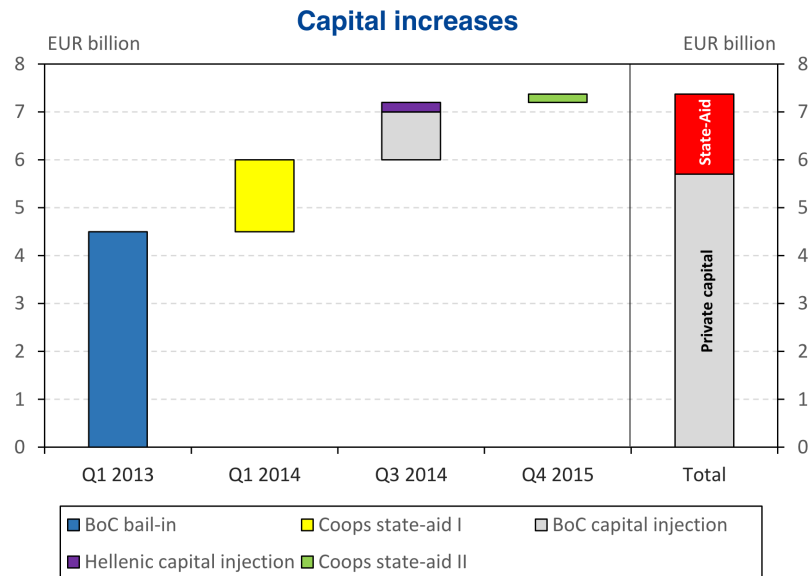
Actual growth vs. initial targets (%)



Source: Eurostat and European Commission (EC)

The Cypriot banking system is now well capitalised

- Public money was used for the recapitalisation of co-op banks only, the other systemic banks were recapitalised with private funds
- Bail-in was unavoidable to ensure debt sustainability
- Capital controls were a necessity to secure the liquidity of the banks. Controls were gradually relaxed and fully lifted in April 2015

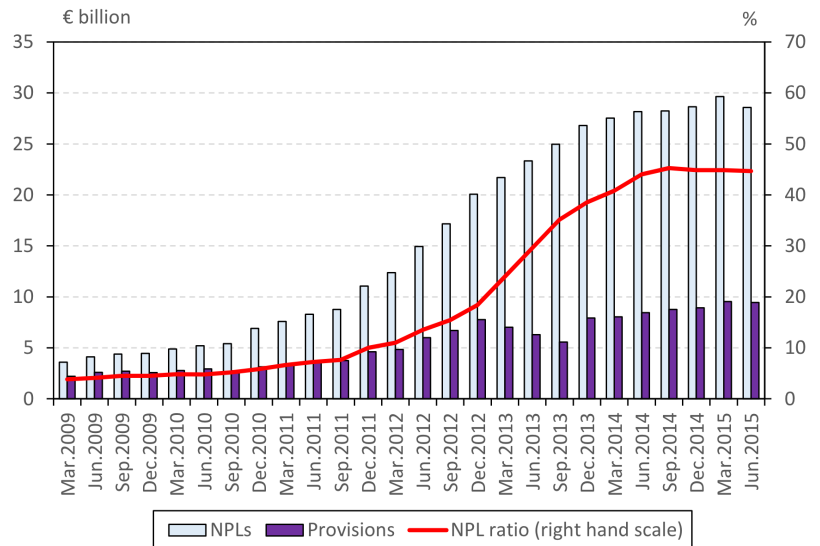


Source: ESM

Reform agenda does not end with the programme

- Address NPLs:
 - Active management of NPLs is essential to support recovery and financing of the economy
 - Securitisation law
- Keep fiscal discipline
- Continue labour market reform
- Finalise privatisation agenda

Non-performing loans and provisions



Source: IMF, ESM calculation

Next steps: Early Warning System and post-programme surveillance

- The ESM will operate its **Early Warning System (EWS)** until loans are fully repaid
- Euro area Member States exiting financial assistance fall under **post-programme surveillance**
- These countries will remain subject to **enhanced surveillance** until they have paid back a **minimum of 75%** of the assistance received
- Post-programme surveillance missions will be carried out **twice a year** by the European Commission with the ECB, IMF and the ESM

Summary: economic recovery is gaining momentum; challenges remain

- Fiscal consolidation efforts and bank restructuring ensured a successful return to funding in **financial markets**
- Cyprus is the **fourth success story** among EFSF/ESM programme countries (after Ireland, Spain, and Portugal)
- The example of Cyprus confirms that ESM's **loans-for-reform approach works**
- **Challenges** remain (high level of NPLs) and reform efforts must continue