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## Key points

- **The economy's solid performance continued into the fourth quarter of 2016 and in the first months of 2017 with encouraging signs across most sectors, including the real estate sector**
- **Since mid-2016 Cypriot government bond yields have defied the upward trend of the European Periphery's yields, thus Cyprus is now able to borrow at cheaper rates than Portugal in the international markets**
- **In March 2017, S&P upgraded the long-term sovereign rating of Cyprus Republic while Fitch and Moody's have kept their earlier assessments unchanged**
- **NPLs continue declining, yet their level remains high. Cyprus is no longer the worst performing EU state in terms of NPEs, and banks are very active in addressing the problem, while showing mixed performance in the attainment of the central bank's restructuring targets in the last quarter of 2016**

### 1. The second GDP estimate of Q4-2016 confirmed that the economy is on a fast growth recovery track

The second and latest estimate of CYPSTAT about the seasonally adjusted Q4 GDP reading was revised marginally above the flash estimate of +0.5%QoQ / +2.8%YoY to +0.7%QoQ / +2.9%YoY. This strong reading, compares to +0.7% QoQ / +2.9% YoY in Q3-2016, up from +1.2% QoQ / +2.6% YoY in Q2-2016 vs. +0.7% QoQ / +3.0% YoY in Q4-2015.

Real GDP growth marked the 7th consecutive positive reading on a both quarterly and annual basis after a three-year recession, confirming our earlier stipulated view in the previous Quarterly Economic Monitor that the economy is not only finally out of the woods but on a fast growth recovery track. The GDP growth rate of Q4 is among the highest in EA-19 and EU-28, both on a quarterly and an annual basis (Figure 2 & 3) and, for a sixth consecutive quarter in a row, above that of EA-19 (Figure 1).

Overall, after a three-year recession over 2012-2014 and a cumulative drop of 10.5% of GDP, the economy expanded by +1.7% YoY in 2015 and accelerated to +2.8% YoY in 2016, confounding initial international organizations' forecasts. In 2016, the Cypriot economy took off, solidifying and speeding up the previous year's recovery, leaving far behind the crisis years.

From a demand point of view, the consumption rebound continued into Q4-2016. Final consumption expanded by +0.2% QoQ / +2.3% YoY in Q4-2016, little down from +0.3% QoQ / +2.5% YoY in Q3-2016, vs. +0.4% QoQ / +1.5% YoY in Q4-2015, making a +1.9ppts contribution to growth. The consumption rebound is underpinned by a number of factors, namely the strong sentiment improvement, the visible labor market conditions improvement (unemployment declined for a third consecutive year in a row from 15.0% in 2015 to 13.3% in 2016 while employment expanded by 2.7% in 2016), the rise in real incomes, the still lower on an annual basis energy prices throughout Q4-2016 and the flourishing tourism sector.

A second force behind the GDP rebound is gross fixed capital formation, which skyrocketed by 96.7% YoY, a trend also repeated in Q2-2016, driven entirely by transportation equipment purchases which are likely due to ship and airplane imports. Net exports had a large negative contribution of 12ppts mirroring the rise of imports. Imports expanded by +12.0% YoY in Q4-2016, compared to -0.4% YoY in Q3-2016 vs. +0.3% YoY in Q4-2015. On the other hand, exports edged up by only +0.1% YoY in Q4-2016, down from +7.9% YoY in Q3-2016 compared to -0.4% YoY in Q4-2015. As a result, the hefty contribution of investments was largely offset by the negative contribution of net exports (imports: +12.0% YoY vs. exports: +0.1%YoY).

On the supply side, GDP dynamics were shaped by the steady performance of key sectoral pillars of the economy. Output in the combined sectors of "Wholesale and retail trade, transport, accommodation and food service activities" expanded by +4.8% YoY in Q4-2016, which was an inch down from the earlier +4.9% YoY in Q3-2016 and +3.2% YoY in Q4-2015. The performance of these national accounts items reflects largely the contribution of the flourishing tourism industry to the ongoing consumption recovery. Tourist arrivals expanded by +19.8% YoY to reach 3.2mn in 2016 vs. 2.7mn in 2015, setting a new all-time record high while tourism revenues increased by +11.9% YoY in 2016. In addition, manufacturing and professional services increased by +4.8% YoY (up from +4.7% YoY in Q3-2016 and +5.5% YoY in Q4-2015) and +5.3% YoY (down from +5.8% YoY in Q3-2016 and +6.6% YoY in Q4-2015) respectively. Furthermore, construction continued its dynamic double-digit recovery, expanding by +10.0% YoY in Q4-2016 compared to 10.3% YoY in Q3-2016 and 10.4% YoY in Q4-2015.

Financial Services is the exception: It remained a drag on economic recovery, recording negative growth for a fifth quarter in a row. Financial services contracted by -6.0% YoY in Q4-2016, down from -6.4% YoY in Q3-2016, compared to +1.5% YoY in Q4-2015. The negative contribution to GDP growth by the financial sector reflects largely the restructuring activities (debt to asset swaps), write-offs and the ongoing deleveraging.

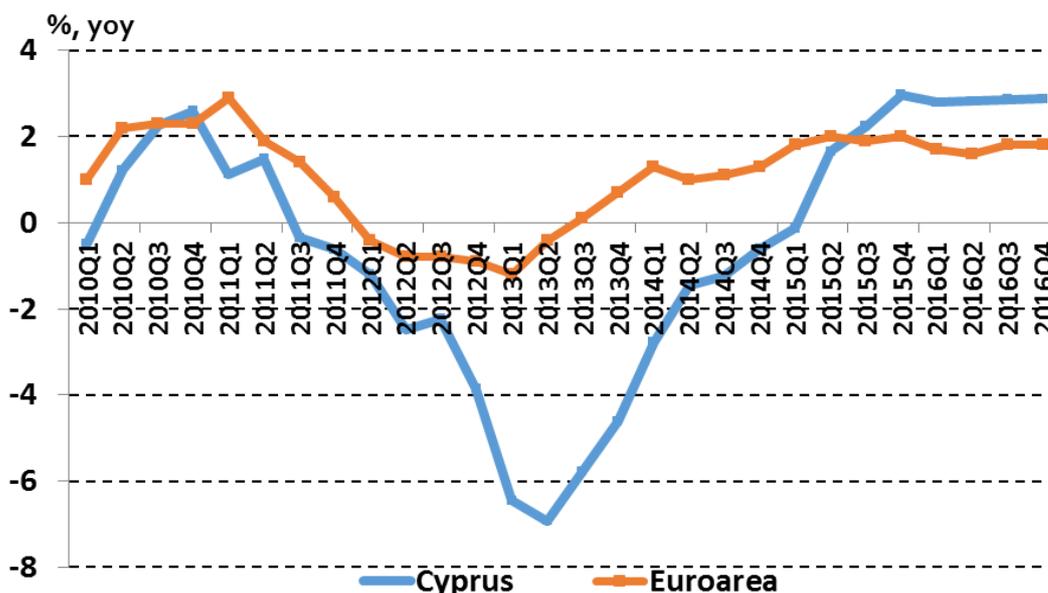
Economic activity continued its upward trend in the first months of 2017. High frequency and leading indicators were performing very well. For a more detailed analysis, we have prepared a special section at the end of this section. More specifically:

- **Sentiment:** The Economic Sentiment Index (ESI) climbed further in Q1-2017, very close to the levels prior to the Lehman Brothers international crisis. The improvement, the highest in EU-28 over the last three years, mirrors the lasting progress within the economic adjustment program, as well as general optimism for the short-term prospects of the Cypriot economy. On the other hand, we do notice that in the last couple of quarters **the correlation between sentiment and output growth has weakened** (Figure 4).
- **Retail Trade:** Retail sales, except motor vehicles and motorcycles - on a calendar adjusted and volume terms have expanded by +3.4% YoY in January and further by +4.0% YoY in February 2017.<sup>1</sup>
- **Credit-card** transactions: The value of credit-card transactions by Cypriots and foreigners expanded by 7.7% YoY and 20.5% YoY in Jan-Feb 2017 (JCC Payments Ltd)
- **Tourism:** The positive momentum for the tourism industry continued in Q1-2017. Tourist arrivals increased by +13.5% YoY in Jan-Mar 2017. Similarly, tourism revenues expanded by +22.9% YoY in Jan-Feb 2017.
- **Industrial sector:** Industrial production was up by 7.1% YoY in Jan-Feb 2017 driven by the robust performance of manufacturing sector in the segments of food products (+9.2% YoY), basic metal products (+11.2% YoY) and non-metallic mineral products (+26.7% YoY) plus electricity supply sector (+10.4% YoY). Similarly industrial confidence climbed to the highest level since April 2013, back to the same pre-crisis level recorded in June 2008 (Figure 5).
- **Property-market:** The number of real-estate market sale contracts has risen by 25% YoY in Jan-Apr 2017 (from 1,881 to 2,011). The reading in March 2017-only (626) was the highest in the last six years (Department of Lands and Surveys). Property prices were on a stabilization/increasing path in the 2H-2016. The Residential Property Price Index (RPPI) recorded its first quarterly increase in Q3-2016 since 2009 (Central Bank of Cyprus). The House Price Index, another index prepared and announced by Eurostat, increased by +2.8% QoQ / + 3.1% YoY in Q4-2016 which is the fourth highest in EU-28 in the same period.

<sup>1</sup> Eurostat provisional data as of May 1<sup>st</sup>, 2017. According to CYPSTAT, the annual rate of expansion in the two month period on an unadjusted basis amounted to +3.2% YoY in Jan-Feb 2017.

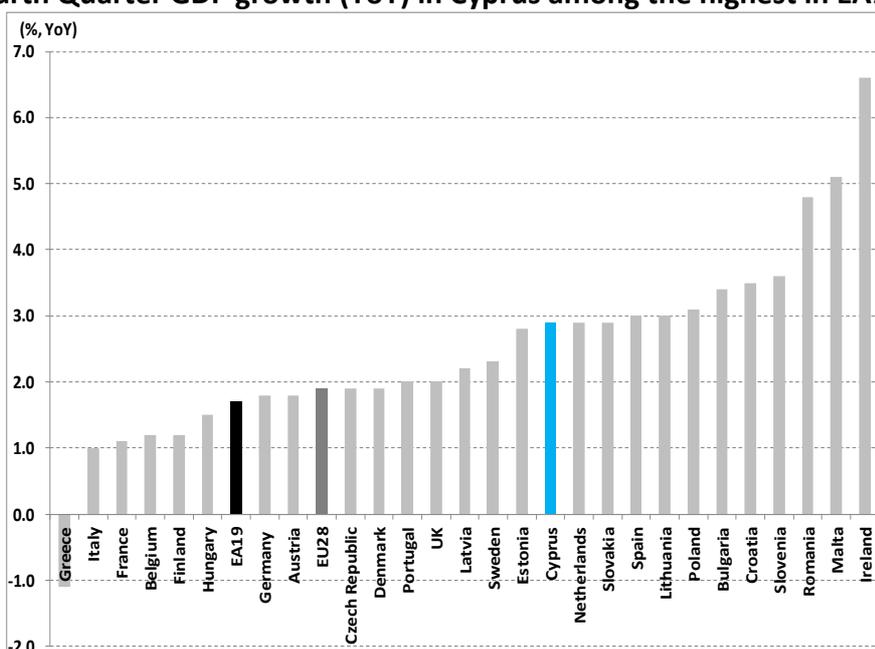
- **Labor market:** Unemployment resumed its downward trend in Q1-2017. The unemployment rate in seasonally adjusted terms declined further to 12.5% in March 2017, down from 13.3% in March 2016.
- **Deposits:** Deposits growth continued accelerating on an annual basis in Q1-2017. The annual rate of expansion climbed to 7.1% YoY in March up from +6.2% YoY in February and 6.0% YoY in January.

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



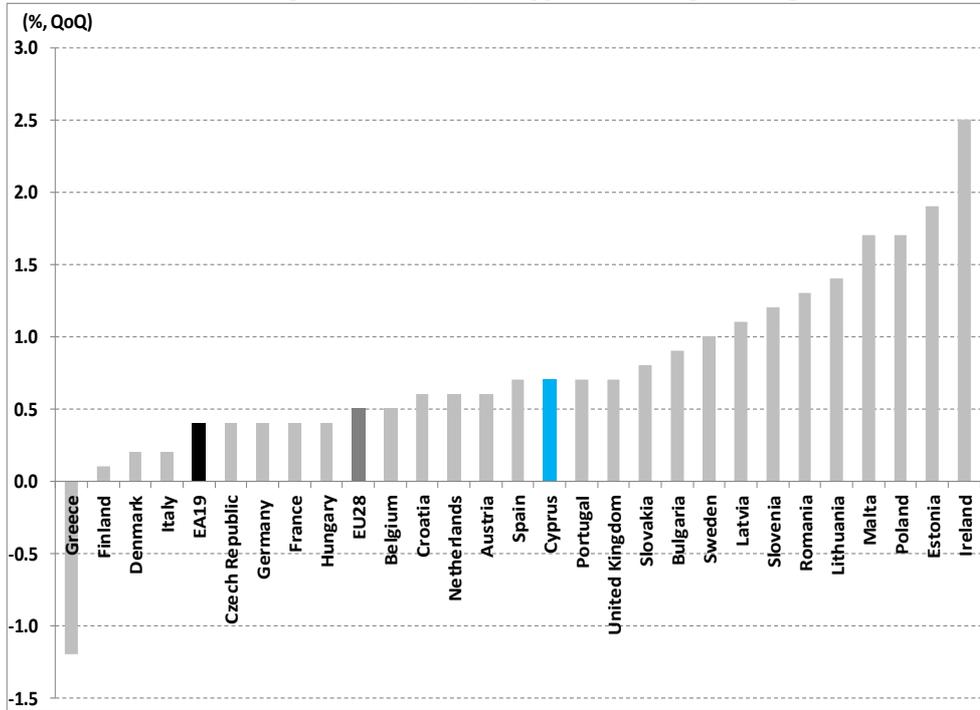
Source: Eurostat, CYSTAT, Eurobank Research

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



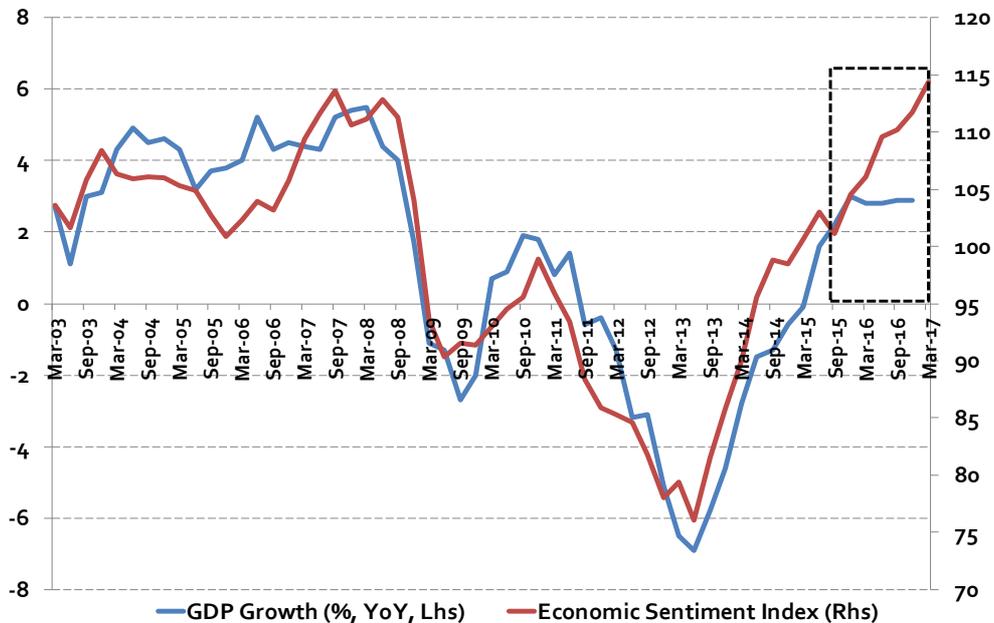
Source: Eurostat, CYSTAT, Eurobank Research

Figure 3: Fourth Quarter GDP growth (QoQ) in Cyprus among the highest in EA19 & EU28



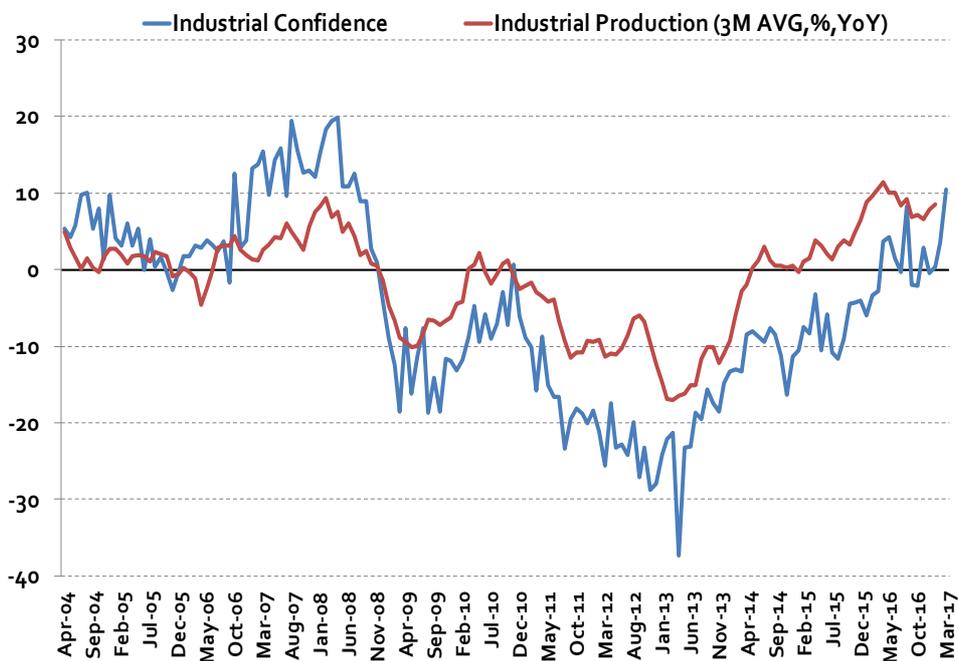
Source: Eurostat, CYPSTAT, Eurobank Research

Figure 4: Economic Sentiment and Economic Growth



Source: Eurostat, CYPSTAT, Eurobank Research

Figure 5: Industrial Confidence and Industrial Production



Source: Eurostat, CYPSTAT, Eurobank Research

## 2. Cyprus versus the rest of the European Periphery

Table 1 provides a few comparative statistics across the European Periphery. Three sets of statistics are presented: Fiscal, competitiveness and financial. The fiscal metrics in the case of Cyprus are in a much better shape than its peers in the Euro Area periphery. The competitiveness metrics-both price and quality- are still not the worst (especially when compared to Italy) in the periphery and on an improving trend. Yet, in the banking sector, a deviation of Cyprus from the rest of the Euro Area periphery can be clearly spotted. This is especially so in the very high NPLs ratio. The private and public sector indebtedness-indicators (if adjusted for the debt of foreign companies registered in Cyprus) are also close to or even better than the rest of the periphery. From that point of view, further progress in addressing the high NPLs ratio could act as a catalyst for further sovereign upgrades.

**Table 1**  
**Basic Metrics FY 2016 unless otherwise noted (Winter-Spring 2017)**

Key Economic Indicators	Cyprus	Greece	Ireland	Italy	Spain	Portugal
GDP growth (% , YoY)	2.8	0.0	5.2	0.9	3.2	1.4
Primary Balance <sup>2</sup> (% of GDP, IMF definition)	+2.3	+4.2	+1.3	+1.4	-2.2	+1.6
General Government Balance (% of GDP, ESA 2010)	+0.4	+0.7	-0.6	-2.4	-4.5	-2.0
Gross Public Debt (% of GDP, ESA 2010)	107.8	179.0	75.4	132.6	99.4	130.4
Current Account <sup>3</sup> Balance (% of GDP)	-5.3	-0.6	+4.7	+2.2	+2.0	+0.8
Total Investment <sup>4</sup> (% of GDP)	15.5	9.9	28.9	17.0	20.4	14.9
Doing Business 2017 (best = 100) Distance to Frontier <sup>5</sup>	72.65	68.67	79.53	72.25	75.73	77.40
REER <sup>6</sup> Q3-2016 (ULC total economy, 2005=100)	91.44	85.63	73.03	100.27	94.52	87.57
REER <sup>7</sup> Q3-2016 (CPI deflated, 2005=100)	93.60	95.68	89.26	94.77	97.66	96.42
Private Sector Indebtness (% of GDP, 2015)	354.9 <sup>8</sup>	126.4	323.6	120.1	173.1	195.9
NPLs <sup>9</sup> (% of Total Loans, December 2016)	44.8%	45.9%	13.6%	15.3%	5.7%	19.5%

Source: Eurostat, ECB, EBA, IMF WEO, World Bank's Doing Business

<sup>2</sup> IMF definition, World Economic Outlook, April 2017. In the case of Greece, the number was derived from the latest ELSTAT announcement and officials' statements.

<sup>3</sup> Eurostat, BPM6 definition. According to Fitch, in the case of Cyprus the number is distorted by the inclusion of special purpose entity flows (NPEs, mainly non-resident shipping industry), and authorities estimate that excluding these entities, the current account would have recorded a deficit of around 0.5% of GDP, narrowing from 1.5% in 2015.

<sup>4</sup> IMF, World Economic Outlook, April 2017

<sup>5</sup> World Bank (Doing Business, Distance to Frontier definition): The distance to frontier score aids in assessing the absolute level of regulatory performance and how it improves over time. This measure shows the distance of each economy to the "frontier," which represents the best performance observed on each of the indicators across all economies in the *Doing Business* sample since 2005. This allows users both to see the gap between a particular economy's performance and the best performance at any point in time and to assess the absolute change in the economy's regulatory environment over time as measured by Doing Business. An economy's distance to frontier is reflected on a scale from 0 to 100, where 0 represents the lowest performance and 100 represents the frontier

<sup>6</sup> Real Effective Exchange Rate corresponds to the trade-weighted baskets of competitor countries of the IC37 = EU28 + 9 other industrial countries (Australia, Canada, United States, Japan, Norway, New Zealand, Mexico, Switzerland and Turkey)

<sup>7</sup> Real Effective Exchange Rate corresponds to the trade-weighted baskets of competitor countries of the Broad group. The underlying Broad group (42) = IC37 + 5 other industrial countries (Russia, China, Brazil, South Korea and Hong Kong). For the broad group only HICP/CPI deflated REER are available.

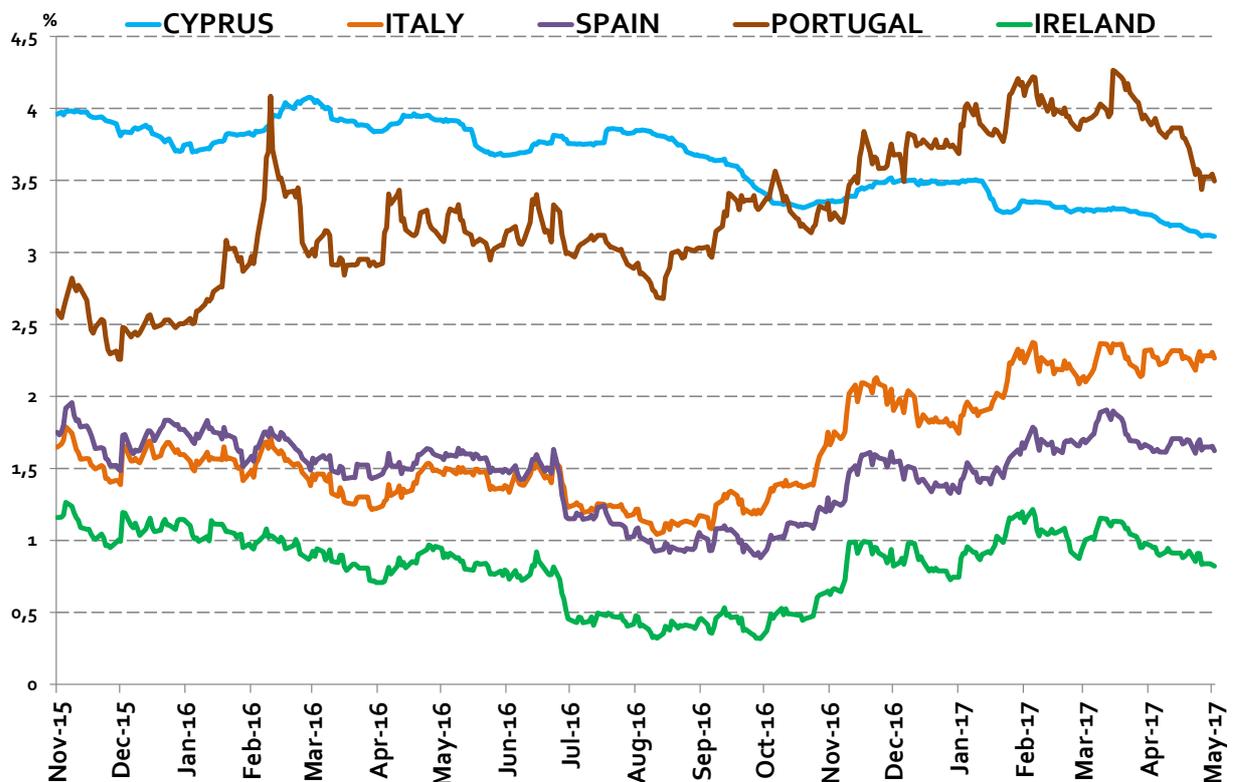
<sup>8</sup> In the case of Cyprus, the number is inflated by the cross-border lending of non-financial foreign corporates who are registered in the island for tax-planning purposes. Anecdotal evidence brings the relevant number at 90% of GDP

<sup>9</sup> EBA definition of NPLs. See EBA Risk Dashboard Data as of Q4-2016, risk-weighted average.

### 3. Optimistic market perceptions of the Cypriot economy

The improving state of the economy is reflected on the borrowing rates of the Cypriot government. Since mid-2016, Cypriot government bond yields are on declining trend at a time when Periphery bond yields were rising. As a result, by November 2016, Cyprus is borrowing at lower interest rates than Portugal (see Figure 6).

Figure 6: Generic 10 Year Government Bond Yields in Euro Area Periphery



Source: Bloomberg, Eurobank Research

### 4. Rating agencies appear hesitant to further upgrade the sovereign rating of Cyprus: Only Standard & Poors out of the three main rating agencies upgraded the Cypriot long term sovereign rating in their recent updates

The divergence of views on the sovereign rating of Cyprus between the rating agencies has increased after the last round of assessments in the spring. Out of the three main rating agencies (Fitch, Moody's and Standard & Poors) only Standard & Poors (S&P) changed the long-term sovereign rating of Cyprus in the last round of individual country assessments in spring 2017.

On March 17th, S&P upgraded the sovereign rating of Cyprus by one notch (from BB to BB+) with a stable outlook. The decision confirmed the expectations of only 5 out 11

economists' StockWatch poll. The decision reflects the better than expected growth performance and fiscal progress so far. According to S&P, the economy is now projected to grow by 2.5% in 2017, and is expected to average 2.3% in real terms over 2018-2019. The envisaged small fiscal surplus in 2018-20 (0.2%-0.4% of GDP) will lead to a discernible debt reduction in the same period. Accordingly, the gross general government debt is expected to decline to 90.2% of GDP by 2020 (82.1% in net terms). The stable outlook balances the S&P view of Cyprus fiscal and economic progress against unusually high levels of NPEs in the financial sector alongside risks of weaker reform delivery ahead of next year's Presidential elections. According to S&P, further upgrades would depend upon a stronger- than anticipated-economic growth and budgetary position leading to further public debt reduction below 80% of GDP. Finally, a further reduction in the currently high level of NPEs, which would indicate further convergence of Cypriot credit and monetary conditions including the monetary policy transmission mechanism to those of the Euro Area.

On March 24th, Moody's deferred its scheduled assessment on Cyprus, thus retaining the sovereign rating at B1. In the latest credit opinion published in late March, the agency cited the small and relatively undiversified economy, the ongoing weakness of the domestic banking sector and very high levels of public and private debt. Moody's cited further fiscal progress as the driver behind further upgrades. That is to say, Moody's will follow the primary surplus targets and whether those targets will be sustained at high levels, which would lead to a steady reduction in the debt burden over the coming years. According to Moody's, sustaining growth at current levels over the coming years plus a more rapid reversal in the previous upward trend for bank NPLs would also be credit positive.

On April 21<sup>st</sup>, Fitch affirmed the long-term sovereign rating of Cyprus at BB- with a positive outlook. Fitch took note of the ongoing economic recovery for a third year in a row following the 2013 crisis, the improved fiscal performance plus the accelerated restructuring effort by the banking sector and its improving liquidity conditions. The agency also upgraded its GDP growth forecast in 2017 to 2.7% from 2.5% previously. Nevertheless, Fitch underlined that the banking sector's exceptionally weak asset quality (NPEs ratio is still the highest of Fitch-rated sovereigns) and the very high gross general government debt (107.8% of GDP relative to the BB-rated country median of 46%) as key factors constraining the credit profile of Cyprus. Among the future developments that may possibly lead to an upgrade, Fitch cited the marked improvement in the overall asset quality of the banking sector, further track record of economic recovery, a reduction in the private sector indebtedness, a decline in the government debt to GDP ratio, a narrowing of the current account deficit and other external imbalances, as well as a sustained track record of capital market access at affordable rates.

There was no scheduled rating decision on behalf of DBRS this spring, yet one is due by mid-June. DBRS changed its outlook (trend) from stable to positive, yet confirmed its rating at B during last December. In its latest report on Cyprus on March 15, DBRS reiterated its earlier view that upward rating action will depend on Cyprus' ability to

sustain economic growth and primary fiscal surpluses over the medium term. In addition, a material reduction of non-performing loans and stronger progress on the privatization plan could also put further upward pressure on the rating.

Following the last round of assessments, the divergence of views on the sovereign rating of Cyprus has increased. The distance from government bond investment grade status is one notch for S&P (currently at BB+), four notches for Moody's (currently at B1), and three notches for Fitch (currently at BB-). The lack of investment grade status prevents Cyprus from qualifying to join ECB's Quantitative Easing (QE). Earlier, when Cyprus was still in a Program, an ECB waiver allowed participation in QE. The Program and the waiver no longer exist.

Overall, during last year Cyprus embarked on a virtuous cycle of sovereign rating upgrades. As of today, two of the rating agencies, Fitch and Moody's, have a positive outlook on Cyprus, implying they could further upgrade Cyprus over the next few months, provided the government were to stay focused on structural reforms and the on-going fiscal discipline.

**Table 2**  
**Foreign Currency Long Term Sovereign Ratings of Euro Area Periphery**

	Moody's		S&P	
	Current Rating	Outlook	Current Rating	Outlook
<b>Cyprus</b>	B1	Positive	BB+	Stable
<b>Greece</b>	Caa3	Stable	B-	Stable
<b>Ireland</b>	A3	Stable	A+	Stable
<b>Italy</b>	Baa2	Negative	BBB-	Stable
<b>Spain</b>	Baa2	Stable	BBB+	Stable
<b>Portugal</b>	Ba1	Stable	BB+	Stable
	Fitch		DBRS	
	Current Rating	Outlook	Current Rating	Outlook
<b>Cyprus</b>	BB-	Positive	B	Positive
<b>Greece</b>	CCC	Stable	CCC High	Stable
<b>Ireland</b>	A	Stable	A High	Stable
<b>Italy</b>	BBB	Stable	BBB High	Stable
<b>Spain</b>	BBB+	Stable	A Low	Stable
<b>Portugal</b>	BB+	Stable	BBB Low	Stable

Source: Rating Agencies

**Table 3**  
**Foreign Currency Long Term Sovereign Ratings of Cyprus**

Moody's	S&P	Fitch	DBRS	Rating Description
Aaa	AAA	AAA	AAA	Prime
Aa	AA	AA	AA	High Grade
A	A	A	A	Upper Medium Grade
Baa	BBB	BBB	BBB	Lower Medium Grade
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	
Caa	CCC	CCC	CCC	
Ca	CC	CC	CC	
Ca	C	C	C	
C	D	D	D	

Source: Rating Agencies

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

**5. Despite the intense restructuring effort of the banks and the decline in the stock of bad loans, NPEs remain the elephant in the room. Banks' performance in the attainment of the central bank's restructuring targets throughout 2016 is mixed.**

According to the data released by the Central Bank of Cyprus, the stock of non-performing exposures (NPEs) declined by €452mn in Q4-2016 on top of the €578mn in Q3-2016. The decline in NPEs reflects three main factors: increased repayments, the migration of successful restructurings to performing facilities after the completion of the observance period plus write-offs and settlements through immovable property exchange. At the same time, total loans expanded by €768mn in Q4-2016 compared to a €477mn decrease in the period before, resulting in the small decline in the NPEs ratio from 48.6% in September to 47% in December.

Overall, the stock of NPEs was down by €3.6bn, from €27.3bn to €23.7bn, or 13.4% cumulatively over the period December 2014 to December 2016. This decrease in the volume of NPEs is not showing up in the ratio statistics because during the same period total loans decreased by a much larger amount, €6.9bn. The net effect was a negligible decline in the ratio of NPEs to total loans, from 47.8% in December 2014 to 45.8% in December 2015 and to 47.0% in December 2016.

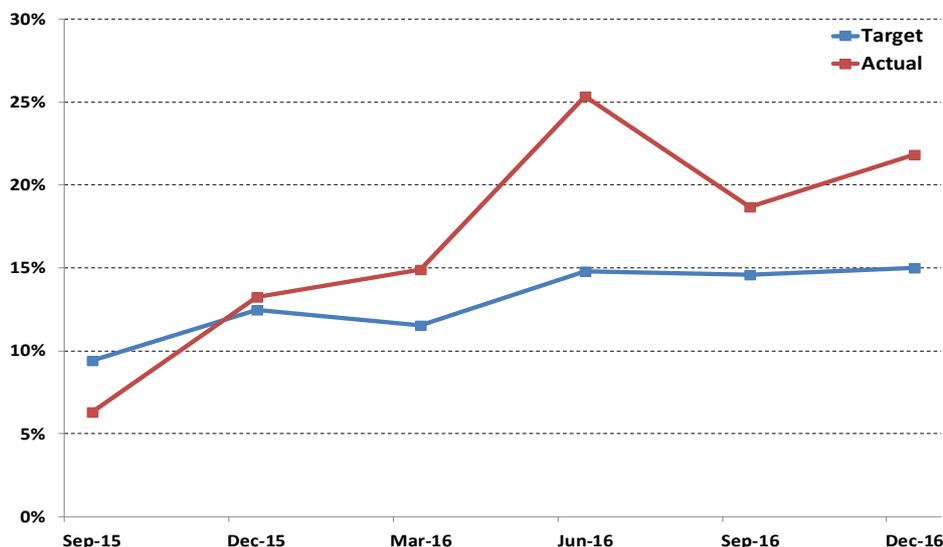
Recall that based on EBA's conservative definition, a restructured loan is still classified as an NPE for a probation period of at least 12 months, even if it is serviced without incurring new arrears. As a result, a very large fraction of the restructured loans are still classified as NPEs (€9.7bn out of €13.4bn in December 2016). Thus, when examining the traditional NPL (90+ past due) ratio, the improvement in the statistic is more striking. The NPL ratio declined from 38.5% in 2014 to 36.1% in 2015 and further to 34.3% in 2016.

In any case, the NPE ratio remains extremely high, the second highest in the Euro Area behind Greece in December 2016. It is important to note that the stock of NPEs is still comparably very large relative to the size of the economy. The NPEs as a percentage of GDP stood at 132.4% in December 2016, down from 155.1% in December 2014. From that point of view, the Central Bank of Cyprus has noted that there is a long road towards the eventual resolution of NPEs.

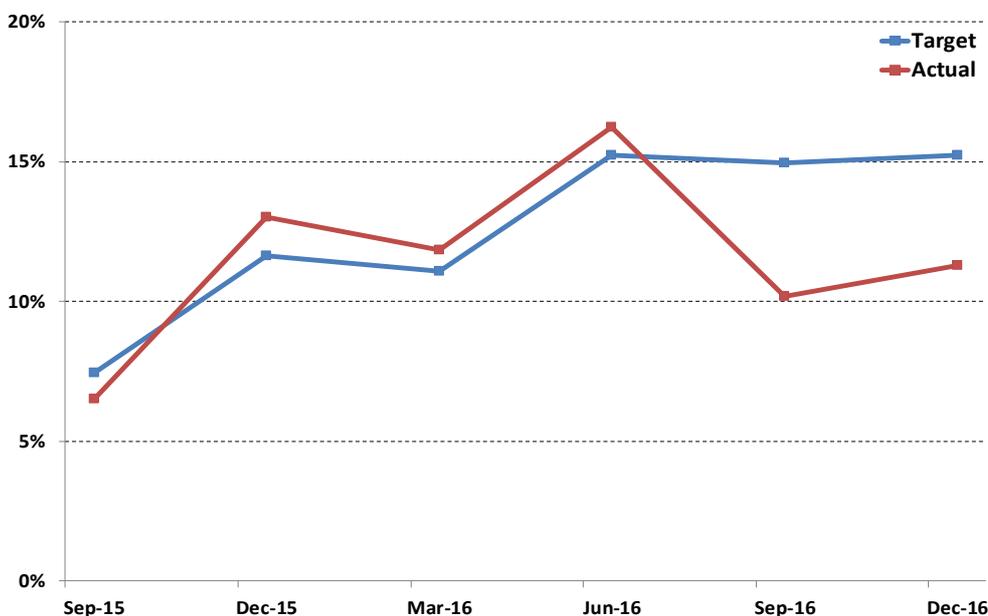
Overall, banks have demonstrated mixed performance in the achievement of their restructuring targets in Q4-2016. The Central Bank uses a set of four indicators to monitor the compliance of the banks in the NPEs restructuring process. In its statement the Central Bank noted that there is an over-performance of the target for the first indicator ("Proposed sustainable solutions") and a marginal under-performance for the third indicator ("Loans that have been restructured and present arrears of less than 8 days"), pointing to the huge effort that is being made in sustainable restructuring of loans in arrears over 90 days.

Specifically, the target for the first indicator was set at 15.0% and the actual realization was 21.8%. The target for the third indicator was 72.2% whereas the actual realization was 71.9%. However, the biggest under-performance was observed in the second indicator ("Concluded sustainable solutions") whose target was 15.2% and the actual realization was 11.3%. A smaller under-performance was observed for the target of the fourth indicator ("Loans that presented arrears of 31-90 days at the beginning of the quarter but by the end of the quarter do not present any arrears"), which was 44.1% whereas the actual realization was 42.9%.

Indicator #1, "Proposed sustainable solutions rate": *The percentage of the balances of sustainable solutions proposed during the quarter in relation to the borrowers with loans exhibiting arrears of over 90 days at the beginning of the quarter*

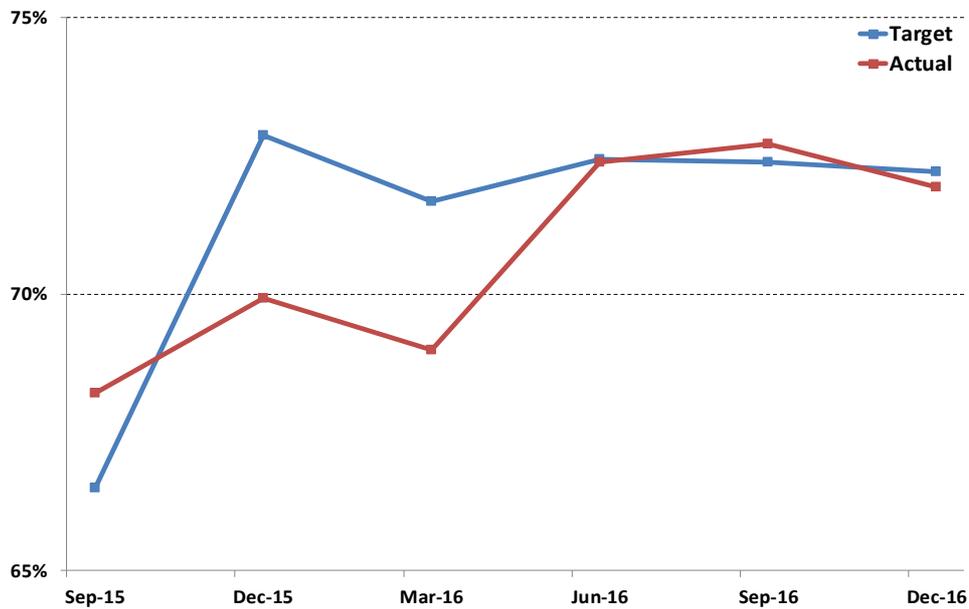


Indicator #2, "Concluded sustainable solutions rate": *The percentage of the balances of sustainable solutions concluded during the quarter in relation to the borrowers with loans exhibiting arrears of over 90 days at the beginning of the quarter*

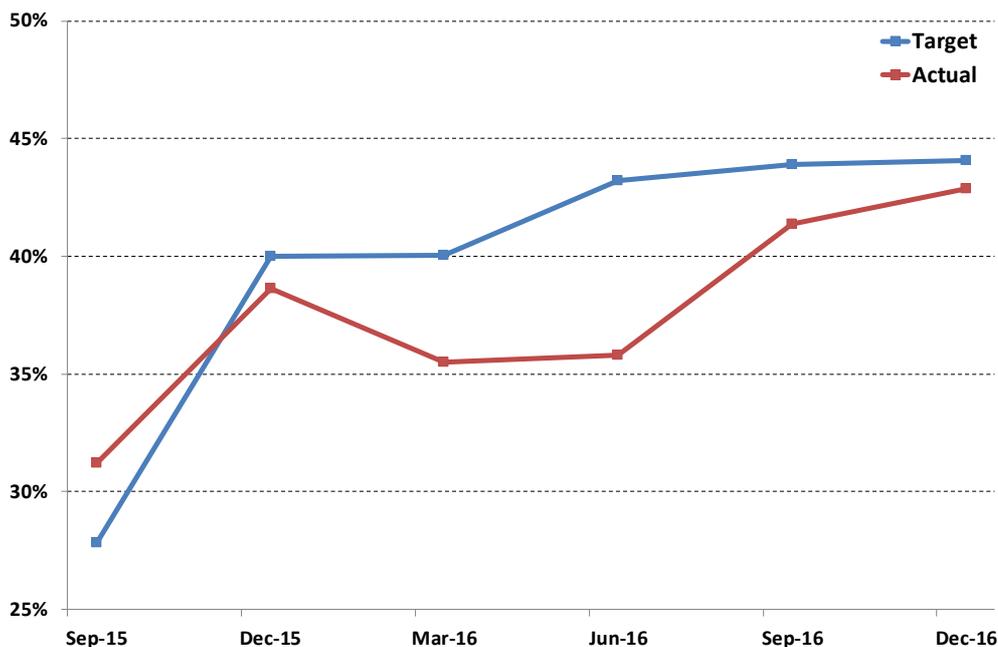


Source: Central Bank of Cyprus, Eurobank Research

Indicator #3, "Terms-being-met rate": *The percentage of the balances of solutions concluded from 1/1/2014 up to the end of the previous quarter which exhibited arrears of less than 8 days at the end of the reporting quarter*



Indicator #4, "Aggregate early-arrears cure rate": *The percentage of the amount of loans that presented early arrears (i.e. 31-90 days in arrears) at the beginning of the reporting quarter, which were cured during the quarter (i.e. presenting no arrears at the end of the reporting quarter) by (i) being restructured with a sustainable repayment schedule and (ii) other effective means*



Source: Central Bank of Cyprus, Eurobank Research

## 6. Interpreting the latest Cypriot Economic News (January-March 2017)

### The real economy continues to surprise positively

#### Economic Sentiment Index (ESI Index)

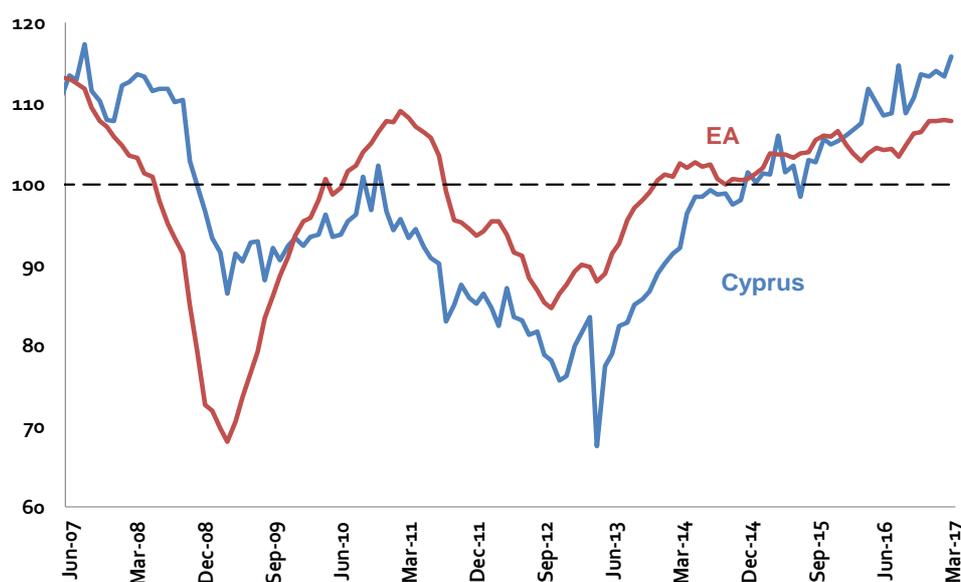
#### Confidence on an upward trend in Q1-2017, close to its pre-Lehman peak

The ESI Index jumped by 2.5 points to 115.8 in March compared to 113.3 in February reaching a new multi-month high. The more pronounced improvement in expectations came from industry (by 6.9 points), and consumer sentiment (by 1.7 points). On the other hand, construction declined by 6.3 points and services edged down by 0.1 points. Including the latest reading, the ESI index stands an inch below its pre-Lehman peak at 117.3, which was recorded in August 2007 and has surpassed the previous multi month high at 114.8 recorded in August 2016.

All in, the ESI Index stands above its long-term average, spurring optimism for the prospects of short-term economic activity. The improvement recorded in the past three years – a total of 48.3 points since April 2013- is the highest in EU-28 over the same sample period. Sentiment improvement is one of the key drivers of the consumption rebound, which feeds into output growth.

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

**Figure 7: Index of Economic Sentiment**



Source: Eurostat, Eurobank Research

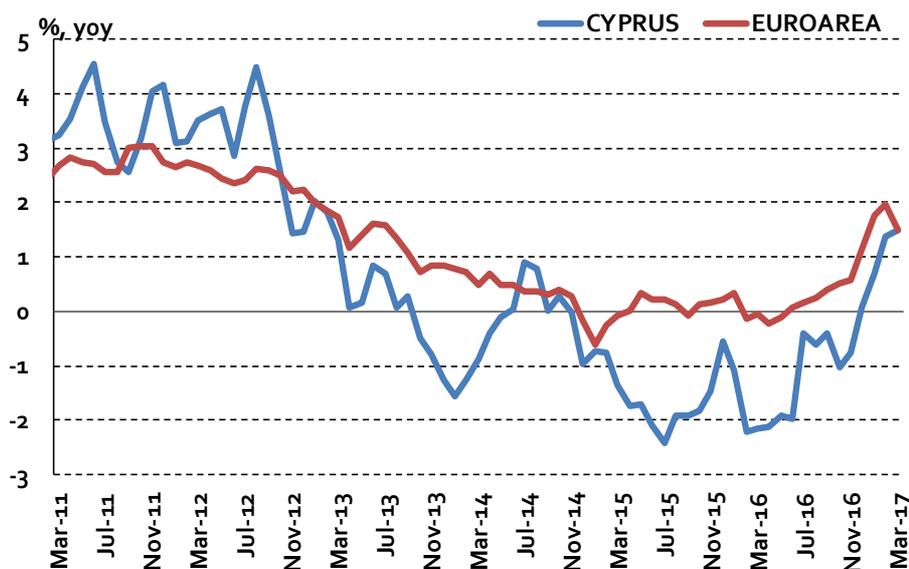
## Consumer prices (HICP)

### Inflation jump in Q1-2017

Consumer prices, measured by HICP, have entered positive territory since December. Having jumped to +0.1% MoM/+1.4% YoY in February up from -0.8% MoM/+0.7% YoY in January and only +0.3% MoM/+0.1% YoY in December, HICP edged further up to +0.9% MoM/+1.5% YoY in March.

The biggest increase on an annual basis were observed in the categories of *Transportation* (+0.8% MoM/+3.1% YoY in March vs. -0.2% MoM/+4.1% YoY in February) and *Utilities* (+1.8% MoM/+10.2 YoY vs. +1.7% MoM/+7.7% YoY), which reflect the pass through of rising world energy prices and the subsequent increase in the local electricity tariffs. As of March, the rise of energy prices and volatile food (fruit and vegetables) accounted for 1.3 ppts and 0.7ppts respectively while non-energy industrial goods and services subtracted another 0.2 ppts from the headline respectively. The March reading is the third consecutive positive in 2017, but also the highest reading since March 2013, after that of last January which marked the end of the prolonged-four year- period of deflation in the island. As a result, the average annual HICP came already at +1.2% YoY in Q1-2017 up from -1.2% YoY in the 2016, -1.4% YoY in 2015 and -0.7% YoY in 2014.

Figure 8: HICP in Cyprus vs. EA-19



Source: Eurostat, Eurobank Research

## Deposits & Loans

### Deposit growth continued accelerating on an annual basis in the first two months of 2017

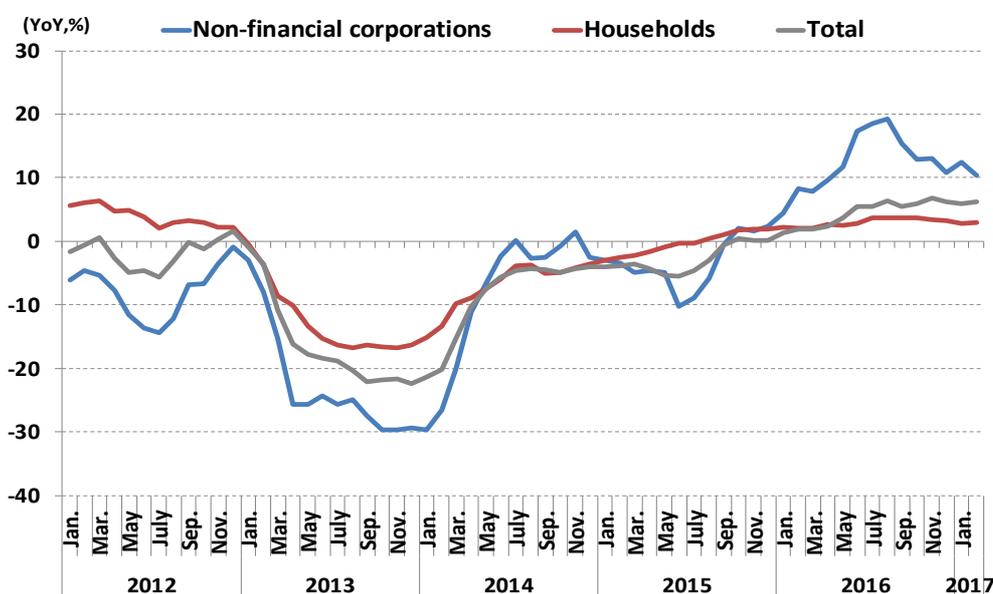
The Central Bank of Cyprus published on March 27<sup>th</sup> the Monetary and Financial Statistics (MFS) of February.<sup>10</sup> From a flow point of view, total deposits recorded a net increase of €174.9mn in February, up from 148.8 mn in September 2016, compared with a net increase of €78.4mn in February 2016. The annual rate of expansion- the seventeen consecutive positive in a row - came at 6.2% YoY in February, compared

<sup>10</sup> [http://www.centralbank.gov.cy/media/xls\\_gr/2ndMFSMarch2017gr.xls](http://www.centralbank.gov.cy/media/xls_gr/2ndMFSMarch2017gr.xls)

to 6.0% YoY in January and 3.7% YoY in May 2016 vs. only 0.2% YoY in December 2015. The outstanding amount of total deposits reached €49.3bn in February 2017, up from €49bn in January 2017, €46.5bn in May 2016 and €45.97bn in December 2015.<sup>11</sup>

Total loans in February 2017 exhibited a net increase of €139.1 mn, compared with a net decrease of €86.4 million in January 2017. The annual growth rate of contraction narrowed to -6.3% YoY in February down from -6.5% YoY in January compared to -11.0% YoY in December 2016 and only -3.4% YoY in December 2015. A substantial part of these repayments concern previous transfers of loans from non-resident MFIs and are not related to the domestic economic activity. The outstanding amount of loans reached €55.2bn in February up from €54.9bn in January, down from €55.3bn in May 2016 and down from €62.7 bn in December 2015.

Figure 9: Annual growth of deposits



Source: Central Bank of Cyprus, Eurobank Research

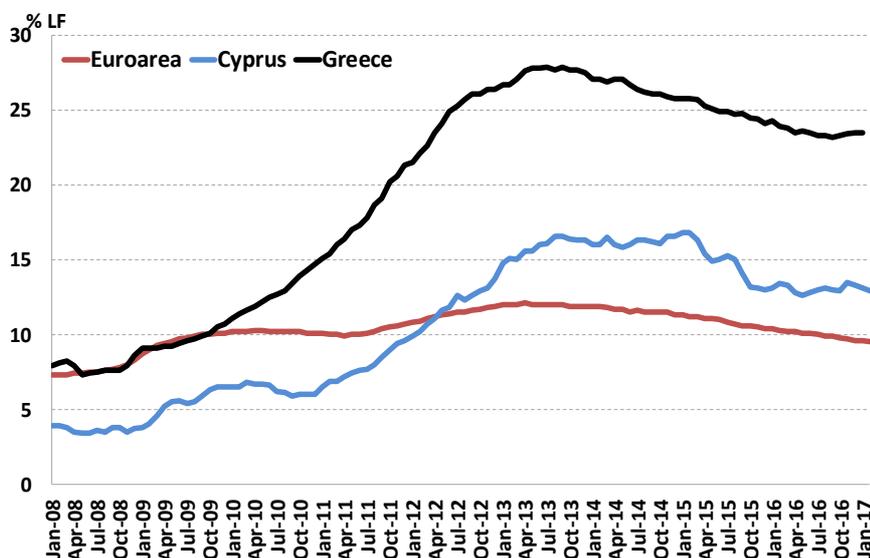
## Unemployment

### Unemployment resumes its downward trend in the first months of 2017

According to the latest Labor Force Survey (LFS), unemployment on a seasonally adjusted basis declined further to 12.5% in March 2017 down from 12.8% in February 2017, down from 13.3% in December 2016, compared to 13.3% in March 2016 and 17% at its peak in October 2013. Overall, Cyprus recorded the highest unemployment decline in the Euro Area (the third highest EU-28 after Croatia) in 2016. Yet, the declining trend of unemployment in Cyprus and Greece stopped in Q4-2016, in contrast with Euroarea, but nevertheless resumed in the first months of 2017 (See Figure 8). Despite the improving trend, unemployment in Cyprus is still the fourth largest in EU-28. Youth & Long-term unemployment are a source of concern and necessitate more attention.

<sup>11</sup> The Central Bank is using ECB methodology to calculate the annual growth with a special formula taking into account the monthly transactions

Figure 10: Unemployment rate



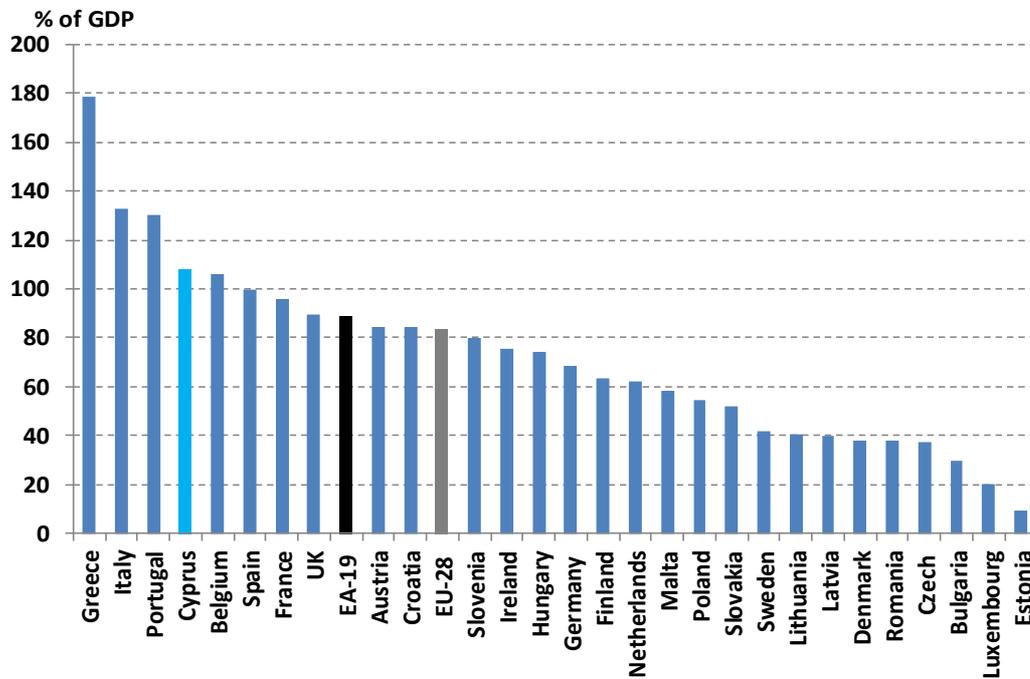
Source: Eurostat, Eurobank Research

### **2016 General Government Deficit and Public Debt (ESA2010 terms)**

#### **Eurostat confirms the fiscal performance of 2016**

On April 24th, Eurostat announced the provisional data for the fiscal deficit and debt in the context of the first notification by EU member states as part of the Excessive Deficit Procedure. In ESA2010 terms, Cyprus recorded a €64mn general government surplus in 2016 which is equivalent of 0.4% of GDP switching from a deficit of €209mn, equivalent of -1.2% of GDP in 2015. In 2016, Cyprus recorded a surplus on the general government level in ESA2010 terms for the first time since 2008. Cyprus is among those seven EU members who registered a general government surplus (compared to Euro area and EU-28 deficit of 1.5% and 1.7% respectively). Accordingly, the general government debt climbed at €19.3bn or 107.8% of GDP in 2016 up from 19.0bn or 107.5% of GDP in 2015. The government debt as a percentage of GDP is the fourth highest in Cyprus behind that of Greece (179%), Italy (132.6%), and Portugal (130.4%). On another note, Eurostat withdrew its reservations on the quality of the data reported by Cyprus in relation to a series of technical issues which had not been clarified in a satisfactory manner during the October 2016 assessment.

Figure 11: General Government Debt across EU-28 members in 2016



Source: Eurostat, Eurobank Research

**Jan-Feb 2017 Budget execution (cash basis)**

**The budget surplus improved in the first two months of 2017**

In the near term, the budget was in surplus in the first two months of 2017. The consolidated government surplus increased to €133.0mn in 2M-2017, up from €38.6mn in 2M-2016. As a percentage of GDP, the consolidated government surplus came at +0.8% in 9M-2016, switching from a beginning deficit of -0.2% in Q1-2016, and compared to a surplus of +0.6% of GDP in 9M-2015. The primary surplus stood at +2.9% of GDP in 9M-2016 almost unchanged from the level during the same period a year ago. Total revenues improved by +2.1% YoY, driven by higher indirect tax and social contributions. On the other hand, total expenditure inched up by +0.4% YoY driven by higher subsidies and spending on pensions. Nevertheless, key spending items such public wages and current transfers remained well contained.

**Table 4: General Government Budget Execution**

<b>General Government Adjusted Budget Balance on cash basis (January-February 2017)</b>		
<b>in % GDP</b>	<b>January-February 2016</b>	<b>January-February 2017</b>
<b>I. Government Budget and SSF</b>		
<b>Total Revenue</b>	<b>5.52%</b>	<b>5.77%</b>
Current revenue	5.52%	5.73%
Direct Taxes	1.87%	1.75%
Indirect Taxes	2.11%	2.36%
of which, VAT	1.22%	1.34%
Social security contributions	1.03%	1.09%
Non-tax revenue	0.51%	0.53%
Capital Revenue	0.00%	0.00%
Grants	0.01%	0.04%
<b>Total Expenditure</b>	<b>5.43%</b>	<b>5.03%</b>
Current expenditure	5.38%	4.95%
Wages and Salaries	1.44%	1.41%
Goods and services	0.20%	0.22%
Subsidies	0.16%	0.03%
Social Security payments	1.36%	1.23%
Pensions	0.48%	0.48%
Social Pensions	0.06%	0.06%
Current transfers	1.32%	1.18%
Non-allocated	0.01%	0.01%
Interest payments	0.35%	0.33%
Capital expenditure	0.73%	0.84%
<b>Balance (I)</b>	<b>0.10%</b>	<b>0.73%</b>
<b>II. Other General Government Bodies</b>		
including		
Local Authorities	0.00%	-0.03%
Semi-public Entities	0.02%	-0.01%
Other Entities	0.01%	0.02%
<b>Balance (II)</b>	<b>0.03%</b>	<b>-0.01%</b>
<b>III. ESA 2010 adjustments</b>		
<b>Balance (III)</b>	<b>0.09%</b>	<b>-0.01%</b>
<b>III. General Government Balance</b>		
<b>Budget Balance (I+II+III)</b>	<b>0.22%</b>	<b>0.72%</b>
<b>Primary Balance (excl. interest)</b>	<b>0.52%</b>	<b>1.06%</b>
<b>Cyprus GDP (Mrd EURO-CYP)</b>	<b>17,901.0</b>	<b>18,600.0</b>

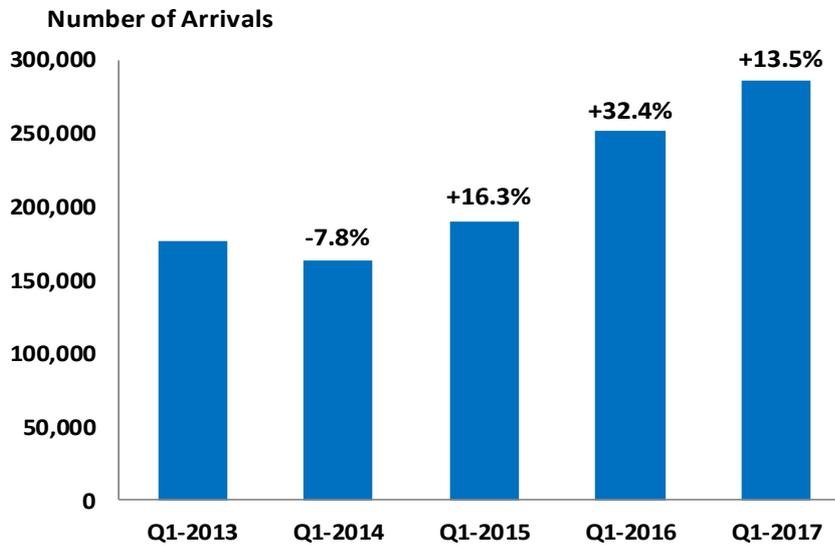
Source: Ministry of Finance, Eurobank Research

### **Tourism arrivals & revenues (January-March 2017 & January-February 2017)**

#### **Poised for another year of records in tourism arrivals**

The positive momentum in the tourism sector continued into Q1-2017. Tourist arrivals increased by +13.5% YoY in Q1-2017 (285,693 vs. 51,608, see Figure 12a). The highest increase was recorded in tourist arrivals from Russia (+88.7% YoY, 48,028) and Israel (+65.9% YoY, 20,819). Tourist arrivals from traditional markets such as Germany (-21.4% YoY) and UK (+3.6% YoY) were relatively weak. Although it is too soon to tell, tourism revenues expanded also robustly by +22.9% YoY in January-February 2017 to €82mn, up from €66.7mn compared to the same month last year. This expansion is much larger than a year earlier.

Figure 12: Tourism Arrivals



Source: CYSTAT, Eurobank Research

### **Residential Property Price Index (RPPI)- Q3-2016**

#### **The RPPI Index recorded in Q3-2016 the first QoQ increase since 2009**

The Central Bank of Cyprus published in mid-November the residential property price index (RPPI) for Q3-2016. On a quarterly basis, the RPPI increased by +0.1% QoQ, recording the quarterly first rise since 2009 vs. -0.5% QoQ in Q2-2016 compared to -0.8% QoQ in Q1-2016. The quarterly rise reflects the combined effect of a negligible increase in both flat apartments and house prices by +0.1% QoQ. On an annual basis, the RPPI declined by a further -1.3% YoY in Q3-2016 further down from -1.7% YoY in Q2-2016, almost unchanged compared to -1.6% YoY in Q1-2016, and smaller in absolute terms than -1.8% YoY in Q4-2015, -3.7% YoY in Q3-2015 and -5.0% YoY in Q2-2015.

Overall, the RPPI trajectory in the past quarters, in combination with other high frequency data from the construction industry and real estate transactions, point to a further stabilization of the real estate sector. According to CYSTAT, the construction output index has accelerated further by 17.9% YoY in Q4-2016 up from 12.0% YoY in Q3-2016 bringing the FY2016 reading at 12.9% YoY, yet still remaining 47.0% below the 2010 average.

# Eurobank Cyprus Research

Economic Indicators	Description	Source	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
<b>National Accounts</b>														
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
GDP (%YoY)	Constant Prices	Eurostat	4.6	3.9	4.5	4.9	3.7	-2	1.4	0.4	-2.4	-5.9	-2.5	1.6
Households and NPISHs Final Consumption Expenditure (YoY%)	Constant Prices	Eurostat	7.6	3.4	4.8	10.3	7.6	-6.2	2.6	0.5	-0.8	-5.9	0.6	1.9
General Government Final Consumption Expenditure (YoY%)	Constant Prices	Eurostat	1.2	2.8	7.0	3.3	5.7	6.4	-2.1	1.3	-3.7	-4.1	-9	1.1
Gross Fixed Capital Formation (YoY%)	Constant Prices	Eurostat	4.3	6.8	21.1	7.9	9.0	-13.7	-5.1	-9.3	-20.5	-15.2	-18	14
Exports of Goods and Services (YoY%)	Constant Prices	Eurostat	2.5	2.1	1.3	5.3	-0.7	-4.3	4.3	4.1	-1.1	1.8	-0.5	1.9
Imports of Goods and Services (YoY%)	Constant Prices	Eurostat	6.9	1.6	5.7	10.5	12.5	-15.0	6.2	-3.1	-4.4	-3.0	2.0	4.0
GDP	Current Prices, SA, mil	Cyprus Statistical Service	13,767	14,731	15,879	17,375	18,822	18,482	19,118	19,547	19,469	18,065	17,394	17,421
GDP (%YoY)	Current Prices, SA, mil	Cyprus Statistical Service	7.8	6.9	8.6	9.6	4.7	-2.5	5.3	0.5	-0.9	-8.9	-1.3	0.9
<b>Labour Market</b>														
Unemployment Rate	NSA	Cyprus Statistical Service		5.3	4.6	3.9	3.7	5.3	6.2	7.9	11.8	15.9	16.1	15.0
Labor Productivity	Per hour worked, % Change	Eurostat	2.6	2.2	3.2	-0.7	0.0	-1.2	1.1	0.7	1.1	1.6	0.4	0.9
Unit Labor Costs	Index, 2010=100	Eurostat	84.2	86.1	88.0	90.6	94.5	99.7	100.0	101.7	101.7	98.3	95.0	93.4
Unit Labour Cost Growth Total Economy	YoY%	Eurostat	1.5	2.3	2.2	3.0	4.3	5.5	0.3	1.7	0.0	-3.3	-3.3	-1.7
<b>Short-term business statistics</b>														
Economic Sentiment Index (ESI)	EoP, SA	EU Commission	106.3	99.8	108.1	108.4	97	93.8	97.1	85.7	76.6	89.6	102.7	106.7
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	
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
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
European Commission Services Confidence Indicator Cyprus	EoP, SA	EU Commission	14.4	6.1	15	8.7	1.8	-3.6	3.6	-25.2	-40.7	-24.2	11.4	8.2
Industrial Production General Index	NSA	Cyprus Statistical Service	103.2	102.7	103.5	111.0	109.9	102.8	100.3	92.5	75.2	69.9	72.8	77.3
Industrial Production General (%YoY)	NSA	Cyprus Statistical Service	3.7	-0.5	0.8	7.2	-1.0	-6.5	-2.4	-7.8	-18.7	-7.0	-9.6	7.8
European Commission Capacity Utilization Cyprus SA	SA	Cyprus Statistical Service	70.0	72.6	66.8	71.3	69.4	63.0	63.9	58.1	53.7	50.8	54.5	61.1
<b>Housing and Real Estate</b>														
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	
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	
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	
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	
<b>Personal/Household Sector</b>														
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
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
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
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
Gross Household Saving Rate	% of Gross Disposable Income	Eurostat	8.7	9.7	10.0	6.3	6.0	9.4	7.3	5.4	0.6	-4.1	-10.8	
<b>International Trade &amp; Balance of payments</b>														
Current account balance (%GDP)	BMP6	Eurostat					-15.6	-7.7	-10.7	-4.0	-5.6	-4.5	-4.5	-3.6
Current Account, Goods & Services Net Balance (%GDP)	BMP6	Eurostat					-12.9	-5.4	-6.6	-3.1	-1.1	1.1	0.7	-1.4
Current Account, Primary Income Net Balance (%GDP)	BMP6	Eurostat					-2.5	-1.3	-3.0	0.3	-3.1	-3.5	-2.8	0.3
Current Account, Secondary Income Net Balance (%GDP)	BMP6	Eurostat					-0.3	-1.1	-1.0	-1.1	-1.4	-2.1	-2.4	-2.6
Imports of Goods (%GDP)	BMP6	Eurostat					42.6	35.0	37.1	35.8	33.7	31.3	32.3	32.5
Exports of Goods (%GDP)	BMP6	Eurostat					12.2	13.2	14.0	15.5	15.6	15.0	16.1	14.3
Imports of Services (%GDP)	BMP6	Eurostat					20.9	19.6	19.9	19.6	20.4	25.9	27.0	28.9
Exports of Services (%GDP)	BMP6	Eurostat					38.4	36.0	36.4	36.8	37.4	43.2	43.9	45.7
Financial Account (%GDP)	BMP6	Eurostat					-18.7	-8.5	-9.2	-0.7	-2.9	-3.4	-4.6	0.5
<b>Government Finance &amp; Debt</b>														
General Government Deficit (-) or Surplus (+) (% GDP)	including Coops banks' recap	Cyprus Statistical Service	-3.7	-2.2	-1.0	3.2	0.9	-5.5	-4.8	-5.7	-5.8	-4.9	-8.9	-1.0
General Government Debt EDP Procedure (% GDP)		Cyprus Statistical Service	64.7	63.4	59.3	54.1	45.3	54.1	56.3	65.8	79.3	102.5	108.2	108.9
<b>Prices</b>														
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
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
<b>Tourism</b>														
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
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
<b>Market Indicators</b>														
10Y Gov Bond Yield Rate	%, Middle Rate	Bloomberg	5.8	5.2	4.1	4.5	4.6	4.6	4.6	5.8	7.0	6.5	6.0	4.5
Cyprus Stock Exchange Index	EoP, Composite Index		1012.27	1704.76	3900.39	4820.72	1101.42	1597.23	1055.21	295.94	114.86	103.31	85.7	67.75