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

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

- 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)

- ESM: 6.3
- IMF: 2.7
- Undisbursed funds: 1

Legend:
- ESM
- IMF
- Undisbursed funds
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**

![Cyprus's ESM loan repayment profile (€ million)](chart.png)
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

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.

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