INTERNATIONAL MONETARY FUND

IMF Country Report No. 15/271

CYPRUS

September 2015

EIGHTH REVIEW UNDER THE EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY AND REQUEST FOR MODIFICATION OF PERFORMANCE CRITERIA—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR CYPRUS

In the context of the Eighth Review Under the Extended Arrangement Under the Extended Fund Facility and request for Modification of Performance Criteria, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on September 23, 2015, following discussions that ended on July 24, 2015, with the officials of Cyprus on economic developments and policies underpinning the IMF arrangement under the Extended Fund Facility. Based on information available at the time of these discussions, the staff report was completed on September 8, 2015.
- A **Statement by the Executive Director** for Cyprus.

The documents listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Cyprus*
Memorandum of Economic and Financial Policies by the authorities of Cyprus*
Technical Memorandum of Understanding*

*Also included in Staff Report

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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International Monetary Fund
Washington, D.C.

Press Release No. 15/433
FOR IMMEDIATE RELEASE
September 23, 2015

International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes Eighth Review of Cyprus' EFF and Approves €126 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the eighth review of Cyprus's economic adjustment program supported by the Extended Fund Facility (EFF) arrangement. The completion of the review enables the disbursement of SDR 99 million (about €126 million), which brings total disbursements under the program to SDR 693 million (about €882 million). Completion of the ninth review would be expected to take place before the end of the year.

The three-year, SDR 891 million (about €1 billion) EFF was approved on May 15, 2013 (see Press Release No. 13/175). Cyprus's economic program is also supported by financial assistance from the European Stability Mechanism (ESM) amounting to €9 billion.

Following the Executive Board's discussion, Mr. Mitsuhiro Furusawa, IMF Deputy Managing Director and Acting Chair, issued the following statement:

"Cyprus's reform program remains a success. Economic activity in the first half of the year has been better than expected, and fiscal outturns are running ahead of projections. Liquidity in the core banking system has continued to improve, and the prospects for resolving non-performing loans are improving. Going forward, it will be important to continue with sound macroeconomic management and maintain the reform momentum.

"A significant improvement in addressing non-performing loans remains an urgent priority to preserve financial stability and boost growth. In this respect, recent progress on making the new private debt restructuring framework operational is encouraging. To ensure effective implementation of the new framework, it is important to closely monitor implementation and correct any deficiencies. Adopting supporting legislation to facilitate loan sales and securitization and continued steps to enable swift transfer of title deeds will be essential to support balance sheet clean-up.

"Further efforts are needed to strengthen banking supervision and regulation. It is important that financial institutions continue their efforts to restructure loans. In light of continued uncertainties in the region, the financial status of Greek-owned subsidiaries will continue to warrant close attention.

"The strong fiscal performance is impressive. Nevertheless, high public debt together with sizeable contingent liabilities warrant continued prudence while ensuring support for growth-enhancing public spending and the safety net. Reform efforts should focus on advancing public administration, improving the management of government guarantees, and strengthening revenue administration.

"The authorities should press ahead on other key structural reforms to support growth. To this end, measures are needed to overcome the delays on the privatization program, and to improve the business environment," Mr. Furusawa said.

INTERNATIONAL MONETARY FUND

CYPRUS

September 8, 2015

EIGHTH REVIEW UNDER THE EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY AND REQUEST FOR MODIFICATION OF PERFORMANCE CRITERIA

EXECUTIVE SUMMARY

Cyprus continues to recover from the crisis, and program performance remains generally strong. Economic activity in the first half of this year turned out better than expected, mainly supported by private consumption. Fiscal outturns are running ahead of projections, and conditions in the core banking system have continued to normalize. All end-June performance criteria were met, and the authorities have made good progress on structural reforms.

Discussions focused on policies to consolidate fiscal and financial stability, and continue laying the foundations for sustainable growth. Resolving the high level of non-performing loans through effective implementation of the new private debt restructuring framework is crucial to consolidate financial stability and boost growth. The authorities should maintain prudent public finances given the still-high public debt ratio and continue advancing structural reforms to support fiscal sustainability and promote growth and job creation.

Risks to the program remain, although their impact would likely be manageable. The domestic political situation remains a challenge to policy implementation. Despite the reduced real and financial linkages between Greece and Cyprus, and the increasing resilience of the Cypriot economy, developments in Greece have the potential to affect Cyprus through the confidence channel.

Completion of the review would make available SDR 99 million (about €126 million). Total access under the arrangement is SDR 891 million (about 563 percent of quota, €1 billion). The European Stability Mechanism has released €5.8 billion (of €9 billion committed); and the disbursement of an additional €500 million is expected in October.

Approved By
Philip Gerson and Mark Flanagan

Discussions took place in Nicosia during July 14–24, 2015. Fund staff met with the Minister of Finance, other Cabinet Ministers, the Governor of the Central Bank of Cyprus, members of Parliament, leaders of the main political parties, and representatives of the private sector. The team comprised M. Lewis (head), R. Agarwal, S. Chen, J. Garrido, A. Hajdenberg, A. Kosonen, Y. Lu, A. Luca, J. Menkulasi, S. Pompe, A. Simone, and O. Wuensch. V. Guzzo and M. Heracleous (IMF resident representative office) assisted the mission. Mr. Kanaris (OED) attended some of the meetings, and C. El Khoury contributed from headquarters. A. Myaing provided assistance from headquarters.

CONTENTS

TABLES

ANNEX

APPENDIX

ATTACHMENTS

BACKGROUND

1. Cyprus continues its steady recovery from the crisis, supported by generally strong program performance. Economic growth has turned positive, public finances continue to surprise on the upside, and there are encouraging signs regarding the still very high level of non-performing loans (NPLs) in the banking system. The Cypriot economy is increasingly resilient, as demonstrated by the limited impact from the periods of acute tension this year in Greece. These outcomes are better than expected at the time of the combined fifth, sixth, and seventh reviews (referred to as "combined reviews" thereafter). All end-June and continuous performance criteria (PCs) were met, and the authorities have also made good progress on their wide-ranging structural reform agenda.

2. Policy implementation has been good, but domestic political conditions continue to pose challenges. The authorities' ownership of the program remains high, and despite the governing party having only a minority in parliament, the government has been able to secure the necessary majorities to pass key legislation. Developments in Greece seem to have weakened support for economic policies materially deviating from those under the program. However, some reforms under the program have encountered delays, and with the May 2016 legislative elections in sight, implementing the ongoing structural reforms will remain a challenge.

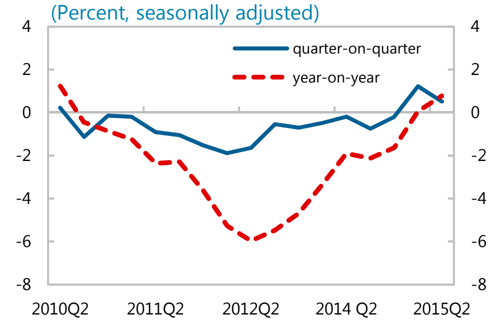
3. Recent developments have renewed optimism over reunification prospects. The April 26th election of Mustafa Akinci as the leader of the Turkish Cypriot Community has catalyzed a resumption and deepening of talks between the two communities over a potential reunification of the island. While it is too early to assess how the process will unfold or its implications for policies, reunification could boost investment and trade in Cyprus, benefiting long-run economic growth.

RECENT DEVELOPMENTS AND OUTLOOK

A. Recent Developments

4. The Cypriot economy has seen positive growth since the beginning of the year. Growth turned positive in the first quarter of 2015—after almost four years of contraction—and further accelerated to 0.8 percent year-on-year (yoy; 0.5 percent quarter-on-quarter) in the second quarter, bringing growth in the first half of 2015 to 0.4 percent yoy. The expansion in the second quarter was broad-based, with positive growth in the manufacturing and most services sectors, although construction continued to contract. Tourist arrivals increased by 6½ percent yoy in the first seven months of 2015 with the loss from the Russian market (about 20 percent) more than offset by gains from other markets, such as the UK and Greece. However, tourism revenues declined by 6 percent yoy in the first half of the year, partly due to the drop in

Real GDP Growth
(Percent, seasonally adjusted)



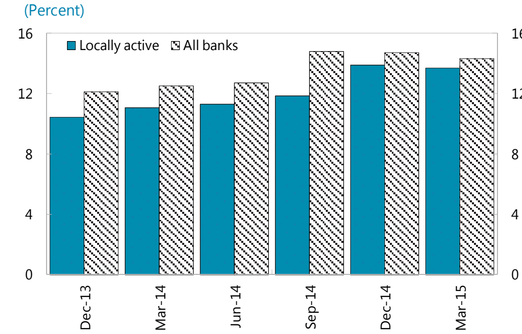
Source: Cystat.

spending by Russian tourists (Figure 1). Unemployment has declined from its peak (16.9 percent in October 2013) but remained high at 16.3 percent in July. Inflation stood at -2.4 percent yoy in July (the lowest rate since 1997), reflecting declining energy and tourism prices, and still-weak economic conditions (Figure 2). In the first quarter, the external current account deficit narrowed compared to the same period last year, reflecting an improved income balance, which more than offset the slight deterioration in the trade balance (Figure 3).

5. Conditions in the core banking system have continued to normalize, although deposits in the Greek-owned subsidiaries remain sensitive to developments in Greece (Figures 4 and 5)**.**

- **Capitalization.** Capitalization of the core banks appears adequate, in line with the results of last year's Comprehensive Assessment (CA) carried out by the European Central Bank (ECB). The average core tier 1 (CET1) ratio of locally active banks at end-March 2015 was 13.7 percent, compared with 13.9 percent at end-2014 and 10.4 percent at end-2013.

Capital Adequacy: CET1 Ratios
(Percent)



Source: CBC.

- **Deposits.** Despite the lifting of capital controls and a moderation of deposit rates, deposits in core domestic banks increased modestly in the first eight months of 2015, while deposits in the Greek-owned subsidiaries declined.[1] Deposit outflows from the Greek-owned subsidiaries largely stopped following the Euro-summit agreement on Greece in July.

- **Liquidity.** Liquidity buffers of domestically-owned banks at end-June were 4 percent (€0.2 billion) higher than at end-2014; while those of foreign-owned locally active banks (mostly Greek-owned subsidiaries) were lower over the same period. ELA funding in the Bank of Cyprus (BoC) declined further to €5.4 billion (about 31 percent of GDP) at end-August compared to €7.4 billion at end-2014, reflecting deposit inflows in recent months and the use of the proceeds from the repayment by the government of most of the Laiki bond (€750 million out of €1.1 billion) in June.

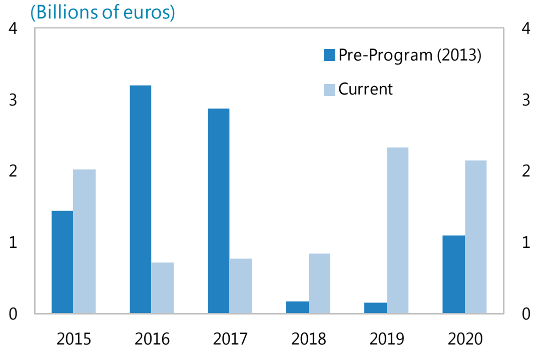
- **Credit.** After two years' contraction, bank credit to the domestic non-financial private sector stabilized in July, while credit to households continued to decline. Credit to the corporate sector has been up for 7 consecutive months (0.7 percent yoy in July). Banks provided €580 million new lending in the first five months of 2015.

[1] Greek-owned subsidiaries' total deposits represented about 13 percent of the domestic deposit market at end-July.

- **Non-performing loans.** The NPL ratio in the core domestic banking system (59 percent at end-April) and provision coverage of NPLs (36 percent) have remained broadly unchanged since end-2014. New NPLs largely represent interest arrears on existing NPLs, with currently performing loans remaining as such. The pace of NPL restructurings accelerated in recent quarters with an increasing proportion of agreements reached based on long-term sustainable solutions instead of short-term forbearance measures like grace periods (Box 1). Locally active banks registered €90 million profits before tax in the first quarter of 2015, compared to €48 million in the same period last year. This increase was mostly driven by a deceleration in building provisions, as loan quality stabilized. Profits have been used to strengthen capital buffers. In addition, the cost-to-income ratio was stable over the year, while net interest income declined.

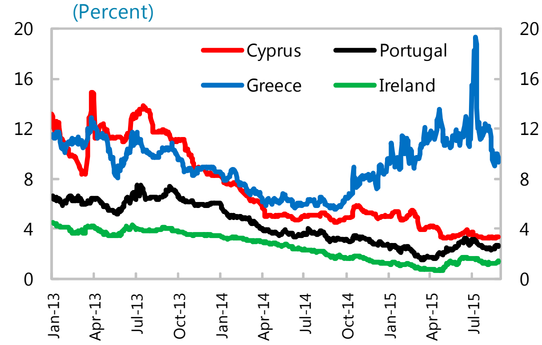
6. **The maturity structure of public debt has improved significantly, while the cost of borrowing has declined.** Broadly in line with the medium-term debt management strategy, most of the Laiki bond was repaid using the proceeds from the 7-year Eurobond issued in April. This, together with the 2013 debt exchange, other liability management operations, and the shift in the composition of debt toward official financing sources, has resulted in an extension of the average maturity of public debt. While still low by euro area standards, the average maturity has risen to 8 years at end-June from 5 years at end-2012. In addition, the average cost has fallen to 3 percent from 4 percent over the same period.

Medium and Long Term Debt Maturity Profile
(Billions of euros)



Sources: Cyprus Public Debt Management Office; and IMF staff estimates.

Long-Term Government Bond Yields 1/
(Percent)



1/ 10-year government bonds. For Cyprus, longest maturity available.
Source: Bloomberg.

7. **Market yields have not been affected by developments in Greece.** The yield of the recently-issued 7-year benchmark Eurobond declined to 3½ percent in late August from 4 percent in April, and has remained largely unaffected by the recent bout of volatility in global markets. During the same period, the average yield of 3-month treasury bills at auction declined to 1.9 percent from 2.7 percent. Under the ECB's bond-buying program, the Central Bank of Cyprus (CBC) purchased Cypriot bonds in the secondary market, likely exerting some downward pressure on yields.[2]

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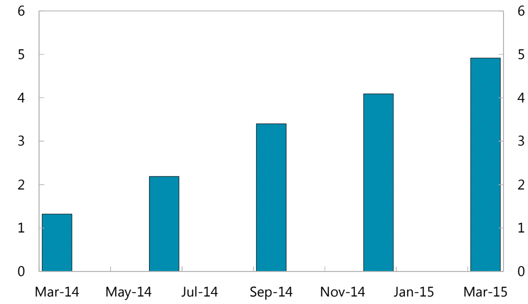
[2] The ECB's rules under the bond-buying program for sub-investment grade countries stipulate that purchases can be made only between the conclusion of one program review and the initiation of discussions on the subsequent

Box 1. Progress on Restructuring of Nonperforming Loans

The stock of restructured loans in Cyprus has increased steadily over the past year. By end-2015:Q1, the stock of restructured loans in the system had increased from €1.3 billion to €4.9 billion year-on-year. But while there has been a steady increase in the pace of restructuring, restructured loans amounted to 19 percent of nonperforming loans at end-2015:Q1, indicating that there is still further room to improve the restructuring efforts.

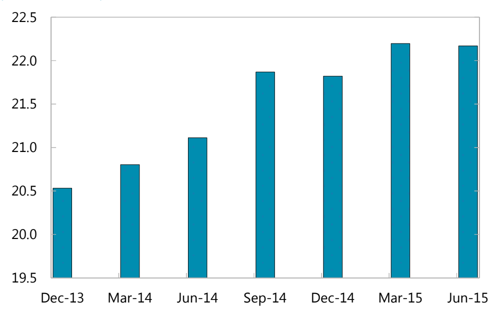
Evolution of Restructured Loans
(Billions of euros)



Source: CBC.

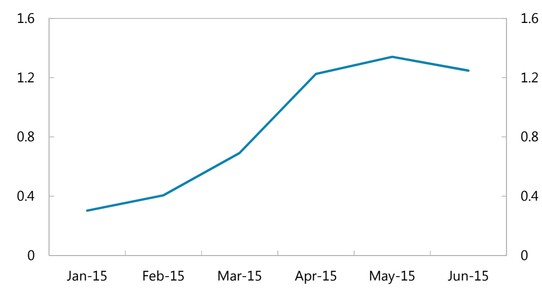
To increase further the pace of loan restructuring, the core domestic banks have taken substantial steps to improve their internal management of NPLs. Each of them has created a centralized arrears management unit (or a restructuring division). With the aid of call centers and centralized restructuring teams these units have directed their focus on both (i) preventing pre-arrears from migrating into 90+ days past due, and on (ii) restructuring loans that have been past due for several months. While there is room for further improving the efficiency of these units—by improving the performance of the call centers, further simplifying the restructuring processes, and creating better standardized solutions—there are preliminary signs of improvement in the data. The amount of loans that are 90+ days past due have shown signs of stabilizing in the last few quarters, and the rate of implemented restructurings in select banks has been increasing.

Estimated 90+ Days Past Due Loans in Core Domestic Banks
(Billions of euros)



Sources: Bank reports; and IMF staff estimates.

Average Rate of Implemented Restructurings in Select Core Domestic Banks
(Percent of loans managed under arrears management units)



Sources: Bank reports; and IMF staff estimates.

The adoption of the new foreclosure and insolvency frameworks should help banks since they increase the willingness of clients to cooperate. While the foreclosure process remains untested, it is expected to significantly reduce the duration of the process. Several banks have already initiated the process by sending the first letters of notification. In particular, preliminary reports suggest that banks are pursuing foreclosures of commercial buildings and land (instead of homes considered as primary residences). While it is too early to tell, there is some preliminary evidence that the clients have responded to these letters with increased willingness to restructure loans.

Foreclosure Procedure

	Prescribed time (days)
Letter for payment - Type I	30
Letter for foreclosure - Type IA	30
Letter for appointment of valuer - Type IB	10
Establishment of market value by two valuers	30
Appointment of third valuer if needed	45
Notification of auction/advertisement	30
Total time period until the first auction	130-175

review. In Cyprus's case, the window for purchases was open from July 2 to July 20 (the volume of Cypriot debt purchased was €98 million), and would reopen in October, subject to conclusion of the current review by the IMF and ESM Boards. The total volume of Cypriot debt eligible for purchase is estimated to be up to €0.5 billion.

B. Outlook

8. The macroeconomic framework envisages a gradual economic recovery:

- **Real GDP growth is projected at 0.5 percent in 2015** (up from 0.2 percent at the time of the combined reviews)**.** The pace of recovery remains modest given the challenges the Cypriot economy faces, including high unemployment and a decline in wages. Nonetheless, the upward revision in growth is consistent with recent economic performance, including the increase in lending to the corporate sector, and stabilization of loan quality. More robust activity in the tourism and professional services sectors signals that exports will contribute more positively to growth, and positive growth in retail sales attests to the resilience of private consumption. This projection is nonetheless conservative, incorporating a presumed restrained outlook for domestic demand and exports in light of continued volatility in the region.[3] The medium-term outlook remains unchanged, with growth expected to pick up to 1.4 percent in 2016, and to remain at around 2 percent from 2017 onwards.[4]

- **The unemployment and inflation projections have been adjusted downwards.** The unemployment rate for 2015 has been revised down slightly, in line with the upward revision to the growth forecast. Inflation has been revised down slightly to -1 percent for 2015, given the outturn to date, including a larger-than-expected decline in prices charged by restaurants and hotels. Inflation is projected to turn positive in 2016, as the impact of lower oil prices subsides, and in line with the anticipated gradual recovery of domestic demand and wages.

Selected Economic Indicators
(Percent change, unless otherwise indicated)

	2014	2015	2016	2017	2018	2019	2020
		Projections					
Real GDP	-2.3	0.5	1.4	2.0	2.2	2.1	1.8
Consumption	-1.6	0.0	0.7	1.0	1.3	1.2	1.0
Private consumption	0.4	0.6	1.1	1.2	1.5	1.3	1.0
Public consumption	-8.7	-2.3	-0.9	0.2	0.5	1.0	1.0
Fixed investment	-18.8	0.2	3.6	4.0	4.5	4.2	3.6
Inventory accumulation 1/	2.7	0.0	0.0	0.0	0.0	0.0	0.0
Foreign balance 1/	-1.0	0.4	0.4	0.7	0.6	0.6	0.6
HICP (period average)	-0.3	-1.0	0.9	1.3	1.5	1.8	1.9
Unemployment rate (EU standard; percent)	16.1	16.0	15.0	13.7	12.4	11.1	10.1

Sources: Eurostat, Central Bank of Cyprus, and IMF staff estimates.
1/ Contribution to growth.

9. The outlook is clouded by a high degree of uncertainty, including from the challenging global environment:

- **Domestic risks.** Slow progress in implementing the new private debt restructuring framework and addressing NPLs could delay balance sheet repair and credit expansion, holding back the

[3] See Box 2 of IMF Country Report 15/155 for a detailed discussion of the baseline assumptions on external developments.

[4] See Box 1 of IMF Country Report 14/92 for a discussion of the link between credit and growth.

recovery and constraining medium-term growth (Box 2). Persistently low inflation could further weigh on stressed private sector balance sheets and public sector debt reduction efforts. The challenging political situation could complicate the passage of important reforms, which could damage confidence and growth. Upside risks center on a stronger improvement in the labor market, greater improvement of consumer confidence, and higher purchasing power through lower oil prices that all could boost private consumption. In addition, private investment may recover more quickly than envisaged, which would likewise contribute to a faster-than-projected pickup of economic activity.

- **Spillover risks from Greece.** The direct real and financial linkages between Greece and Cyprus have been significantly reduced in recent years, and Cyprus has demonstrated increasing resilience to developments in Greece. Nonetheless, the ongoing uncertainty in Greece could still affect Cyprus, including through lower external demand and higher funding costs. Thus, the impact on Cyprus of any adverse developments in Greece would depend in part on the nature of the euro-area-wide policy response. There are also mitigating factors: for example, recent reports suggest that several Greek shipping firms are considering plans to transfer part of their business to Cyprus.

- **Other external risks.** Cyprus's external debt, although below 300 percent of GDP at end-2014 (from a peak of 447 percent of GDP in 2010), remains sensitive to shocks, in particular to interest rates and growth (Figure 6). The outlook for Russia represents a source of uncertainty for the Cypriot economy. Upside external risks center on more robust external demand or greater compression of yields, for example, due to the positive impact of the ECB's bond-buying program. With the GDP projection for this year already incorporating some downside external risks, growth may also surprise on the upside if these risks fail to materialize.

POLICY DISCUSSIONS

10. Discussions focused on policy priorities until the end of the program in early 2016. The emphasis was on (i) legal and supervisory measures to accelerate NPL workouts; (ii) fiscal policy in 2015 and the medium-term to ensure debt sustainability; and (iii) structural reforms to support fiscal sustainability and promote growth.

A. Financial Sector Policy

NPLs and the private debt restructuring framework

11. Addressing the high level of NPLs remains a priority to restore credit and support growth. Cyprus has the highest NPL ratio in Europe, making concrete progress on loan restructuring vital to repair the balance sheets of banks and borrowers and reestablish the conditions for strong economic growth. Significant progress has been achieved in laying the ground for accelerating NPL

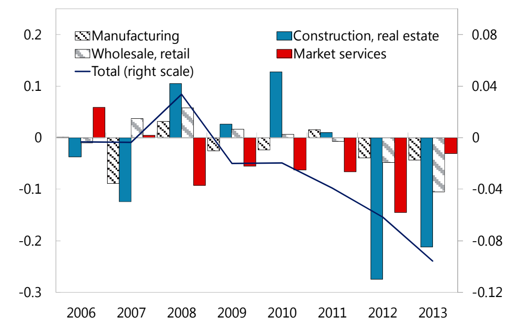
Box 2. Non-Financial Corporate Balance Sheets and Their Implications for Investment

Weak and deteriorating corporate balance sheets in Cyprus since the global financial crisis have negatively affected investment through the channels of debt overhang and high leverage. Going forward, an improvement in corporate balance sheets through debt restructuring will be important to support the recovery of investment and boost medium term growth.

Cyprus's non-financial corporate (NFC) debt-to-GDP ratio, at 300 percent as of end-2014, was among the highest in the euro area (see Figure below). Despite a decline in the nominal level, the NFC debt-to-GDP ratio increased over 2013–14 due to real economic contraction and deflation. The debt burden is uneven among sectors, with the secondary sector more heavily indebted than the tertiary sector.

Firm-level analysis shows that the balance sheet soundness of Cypriot NFCs has weakened since the global financial crisis due to sluggish growth and further debt accumulation. With the growth rate of corporate sales declining from 11 percent in 2008 to -11 percent in 2013, debt-to-sales ratio increased from 2.3 to 3.8 during this period. There was an increasing concentration of debt in firms with weak balance sheets. In 2013, about 39 percent of corporate debt was held by illiquid or insolvent firms, up from less than 6 percent in 2010.[1]

NFC Net Investment Rate 2/



Sources: Orbis, and IMF staff estimates.

Meanwhile, investment contracted significantly in Cyprus. Gross fixed capital formation fell by 60 percent over 2008–14, with its share in GDP declining from 27 percent in 2008 to 12 percent in 2014. At the firm level, the corporate net investment rate declined from 3 percent in 2008 to -10 percent in 2013.[2]

Weak corporate balance sheets are likely to affect corporate investment through several channels:

- **Debt overhang.** The average earnings-to-debt ratio declined from 15 percent in 2010 to 9 percent in 2013.
- **Leverage.** The sector's overall debt burden remains high with an average debt-to-assets ratio of 57½ percent in 2013, a slight decrease from a peak of 60½ percent in 2011.
- **Debt maturity profile.** The average debt maturity has increased in the past few years with long-term debt accounting for 30 percent of total debt in 2013, up from 20 percent in 2005.

Investment Implications of NFC Balance Sheet

Dep. variable: Net investment rate	Coef.	p-val
Earning to debt ratio	0.15	0.00
Debt to assets ratio	-0.21	0.00
Long-term debt to debt ratio	0.17	0.00
Sales growth	0.34	0.00
ln(assets)	0.01	0.00
AR(1): z	-2.36	0.02
AR(2): z	0.62	0.54
Hansen test	52.96	1.00

Dynamic GMM model with 2 lags of dependent variable.

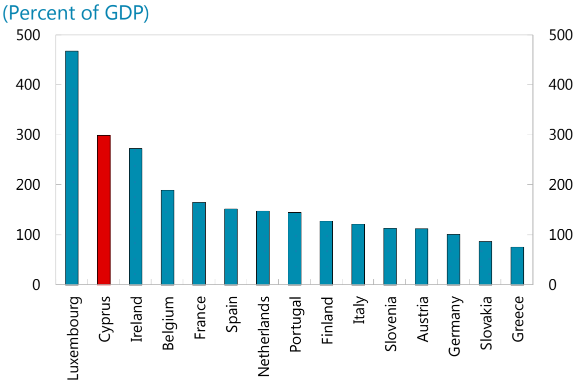
Staff analysis quantified the link between these key balance sheet soundness indicators and the net investment rate using annual firm-level data during 2005–13 for Cyprus.[2] Regression results show that debt overhang and high leverage had significantly negative impacts on investment during this period while the longer debt maturity contributed positively (see text table). The changes in these three variables contributed to 24 percent of the decline in corporate investment over 2008–13.

[1] A firm is defined to be insolvent if its debt to total assets ratio is greater than 1 and illiquid if its cash and cash equivalents are less than current liabilities.

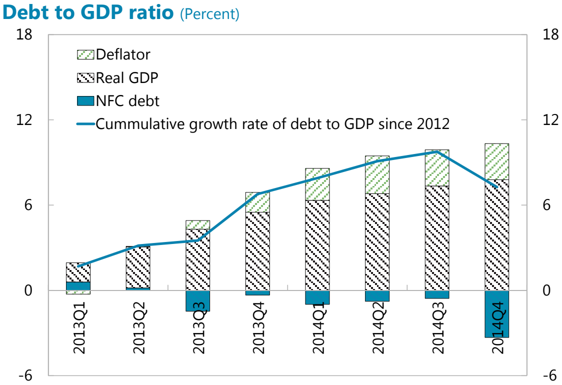
[2] The net investment rate is defined as the change in capital stock divided by capital stock.

Box 2. Non-Financial Corporate Balance Sheets and the Implications for Investment (concluded)

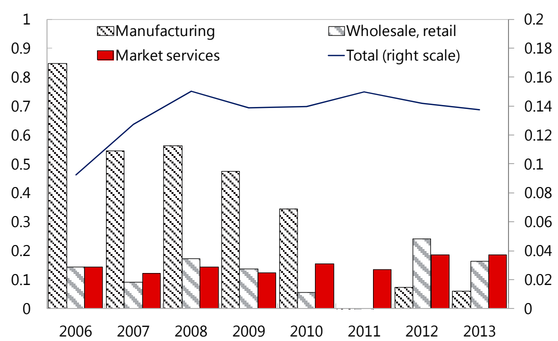
Financial Debt of NFC, 2014
(Percent of GDP)



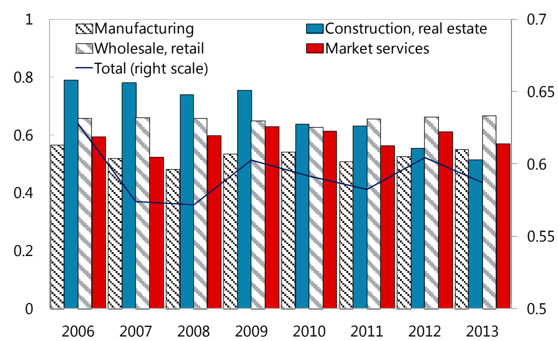
Contributions to the Cumulative Growth Rate of NFC Debt to GDP ratio (Percent)



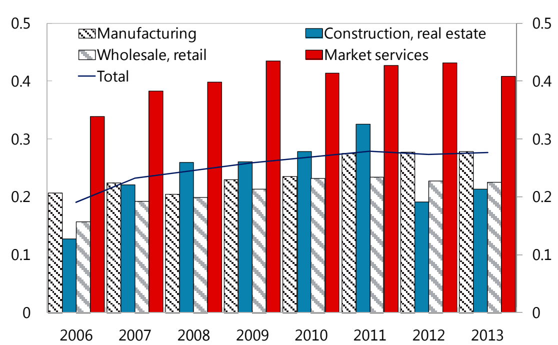
NFC Earnings to Debt Ratio



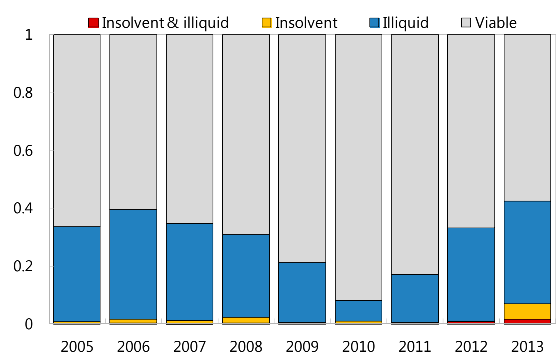
NFC Debt to Assets Ratio



NFC Long-Term Debt to Debt Ratio



NFC Debt and Balance Sheet Health



Sources: Cystat; Haver; Orbis; and IMF staff estimates.

resolution, including setting up and making operational the new legal framework for private debt restructuring, and having banks put in place large-scale internal workout units and policies in line with the Arrears Management Framework and the Code of Conduct. In addition, banks expect both the recently-introduced temporary tax relief for capital gains on property transactions in the context of debt restructuring and a temporary halving of property transfer fees to increase incentives for creditors and borrowers to find restructuring solutions (Box 3). However, further efforts across several fronts are still needed to tackle the NPL problem comprehensively.

Box 3. Fiscal Impact of Recent Revisions to Taxes and Welfare Benefits

The authorities have recently introduced several revisions to property transfer fees, capital gains taxation, business taxation, and welfare benefits with an estimated fiscal cost of about 0.2 percent of GDP per year.

A 50 percent reduction in property transfer fees. The bill, approved by Parliament in June, allows for a reduction of transfer fees by 50 percent for all the property sales and mortgage registration that take place between June 2015 and December 31, 2016. The expected fiscal cost of this measure is 0.1 percent of GDP per year. The reduction of transaction costs is to facilitate the transfer of title deeds in the short term, pending the completion of the immovable property tax reform, expected in 2016, that would shift the basis for property taxation from transactions more toward property values.

Amendments to capital gains taxation. To facilitate debt restructuring, the amendments exempt immovable property transferred to a bank and property sales carried out after May 7, 2015 associated with debt restructuring from capital gains taxation until May 6, 2017 and end-December 2017 respectively. In addition, properties purchased between July 2015 and end-December 2016 will not be subject to the capital gains tax when sold in subsequent years. While the amendments may limit the upside collection risks from real estate market improvements, no significant fiscal implications are expected, as they are temporary, and the average capital gains tax from all activities was small—0.2 percent of GDP per year in 2013 and 2014.

Two revisions to business taxation. The first provision is the introduction of a notional interest deduction for equity financing of new investments. The purpose is to retain and expand offshore business attracted by double taxation treaties, as a way to minimize the negative impact from the newly introduced de-offshorization legislation by Russia, which discourages the back-to-back loan structures. The second one is the revision of the definition of non-domicile, which exempts foreign individuals from taxation on interest, dividends, and rents for 17 years. Both provisions are accompanied by anti-abuse clauses. These provisions are not expected to have a material fiscal impact in 2015 and 2016, as the financial impact of the new notional interest deduction will take time to materialize, and currently few foreign individuals pay taxes on interest, dividends, and rents.

Amendments to GMI legislation. The amendments slightly expand the eligibility criteria for GMI to address issues that arose during the GMI implementation. The main elements include higher eligibility thresholds for cash and property under certain conditions, and the simplification of the procedure for the representative of a disabled person to apply for GMI. The amendments were approved by Parliament in July. Their fiscal impact is expected to be less than 0.1 percent of GDP on an annual basis.

A new mortgage subsidy scheme. The scheme, approved by the COM in June, subsidizes the interest of mortgage loans for primary residences with the aim of supporting vulnerable households, who can become viable with such support. The scheme is to be administered by the Land Development Corporation (LDC), an existing public corporation in charge of subsidized housing schemes. Funding for this scheme is from LDC's own budget with no implication for general government finances.

12. Effective implementation of the new private debt-restructuring framework is critical (MEFP ¶13)**.** The new insolvency framework allows over-indebted borrowers to restructure their debt under safeguards (Annex 1 presents the key elements of the new framework), while the new foreclosure regime facilitates the sale of collateral if no sustainable solution can be found. Cross-country evidence shows that a stronger legal and institutional framework for private debt restructuring and contract enforcement is associated with a lower level of NPLs (Box 4). To this end, the authorities are working on several fronts to make the framework fully operational:

- **Implementation.** The Insolvency Service has been established and licenses have been granted to the first group of insolvency practitioners, who have begun to receive applications for new insolvency procedures. In addition, the administrative acts and regulations needed to ensure the functioning of the insolvency regime have been adopted (**end-August 2015 structural benchmark—SB**). Changes have been made to court rules to facilitate the implementation of the foreclosure framework, and they will be reviewed by end-October to ensure that they likewise facilitate the implementation of the new insolvency procedures. However, there is scope to improve the efficiency of court processes and post-court enforcement of commercial claims. To this end, the authorities have committed to adopt amendments to the civil procedure and other relevant laws by end-March 2016, including to (i) limit interim applications and interlocutory measures (that in the past have led to significant delays in court procedures); and (ii) increase the availability of information on debtors' financial situation.

- **Review and monitoring.** The new insolvency and foreclosure frameworks are a major step forward but include some provisions that may deviate from best international practices.[5] To address these and any other issues (including remaining potential tax or regulatory disincentives to debt restructuring) that may weaken the effectiveness of the new frameworks, the authorities will conduct a comprehensive review of the private debt restructuring legal framework and prepare an action plan by end-December 2015. The Council of Ministers (COM) will adopt any necessary adjustments to the frameworks by **end-January 2016** (**modified SB**).[6]

- **Title deeds.** There is a significant disconnect between the economic and legal ownership of properties, arising from the practice of conducting property transactions without transferring the titles. This constitutes a considerable obstacle to the smooth functioning of the debt restructuring framework and the property market. The temporary reduction of property transfer fees will mitigate one of the incentives for this practice. Importantly, legislation has been recently adopted to allow for the transfer of titles in "legacy cases", which entail transactions where buyers registered their contract by end-2014 and fully paid the purchase price, but titles were not transferred because the property is encumbered by a mortgage of the property

[5] See paragraph 15 and Box 3 of IMF Country Report 15/55 for a detailed discussion of these provisions of the new legal insolvency framework.

[6] The authorities originally intended to submit the proposed adjustments to the COM by end-September as a SB, but consider that this revised timeline will allow them to better incorporate input from initial experiences under the new framework.

developer. This was a key objective of the end-June 2015 SB on adoption of legislation by the COM to accelerate the transfers of title deeds. However, the implementation of the SB was incomplete because additional legislation was needed to deal with the transfer of titles in new transactions. To address these cases, the COM will approve required legislation by **end-October 2015** (**new SB**).

13. Supervisory tools to encourage NPL workouts need to be further strengthened (MEFP ¶3)**.** The CBC has begun strengthening its supervisory capacity on arrears management, to be supported by IMF technical assistance. In addition, more work is needed in the following areas:

- **Loan restructuring reporting and targets.** Close monitoring is critical to swiftly identify operational bottlenecks and policy deficiencies, enhance transparency, and take timely corrective measures. To this end, the CBC has set up a targeting framework and has published for the first time aggregated results in early September (**end-July 2015 SB**). Starting this July, rolling quarterly targets are being set for two quarters ahead with reporting done on a monthly basis.

- **Projected performance of loan restructuring.** The ECB CA assessed the capitalization of the Cypriot core banks last year, based on well-defined assumptions on the banks' expected restructuring progress. Since then, the economic environment has improved, insolvency and foreclosure legislation has been adopted, and the number of debt restructurings is increasing. To reflect these developments, by end-September, the CBC will update its system-wide projections on NPL management by banks, in particular with respect to cure rates, collateral values, and the time to restructure or liquidate. The updated projections will inform supervisory priorities.

14. Enabling the sale and securitization of bank loans would speed up balance sheet clean-up (MEFP ¶3)**.** The COM has approved draft legislation to facilitate the sale of loans to non-banks, and its adoption by Parliament is expected by **end-September 2015** (**new SB**). This would allow third parties to acquire loans in Cyprus with minimal regulatory burden, while ensuring that small borrowers continue to be protected under the Code of Conduct. Work is underway to establish a legal framework to enable the bundling of loans and other assets and facilitate their securitization. The necessary legal changes are expected to be adopted by Parliament by **end-December 2015** (**new SB**).

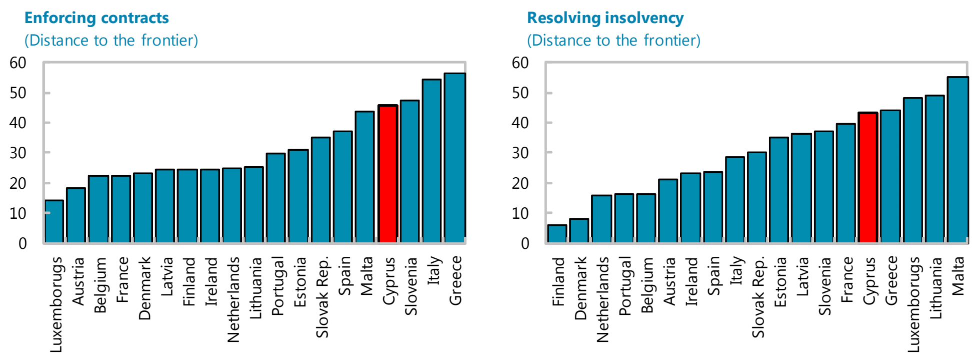
Banking regulation and supervision

15. Continued efforts are also needed to strengthen banking regulation and supervision (MEFP ¶6)**.** The CBC has hired additional staff to address critical needs, including in support of the transition to the SSM and the Single Resolution Mechanism (SRM; to be launched on January 1, 2016). To enhance the effectiveness of the Cypriot regulatory framework and to ensure that procedural requirements are proportionate to the risk of borrowers and loans, the CBC will

Box 4. NPLs, Institutions, and the Macroeconomic Environment

Addressing the high level of NPLs—by strengthening banks' internal structures for arrears management and upgrading the legal framework for private debt restructuring—is at the core of Cyprus's adjustment program. This box presents evidence that institutions, together with the macroeconomic environment, matter for the quality of banks' portfolio, supporting the case for strong implementation of the reforms envisaged under the program.

The institutions underpinning the relationship between lenders and borrowers in Cyprus have been historically weak. The 2015 World Bank's Ease of Doing Business report 2015 ranks Cyprus 113 out of 189 countries in the category of "enforcing contracts" and at a more benign 51st position regarding "resolving insolvency", although still among the weakest in the euro area. In particular, enforcing contracts in Cyprus takes a long time, requires excessive procedures and is financially costly. Ongoing reforms under the program seek to remedy this situation, although further effort will be needed to complement legal changes.



Source: Ease of Doing Business Report.

The strength of the legal and institutional frameworks, together with the macroeconomic performance, has a direct link with the quality of banks' portfolios. Evidence from countries in the euro area for the period 2004–14 shows, as expected, that the level of NPLs rises with higher unemployment and private sector indebtedness, and declining house prices. In addition, the regression analysis based on a composite index finds a statistically significant relationship between the quality of legal institutions and the level of NPLs.

Impact of Macroeconomic Variables and Legal Framework on NPLs

	Fixed Effects	Difference GMM	System GMM
Lagged NPL ratio	0.94***	0.59***	0.90***
House prices	-0.035***	-0.08***	-0.11***
Private debt/GDP	0.04***	0.04***	0.01***
Unemployment rate	0.25***	0.52***	0.18***
Legal framework[1/]	2.88**	0.84***	0.46***
Constant	-6.53***		-1.35***
R^2	0.88		
N	150	140	160

* p<0.1; ** p<0.05; *** p<0.01

1/ The legal framework indicator is constructed as the z-scores of the average of the "Distance to the Frontier" with respect to enforcing contracts and resolving insolvency. Similar results were obtained with an index averaging the different features under these categories. For insolvency: time required to conclude it, costs as a percent of the estate, and the recovery rate. For contract enforcement: time, cost as a percent of the claim, and number of procedures. A lower value indicates stronger institutions.

streamline its loan origination directive by end-November. Following the establishment of a centralized credit register, work is underway to expand its reach to non-banks with the ultimate aim of setting up a credit scoring system, allowing all interested private and public sector creditors to make better informed lending decisions. Finally, the resolution authority has appointed an external advisor for the disposal of Laiki's assets other than its stake in BoC, Laiki's most significant asset. For the sale of the latter, an advisor will be appointed by end-October. Starting in 2016, the European Single Resolution Board (SRB) will take over the responsibility of resolving Laiki.

16. In addition, managing potential spillovers from Greece to Greek-owned subsidiaries is important to ensure broader financial stability. Since late last year, the CBC has taken measures to significantly reduce subsidiaries' exposure to their parents and to Greek risk more broadly. The Greek parent banks, together with the SSM and the Bank of Greece (as their supervisors), continue to be responsible for the financial soundness, including ensuring capital levels are sufficient, and the smooth operation of the subsidiaries. However, the CBC has a range of supervisory tools at its disposal, and will continue to monitor the situation closely. Continued SSM focus on the soundness of the Greek banks on a consolidated basis will be instrumental in ensuring stability of the Cypriot subsidiaries of Greek banks.

Other financial sector issues

17. Central bank governance needs to be modernized. The CBC's organization and governance arrangements have remained largely unchanged since its inception. A comprehensive overhaul is called for, as the assumption of new responsibilities and the accession to the Euro system and the European banking union has fundamentally changed the CBC's role. The CBC has hired a private firm to consult on the organizational setup. The projects to implement the new organization setup are expected to start within months. Further work is needed to update its governance framework in line with the international best practice.

18. Additional steps are needed to streamline and increase the efficiency of the coops sector (MEFP ¶4)**.** Following on earlier consolidation reforms, the sector needs to centralize its control functions, such as risk, audit and compliance, and revise its financial control processes. The CCB will hire an external consultant by mid-October to identify necessary actions to enhance the sector's shareholder value and prospects.

19. Progress on the effective implementation of the AML/CFT framework needs to be sustained (MEFP ¶8)**.** The CBC has finalized the reports of the on-site inspections of 11 banks in 2014, and has initiated the inspections of 13 new financial institutions under the 2015 program using the new risk-based AML/CFT tools. Supervisors of professions continue to conduct AML/CFT inspections using risk-based tools. Progress is needed in three areas: (i) reducing the time lag between on-site inspections, finalization of the reports, and imposition of sanctions; (ii) enhancing further the supervision of banks and professions by bolstering institutional and staff capacity; and (iii) swiftly implementing the governmental action plan to enhance the transparency of companies. To minimize reputational and financial risks in relation to the branch of FBME operating in Cyprus, including in the context of the final ruling by the U.S. authorities in July 2015, the authorities should continue to take appropriate actions based on the results of the 2014 inspection and follow-up visits.

B. Fiscal Policy

20. The end-June cumulative cash primary fiscal surplus reached 0.3 percent of GDP, better than the program target by 0.7 percent of GDP (Figure 7)**.** Revenues have been better than anticipated by 0.4 percent of GDP primarily due to buoyant VAT and other revenues, with the latter partly reflecting temporary factors (such as more rapid airport royalty payments) that are expected to be reversed by year-end. Primary spending has undershot the target by 0.3 percent of GDP on account of lower-than-expected unemployment and redundancy benefits, and minor under-execution in several other categories of expenditure.

21. The 2015 primary surplus target has been raised to 1.3 percent of GDP (MEFP ¶10)**.** The 0.3 percent of GDP revision largely reflects one-off fees to be collected by the competition authority in the second half of 2015, part of the revenue over-performance in the first half of the year, and the lower social transfers which are expected to be sustained for the rest of the year. Recent revisions to taxes and welfare benefits are expected to have a negligible fiscal impact in 2015 (Box 3), although the authorities should closely monitor the fiscal impact of these measures. Should economic performance turn out worse than forecasted, automatic stabilizers would be allowed to operate.

General Government, 2015

(Percent of GDP)

	January-June		January-December	
	Combined reviews	Actual	Combined reviews	Revised proj.
Revenue	**17.6**	**18.0**	**39.3**	**39.6**
Taxes on production and imports	6.8	7.0	14.7	14.9
Current taxes on income and wealth	3.9	3.8	10.0	9.8
Social contributions	4.4	4.5	9.0	9.0
Other revenue	2.4	2.7	5.7	5.9
Expenditure	**19.2**	**19.0**	**41.1**	**40.9**
Current expenditure	18.2	18.1	38.0	37.7
Intermediate consumption	1.5	1.5	3.6	3.6
Compensation of employees	6.0	6.0	13.1	13.0
Social transfers 1/	7.2	7.1	14.9	14.9
Interest	1.3	1.3	2.7	2.7
Subsidies and other current expenditure	2.2	2.2	3.7	3.6
Capital expenditure	1.0	1.0	3.1	3.2
General government balance	**-1.7**	**-1.0**	**-1.7**	**-1.3**
General government primary balance	**-0.4**	**0.3**	**1.0**	**1.3**
General government primary spending	**18.0**	**17.7**	**38.4**	**38.2**

Sources: Ministry of Finance; and IMF staff estimates.

1/ Some expenditure related to Cyprus airways for the second half of 2015 was included in other current expenditure in the combined reviews. This has been reclassified as social transfers in this review. Excluding this, the underperformance in social transfers is estimated to be carried over to the second half of 2015.

22. The primary surplus targets for the medium and long term remain unchanged (MEFP ¶11)**.** The target of 2.4 percent of GDP in 2016 represents a largely unchanged underlying fiscal position relative to the 2015 primary surplus net of one-off factors. Compared to the forecast during the combined reviews, the positive base effect from the lower-than-expected social transfers in 2015, and an unanticipated dividend from the telecom authority (CyTA) are expected to offset the impact of the amendments to the Guaranteed Minimum Income (GMI) legislation and the shift to 2016 from 2015 of the revenue loss related to the EU directive that changes the taxation of certain services to a consumption-place basis. The authorities are committed to raising the primary surplus to 3 percent of GDP in 2017 and to maintaining a primary surplus in the range of 3 to 4 percent of GDP from 2018 onwards,[7] which will keep public debt on a downward path and reduce the debt-to-GDP ratio to about 80 percent in 2020.[8]

C. Structural Reforms

23. The authorities remain committed to implementing a series of structural reforms to ensure fiscal sustainability (MEFP ¶12–14, and 16)**:**

- To improve the ***management of fiscal risks*** arising from guarantees (currently equivalent to about 20 percent of GDP), the authorities have adopted a new government guarantee management framework **(end-June 2015 SB)**. To ensure the full implementation of the Fiscal Responsibility and Budget System Law (FRBSL), the COM has recently approved public investment guidelines, and Parliament will adopt pending regulations and the law regulating the functioning, oversight, and governance of the SOEs by end-October.

- To control the growth of the public sector wage bill after the conclusion of the program and to increase the efficiency of the public sector, the authorities are carrying on a ***public administration reform***. Draft legislation ruling public wage increases, promotions, and mobility has been approved by the COM and is expected to be adopted by Parliament by end-December (**existing SB**).

- Building on the experience with the GMI scheme, the authorities plan to ***consolidate benefits within each of the disability and education areas*** to improve targeting and reduce abuse, including by building a national registry of beneficiaries and their benefits. They are carefully monitoring the implementation of the ***GMI***, with the aim of finalizing an assessment of its fiscal costs, targeting accuracy, and coverage by end-September.

- In line with the need to strengthen leadership on the ***revenue administration reform***, two vacant assistant commissioner positions have been filled, completing the senior management

[7] For the purpose of the macroeconomic framework, the primary surplus from 2018 onwards is assumed to be 3½ percent of GDP.

[8] The projection assumes that the program buffer will be disbursed toward the end of the program period after risks have subsided. It is thus envisaged that the buffer would be used for liability management operations to smooth the medium-term debt profile, which will not lead to an increase in gross debt.

team of the new unified tax department. Looking forward, the authorities will continue to integrate the tax departments by establishing a single registration process for all domestic taxes, making the large taxpayers office fully functional, and establishing an integrated legal framework for tax procedures under a new tax procedures code. Efforts to improve compliance and mitigate the risk of revenue loss include continuing to implement the new collection enforcement measures, such as garnishing of bank accounts, and steps to reduce the large backlog of un-assessed tax returns (Box 5). In addition, the authorities will revise the legal framework governing the criminal investigation unit in the new unified department to introduce judicial oversight in line with international best practice.

Box 5. Outstanding Backlog of Tax Assessments

A substantial number of tax returns going back as far as 2004 were left un-assessed, leading to large amounts of uncollected outstanding tax liabilities. This backlog needs to be urgently addressed within a comprehensive strategy to minimize revenue losses while balancing this with the burden that potentially large tax liabilities could create for taxpayers.

A substantial backlog of un-assessed income tax returns points to potentially large amounts of uncollected tax liabilities. Mainly due to serious IT deficiencies and insufficient staffing, a large number of returns filed by companies, self-employed, and individual taxpayers have not been assessed, some going back as far as 2004. The total number of tax returns that await assessment is over 1.3 million. The delay in assessing companies' tax returns alone is estimated to have cost the budget about 2 percent of GDP. While many of the un-assessed returns of individuals might involve small amounts, the total tax liabilities from the self-employed could be significant. Even though most of the potential tax owed is within the statute of limitations, tax for years other than the most recent period will be difficult to collect.

Income Tax Returns Received But Not Assessed

Tax	Number of tax returns	Tax declared as payable (€ mln)	Years involved
Companies: returns processed, tax not assessed	48,996	432	2004-13
Income tax (companies), filed manually and not processed	16,800	NA	2003-13
Income tax (self-employed), processed but not assessed	124,345	NA	2009-13
Income tax (employees, pensioners, others) processed but not assessed	914,590	NA	2009-13
Income tax (individuals, type not specified) not yet processed	231,000	NA	2011-13

Source: Cyprus Tax Department.

A comprehensive approach is needed to address the backlog of un-assessed tax returns. While the IT deficiencies and staffing issues can be resolved with a targeted effort, the collection approach should be balanced with the burden that potentially large tax payment liabilities could create for taxpayers. The timing of the release of assessments should be guided by a comprehensive approach to address the backlog, including by: (i) identifying the size and profile of the affected taxpayers, taking into consideration the statute of limitations so as to minimize legal challenges; (ii) putting in place a process that minimizes the administrative burden to the tax department and additional costs to taxpayers; (iii) prioritizing the most recent tax returns to maximize collection chances; and (iv) establishing an adequate governance structure (i.e. project leadership) as well as a communication strategy for key stakeholders.

24. The process to privatize state-owned enterprises is moving ahead despite some delays (MEFP ¶15). The COM has approved legislation to corporatize CyTA, and the government has made good progress towards a key agreement with the unions on the status of CyTA employees following privatization. As these discussions took longer than expected, the transfer of the company into private hands is now envisaged to happen a few months after the end of the program. Bids for the commercial activities of the Limassol port are due before the end of the year, with a view to finalizing the transaction in early 2016.

25. The authorities are in the first stage of implementing their action plan to stimulate economic growth (MEFP ¶16)**.** A number of diagnostic studies are being conducted to support reforms across different areas (e.g., tourism, shipping, and electronic government) and assess weaknesses of the regulatory and licensing frameworks throughout the economy. With the outcome of the ongoing studies expected in the second half of the year, this preparatory work needs to be promptly translated into concrete actions.

PROGRAM MODALITIES

26. Compliance with program conditionality has been generally strong. All end-June 2015 PCs and continuous PCs were met. Most SBs have been implemented, albeit some with delays (Table 10). The implementation of the end-June SB related to title deeds was incomplete; as noted in ¶12, separate legislation will be adopted to complete this reform.

27. Updated and new conditionality under the arrangement is being proposed (MEFP Tables 1 and 2)**:**

- **Quantitative PCs.** The authorities are proposing to modify several PCs for end-September and end-December. In particular, the PCs on the primary balance and primary expenditure will be modified to reflect the authorities' objective to lock in fiscal savings resulting from the stronger fiscal performance in the first half of the year. The ceilings on government debt will be raised to reflect a delay of the asset swap with the CBC to the fourth quarter; a partial rather than full repayment of the Laiki bond; and the authorities' revised aim to use a larger share of the proceeds from their planned debt issuance in the fourth quarter to increase cash buffers (instead of making debt repayments) to ensure they remain comfortable. The ceilings on government guarantees will be slightly raised to incorporate new guarantees by a government entity recently included in the definition of general government.

- **Structural benchmarks.** As outlined in the previous sections, three new SBs are proposed and one modified.

Proposed New and Modified Structural Benchmarks

Measures	Timing
Adoption by Parliament of legislation to enable the sale of loans in line with CBC directives while retaining the protections of borrowers offered under the Code of Conduct	End-September 2015
Approval by the Council of Ministers of legislation for the issuance and transfer of title deeds in non-legacy and new property transactions	End-October 2015
Adoption by Parliament of legislation to remove existing impediments to the securitization of assets	End-December 2015
Adoption by the Council of Ministers of any necessary adjustments to correct deficiencies of the insolvency and foreclosure frameworks, including legislative changes	End-January 2016 (modified SB)

28. Risks to program implementation remain, although there are some mitigating factors. Downside risks to the program center on those discussed in ¶9, notably domestic political opposition, challenges related to getting NPLs down, and possible spillovers from Greece. Mitigating factors include the good track record of program implementation and the authorities' clear commitment to the measures under the program going forward. In addition, the recent pick-up in private debt restructuring signals that efforts by the authorities and banks to tackle NPLs are starting to bear results. Regarding spillover risks from Greece, the authorities have a range of tools at their disposal and are monitoring the Greek-owned subsidiaries closely. The broader financial system already has weathered well several rounds of tension with regard to the subsidiaries.

29. Financing assurances for the program remain in place. The program is expected to be fully financed through its expiration in May 2016. Available government deposits of about €1.4 billion at end-June, expected proceeds of €0.1 billion from the transfer of the coinage function from the CBC to the Treasury at end-2015, the expected transfer of €0.1 billion of central bank profits to the government in 2016, and the undisbursed funds from the ESM/IMF more than cover the projected financing needs through May 2016 (€2.3 billion). Market conditions permitting, the authorities intend to issue another Eurobond in the second half of 2015. The proceeds will be used to smooth maturities, minimize refinancing risk after the program, and ensure a comfortable cash buffer in line with the debt management strategy.

30. Capacity to repay the Fund remains comfortable. The macroeconomic outlook, and public finances are stronger than envisaged during the combined reviews, thus further mitigating any repayment risks. Access to the capital markets, if sustained, would facilitate repayment to the Fund. The Eurobond issuance in April, resulting in a lower interest bill and a smoother repayment profile, has reduced immediate post-program financing needs. Debt service to the Fund relative to GDP and exports remains manageable. As shown in Table 8, the Fund's peak exposure to Cyprus occurs in 2016 at 563 percent of quota or 6 percent of GDP.

STAFF APPRAISAL

31. Policies implemented under the program continue to yield results. Economic activity is improving, supported by both external and domestic demand, and fiscal adjustment is advancing ahead of schedule. This has allowed Cyprus to tap the international bond market in April 2015, the second market issuance since the 2013 crisis. Liquidity in the core banking system has continued to normalize, and the prospects for NPL resolution are improving.

32. Despite the impressive progress, the road ahead remains challenging. Risks to the program are manageable, and the authorities' ownership is strong, but domestic political challenges will continue to test policy implementation. In addition, the external environment—in particular Greece—contributes to uncertainty. In this setting, it is crucial that the authorities continue with their sound macroeconomic management and maintain the reform momentum. The reforms to be introduced in the remaining program period are critical to ensure that the linked objectives of the program—sustained growth, coupled with fiscal and financial stability—are attained.

33. In particular, a significant improvement in dealing with NPLs is essential to consolidate financial stability and boost growth. Recent progress on making the new private debt restructuring framework operational is encouraging. To ensure the effectiveness of the new framework, implementation performance needs to be monitored closely and any deficiencies addressed. Evidence that banks have geared up their efforts to restructure NPLs is likewise encouraging, and the authorities should continue their supervisory work to ensure that these efforts succeed. Adopting supporting legislation to facilitate loan sales and securitization and to enable swift transfers of title deeds will be essential to support balance sheet clean-up and reduce NPLs.

34. Financial regulation and supervision need to be further strengthened. In this context, the CBC should continue to strengthen its supervisory capacity, in partnership with the SSM, and should ensure a smooth transition to the SRM. In addition, credit information should be expanded to allow for the creation of a credit scoring system. Close attention to the Greek-owned subsidiaries is warranted, and the authorities should continue to reform the coop sector.

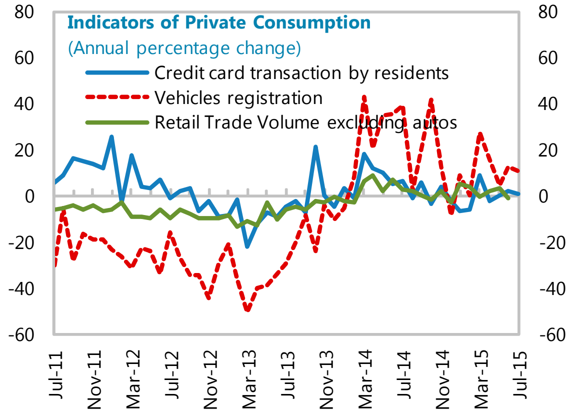
35. Cyprus's strong fiscal performance under the program should be maintained and be supported by ambitious structural reforms. Fiscal outturns continued to exceed expectations in the first half of 2015. However, with public debt and contingent liabilities still high, prudent budget execution should continue, while ensuring support for growth-enhancing public spending and the social safety net. Advancing public administration reform is critical to ensure an affordable wage bill and enhance government efficiency. Progress on managing government guarantees and reforming the revenue administration should be sustained to help to minimize fiscal risks and broaden the tax base.

36. Efforts to support growth should be stepped up. Stronger growth will support fiscal and financial stability, and is needed to ensure a sustained improvement in the living standards and employment prospects of the Cypriot population. To this end, the authorities should press ahead on key structural reforms. This includes overcoming the delays on the privatization program, which is important to help raise investment and efficiency in the economy. In addition, to lessen the weight of the regulatory burden on economic activity, the authorities should move forcefully beyond the diagnostic phase, and implement concrete actions to improve the business environment.

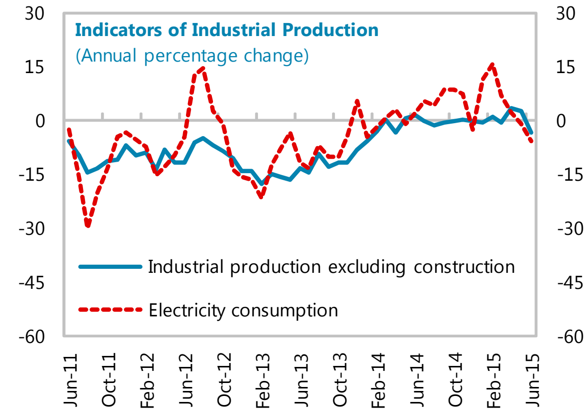
37. On the basis of the continued progress under the program and policy commitments going forward, staff supports the completion of the eighth review and the proposed modifications of performance criteria.

Figure 1. Cyprus: High Frequency Indicators

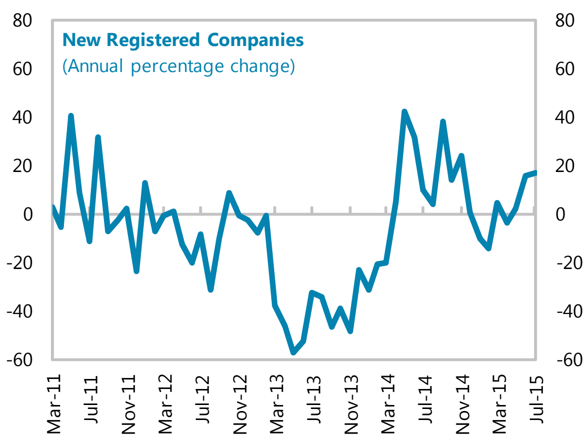
The resilience of private consumption has continued.



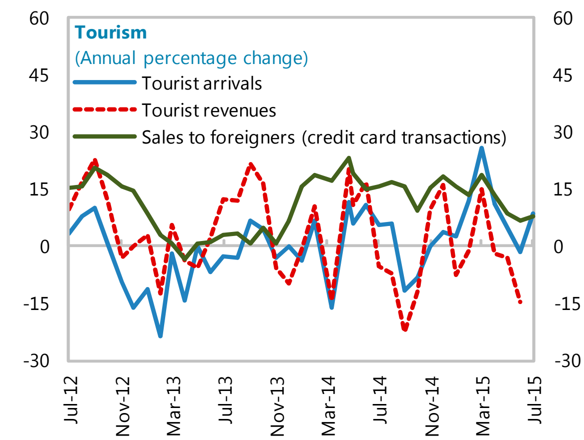
Industrial production has declined in recent months.



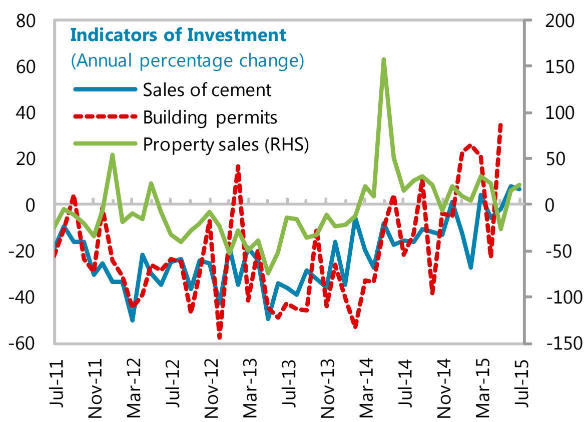
New company registrations have started to pick up.



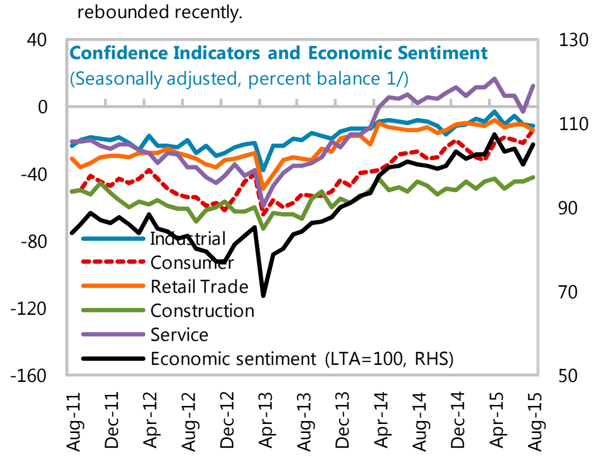
Arrivals picked up again in July after a dip in June.



Construction and real estate activity may have bottomed out.

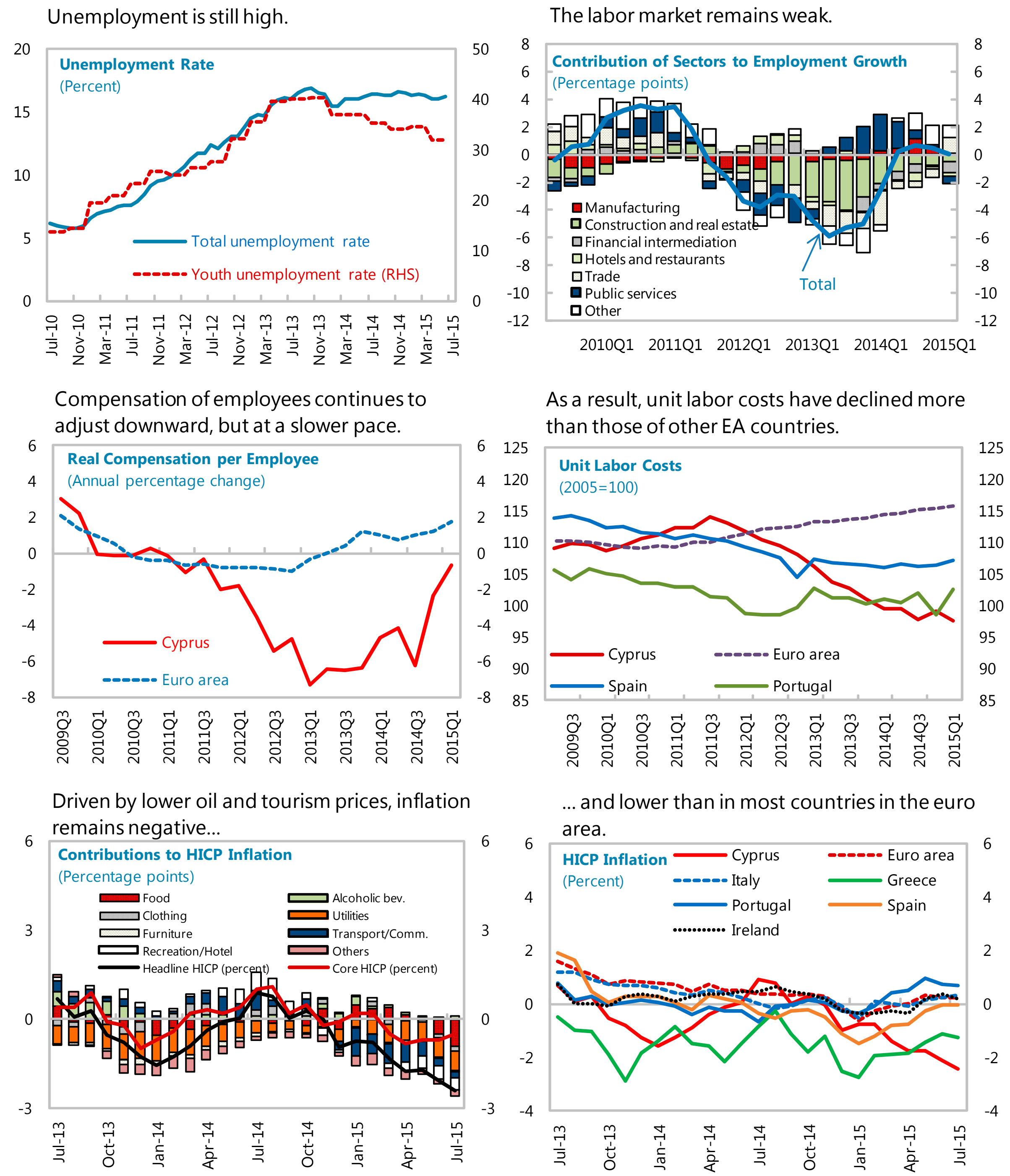


Confidence indicators and economic sentiment have rebounded recently.



Sources: Cystat; Eurostat; MoF; and IMF staff estimates.
1/ Percent balance equals percent of respondents reporting an increase minus the percent of respondents reporting a decrease.

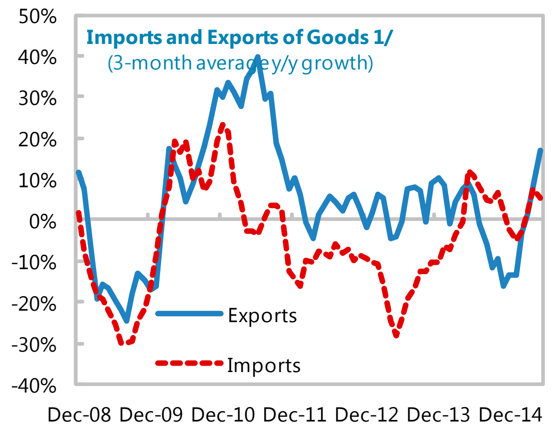
Figure 2. Cyprus: Employment and Inflation Developments



Sources: Cystat; ECB; Eurostat; and IMF staff estimates.

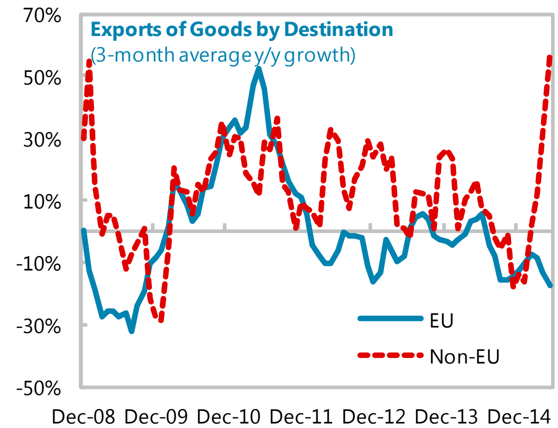
Figure 3. Cyprus: External Indicators

Both imports and exports picked up this year, but mainly reflecting nonresident transit trade.

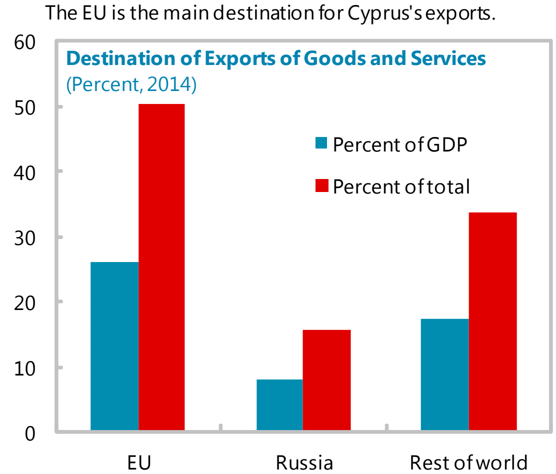


1/ Excluding imports and exports related to the transfer of economic ownership of mobile equipment.

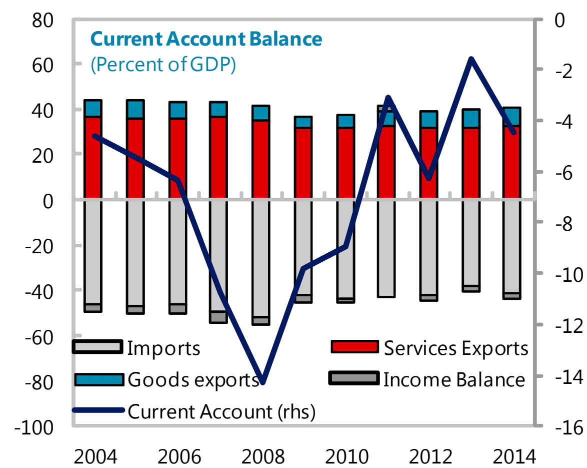
This is in particular the case for exports, as evidenced by the jump in trade with non-EU trading partners.



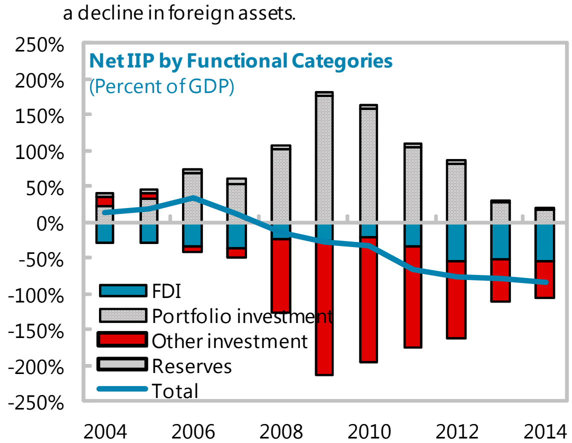
The EU is the main destination for Cyprus's exports.



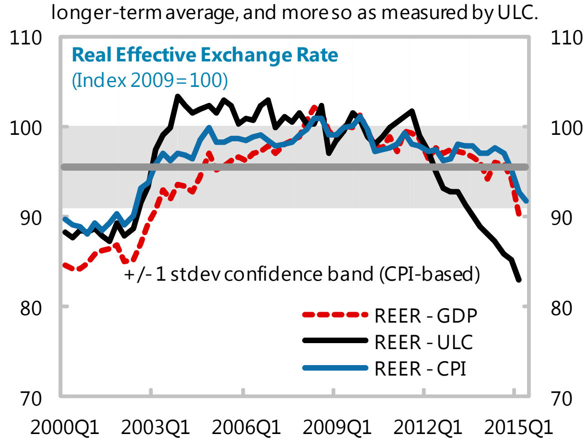
The current account worsened last year, mainly on account of higher imports...



...while the net IIP further deteriorated, reflecting mainly a decline in foreign assets.

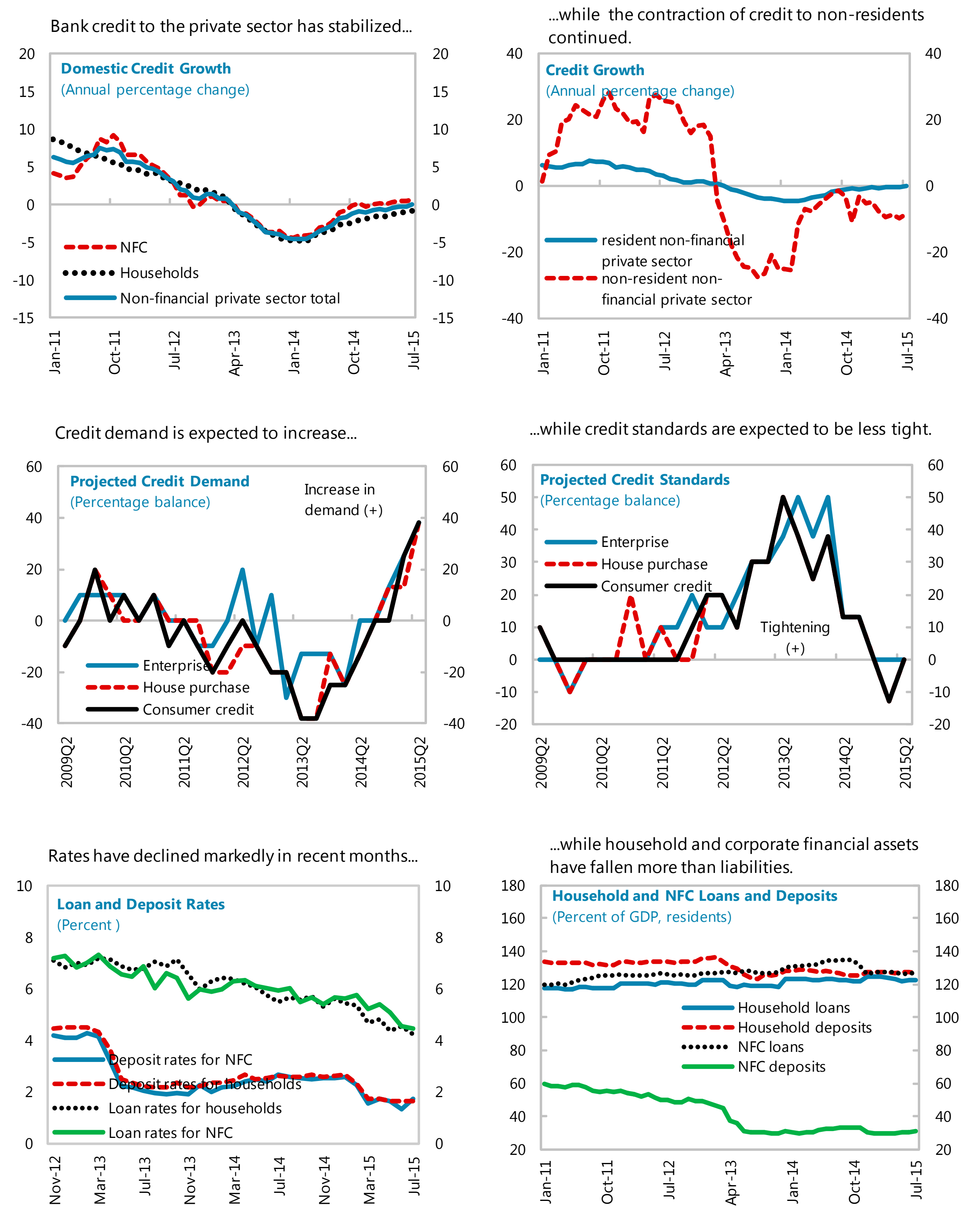


The real effective exchange rate has adjusted down to its longer-term average, and more so as measured by ULC.



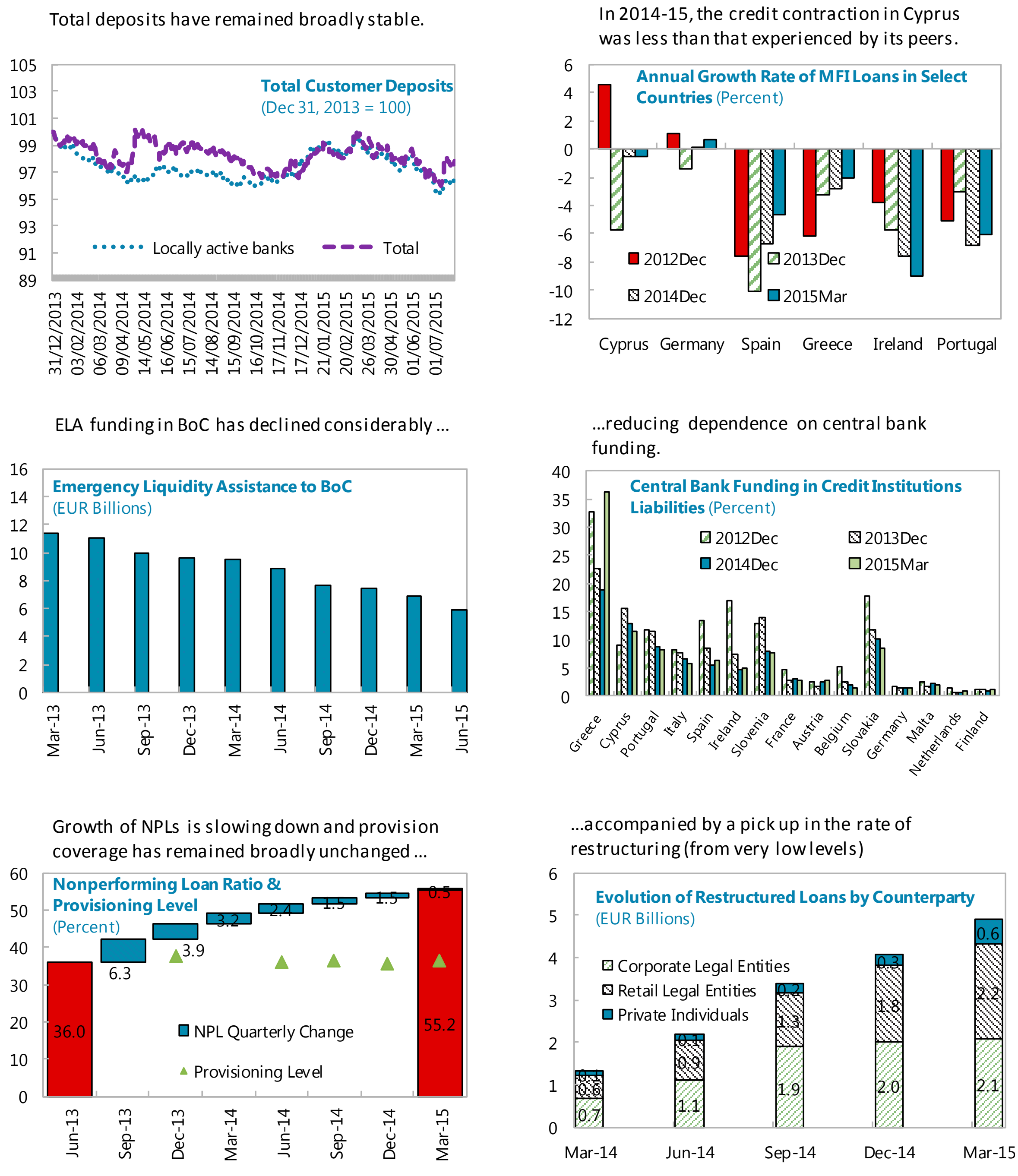
Sources: Eurostat; Central Bank of Cyprus; and IMF staff estimates.

Figure 4. Cyprus: Credit Developments



Sources: Central Bank of Cyprus; Cystat; ECB; and IMF staff estimates.

Figure 5. Cyprus: Banking Sector Developments

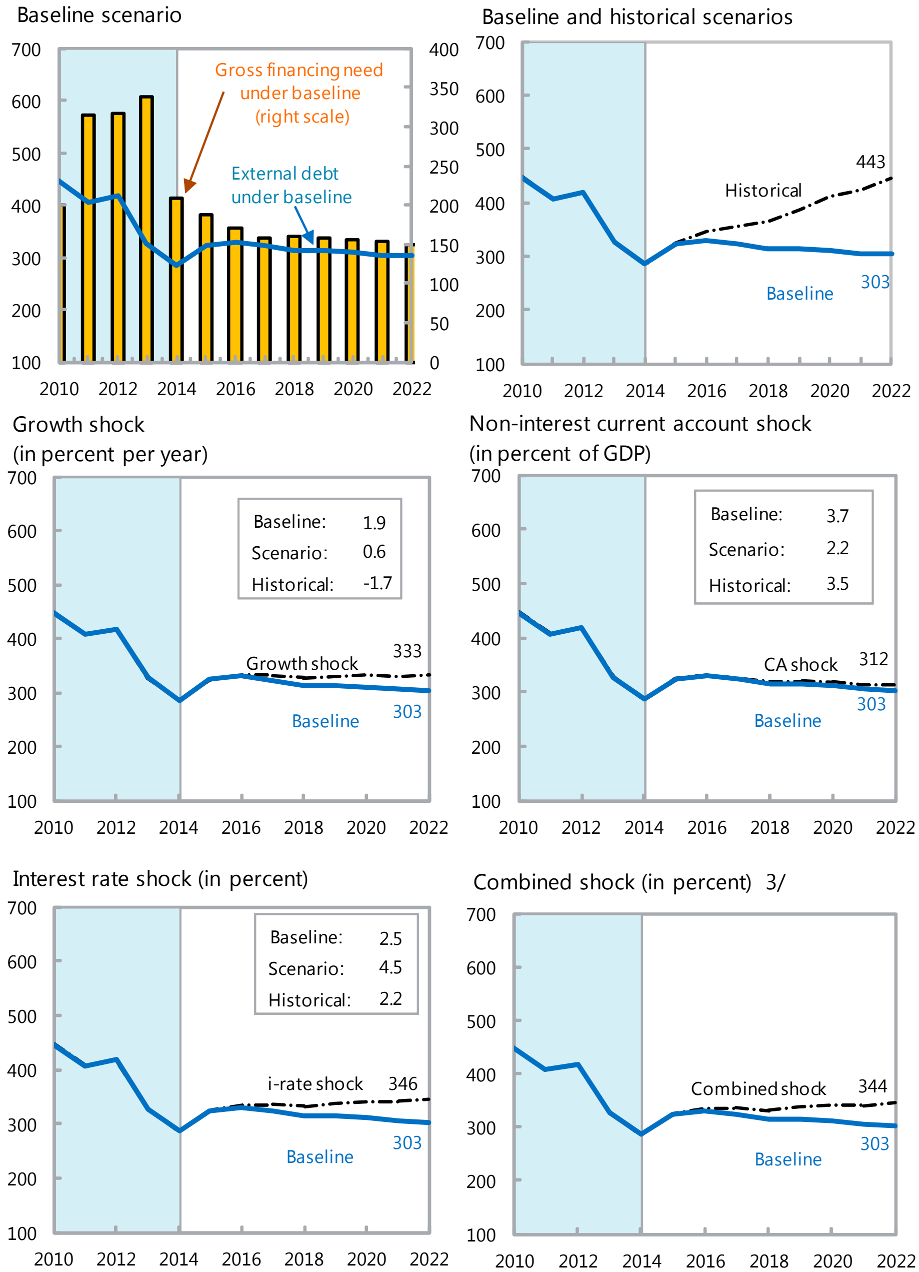


Sources: CBC; ECB; and Fund staff estimates.

Notes: At end-2014 the CBC changed its definition of NPLs to be consistent with the European Banking Authority's definition. Therefore, the March 2015 number is estimated by staff to retain continuity with the old series. In Dec 2014, there was a €1.6 billion reduction in provisions of BOC on account of a netting adjustment on ex-Laiki portfolio. The December 2014 and March 2015 provisioning level excludes this adjustment to retain continuity with the old series.

Figure 6. Cyprus: External Debt Sustainability—Bound Tests 1/ 2/

(Percent of GDP)



Sources: Ministry of Finance; CBC; and Fund staff estimates.

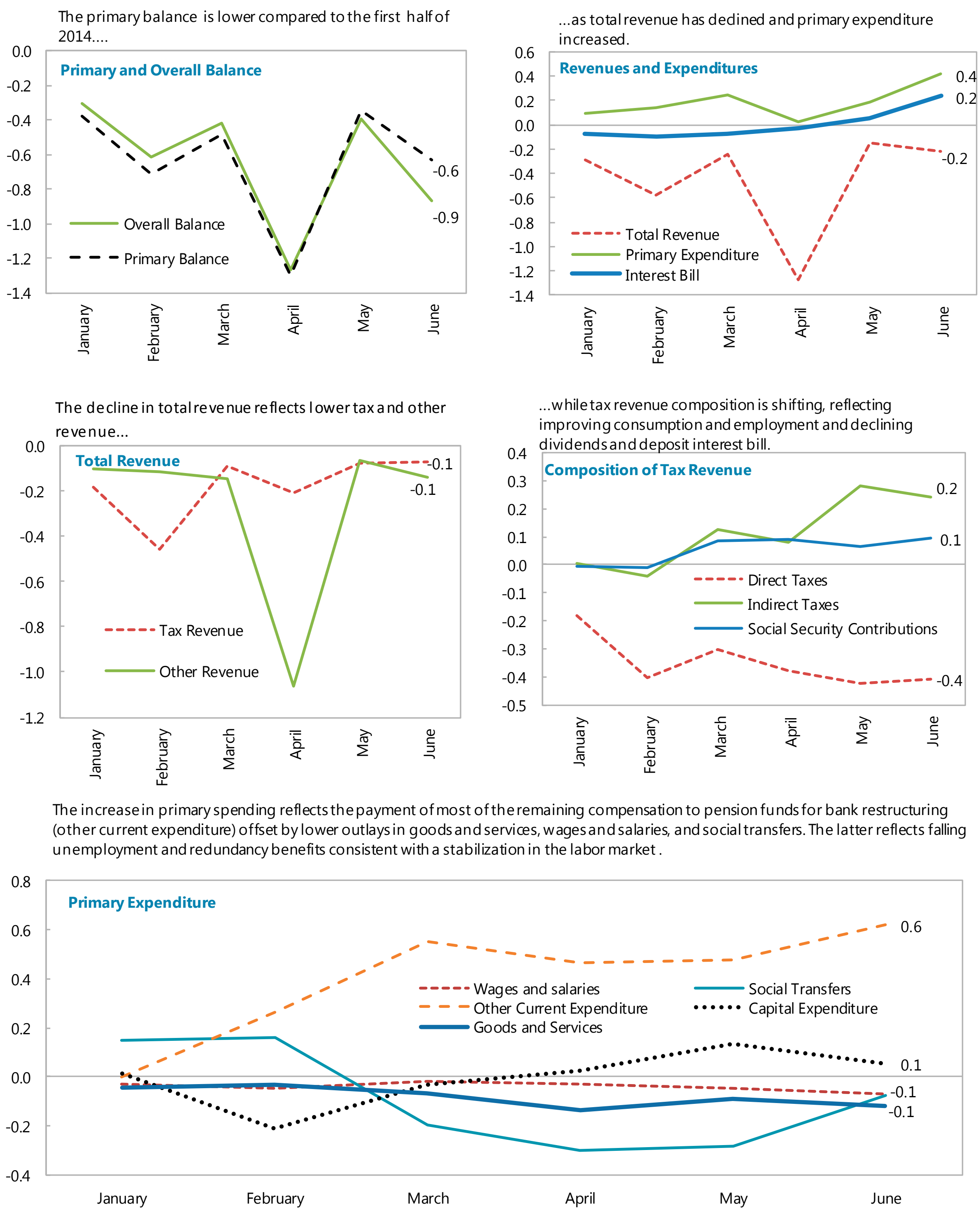
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Five-year historical average for the variable is also shown.

2/ For historical scenarios, the historical averages are calculated over the five-year period, and the information is used to project debt dynamics five years ahead.

3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

Figure 7. Cyprus: Fiscal Developments in 2015 1/

(Cumulative percent of GDP difference relative to previous year)



Sources: Ministry of Finance; and IMF staff estimates.
1/ ESA 2010, cash basis data.

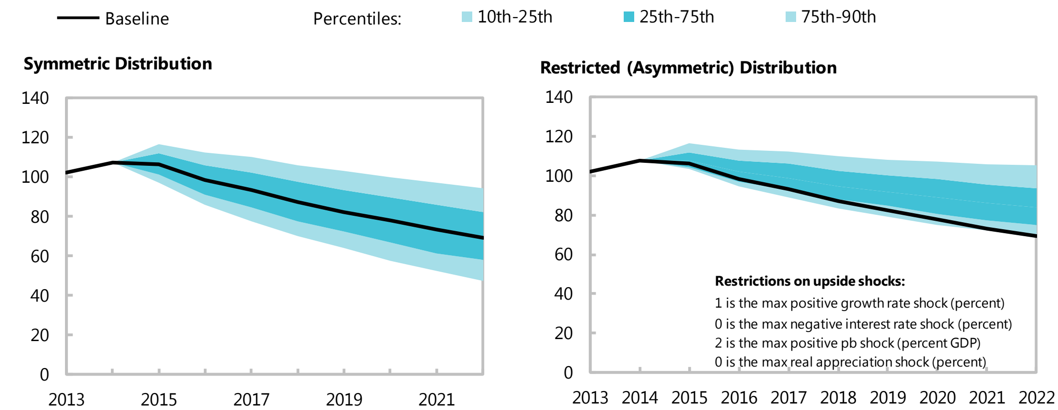
Figure 8. Cyprus: Public Debt Sustainability Analysis—Risk Assessment

Heat Map

Debt level 1/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs 2/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile 3/	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

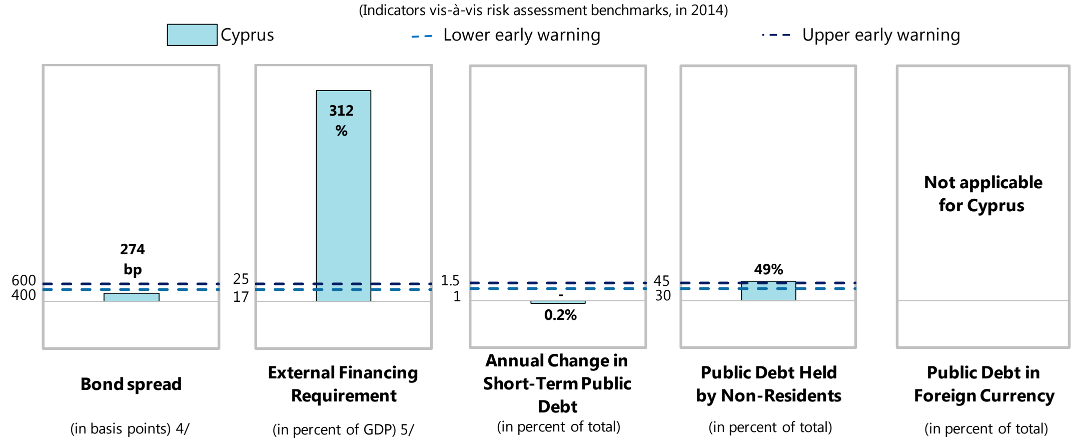
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2014)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 85% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 20% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

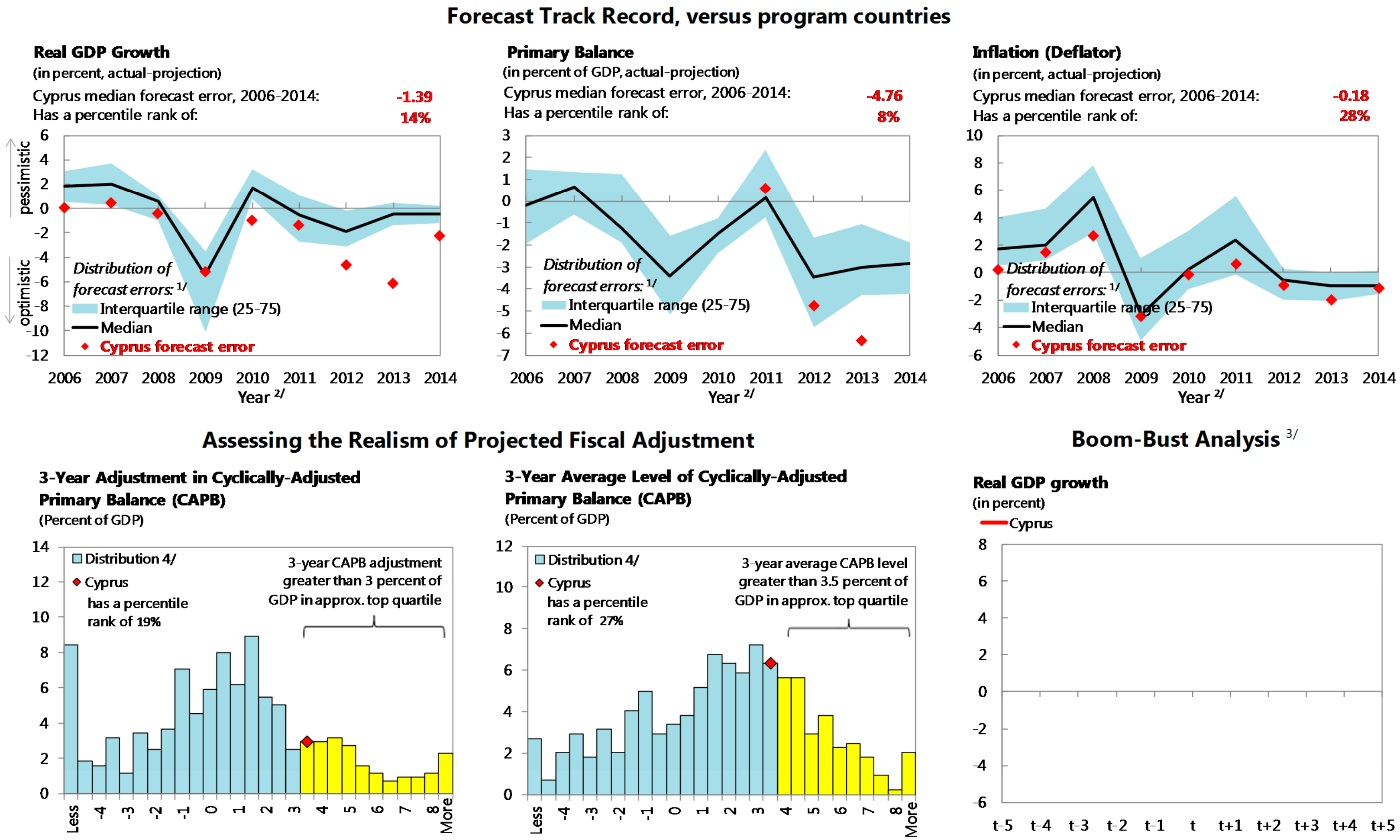
3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.
Lower and upper risk-assessment benchmarks are:

400 and 600 basis points for bond spreads; 17 and 25 percent of GDP for external financing requirement; 1 and 1.5 percent for change in the share of short-term debt; 30 and 45 percent for the public debt held by non-residents.

4/ Long-term bond spread over German bonds, an average over the last 3 months, 06-May-15 through 07-Aug-15.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

Figure 9. Cyprus: Public Debt Sustainability Analysis—Realism of Baseline Assumptions



Source : IMF Staff.

1/ Plotted distribution includes program countries, percentile rank refers to all countries.

2/ Projections made in the spring WEO vintage of the preceding year. The 2012 spring WEO forecast did not factor in extreme tail risks which materialized in March 2013.

3/ Not applicable for Cyprus.

4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Figure 10. Cyprus: Public Debt Sustainability Analysis—Baseline Scenario

(In percent of GDP unless otherwise indicated)

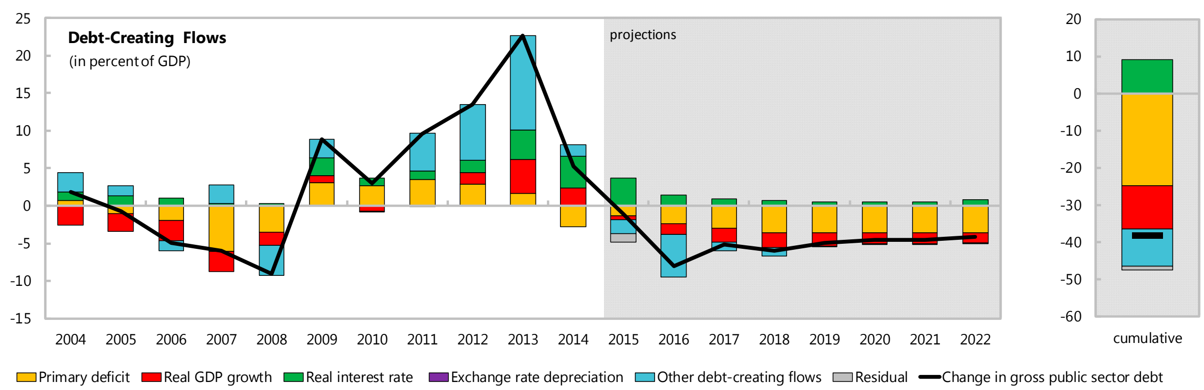
Debt, Economic and Market Indicators [1/]

	Actual			Projections							
	2004-2012 [2/]	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Nominal gross public debt	60.4	102.2	107.5	106.4	98.4	93.2	87.3	82.4	77.8	73.3	69.2
Public gross financing needs	12.4	17.4	16.0	12.8	6.1	3.6	4.9	12.2	10.7	5.8	6.4
Real GDP growth (in percent)	2.1	-5.4	-2.3	0.5	1.4	2.0	2.2	2.1	1.8	1.9	1.9
Inflation (GDP deflator, in percent)	2.7	-1.4	-1.2	-0.9	0.7	1.2	1.4	1.7	1.7	1.8	1.5
Nominal GDP growth (in percent)	4.8	-6.7	-3.4	-0.5	2.1	3.2	3.6	3.8	3.6	3.7	3.4
Effective interest rate (in percent) [4/]	4.9	3.3	2.9	2.5	2.1	2.2	2.2	2.3	2.4	2.6	2.7

As of August 07, 2015		
Sovereign Spreads		
EMBIG (bp) 3/		262
5Y CDS (bp)		316
Ratings	Foreign	Local
Moody's	B3	B3
S&Ps	B+	B+
Fitch	B-	B-

Contribution to Changes in Public Debt

	Actual			Projections									
	2004-2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	1.8	22.7	5.3	-1.1	-8.0	-5.1	-6.0	-4.9	-4.6	-4.5	-4.1	-29.7	
Identified debt-creating flows	1.8	22.7	5.3	0.0	-8.0	-5.1	-6.0	-4.9	-4.6	-4.5	-4.1	-28.6	
Primary deficit	0.0	1.6	-2.8	-1.3	-2.4	-3.0	-3.6	-3.6	-3.6	-3.6	-3.6	-17.5	-0.5
Primary (noninterest) revenue and grants	37.9	37.6	40.2	39.6	39.1	38.8	38.8	38.8	38.9	38.8	38.7	233.8	
Primary (noninterest) expenditure	38.0	39.2	37.4	38.2	36.7	35.8	35.2	35.1	35.3	35.2	35.2	216.3	
Automatic debt dynamics [5/]	0.0	8.4	6.6	3.2	0.0	-1.0	-1.3	-1.3	-0.9	-0.8	-0.5	-1.3	
Interest rate/growth differential [6/]	0.0	8.4	6.6	3.2	0.0	-1.0	-1.3	-1.3	-0.9	-0.8	-0.5	-1.3	
Of which: real interest rate	1.1	3.9	4.2	3.7	1.5	0.9	0.7	0.5	0.5	0.5	0.8	7.8	
Of which: real GDP growth	-1.2	4.6	2.4	-0.5	-1.5	-1.9	-2.0	-1.8	-1.5	-1.4	-1.3	-9.1	
Exchange rate depreciation [7/]	0.0	0.0	0.0	...	...	...	...	...	...	...	...	...	
Other identified debt-creating flows	1.8	12.6	1.5	-1.9	-5.6	-1.1	-1.1	0.0	0.0	0.0	0.0	-9.8	
Net privatization/asset sales proceeds (negative)	0.0	0.0	0.0	0.0	-5.6	-1.1	-1.1	0.0	0.0	0.0	0.0	-7.8	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other debt flows	1.8	12.6	1.5	-1.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-2.0	
Residual, including asset changes [8/]	0.0	0.0	0.0	-1.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-1.1	



Source: IMF staff estimates.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the denominator in footnote 5 as r - π (1+g) and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

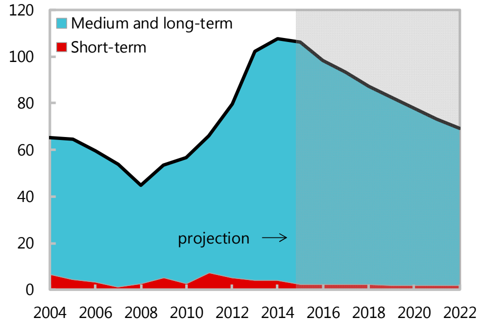
8/ For projections, includes exchange rate changes during the projection period. In 2015, the residual refects the Euro 0.6 billion asset swap.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

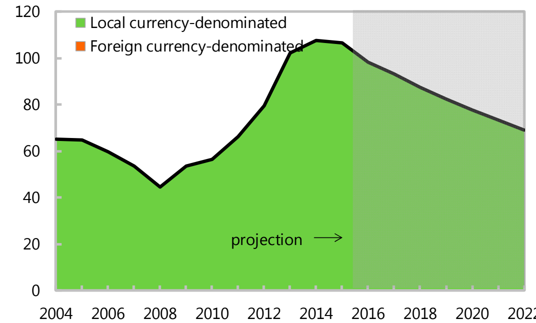
Figure 11. Cyprus: Public Debt Sustainability Analysis—Composition of Public Debt and Alternative Scenarios 1/

Composition of Public Debt

By Maturity
(in percent of GDP)



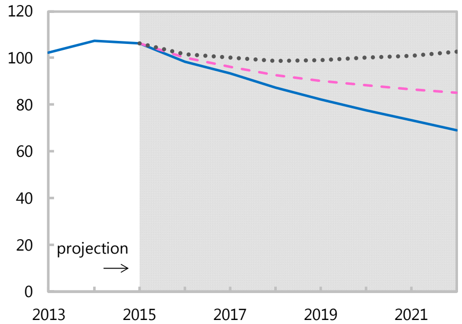
By Currency
(in percent of GDP)



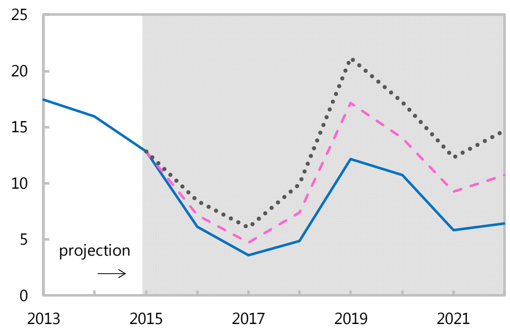
Alternative Scenarios

Baseline   Historical   Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(Percent)

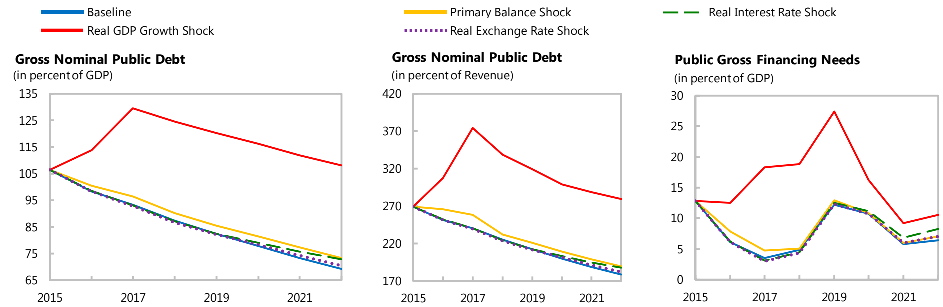
Baseline Scenario	2015	2016	2017	2018	2019	2020	2021	2022
Real GDP growth	0.5	1.4	2.0	2.2	2.1	1.8	1.9	1.9
Inflation 1/	-0.9	0.7	1.2	1.4	1.7	1.7	1.8	1.5
Primary Balance	1.3	2.4	3.0	3.6	3.6	3.6	3.6	3.6
Effective interest rate	2.5	2.1	2.2	2.2	2.3	2.4	2.6	2.7
Constant Primary Balance Scenario								
Real GDP growth	0.5	1.4	2.0	2.2	2.1	1.8	1.9	1.9
Inflation 1/	-0.9	0.7	1.2	1.4	1.7	1.7	1.8	1.5
Primary Balance	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Effective interest rate	2.5	2.2	1.7	1.6	1.8	2.4	2.7	2.6

Historical Scenario	2015	2016	2017	2018	2019	2020	2021	2022
Real GDP growth	0.5	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Inflation 1/	-0.9	0.7	1.2	1.4	1.7	1.7	1.8	1.5
Primary Balance	1.3	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Effective interest rate	2.5	2.2	1.7	1.7	1.9	2.7	3.2	3.3

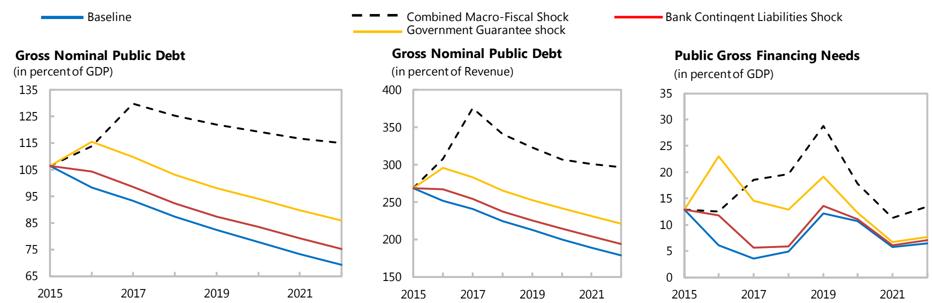
Source: IMF staff estimates.
1/ GDP deflator growth.

Figure 12. Cyprus: Public Debt Sustainability Analysis—Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



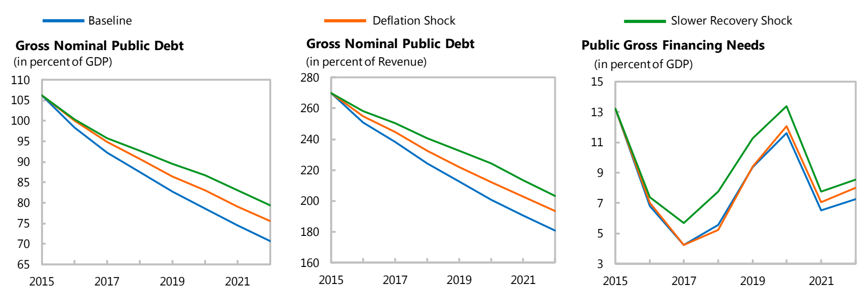
Underlying Assumptions
(Percent)

Primary Balance Shock	2015	2016	2017	2018	2019	2020	2021	2022
Real GDP growth	0.5	1.4	2.0	2.2	2.1	1.8	1.9	1.9
Inflation	-0.9	0.7	1.2	1.4	1.7	1.7	1.8	1.5
Primary balance	1.3	0.7	1.3	3.6	3.6	3.6	3.6	3.6
Effective interest rate	2.5	2.2	1.6	1.6	1.7	2.2	2.5	2.3
Real Interest Rate Shock								
Real GDP growth	0.5	1.4	2.0	2.2	2.1	1.8	1.9	1.9
Inflation	-0.9	0.7	1.2	1.4	1.7	1.7	1.8	1.5
Primary balance	1.3	2.4	3.0	3.6	3.6	3.6	3.6	3.6
Effective interest rate	2.5	2.2	1.7	1.7	1.9	2.8	3.5	3.7
Combined Shock								
Real GDP growth	0.5	-5.7	-5.1	2.2	2.1	1.8	1.9	1.9
Inflation	-0.9	-1.0	-0.6	1.4	1.7	1.7	1.8	1.5
Primary balance	1.3	-3.2	-8.2	1.5	2.6	3.6	3.6	3.6
Effective interest rate	2.5	2.2	1.8	2.0	2.4	3.5	4.2	4.5
Bank Contingent Liabilities Shock								
Real GDP growth	0.5	1.4	2.0	2.2	2.1	1.8	1.9	1.9
Inflation	-0.9	0.7	1.2	1.4	1.7	1.7	1.8	1.5
Primary balance	1.3	-3.2	3.0	3.6	3.6	3.6	3.6	3.6
Effective interest rate	2.5	2.2	1.6	1.6	1.7	2.2	2.5	2.3

Source: IMF Staff Estimates

Real GDP Growth Shock	2015	2016	2017	2018	2019	2020	2021	2022
Real GDP growth	0.5	-5.7	-5.1	2.2	2.1	1.8	1.9	1.9
Inflation	-0.9	-1.0	-0.6	1.4	1.7	1.7	1.8	1.5
Primary balance	1.3	-3.2	-8.2	1.5	2.6	3.6	3.6	3.6
Effective interest rate	2.5	2.2	1.6	1.6	1.7	2.4	2.7	2.6
Real Exchange Rate Shock								
Real GDP growth	0.5	1.4	2.0	2.2	2.1	1.8	1.9	1.9
Inflation	-0.9	1.1	1.2	1.4	1.7	1.7	1.8	1.5
Primary balance	1.3	2.4	3.0	3.6	3.6	3.6	3.6	3.6
Effective interest rate	2.5	2.2	1.6	1.7	1.8	2.3	2.5	2.4
Government Guarantee shock								
Real GDP growth	0.5	1.4	2.0	2.2	2.1	1.8	1.9	1.9
Inflation	-0.9	0.7	1.2	1.4	1.7	1.7	1.8	1.5
Primary balance	1.3	-14.6	3.0	3.6	3.6	3.6	3.6	3.6
Effective interest rate	2.5	2.1	1.6	1.6	1.7	2.3	2.6	2.5

Additional Stress Tests



Underlying Assumptions
(Percent)

	2015	2016	2017	2018	2019	2020	2021	2022
Deflation Shock								
Real GDP growth	0.2	1.4	2.0	2.2	2.1	1.8	1.8	1.9
Inflation	-0.9	-0.7	-0.1	0.4	1.2	1.3	1.7	1.5
Primary balance	1.0	2.4	3.0	3.6	3.6	3.6	3.6	3.6
Effective interest rate	2.5	2.4	1.9	1.8	2.0	2.6	2.9	2.7

	2015	2016	2017	2018	2019	2020	2021	2022
Slower Recovery Shock								
Real GDP growth	0.2	0.4	0.8	1.0	1.2	1.5	1.8	1.9
Inflation	-0.9	0.4	0.9	1.1	1.5	1.6	1.9	1.5
Primary balance	1.0	2.0	2.5	3.1	3.2	3.1	3.5	3.7
Effective interest rate	2.5	2.4	1.9	1.9	2.1	2.7	3.0	3.0

Source: IMF staff estimates.

Table 1. Cyprus: Selected Economic Indicators, 2010–20

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
					Est.	Projections					
Real Economy				(Percent change, unless otherwise indicated)							
Real GDP	1.4	0.3	-2.4	-5.4	-2.3	0.5	1.4	2.0	2.2	2.1	1.8
Domestic demand	2.4	-2.1	-3.9	-9.9	-1.3	0.1	1.1	1.4	1.7	1.6	1.3
Consumption	0.7	1.6	-1.1	-5.8	-1.6	0.0	0.7	1.0	1.3	1.2	1.0
Private consumption	1.3	1.8	-0.7	-6.0	0.4	0.6	1.1	1.2	1.5	1.3	1.0
Public consumption	-1.4	0.7	-2.7	-4.9	-8.7	-2.3	-0.9	0.2	0.5	1.0	1.0
Fixed investment	-5.1	-9.4	-20.7	-17.1	-18.8	0.2	3.6	4.0	4.5	4.2	3.6
Inventory accumulation 1/	3.2	-1.4	1.0	-2.4	2.7	0.0	0.0	0.0	0.0	0.0	0.0
Foreign balance 1/	-1.1	2.4	1.7	4.7	-1.0	0.4	0.4	0.7	0.6	0.6	0.6
Exports of goods and services	2.6	4.2	-1.7	-5.0	5.7	0.9	1.5	2.9	3.3	3.2	3.1
Imports of goods and services	4.5	-0.6	-4.6	-13.6	8.1	0.3	1.0	1.8	2.4	2.3	2.2
Potential GDP growth	1.7	1.5	-1.5	-5.4	-2.2	-0.2	0.4	1.0	1.6	1.9	1.8
Output gap (percent of potential GDP)	-1.2	-2.4	-3.3	-3.3	-3.4	-2.8	-1.8	-0.9	-0.3	-0.1	0.0
HICP (period average)	2.6	3.5	3.1	0.4	-0.3	-1.0	0.9	1.3	1.5	1.8	1.9
HICP (end of period)	1.9	4.2	1.5	-1.3	-1.0	-1.0	0.9	1.3	1.5	1.8	1.9
Unemployment rate (EU standard, percent)	6.3	7.9	11.9	15.9	16.1	16.0	15.0	13.7	12.4	11.1	10.1
Employment growth (percent)	1.4	-1.5	-2.4	-6.1	-0.1	0.1	1.2	1.6	1.7	1.6	1.5
Public Finance					(Percent of GDP)						
General government balance	-4.8	-5.8	-5.8	-4.4	-0.2	-1.3	0.1	0.9	1.7	1.7	1.7
Revenue	37.7	37.0	36.3	37.6	40.2	39.6	39.1	38.8	38.8	38.8	38.9
Expenditure	42.5	42.8	42.1	42.0	40.4	40.9	38.9	37.8	37.2	37.0	37.2
Primary Fiscal Balance	-2.7	-3.6	-2.9	-1.6	2.8	1.3	2.4	3.0	3.6	3.6	3.6
General government debt	56.5	66.0	79.5	102.2	107.5	106.4	98.4	93.2	87.3	82.4	77.8
Balance of Payments					(Percent of GDP)						
Current account balance	-9.0	-3.1	-6.3	-1.6	-4.5	-4.2	-3.8	-3.6	-3.8	-3.8	-4.0
Trade Balance (goods and services)	-5.7	-3.9	-2.8	1.7	-0.6	-0.1	0.1	0.3	0.5	0.7	0.9
Exports of goods and services	37.7	39.4	39.2	40.0	40.6	40.4	40.6	41.1	41.5	41.9	42.3
Imports of goods and services	43.4	43.3	42.0	38.3	41.2	40.5	40.6	40.7	41.0	41.2	41.4
Goods balance	-24.5	-22.3	-19.9	-16.2	-18.5	-17.3	-17.3	-17.3	-17.4	-17.4	-17.4
Services balance	18.8	18.4	17.1	18.0	17.9	17.2	17.3	17.6	17.8	18.1	18.4
Income, net	-2.0	1.8	-2.3	-2.5	-2.7	-3.0	-2.8	-2.8	-3.2	-3.5	-3.8
Transfer, net	-0.6	-1.0	-1.1	-0.9	-1.2	-1.1	-1.1	-1.1	-1.1	-1.1	-1.1
Capital account, net	0.2	0.2	0.1	1.3	0.8	0.8	0.8	0.8	0.8	0.7	0.7
Financial account, net	8.6	4.0	4.4	-24.0	-3.7	-3.1	-12.6	2.9	3.3	3.6	4.1
Direct investment	0.3	0.7	6.2	0.9	1.8	0.7	7.3	1.9	4.1	4.0	4.0
Portfolio investment	-10.1	29.5	27.5	64.8	11.1	3.0	-7.9	-3.2	-1.8	4.4	2.8
Other investment	17.4	-26.4	-29.6	-89.8	-16.5	-6.9	-12.0	4.2	1.1	-4.7	-2.7
Reserves (- inflow; + outflow)	1.0	0.2	0.3	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Program financing	0.0	0.0	0.0	26.7	7.3	6.5	15.6	0.0	-0.3	-0.5	-0.9
European Union	0.0	0.0	0.0	25.3	6.3	3.4	14.9	0.0	0.0	0.0	0.0
IMF	0.0	0.0	0.0	1.4	1.1	3.0	0.7	0.0	-0.3	-0.5	-0.9
Errors and omissions	0.2	-1.2	1.8	-2.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Savings-Investment Balance											
National saving	14.2	15.9	10.1	10.5	7.4	7.7	8.4	8.9	9.0	9.3	9.3
Government	0.8	-1.1	-2.0	-1.5	2.7	1.9	3.4	4.3	5.0	5.1	5.1
Non-government	13.4	17.0	12.1	12.0	4.7	5.9	5.0	4.6	4.0	4.2	4.2
Gross capital formation	23.2	19.0	16.3	12.1	11.9	11.9	12.2	12.5	12.8	13.1	13.3
Government	5.5	5.6	5.8	6.5	5.4	6.3	5.3	5.0	4.8	4.7	4.7
Private	17.7	13.4	10.6	5.7	6.5	5.6	6.9	7.5	8.0	8.4	8.6
Foreign saving	-9.0	-3.1	-6.3	-1.6	-4.5	-4.2	-3.8	-3.6	-3.8	-3.8	-4.0
Memorandum Item:											
Nominal GDP (billions of euros)	19.1	19.5	19.4	18.1	17.5	17.4	17.8	18.4	19.0	19.8	20.5

Sources: Eurostat, Central Bank of Cyprus, and IMF staff estimates.

1/ Contribution to growth.

Table 2. Cyprus: Fiscal Developments and Projections, 2010–20

(Percent of GDP)

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
						Projections					
Revenue	37.7	37.0	36.3	37.6	40.2	39.6	39.1	38.8	38.8	38.8	38.9
Current revenue	37.6	37.0	36.2	37.5	40.1	39.5	39.0	38.7	38.8	38.7	38.9
Tax revenue	24.5	24.5	24.0	24.2	25.1	24.7	24.4	24.5	24.6	24.7	24.7
Indirect taxes	14.6	13.9	14.0	13.8	14.8	14.9	14.6	14.9	14.8	14.9	14.9
Direct taxes	9.9	10.6	10.0	10.4	10.3	9.8	9.8	9.7	9.8	9.8	9.8
Other taxes (capital taxes)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Social security contributions	8.1	8.0	7.8	7.6	8.9	9.0	9.0	9.1	9.2	9.2	9.2
Other current revenue	5.0	4.4	4.5	5.8	6.1	5.9	5.6	5.1	5.0	4.9	5.0
Sales	2.4	2.2	2.5	2.5	2.8	2.8	2.8	2.8	2.8	2.8	2.9
Other	2.6	2.2	2.0	3.3	3.3	3.1	2.8	2.3	2.1	2.0	2.1
Capital revenue	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure	42.5	42.8	42.1	42.0	40.4	40.9	38.9	37.8	37.2	37.0	37.2
Current expenditure	36.9	38.1	38.2	39.0	37.5	37.7	35.7	34.5	33.8	33.7	33.8
Wages and salaries	14.5	14.8	14.6	14.2	13.1	13.0	12.7	12.7	12.7	12.6	12.6
Goods and services	4.5	4.5	4.2	4.2	3.8	3.6	3.5	3.3	3.2	3.2	3.2
Social Transfers	13.1	13.5	13.4	13.9	14.7	14.9	14.6	14.0	13.7	13.7	13.9
Subsidies	0.3	0.4	0.5	0.5	0.5	0.5	0.5	0.4	0.4	0.4	0.4
Interest payments	2.1	2.2	2.9	2.8	3.0	2.7	2.2	2.0	2.0	1.9	1.9
Other current expenditure	2.5	2.7	2.7	3.5	2.4	3.1	2.2	2.0	1.9	1.8	1.8
Capital expenditure 2/	5.6	4.6	3.8	2.9	2.9	3.2	3.2	3.3	3.4	3.4	3.4
Overall balance 3/	-4.8	-5.8	-5.8	-4.4	-0.2	-1.3	0.1	0.9	1.7	1.7	1.7
Statistical discrepancy	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing	-4.8	-5.8	-5.8	-4.4	-0.2	-1.3	0.1	0.9	1.7	1.7	1.7
Net financial transactions	-4.8	-5.8	-5.8	-4.4	-0.2	-1.3	0.1	0.9	1.7	1.7	1.7
Net acquisition of financial assets	-0.5	4.9	7.9	13.0	1.9	-3.0	-5.6	-1.1	-1.1	0.0	0.0
Currency and deposits	-1.1	4.3	-3.3	4.3	2.1	0.4	0.0	0.0	0.0	0.0	0.0
Securities other than shares 4/	0.0	0.0	0.0	8.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Loans	0.7	1.0	1.6	0.0	-0.4	0.0	0.0	0.0	0.0	0.0	0.0
Shares and other equity	0.0	0.0	9.6	0.4	0.2	0.0	-5.6	-1.1	-1.1	0.0	0.0
Other assets	0.0	-0.4	0.0	0.0	0.0	-3.4	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	4.3	10.7	13.7	17.4	2.0	-1.6	-5.8	-2.0	-2.7	-1.7	-1.7
Currency and deposits	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Securities other than shares	4.3	7.0	1.6	-8.5	-4.8	-4.7	-20.7	-0.6	2.3	2.5	3.0
Loans	-0.1	3.7	11.6	25.9	6.9	3.1	15.0	-1.5	-5.0	-4.2	-4.7
Other liabilities	0.0	0.0	0.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:											
Primary balance 5/	-2.7	-3.6	-2.9	-1.6	2.8	1.3	2.4	3.0	3.6	3.6	3.6
Public debt	56.5	66.0	79.5	102.2	107.5	106.4	98.4	93.2	87.3	82.4	77.8

Sources: Eurostat; and IMF staff estimates.

1/ Historical fiscal statistics until 2012 are based on Eurostat and are thus reported on an accrual basis. For 2013, 2014, and projections, and to be consistent with the cash basis of the program, the fiscal statistics are reported on a cash basis.

2/ Capital expenditure in 2016 includes payments for guarantees that are expected to be called that year which are recorded as capital transfers under ESA.

3/ The overall balance in 2014 excludes the €1.5 billion recapitalization of the cooperative sector. Projections for 2017-18 include unspecified additional fiscal measures: 70 percent are assumed on the spending side and the rest on the revenue side.

4/ The draw down of ESM bonds received in 2013 to recapitalize the cooperative sector in 2014 is excluded from this line consistent with the exclusion of the recapitalization of the cooperative sector in the overall and primary balance.

5/ The primary fiscal balance in 2014 excludes the €1.5 billion recapitalization of the cooperative sector. Primary fiscal balances in 2015 and 2016 include expected dividends of €0.2 billion, to be distributed by the CBC in line with CBC's duties under the Treaties and the Statute.

Table 3. Cyprus: Gross Financing Requirements and Sources of Financing, 2013–17
(Millions of euros)

	2013 May-December	2014	2015	2016	2017
Gross financing requirement including a buffer	**5,839.7**	**3,028.1**	**3,729.7**	**4,381.9**	**850.3**
Government	3,400.3	2,855.6	3,328.0	1,081.8	650.3
Fiscal deficit ("+" = financing need)	828.0	73.9	237.2	-25.7	-173.8
Debt maturities	2,572.3	2,781.7	3,090.9	1,107.5	824.1
Medium- and long-term	1,596.2	2,031.4	2366.5	707.5	424.1
Domestic	138.3	1,353.1	1,407.8	431.2	360.0
Foreign	1,457.9	678.3	958.7	276.3	64.1
Short-term	976.0	750.3	724.4	400.0	400.0
Domestic	976.0	750.3	724.4	400.0	400.0
Foreign	0.0	0.0	0.0	0.0	0.0
Banks recapitalization/support	1,500.0	0.0	0.0	0.0	0.0
Additional Debt Repayments 1/	0.0	0.0	0.0	3,300.0	200.0
Market financing	**776.2**	**1,715.9**	**2,177.7**	**607.7**	**650.3**
Government	776.2	1,715.9	2,177.7	607.7	650.3
Fiscal deficit	0.0	0.0	0.0	0.0	0.0
Debt maturities	776.2	1,715.9	2,177.7	607.7	650.3
Medium- and long-term 2/	25.9	991.5	1,777.7	207.7	250.3
Short-term	750.3	724.4	400.0	400.0	400.0
Net financing requirement	**5,063.6**	**1,312.1**	**1,552.0**	**3,774.2**	**200.0**
Government	2,624.2	1,139.7	1,150.4	474.1	0.0
Fiscal deficit	828.0	73.9	237.2	-25.7	-173.8
Debt maturities	1,796.1	1,065.8	913.2	499.8	173.8
Medium- and long-term	1,570.4	1,039.9	588.8	499.8	173.8
Short-term	225.7	25.9	324.4	0.0	0.0
Official Financing Sources and Financial Buffers	**5,063.6**	**1,312.1**	**1,552.0**	**3,774.2**	**200.0**
Domestic Financing Sources	**225.7**	**25.9**	**424.4**	**1,000.0**	**200.0**
Use of cash balances	225.7	25.9	324.4	0.0	0.0
Central Bank Dividends/Coinage	0.0	0.0	100.0	0.0	0.0
Privatizations Proceeds	0.0	0.0	0.0	1,000.0	200.0
Official financing sources	**4,837.8**	**1,286.2**	**1,127.6**	**2,774.2**	**0.0**
IMF	252.8	186.2	527.6	124.2	0.0
ESM	4,585.0	1,100.0	600.0	2,650.0	0.0

Source: IMF staff estimates.

1/ Refers to additional debt repayments that would be made with privatization proceeds and a debt management operation in 2016 and with privatization proceeds only in 2017 assuming the full disbursement of the program envelope and the full materialization of privatization proceeds as projected.

2/ Medium and long term market financing in 2013 refers to EIB financing. In 2014, it includes EIB financing and the €850 million issued in May and June of 2014. The 2015 figure includes EIB financing, the April 2015 market issuance, and a second expected issuance in 2015:Q4.

Table 4. Cyprus: Balance of Payments, 2010–20 1/

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
					Est. 2/			Projections			
					(Millions of Euros)						
Current Account Balance	-1,711	-602	-1,217	-287	-783	-725	-674	-663	-725	-758	-815
Trade Balance (Goods and Services)	-1,082	-763	-546	313	-108	-14	10	58	87	138	189
Goods Balance	-4,665	-4,349	-3,856	-2,941	-3,243	-3,008	-3,073	-3,174	-3,307	-3,437	-3,570
Exports	1,137	1,411	1,440	1,501	1,477	1,517	1,558	1,625	1,701	1,784	1,867
Imports	-5,802	-5,760	-5,296	-4,442	-4,720	-4,525	-4,632	-4,800	-5,008	-5,221	-5,437
Services Balance	3,583	3,585	3,310	3,253	3,134	2,994	3,084	3,233	3,394	3,575	3,759
Exports	6,049	6,262	6,167	5,750	5,634	5,525	5,675	5,918	6,196	6,496	6,801
Imports	-2,468	-2,676	-2,857	-2,497	-2,500	-2,532	-2,591	-2,685	-2,802	-2,921	-3,042
Current Income	-379	357	-456	-452	-468	-515	-489	-522	-607	-682	-783
Current Transfers	-116	-196	-215	-171	-207	-195	-195	-199	-206	-214	-220
Capital Account	36	46	23	244	144	144	144	144	144	144	144
Financial Account	1,647	781	847	-4,356	-647	-547	-2,244	526	635	714	847
Direct Investment	65	132	1,197	169	306	131	1,303	347	771	791	819
Portfolio Investment	-1,934	5,753	5,340	11,734	1,944	520	-1,414	-589	-343	861	572
Financial Derivatives	-59	-261	-870	-55	37	0	0	0	0	0	0
Other Investment	3,372	-4,885	-4,877	-16,211	-2,928	-1,197	-2,132	769	208	-937	-544
Reserves (- inflows, + outflows)	200	43	57	30	-6	0	0	0	0	0	0
Errors and Omission	31	-225	346	-439	0	0	0	0	0	0	0
Program Financing	0	0	0	4,838	1,286	1,128	2,774	-8	-54	-101	-176
					(Percent of GDP)						
Current Account Balance	-9.0	-3.1	-6.3	-1.6	-4.5	-4.2	-3.8	-3.6	-3.8	-3.8	-4.0
Trade Balance (Goods and Services)	-5.7	-3.9	-2.8	1.7	-0.6	-0.1	0.1	0.3	0.5	0.7	0.9
Goods Balance	-24.5	-22.3	-19.9	-16.2	-18.5	-17.3	-17.3	-17.3	-17.4	-17.4	-17.4
Exports	6.0	7.2	7.4	8.3	8.4	8.7	8.8	8.8	8.9	9.0	9.1
Imports	-30.4	-29.6	-27.3	-24.5	-27.0	-26.0	-26.0	-26.1	-26.3	-26.4	-26.6
Services Balance	18.8	18.4	17.1	18.0	17.9	17.2	17.3	17.6	17.8	18.1	18.4
Exports	31.7	32.1	31.8	31.7	32.2	31.7	31.9	32.2	32.6	32.9	33.2
Imports	-12.9	-13.7	-14.7	-13.8	-14.3	-14.5	-14.6	-14.6	-14.7	-14.8	-14.9
Current Income	-2.0	1.8	-2.3	-2.5	-2.7	-3.0	-2.8	-2.8	-3.2	-3.5	-3.8
Current Transfers	-0.6	-1.0	-1.1	-0.9	-1.2	-1.1	-1.1	-1.1	-1.1	-1.1	-1.1
Capital Account	0.2	0.2	0.1	1.3	0.8	0.8	0.8	0.8	0.8	0.7	0.7
Financial Account	8.6	4.0	4.4	-24.0	-3.7	-3.1	-12.6	2.9	3.3	3.6	4.1
Direct Investment	0.3	0.7	6.2	0.9	1.8	0.8	7.3	1.9	4.1	4.0	4.0
Portfolio Investment	-10.1	29.5	27.5	64.8	11.1	3.0	-7.9	-3.2	-1.8	4.4	2.8
Financial Derivatives	-0.3	-1.3	-4.5	-0.3	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Other Investment	17.7	-25.1	-25.1	-89.5	-16.7	-6.9	-12.0	4.2	1.1	-4.7	-2.7
Reserves (- inflows, + outflows)	1.0	0.2	0.3	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Errors and Omission	0.2	-1.2	1.8	-2.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Program Financing	0.0	0.0	0.0	26.7	7.3	6.5	15.6	0.0	-0.3	-0.5	-0.9

Sources: Central Bank of Cyprus; Eurostat; and IMF staff estimates.

1/ Balance of Payments historical data and projections are presented according to the BPM5 methodology, and thus exclude data related to the operations of Special Purpose Entities (entities without a physical presence in Cyprus).

2/ Estimated based on BPM6 data produced by the Central Bank of Cyprus.

Table 5. Cyprus: External Financing Requirements and Sources, 2012–20
(Millions of euros)

	2012	2013	2014	2015	2016	2017	2018	2019	2020
			Est.			Projections			
GROSS FINANCING REQUIREMENTS	**60,086**	**61,858**	**35,403**	**29,924**	**30,394**	**29,361**	**30,440**	**31,205**	**32,019**
Current account deficit ("-" = CA surplus)	1,217	287	783	725	674	663	725	758	815
Medium- and long-term debt amortization	5,800	12,589	3,282	3,242	3,725	2,927	3,649	3,993	4,169
Public sector	593	1,458	382	374	859	64	745	1,043	1,157
Banks	4,380	10,056	1,362	1,345	1,342	1,340	1,351	1,365	1,379
Other private	827	1,075	1,539	1,523	1,523	1,523	1,554	1,585	1,633
Short-term debt amortization	53,069	48,982	31,337	25,957	25,995	25,763	26,012	26,354	26,859
Public sector	8,290	7,494	7,363	2,724	1,635	1,471	1,324	1,192	1,072
Central Bank	7,992	7,494	7,363	2,724	1,635	1,471	1,324	1,192	1,072
General government and SOEs	298	0	0	0	0	0	0	0	0
Banks	43,727	40,414	21,891	21,253	22,381	22,313	22,510	22,768	23,033
Other private	1,053	1,075	2,083	1,979	1,979	1,979	2,177	2,395	2,754
EU and IMF	0	0	0	0	0	8	54	101	176
SOURCES OF FINANCING	**60,086**	**57,020**	**34,117**	**28,796**	**27,620**	**29,361**	**30,440**	**31,205**	**32,019**
Capital account (net)	23	244	144	144	144	144	144	144	144
Foreign direct investment (net)	1,197	169	306	131	1,303	347	771	791	819
CYP investment abroad	219	-232	-306	-261	-356	-551	-571	-593	-614
Foreign investment in CYP	979	402	613	392	1,658	898	1,342	1,384	1,433
New borrowing and debt rollover	54,254	35,782	29,621	30,438	28,804	29,299	29,973	32,079	32,517
Medium and long-term borrowing	5,271	4,444	3,665	4,442	3,041	3,287	3,619	5,220	5,079
General Government	2,120	26	910	1,587	188	230	506	1,978	1,767
Banks	1,084	4,334	1,293	1,332	1,329	1,381	1,404	1,419	1,435
Other private	2,067	85	1,462	1,523	1,523	1,676	1,709	1,823	1,877
Short-term borrowing	48,982	31,337	25,957	25,995	25,763	26,012	26,354	26,859	27,438
Public sector	7,494	7,363	2,724	1,635	1,471	1,324	1,192	1,072	965
Central Bank	7,494	7,363	2,724	1,635	1,471	1,324	1,192	1,072	965
General government	0	0	0	0	0	0	0	0	0
Banks	40,414	21,891	21,253	22,381	22,313	22,510	22,768	23,033	23,305
Other private	1,075	2,083	1,979	1,979	1,979	2,177	2,395	2,754	3,167
Other	4,612	20,825	4,045	-1,916	-2,631	-429	-448	-1,808	-1,461
Of which: Net errors and omissions	346	-439	0	0	0	0	0	0	0
FINANCING GAP	**0**	**4,838**	**1,286**	**1,128**	**2,774**	**0**	**0**	**0**	**0**
ESM	0	4,585	1,100	600	2,650	0	0	0	0
IMF	0	253	186	528	124	0	0	0	0
ROLLOVER RATES									
General government 1/	238%	0%	212%	425%	22%	359%	68%	190%	153%
Central bank	94%	98%	37%	60%	90%	90%	90%	90%	90%
Private	89%	54%	97%	104%	100%	102%	102%	103%	103%
Banks	86%	52%	97%	105%	100%	101%	101%	101%	101%
Non-financial corporates	167%	101%	95%	100%	100%	110%	110%	115%	115%

Sources: Eurostat; Central Bank of Cyprus; and IMF staff estimates.
1/ Rollover rate does not include EIB loan.

Table 6. Cyprus: Monetary Indicators, 2010–20
(Billions of euros, unless otherwise indicated, end of period)

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
						Projections					
Aggregated Balance Sheet of Monetary Financial Institutions (MFIs)											
Assets	135.0	131.4	128.1	90.3	91.1	89.6	89.5	89.8	90.8	91.6	92.9
Claims on Central Bank of Cyprus	2.3	2.9	3.9	2.7	4.2	4.1	4.2	4.3	4.4	4.5	4.6
Claims on Cypriot resident other MFIs	5.6	5.0	4.6	3.3	4.1	4.1	4.2	4.3	4.5	4.6	4.8
Claims on Cypriot resident non MFIs	54.0	58.2	60.6	55.0	53.5	51.2	50.7	50.5	50.9	50.6	50.9
General government	4.5	5.3	6.5	5.4	4.5	2.8	2.6	2.6	2.5	2.5	2.5
Private sector excluding brass plates 1/	46.5	48.6	49.3	46.5	45.3	44.9	44.4	44.2	44.2	44.4	44.7
Households	22.5	23.5	23.9	22.3	21.9	21.3	20.9	20.5	20.4	20.5	20.6
Non-financial corporations	23.3	24.1	24.4	23.4	21.8	21.8	21.9	22.0	22.1	22.2	22.5
Non-bank financial intermediaries	0.7	1.0	1.0	0.8	1.7	1.7	1.7	1.7	1.7	1.7	1.7
Brass plates	3.0	4.4	4.8	3.1	3.6	3.6	3.6	3.6	3.6	3.7	3.7
Claims on non-residents	69.3	61.3	55.9	25.3	25.6	26.5	27.1	27.6	28.4	29.2	29.9
Other assets	3.8	3.9	3.2	3.9	3.8	3.6	3.3	3.1	2.6	2.6	2.6
Liabilities	135.0	131.6	128.1	90.3	91.1	89.6	89.5	89.8	90.8	91.6	92.9
Liabilities to the Central Bank of Cyprus and Eurosystem	5.5	5.5	9.8	11.2	8.5	6.4	5.6	4.8	4.3	3.8	3.7
Liabilities to Cypriot resident other MFI	5.5	4.9	4.5	3.1	3.6	3.6	3.6	3.8	3.9	4.0	4.2
Deposits of Cypriot resident non MFIs	45.4	43.7	43.3	33.0	32.3	32.1	32.6	33.3	34.3	35.1	36.0
General government	0.5	0.5	0.5	0.4	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Private sector excluding brass plates	36.8	37.4	37.5	29.9	29.3	29.2	29.6	30.3	31.3	32.1	32.9
Households	25.4	26.0	26.4	23.3	22.3	22.2	22.5	23.0	23.8	24.4	25.1
Non-financial corporations	6.7	6.7	5.7	3.9	3.8	3.8	3.8	3.9	4.0	4.1	4.2
Non-bank financial intermediaries	4.7	4.6	5.4	2.7	3.2	3.2	3.2	3.3	3.4	3.5	3.6
Brass plates	8.1	5.8	5.3	2.6	2.5	2.5	2.5	2.5	2.5	2.6	2.6
Deposits of non-residents	60.6	56.5	51.3	24.5	24.1	24.2	24.4	24.7	25.0	25.4	25.8
Debt securities	2.4	2.6	1.7	0.5	0.4	0.6	0.6	0.6	0.6	0.6	0.6
Capital and reserves	12.8	11.3	15.1	16.4	20.8	21.1	21.1	21.1	21.1	21.1	21.1
Other liabilities	2.8	7.1	2.4	1.6	1.5	1.5	1.5	1.5	1.5	1.5	1.5
Money and Credit											
General government sector credit, net 2/	5.2	5.3	7.2	5.5	4.3	2.5	2.4	2.4	2.3	2.3	2.2
Cypriot resident broad money (M2)	46.6	45.0	44.6	34.5	34.1	34.0	34.1	34.9	35.9	36.8	37.7
Cypriot resident narrow money (M1)	10.6	11.1	11.5	10.4	11.4	11.6	11.8	12.3	12.8	13.3	13.7
						(Percent of GDP)					
General government sector credit, net	27.5	27.0	36.9	30.5	24.5	14.5	13.5	12.8	12.1	11.5	10.9
Private sector credit excluding brass plates	244.0	249.7	253.9	256.8	259.1	257.5	249.8	240.8	232.4	224.6	218.6
Brass plates credit	15.9	22.3	24.6	17.0	20.5	20.6	20.3	19.7	19.2	18.6	18.0
Cypriot resident broad money (M2)	244.2	230.9	230.0	190.2	194.8	195.3	191.7	189.7	188.7	186.1	184.2
Cypriot resident narrow money (M1)	55.9	57.1	59.1	57.4	65.0	66.3	66.5	67.2	67.5	67.1	66.9
						(Annual percentage change)					
General government sector credit, net	-1.6	0.4	36.2	-22.9	-22.2	-41.3	-4.8	-1.7	-2.5	-1.6	-1.5
Private sector credit excluding brass plates	8.8	4.6	1.3	-5.6	-2.5	-1.1	-0.9	-0.5	0.0	0.4	0.8
Brass plates credit	2.3	44.0	9.9	-35.7	17.0	-0.1	0.4	0.5	0.6	0.6	0.6
Cypriot resident broad money (M2)	10.4	-3.4	-0.8	-22.8	-1.1	-0.2	0.3	2.1	3.0	2.4	2.5
Cypriot resident narrow money (M1)	2.3	4.4	3.2	-9.4	9.4	1.6	2.4	4.3	4.1	3.2	3.2
Memorandum items:											
Deposits from Cypriot private sector excluding brass plates (y-o-y percent change)	6.5	1.7	0.3	-20.2	-2.0	-0.5	1.5	2.2	3.3	2.6	2.6
Brass plates deposits (y-o-y percent change)	33.8	-28.3	-9.4	-50.4	-5.2	-0.5	0.5	0.8	0.9	1.0	0.9

Sources: European Central Bank; Central Bank of Cyprus; and IMF staff estimates.

1/ Includes public entities classified outside the general government. The data excludes brass plates, which are companies with a physical presence in Cyprus and, therefore, treated as residents but with limited interaction with the domestic economy.

2/ Includes CBC's net claims on general government.

Table 7. Cyprus: Financial Soundness Indicators, 2010–15:Q1 1/

(Percent, unless otherwise specified)

	2010	2011	2012	2013	2014	2015:Q1
Capital Adequacy						
Regulatory Capital ratio	12.4	12.1	7.3	14.0	15.4	15.5
Tier I capital ratio	10.9	11.0	6.3	12.8	14.6	14.8
Risk weighted assets (billions of euro)	80.3	51.7	71.0	45.0	45.6	45.8
Asset Quality						
Non-performing loans to total gross loans 2/	5.8	10.0	18.4	38.6	44.9	44.8
Provisions to nonperforming loans	2.6	4.2	7.1	11.4	14.0	14.4
Non-performing loans to total gross loans (local operations) 3/	12.4	16.2	25.5	46.2	56.1	57.1
Earnings and Profitability						
Return on assets	0.6	-3.9	-3.7	-2.9	0.1	0.8
Return on equity	12.0	-59.4	-62.3	-39.8	0.8	8.4
Interest margin to gross income ratio	74.3	83.7	76.8	82.7	78.3	79.2
Liquidity						
Liquid assets to total assets	29.1	22.3	19.6	18.6	15.6	19.0
Customer deposits to total (non-interbank) loans	94.5	81.7	81.5	69.9	73.6	71.3
Market Indicators (end period)						
Cyprus Stock Exchange (CSE) General Index (Mar 2004=1000)	1,055.2	295.9	114.9	103.3	84.6	79.9
Market capitalization (CSE) (billions of euro)	4.2	1.4	1.7	0.4	0.7	2.5

Sources: Bloomberg; CBC; Haver; and IMF staff estimates.

1/ Unless otherwise specified, these FSIs cover consolidated accounts of domestic and foreign banks operating in Cyprus.

2/ As of end 2014, banks report NPLs as per the EU's regulation on reporting NPLs and forborne exposures. The main changes with respect to the previous definition are that the minimum probation period for forborne loans remaining classified as NPLs has increased from 6 to 12 months, and performing restructured loans are now classified as NPLs if they present arrears greater than 30 days.

3/ Local operations are confined to banks active in the local market, excluding overseas branches and subsidiaries of Cyprus-based banks and the operations of banks whose operations are almost fully conducted overseas.

Table 8. Cyprus: Indicators of Fund Credit, 2012–20 1/

(Millions of SDRs)

	2012	2013	2014	2015	2016	2017	2018	2019	2020
Existing and prospective Fund credit									
Disbursement	0.0	222.8	148.5	420.8	99.0	0.0	0.0	0.0	0.0
Stock	0.0	222.8	371.3	792.0	891.0	884.8	841.5	761.1	620.8
Obligations	0.0	1.6	3.8	8.0	16.7	23.9	61.9	99.5	155.5
Repurchase	0.0	0.0	0.0	0.0	0.0	6.2	43.3	80.4	140.3
Charges	0.0	1.6	3.8	8.0	16.7	17.7	18.6	19.1	15.2
Stock of existing and prospective Fund credit									
In percent of quota	0.0	140.8	234.7	500.6	563.2	559.3	531.9	481.1	392.4
In percent of GDP	0.0	1.4	2.7	5.7	6.3	6.0	5.5	4.8	3.8
In percent of exports of goods and services	0.0	3.4	6.5	14.1	15.4	14.7	13.4	11.5	9.0
Obligations to the Fund from existing and prospective Fund credit									
In percent of quota	0.0	1.0	2.4	5.1	10.6	15.1	39.1	62.9	98.3
In percent of GDP	0.0	0.0	0.0	0.1	0.1	0.2	0.4	0.6	1.0
In percent of exports of goods and services	0.0	0.0	0.1	0.1	0.3	0.4	1.0	1.5	2.2

Source: IMF staff estimates.

1/ Calculated based on full disbursements of the available amounts of the arrangement.

Table 9. Cyprus: Schedule of Reviews and Purchases 1/

	Amount of Purchase		
Availability Date	Millions of SDR	Percent of Quota	Conditions
May 15, 2013	74.25	46.93	Approval of arrangement
September 15, 2013	74.25	46.93	First review based on end-June 2013 performance criteria
December 15, 2013	74.25	46.93	Second review based on end-September 2013 performance criteria
March 15, 2014	74.25	46.93	Third review based on end-December 2013 performance criteria
June 15, 2014	74.25	46.93	Fourth review based on end-March 2014 performance criteria
September 15, 2014	74.25	46.93	Fifth review based on end-June 2014 performance criteria
December 15, 2014	74.25	46.93	Sixth review based on end-September 2014 performance criteria
March 15, 2015	74.25	46.93	Seventh review based on end-December 2014 performance criteria
September 15, 2015	99.00	62.58	Eighth review based on end-June 2015 performance criteria
December 15, 2015	99.00	62.58	Ninth review based on end-September 2015 performance criteria
March 15, 2016	99.00	62.58	Tenth review based on end-December 2015 performance criteria
Total	891.00	563.21	

Source: IMF staff estimates.

1/ The 5th, 6th, and 7th reviews were combined, and performance assessed on the basis of continuous performance criteria and end-September 2014 targets.

Table 10. Cyprus: Conditionality for the Eighth Review

Measures	Timing	Status
Adoption by the Council of Ministers of legislation ensuring that the ownership of titles reflects the economic ownership of the property at all times	End-June 2015	Incomplete; legislation covers only legacy cases
Adoption by the Council of Ministers of the institutional arrangements to monitor and manage government guarantees	End-June 2015	Implemented in September
Publication by the CBC of the targets of loan restructuring, and banks and coops' aggregate performance against them	End-July 2015	Implemented in September
Adoption of administrative acts and regulations needed to fully ensure the functioning of the insolvency regime	End-August 2015	Met

Table 11.Cyprus: External Debt Sustainability Framework, 2010–22

(Percent of GDP, unless otherwise indicated)

	Actual							Projections								Debt-stabilizing non-interest current account 6/
	2010	2011	2012	2013	2014 (Est.)			2015	2016	2017	2018	2019	2020	2021	2022	
Baseline: External debt	447.4	406.9	417.8	327.1	285.2			**324.2**	**329.3**	**323.1**	**313.6**	**313.2**	**310.7**	**304.8**	**302.7**	**-6.0**
Change in external debt	152.9	-40.5	10.9	-90.7	-41.9			39.0	5.1	-6.3	-9.4	-0.4	-2.5	-5.9	-2.1	
Identified external debt-creating flows (4+8+9)	14.9	-33.5	29.8	3.1	11.8			1.3	-6.4	-3.9	-6.7	-7.4	-6.0	-5.5	-5.4	
Current account deficit, excluding interest payments	0.9	-5.0	-3.9	-6.9	-2.4			-3.0	-3.5	-3.9	-3.7	-3.7	-3.5	-3.7	-3.9	
Deficit in balance of goods and services	5.7	3.9	2.8	-1.7	0.6			0.1	-0.1	-0.3	-0.5	-0.7	-0.9	-1.1	-1.4	
Exports	37.7	39.4	39.2	40.0	40.6			40.4	40.6	41.1	41.5	41.9	42.3	42.8	43.5	
Imports	43.4	43.3	42.0	38.3	41.2			40.5	40.6	40.7	41.0	41.2	41.4	41.7	42.1	
Net non-debt creating capital inflows (negative)	1.7	-6.6	-11.7	-13.9	-4.0			-1.3	-5.7	-1.2	-3.7	-4.9	-4.6	-3.9	-3.7	
Automatic debt dynamics 1/	12.4	-22.0	45.3	24.0	18.2			5.6	2.9	1.2	0.7	1.1	2.1	2.0	2.2	
Contribution from nominal interest rate	8.1	8.0	10.1	8.5	6.9			7.2	7.3	7.5	7.5	7.5	7.5	7.6	7.7	
Contribution from real GDP growth	-4.2	-1.1	10.5	23.2	7.6			-1.5	-4.4	-6.3	-6.8	-6.4	-5.4	-5.5	-5.5	
Contribution from price and exchange rate changes 2/	8.4	-28.9	24.7	-7.8	3.6			...	...	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	138.0	-7.0	-18.9	-93.9	-53.6			37.7	11.5	-2.3	-2.7	7.0	3.5	-0.4	3.3	
External debt-to-exports ratio (in percent)	1186.9	1033.4	1066.2	817.3	702.1			802.0	810.2	786.9	755.9	747.8	733.9	711.4	696.1	
Gross external financing need (in billions of US dollars) 4/	50.5	85.3	79.0	81.4	48.3			36.4	34.2	33.4	35.0	36.1	37.5	38.5	39.0	
in percent of GDP	199.5	314.8	316.4	338.1	207.8			186.9	170.1	159.0	159.2	157.2	155.3	153.7	150.4	
Scenario with key variables at their historical averages 5/						5-Year Historical Average	5-Year Standard Deviation	**324.2**	**344.6**	**354.1**	**364.0**	**386.9**	**410.9**	**424.7**	**443.5**	**11.2**
Key Macroeconomic Assumptions Underlying Baseline																
Nominal GDP (US dollars)	25.3	27.1	25.0	24.1	23.3			19.5	20.1	21.0	22.0	23.0	24.2	25.1	25.9	
Real GDP growth (in percent)	1.4	0.3	-2.4	-5.4	-2.3	-1.7	2.6	0.5	1.4	2.0	2.2	2.1	1.8	1.9	1.9	
GDP deflator in US dollars (change in percent)	-2.8	6.9	-5.7	1.9	-1.1	-0.2	4.8	-16.5	1.6	2.3	2.4	2.4	3.3	1.8	1.5	
Nominal external interest rate (in percent)	2.7	1.9	2.3	2.0	2.0	2.2	0.3	2.1	2.3	2.4	2.4	2.5	2.5	2.5	2.6	
Growth of exports (US dollar terms, in percent)	1.0	12.0	-8.4	-1.5	-1.9	0.2	7.4	-16.6	3.6	5.4	5.8	5.6	6.4	4.9	4.9	
Growth of imports (US dollar terms, in percent)	2.2	7.0	-10.7	-12.1	4.1	-1.9	8.8	-17.6	3.3	4.7	5.4	5.0	5.8	4.4	4.4	
Current account balance, excluding interest payments	-0.9	5.0	3.9	6.9	2.4	3.5	2.9	3.0	3.5	3.9	3.7	3.7	3.5	3.7	3.9	
Net non-debt creating capital inflows	-1.7	6.6	11.7	13.9	4.0	6.9	6.2	1.3	5.7	1.2	3.7	4.9	4.6	3.9	3.7	

Source: IMF staff estimates.

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Annex I. The Insolvency Reforms in Cyprus

To address the high levels of private debt and non-performing loans, the authorities implemented a reform to enhance the corporate and personal insolvency frameworks. This annex presents the background for the reform, lists the main features of the reform package, and points to the way forward.

Background. At the onset of the 2013 crisis, Cyprus lacked a modern insolvency system to address over-indebtedness of firms and individuals. It was widely considered that a complete overhaul of the insolvency system was needed, as the legislation was essentially unchanged since Cyprus's independence in 1960 and reflected outdated English law of an earlier period. In this context, use of insolvency procedures was minimal, bankruptcy of individuals was punitive and restrictive, and corporate insolvency law was focused on liquidation, not reorganization, with the only available collective restructuring tool outdated and limited to unsecured debt. These features had been key obstacles to private debt restructurings.

The insolvency reform. The reform of the insolvency system started with a strategy adopted by the Government in July 2014, and endorsed by Parliament in September 2014. The strategy sought to reinforce creditor rights, while offering viable companies and individuals the opportunity to restructure, and protecting honest debtors by offering them a fresh start and, where possible, protecting their primary residences.

The insolvency reform package, composed of five laws, covering companies and individuals, was passed by Parliament on April 18, 2015:

- A reform of the winding-up procedure in the Companies Act
- A law introducing a new corporate reorganization procedure (examinership) for inclusion in the Companies Act
- A reform and modernization of the Bankruptcy Law for individuals
- A personal insolvency law introducing two new procedures: the Personal Repayment Plan (PRP) and the Debt Relief Order (DRO).
- A law providing for a new regulation of insolvency practitioners (IPs) and for the creation of a new national insolvency regulator, the Insolvency Service (IS).

The Insolvency System in Cyprus after the 2015 Reforms

Procedures/Debtors	Companies	Individuals
Liquidation of the estate	Winding-up	Bankruptcy
Debt restructuring	Examinership	Personal Repayment Plan (PRP)
Debt relief		Debt Relief Order (DRO)

The new ***corporate insolvency regime*** provides for both liquidation and restructuring. On liquidation, there is a revamped and speedier procedure for winding up nonviable companies. The reformed procedure has introduced important changes in the commencement criteria, in the governance of the procedure, and in the modalities of the sale of encumbered assets. The reform also introduced a new reorganization procedure (examinership), modeled after the Irish law procedure, to preserve viable companies. The examinership provides an opportunity of reorganization for viable companies by allowing them to design a restructuring plan during a period where the company is protected from enforcement actions while management continues to run the business, under the supervision of an examiner. The goal of the procedure is to reach an agreement with all creditors, both secured and unsecured, that makes the preservation of the enterprise possible.

Reforms to the ***personal insolvency regime*** are two-fold. First, important changes have been made in the old Bankruptcy Law, removing many punitive and restrictive elements. The new regime is based on a streamlined procedure that allows honest debtors to receive a discharge for their debts within three years from the start of the procedure. Second, and more importantly, new procedures have been introduced to facilitate debt relief for debtors with virtually no income and no assets, and to allow viable debtors to restructure their debt over time. These procedures, introduced by the personal insolvency law, are the following:

- **The Personal Repayment Plan (PRP)**, based on the Irish Personal Insolvency Arrangement, provides an opportunity for debt restructuring to debtors who have a stable source of income. It allows them, where possible, to keep some of their assets, including their primary residence. The key features of the PRP are described below:
    - Secured and unsecured debt may be restructured, including business related debt.
    - A debtor can initiate the restructuring by applying to the IS. The IS then appoints an IP to assist the debtor in preparing a repayment plan. The plan will aim at maximizing the debtor's repayment to its creditors, while allowing the debtor to keep reasonable living expenses (determined in a uniform manner in accordance with guidelines issued by the IS) to support the household.
    - If the repayment plan is approved by creditors (which requires that creditors representing no more than 35 percent of the value of the voting debts vote against the plan and no more than 50 percent of the value of the secured or unsecured creditors vote against the plan), it becomes binding on all creditors upon confirmation by the Court (cram down). The law has special provisions for public creditors, allowing them to consent to their inclusion in the plan.
    - The new law has also included the possibility of a court-imposed plan in cases where creditors do not accept the repayment proposals of the debtors, provided the Court finds that certain minimum conditions are satisfied. These conditions include (i) that creditors cannot receive less under the plan than what they would have received in a liquidation of the debtor's estate (so-called "liquidation test"), and (ii) the debtor will not

lose ownership of his/her primary residence (with a market value of no more than €300,000).

  - An important innovation is the possibility of a coordinated examinership/PRP for micro enterprises and their owners.
  - Finally, given the wide-spread use of personal guarantees in Cyprus prior to the crisis, the new insolvency legislation includes specific provisions on the treatment of guarantors in the insolvency processes[1].

- **The Debt Relief Order (DRO)**, based on the similar UK and Irish procedures, offers relief to debtors with virtually no income, no assets by offering a discharge of unsecured debts up to €25,000 following extensive financial disclosure by the debtor and court approval. Debt to public creditors can be included in the discharge with their consent.

- **Safeguards.** Both the DRO and the PRP are subject to safeguards to ensure that debtors behave honestly. They include (i) the requirement that the debtor submit a detailed financial statement and ongoing obligations of disclosure; (ii) scrutiny of the debtor's position and implementation of the plan by the IP; (iii) the possibility for the IP to initiate a modification of the plan if the circumstances of the debtor change; and (iv) the possibility that debt relief could be revoked if the debtor does not comply with the duties and obligations of the PRP process.

The ***institutional framework*** for both corporate and personal insolvency has been reinforced by the introduction of qualifications for IPs and by the creation a new supervisory authority, the IS, which will perform a number of critical functions under the new insolvency system.

In parallel with reforming the insolvency legislation, the Cypriot authorities have also introduced changes to the ***foreclosure regime*** aimed at accelerating foreclosure processes that could take years. In addition, a mediation procedure under the auspices of the ***financial Ombudsman*** was introduced to help facilitate out of court consensual negotiations between banks and borrowers.

Next steps. The reform of insolvency law in Cyprus is a major effort in legislative reform. While the authorities drew on the experiences and solutions adopted in the other common law European jurisdictions, adapting these solutions to Cypriot realities was always an important consideration to ensure its effectiveness. The authorities are making efforts to make the new insolvency regime fully operational and effective. The authorities are planning to keep the new laws under continuous review and adjust them as needed. They will establish a data collection system that would help to assess the effectiveness of the reforms. The first group of IPs have been licensed and the first applications procedures have been received. In addition, court rules and procedures are being modernized to support a smoother functioning of the insolvency regime.

[1] See Box 3 of IMF Country Report 15/155 for a detailed discussion of the specific provisions.

Appendix I. Cyprus: Letter of Intent

Nicosia, September 4, 2015

Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington DC

Dear Ms. Lagarde:

In the attached update of the Memorandum of Economic and Financial Policies (MEFP), we describe progress and policies toward the objectives of the economic program of the Cypriot government, which is being supported by an arrangement under the Extended Fund Facility.

Our program, underpinned by the firm commitment of the authorities, is bearing results and laying the ground for sustained growth, increased employment, and improved living standards for the Cypriot population. The economic recovery that started in early 2015 has continued, despite a challenging external environment. The financial situation of the three largest banks has strengthened, with encouraging evidence that loan restructuring is proceeding at a faster pace. Fiscal performance has exceeded expectations and, as a result, we have met all end-June and continuous performance criteria (PCs). Despite some delays, we have also made significant progress on the program's structural reform agenda, with all but one of the structural benchmarks implemented in full. The sole exception was the end-June SB related to adoption by the Council of Ministers (COM) of legislation to accelerate the transfers of title deeds. This legislation, which has already been adopted by Parliament, focuses only on legacy cases. Legislation to address title deed transfer in non-legacy and new property transactions will be adopted by the COM by end-October.

Looking forward, in support of our program objectives,

- In the financial sector, we will continue to prioritize addressing the high level of NPLs. Following on the reforms to date, we will make the private debt restructuring framework fully operational, including by tackling the current backlog of unissued and un-transferred title deeds, monitoring the implementation of the new insolvency and foreclosure frameworks on an ongoing basis and further improving them as needed. We will also continue to strengthen financial sector supervision and the tools to enforce the restructuring of loans by the banking system. We are vigilant of potential external spillovers and are ready to take measures, if necessary.
- We will continue to pursue a sound fiscal policy that supports growth while improving the public debt position.

- We will advance on our structural reform agenda, notably on tax administration, the management of fiscal risks, and public administration reform. We will also move forward on critical growth-enhancing reforms, including the privatization program.

Financing of our program remains adequate, and based on the above, we request the following:

- Completion of the eighth review under the EFF arrangement and the purchase under this arrangement in the amount of SDR 99 million.
- Modification of performance criteria for end-September and end-December 2015.
- Establishment of new or modified SBs (Table 2).

We are fully committed to the policies set forth in the attached MEFP, which we believe are sufficient to achieve the objectives under the program. We stand ready to take any measures that may become appropriate for this purpose as circumstances change. We will consult with the Fund on the adoption of any such actions in advance of revisions to the policies contained in this letter and the MEFP, in accordance with the Fund's policies on such consultations.

Sincerely,

/s/	/s/
Harris Georgiades	Chrystalla Georghadji
Minister of Finance	Governor of the Central Bank of Cyprus

Attachment I. Cyprus: Memorandum of Economic and Financial Policies

A. Recent Developments and Outlook

1. Economic performance continues to exceed expectations. Economic indicators point to a moderate expansion in the second quarter of 2015, following positive growth in the first quarter after almost four years of recession. The recovery continues to be led by professional services and tourism and, on the demand side, private consumption. There have been no appreciable spillovers to the real economy from events in Greece. However, the unemployment rate is still high, hovering at around 16 percent. Prices continued declining through June, largely reflecting declines in the energy and tourism sectors. The three largest banks continue on the path to normalization and sovereign debt yields have declined further, benefitting from purchases by the Eurosystem under the Public Sector Purchase Program started in July.

2. We continue to expect a gradual economic recovery. Reflecting the continued positive momentum in the second quarter, we have revised our growth forecast for 2015 to 0.5 percent (from 0.2 percent). Arrivals from other origins are expected to largely offset the negative impact on tourism from a weak Russian economy, while the favorable performance of the business services sector is anticipated to continue. On the demand side, investment and private consumption are now expected to be somewhat stronger, supported in part by new bank credit. For the years ahead, the forecast remains unchanged; growth is projected at 1.4 percent in 2016 and around 2 percent thereafter, supported by a gradual recovery of private consumption and investment. Accordingly, we expect a gradual decline in unemployment. We now project inflation to be slightly more negative this year at -1 percent and return to positive territory in 2016. The outlook is subject to positive and negative risks. On the external front, direct spillovers from Greece are expected to remain contained given reduced trade links, while we continue to closely monitor links through the financial sector. There could be also indirect effects through confidence and EU external demand. A positive impact of euro depreciation on exports, further compression of yields due to the ECB's quantitative easing, and a milder contraction in Russia than assumed constitute upside risks. On the domestic front, slower than expected cleanup of NPLs and the ensuing impact on private sector balance sheets and credit growth could stymie the recovery.

B. Financial Sector Policies

Addressing High NPL Levels

3. We remain committed to addressing the high level of NPLs in our banking system as a matter of priority. The NPL ratio of the core domestic banking sector has stabilized, remaining at 59 percent at end March. We continue to attack this problem from three fronts, aimed at encouraging voluntary debt restructuring and increasing the pace of durable solutions, with the ultimate objective of expediting the cleanup of private sector balance sheets and reviving credit growth. First, we are taking steps to ensure effective implementation of the recently established foreclosure and insolvency regimes. Second, we continue strengthening the enforcement of supervisory tools for arrears management. Finally, we are revising the legislation to facilitate banks' disposal of distressed assets. To enhance public awareness on this subject, by end-September 2015, we will issue, in collaboration with the Association of Banks, a consumer-friendly publication and launch an interactive website to explain the process of debt restructuring, including tools likely to be used by banks and the insolvency and foreclosure processes.

Legal Framework

- **Foreclosure and insolvency regimes.** The effective implementation of the adopted legal frameworks is organized along two broad workstreams. First, we are taking the actions needed to fully operationalize the new frameworks. Second, we are identifying and will make adjustments to the frameworks, including through any necessary amendments to the legislation.

    - **Implementation.** To facilitate implementation of the foreclosure framework and allow the courts to process cases on a timely basis, we revised the relevant court rules in July. With respect to the insolvency regime, we have established the new Insolvency Service, which centralizes the administration of the new framework, including by appointing staff and making it possible to initiate insolvency procedures. We have also put in place the processes to license insolvency practitioners and have started granting licenses. Moreover, we have adopted all administrative acts and regulations needed to ensure the functioning of the insolvency regime (end-August **structural benchmark**). We will prepare and implement an action plan for capacity building for the actors responsible for the implementation of the insolvency framework, including the courts. This will include training and the development of standardized materials. Going forward, by end-October 2015, we will review the relevant court rules to ensure that they facilitate effective functioning of the new insolvency processes and reduce the courts' workload, seeking to increase court capacity to process cases on a timely basis. With the aim of improving the efficiency of court processes and post-court enforcement, by end-March 2016, the Council of Ministers, following consultation with relevant stakeholders and program partners, will adopt amendments to the Civil Procedure Law and any other relevant laws, including to (i) limit interim applications and interlocutory measures in line with international best practices; and (ii) increase the availability of information on debtors' financial situation.

    - **Framework review.** To ensure that the new insolvency framework achieves its objectives, we will monitor its performance on a continuous basis and make adjustments as needed. By end-December 2015, we will conduct a comprehensive review of the private sector debt restructuring legal framework with an action plan for modifications to the framework to correct any deficiencies. Building on the recent changes, the review will also seek to identify potential tax disincentives to debt restructuring for banks, other creditors and borrowers and propose necessary adjustments, while taking into account fiscal implications. On the basis of the review, by end-January 2016, the Council of Ministers will adopt any necessary adjustments to the insolvency and foreclosure frameworks (**modified structural benchmark)**. This will include (i) removing any impediments to the effectiveness of the procedures, in particular, the possibility of debtors to apply to the court for suspension of enforcement without any obligation on the part of the debtor; and (ii) ensuring guarantors are not shielded from their payment obligations without due regard to their payment capacity.

- **Title deeds.** We are taking steps to address the backlog of immovable properties that were purchased without proper transfer of title to, *inter alia*, restore the smooth functioning of the property market. In June, the Council of Ministers adopted legislation ensuring that for legacy cases the ownership of titles reflects the economic ownership of the property (**existing structural benchmark**), and the legislation was adopted by parliament in early September. It provides for the swift transfer of titles and the release of encumbrances, while providing safeguards against abuse and a rule-based mechanism aimed at treating buyers, sellers, and holders of collateral in an equitable manner taking into account compliance with their obligations related to the property transaction and enabling adequate compensation, if available. To ensure that the ownership of titles reflects the economic ownership at all times, by end-October 2015, the Council of Ministers will approve legislation to deal with non-legacy and new property transactions (**new structural benchmark**). The legislation will enable swift transfer of titles once the purchase price has been paid in full, the release of encumbrances, and a system of escrow to ensure the safety of payments. By end-October 2015, we will present to program partners legal or contractual standards for property sales contracts and connected loan and mortgage arrangements. We will also propose further legislative and administrative measures necessary to incentivize the swift issuance and transfer of title deeds.

Banks' arrears management

- ***Debt resolution reporting and targeting.*** To encourage banks and coops to reduce NPLs and ensure continuous monitoring, the CBC has agreed with banks and coops on institution- and portfolio- specific targets for the various phases of the restructuring process for two quarters ahead. The aggregate targets and performance against them during the last quarter have been published (end-July **structural benchmark**). The results show that the pace of restructurings has increased substantially, although we will continue monitoring the sustainability of the solutions. The data quality and coverage of our supervisory reporting framework for NPLs and restructuring will be improved further by requiring banks to submit monthly data in line with specific requirements starting with September data.

- **Projected performance of loan restructuring**: Based on the actual and targeted restructuring performance of banks, the new debt restructuring legal framework, and the program's macroeconomic framework, the CBC will, by end-September 2015, analyze the estimated path of system-wide loan restructuring and recovery. We will also continue to study the financial situation of borrowers to inform macro-prudential policies and to further adjust the loan restructuring strategy. The CBC will have preliminary findings available by end-October 2015, with the aim of publishing final results by end-December 2015.

- ***Supervision of bank's management of problem assets***. The CBC needs to strengthen its capacity and skills to effectively supervise the banks' problem assets policies and operations, including with the support of external expertise.

Disposal of distressed assets

- ***Secondary market for loans.*** To facilitate the transfer of existing loans, the Council of Ministers approved a draft law to enable the sale of loans in line with CBC directives while retaining the protections of borrowers offered under the Code of Conduct. The law will be adopted by Parliament by end-September 2015 (**new structural benchmark**). In addition, the Council of Ministers will adopt by end-October 2015 draft legislation to remove existing impediments to the securitization of assets. The bill includes, inter alia, the removal of the requirement to obtain prior consent of borrowers and any changes to the tax system deemed necessary. The law will be adopted by Parliament by end-December 2015 (**new structural benchmark**).

Restructuring of the Cooperative Credit Sector

4. We continue making progress with the restructuring of the coops sector. Building on the thorough restructuring already undergone by the sector, our actions remain focused on strengthening the sector's capacity, including by speeding up loan restructuring. To this end, work is proceeding on the following areas:

- ***Governance.*** We have modified the organizational structure of the Cooperative Central Bank (CCB), taking into account the regulatory obligations and the SSM's views, with the aim of streamlining the responsibilities of the CCB's divisions. To strengthen the oversight of the CCB over the Cooperative Credit Institutions (CCIs), in June, we amended the affiliation directive. Going forward, we will continue to increase the efficiency and to simplify the structure of the sector. To this end, by end-October 2015 we will submit a time-bound action plan to centralize the sector's control functions, namely risk, audit and compliance, subject to approval by the competent supervisor.

- ***Financial control and risk processes.*** The CCB has embarked, since June, on a plan to strengthen its financial control and reporting processes, including by upgrading the management information systems. The implementation strategy has been designed to ensure a smooth transition and takes into account the CCB's additional responsibilities in the areas of finance and risk management. The new structure of the financial control division, including the upgrade of staffing and capabilities, will be completed by March 2016.

- By mid-October 2015, we will retain an external consultant to identify the necessary actions to enhance the sector's shareholder value and prospects, including by reviewing its structure.

Maintaining Adequate Liquidity

5. We will continue to ensure adequate liquidity in our banking system. Following the full liberalization of deposits and external flows, the CBC continues to monitor conditions and stands ready to take appropriate measures following the procedures and rules of the CBC and the Eurosystem. Although liquidity has improved, additional government guarantees in line with state aid rules for the issuance of bank bonds could be used as collateral against liquidity, but only if necessary to safeguard financial stability.

Strengthening Financial Sector Supervision

6. We will continue strengthening banking supervision. To this end, we are making progress on three important areas:

- ***Transition to the SSM***. We will ensure sufficient resources are available at the CBC to carry out its duties on supervision and resolution. Accordingly, we have already hired 10 additional staff to address resource needs in the area of banking supervision. We are also reviewing our regulatory framework against European best practice and recent experience. To this end, by end-November 2015 we will streamline our directive on loan origination.

- **Expanding credit information.** Accurate information on the payment performance of individuals and enterprises facilitates the assessment of risk and credit supply decisions. We will strengthen the credit registry by establishing a credit scoring system available to banks and other creditors. As a first step, by end-December 2015 and drawing on external expertise, we will determine the additional data needs.

- ***Resolution of Laiki***. The resolution authority has finalized a plan for completing the resolution of Laiki. To this end, the Resolution Authority has appointed an investment advisor to manage the sale of Laiki's foreign assets. A second advisor will be appointed by end-October 2015 to manage the disposal of Laiki's stake in BoC.

7. We remain committed to implementing our agenda to reinforce insurance and pension fund supervision.

Strengthening the AML Framework

8. We continue strengthening the implementation of the AML/CFT framework. Work in this area is proceeding as follows:

- ***AML/CFT supervision of banks***: The CBC is conducting onsite inspections according to the 2015 supervisory plan and in line with the new risk-based AML/CFT supervision methodology. It will apply, as needed, appropriate supervisory measures. In the course of 2015, the CBC will streamline the inspection procedures to reduce the time between the visit to the financial institution, the finalization of the report and the imposition of sanctions, when appropriate. To protect the integrity of the financial sector, the CBC took swift action to put the local branch of FBME Bank Ltd. under resolution following the measures taken by its correspondent banks after its designation by the US authorities as a financial institution of primary money laundering concern. The CBC intends to swiftly take appropriate actions following the July 2014 inspection and follow up visits, and the final ruling issued by the U.S authorities in July 2015.

- ***AML/CFT supervision of professions***: The Cyprus Securities and Exchange Commission will recruit additional qualified supervisors and conduct inspections according to its yearly supervisory program, and the CBA and ICPAC will continue providing training to their staff to enhance their inspections.

- ***Registrar of Companies***: Work is underway to restructure the Department of the Registrar of Companies. By end-December 2015, we will strike off the registry the backlog of companies non-compliant with the requirement to submit annual reports. A reorganization of the department, with a view to modernize its operations in line with the new law, with implementation beginning by end-March 2016.

C. Fiscal Policy

9. The cash primary balance through June exceeded our target by a substantial margin. The general government accounts had a cash primary surplus of 0.3 percent of GDP, compared with a target of a 0.4 percent of GDP deficit. This outcome reflects buoyant VAT revenues, as well as temporary factors, such as change in payment profile of airport royalties which led to higher collections earlier in the year; and lower-than-expected unemployment and redundancy benefits.

10. We have raised the cash primary balance target for 2015 to 1.3 percent. The revision of 0.3 percent reflects the lower unemployment and redundancy outlays, some revenue overperformance, and one-off non-tax revenue. Despite the favorable revenue outturn through June, we will maintain a prudent stance in light of the temporary nature of some of the factors behind this outturn and the uncertainty associated with the external environment. In this respect, we will let automatic stabilizers operate if economic activity turns out worse than forecasted, but any over-performance due to faster GDP growth would be saved. Spending on the recently adopted mortgage subsidy scheme will be contained and will not lead to increased overall expenditure outlays. The envisaged reform of the immovable property tax, combined with the recent reduction of the property transfer fee, will be fiscally neutral. In addition, we will monitor the impact of changes to tax laws introduced in 2015. These include the notional interest allowance for new equity and the defense tax exemption for non-domicile tax residents.

11. The medium term fiscal targets remain unchanged. For 2016 and 2017, we will target surpluses of 2.4 and 3 percent of GDP, respectively. The unchanged 2016 primary surplus mainly reflects expected a continued reduction in unemployment and redundancy benefits and a previously unprogrammed dividend from the telecom company (CyTA), which will offset the revenue impact from the implementation of the EU directives on changes to the VAT place of supply for certain services and the contribution to the National Resolution Fund. For 2018 and beyond we will continue to target a primary surplus between 3 and 4 percent of GDP.

D. Structural Reforms

12. We are implementing our comprehensive welfare reform that ensures a guaranteed minimum income (GMI) for all those in need. We will take actions to ensure that the new welfare system is fully in place and that outcomes are promptly analyzed:

- In line with the adopted welfare reform, by mid-October 2015 we will prepare plans to unify the legislative and administrative framework for all disability benefits ensuring consistency with medium term budgetary targets. The plan to consolidate education benefits will be adopted by Parliament by end-October 2015.

- By end-September 2015 we will finalize an assessment report of the implementation of the GMI, including main outcomes, the number of applications, fiscal costs, targeting accuracy, and coverage. The assessment will also discuss possible refinements going forward.

- By end-December 2015, we will build a registry of benefits in line with our new welfare law including the profiles and eligibility of all beneficiaries, cross-checked with other databases.[1]

- By end-March 2016, and with the registry in place, we will re-examine the overall welfare reform to realize efficiency gains from the consolidation of all information on welfare programs.

13. We are advancing our tax administration reform. Our efforts are focused on finalizing the integration of the two previously existing tax authorities into the single Department of Taxation by end-June 2016 and on enhancing tax collection.

- ***Addressing assessment backlogs and tax arrears***: We have identified a large backlog of un-assessed tax returns which may entail substantial collectible revenue. To address this, by end-September we will establish a project team, which will identify the size and nature of the unassessed tax returns and determine the taxes and refunds due. By end-October 2015, we will prepare an action plan to reduce this backlog. We continue to implement our tax debt recovery plan including the use of the new enforcement powers. To monitor progress, in June, we prepared the first quarterly implementation report, specifying targeted groups, collection enforcement measures used, and recovered debt.

- ***Reforming the revenue administration***: We have appointed two assistant commissioners, thereby completing the senior management team. Going forward, we will establish a single registration process for all domestic taxes by end-September 2015, as well as finalize the cleansing of the taxpayer register by end-December 2015. By end-December 2015, the LTO

[1] The registry of benefits will entail establishing a single view of social benefits for each beneficiary via an interface which will link three registries: Ministry of Labor, Welfare and Social Insurance, the Ministry of Education and Culture and the Ministry of Interior.

established in January will be fully functional including taxpayer services, risk assessment and compliance activities aiming to continuing to expand coverage of revenue collections. In line with this goal, we will allocate appropriate human resources. We will also establish an integrated legal framework for tax procedures under a new tax procedures code, to be approved by the Council of Ministers by end-December 2015. In order to mitigate the risk of revenue loss during the integration process the Performance and Monitoring Unit will prepare a monthly update of performance indicators, including registration, filing, payment and debt collection. Based on these indicators we will prepare a quarterly assessment report to analyze performance and identify remedial actions, as needed. The first report will be prepared by end-October 2015. We will consider possible changes to the legal framework governing the criminal tax investigation unit to introduce judicial oversight.

14. We are enhancing the management of fiscal risks arising from government guarantees and finalizing the implementation of the Fiscal Responsibility and Budget Systems Law (FRBSL). The stock of government guarantees (about 20 percent of GDP) may pose risks to our public finances. In early September, the Council of Ministers approved the institutional framework to monitor and manage existing and new government guarantees **(existing structural benchmark)**. Recent improvements in our risk assessment analysis will be incorporated into the updated risk assessment report we will prepare by end-October 2015. In order to ensure the full implementation of the FRBSL, the public investment guidelines have been approved by the Council of Ministers and Parliament will adopt the FRBSL regulations and the law regulating the creation and functioning of SOEs by end-October 2015.

15. We remain committed to the privatization of state-owned enterprises. Privatization is expected to improve economic efficiency, help to reduce our public debt, and encourage foreign direct investment. We have received expressions of interest in the concession of the commercial activities of the Limassol port and a significant number of bidders have been pre-qualified, paving the way for the start of the due diligence process. The regulatory framework of the Cyprus Port Authority (CPA) will be amended and implemented by end-November 2015. The concession agreement will be signed before the end of the program. Legislation to convert CyTA into a limited liability company will be adopted by parliament by end-October 2015. We are committed to finalizing CyTA's privatization by mid-2016. In July, we hired an independent energy advisor to prepare a study for the unbundling and ownership structure of the Electricity Authority of Cyprus (EAC). Any decision regarding the unbundling of EAC will be implemented by end-March 2016.

16. We are continuing reforms in other areas aimed at boosting growth prospects and strengthening the public administration.

- We are implementing the Action Plan for Growth for which a key aim is improving the business environment. To this end, we will develop a time-bound action plan to strengthen the enforcement of contracts, including streamlining judicial procedures. To stimulate private investment, the Council of Ministers will adopt by end-December 2015 a framework to attract strategic investments, through fast-tracking administrative procedures for licensing. In addition, to support the development of the tourism sector, by end-September 2015 we will produce an initial assessment of the regulatory framework governing the sector. All necessary legal amendments to modernize the framework will be approved by the Council of Ministers by end-March 2016. Finally, with a view of improving the business environment, an action plan to implement Smart Regulation will be adopted by the Council of Ministers by end-October 2015.

- To enhance the effectiveness of our public administration, while also ensuring its affordability, in early September 2015, the Council of Ministers will approve a reform package including a revision of the wage setting framework and the opening of promotion posts to the wider civil service. The package will be adopted by Parliament by end-December 2015 (**existing structural benchmark**). Salary and employment decisions will be consistent with general government compensation of employees as a share of GDP remaining on a descending path over the medium term. We will complement this with reforms to enhance staff mobility to promote the efficient allocation of human resources.

E. Program Financing and Monitoring

17. Financing for our program is assured. In line with the practice in most other European countries, we will transfer the rights and liabilities associated with coins issuance from the CBC to the MoF and receive additional financing of €100 million associated with this transfer by end-December 2015. In addition, the CBC is expected to transfer an additional €100 million in central bank profits to the government during 2016, in line with CBC duties under the Treaties and the Statute. We intend to issue additional debt in the international markets before the end of this year to smooth maturities, minimize refinancing risk after the program and ensuring comfortable cash buffers, in line with our debt management strategy, market conditions permitting.

18. Implementation of policies under our program will continue to be monitored through quarterly PCs and reviews. Our program includes performance criteria and structural benchmarks defined in Tables 1 and 2 and in the Technical Memorandum of Understanding (TMU). In particular, there are also continuous performance criteria on the non-accumulation of external payment arrears, on non-imposition of restrictions of payments and transfers for current international transactions, and on non-introduction of multiple currency practices.

19. We authorize the IMF to publish the Memorandum of Economic and Financial Policies, its attachments, and the related staff report.

Table 1. Cyprus: Quantitative Conditionality 1/

(Millions of euros unless otherwise specified)

	Performance Criteria			Performance Criteria	
	Jun-15			Sep-15	Dec-15
	Target	Adjusted target 2/	Actual		
Floor on the general government primary balance 2/	-71	-75	52	300	232
Ceiling on the general government primary expenditure 2/	3,124	3,128	3,081	4,659	6,660
Ceiling on the stock of general government debt	19,966		19,214	19,269	18,532
Ceiling on the accumulation of new general government guarantees 3/	40	27	27	93	133
Ceiling on the accumulation of external arrears 2/ 4/	0		0	0	0
Ceiling on the accumulation of domestic arrears 2/	0		-2	0	0
Ceiling on the accumulation of tax refund arrears by the general government 2/	33		13	33	33

1/ As defined in the technical memorandum of understanding.

2/ Cumulative since January of the corresponding year. The primary balance and primary spending targets were adjusted down and up by €4 million, respectively, reflecting compensation of pension fund payments during 2015:Q2 in line with the TMU.

3/ Adjusted downwards due to €13 million lower EIB guarantees than anticipated in line with the TMU.

4/ Continuous performance criterion.

Table 2. Structural Benchmarks

Measures	Timing
Existing structural benchmarks	
Parliamentary approval of a reform package including a revision of the wage setting framework	End-December 2015
New and modified structural benchmarks	
Adoption by Parliament of legislation to enable the sale of loans in line with CBC directives while retaining the protections of borrowers offered under the Code of Conduct	End-September 2015
Approval by the Council of Ministers of legislation for the issuance and transfer of title deeds in non-legacy and new property transactions	End-October 2015
Adoption by Parliament of legislation to remove existing impediments to the securitization of assets	End-December 2015
Adoption by the Council of Ministers of any necessary adjustments to correct deficiencies of the insolvency and foreclosure frameworks, including legislative changes	End-January 2016 (modified SB)

Attachment II. Cyprus: Technical Memorandum of Understanding

1. This Technical Memorandum of Understanding (TMU) sets out the understandings regarding the definitions of the indicators subject to quantitative targets (performance criteria and indicative targets), specified in the tables annexed to the Memorandum of Economic and Financial Policies (MEFP). It also describes the methods to be used in assessing the program performance and the information requirements to ensure adequate monitoring of the targets. We will consult with the Fund, European Commission and ECB on a timely basis before modifying measures contained in this letter, or adopting new measures that would deviate from the goals of the program, and provide the European Commission, ECB and the Fund with the necessary information for program monitoring.

2. For program purposes, all foreign currency-related assets, liabilities, and flows will be evaluated at "program exchange rates" as defined below, with the exception of the items affecting government fiscal balances, which will be measured at current exchange rates. In particular, the exchange rates for the purposes of the program are set €1 = U.S. 1.1221 dollar, €1 = 134.90 Japanese yen, €1.25403= 1 SDR.

3. For reporting purposes, the Ministry of Finance (MOF) and the Central Bank of Cyprus (CBC) will employ the reporting standards and templates considered to be appropriate given the transmission of data covered by this TMU, unless otherwise stated or agreed with the EC, the ECB and the Fund.

A. Quantitative Performance Criteria and Indicative Targets

Floor on the General Government Primary Cash Balance (performance criterion)

4. For the purposes of the program, the general government includes the institutions listed under this category according to ESA 2010 for Excessive Deficit Procedure (EDP) reporting purposes. In particular, the general government includes:

- *The central government*. Includes the Constitutional Powers, the Constitutional Services, the Independent services, the Independent offices, the Ministries and the departments, services, and other bodies they supervise, 21 special purpose funds, and 14 semi government organizations.

- *The local governments*. Comprise 39 municipalities, 356 village authorities, and all agencies and institutions attached thereto which are classified as local governments according to ESA 2010.

- *The social security funds*. These include the medical treatment scheme, the regular employees' provident fund, the social insurance fund, the holiday fund, the redundancy fund, and the protection of the rights of employees' fund.

- *Any newly created institution defined as general government under ESA 2010*. This includes any new budgetary institution, special fund, social security fund, semi-government organization, municipality, village authority, and any other entity created during the program period to carry out operations of a fiscal nature. The government will inform the IMF, European Commission and ECB staff of the creation or any pending reclassification of any such new funds, programs, or entities immediately. The general government, as measured for purposes of the program monitoring, for a given year shall not include entities that are re-classified from outside general government into general government during that year.

5. The performance criteria are set on the general government cash primary balance (GGPCB), defined as the general government cash balance (GGCB) minus general government interest receipts plus general government interest payments. In turn, GGCB is defined as total revenue (tax revenue, social security contributions, grants and other revenue) minus total expenditure. The payment of called guarantees will be recorded as cash expenditures. Privatization receipts, as defined below, and the proceeds from the sale of land and buildings, will be excluded from revenue. The floor on the GGPCB in each year will be measured cumulatively from the start of that calendar year.

- Privatization receipts are those receipts associated with the disposal to private owners by a government unit of the controlling equity of a public corporation or quasi-corporation.

- The floor on the GGPCB will be adjusted downwards by the payments related to bank support, when carried out under the program's banking sector support and restructuring strategy. Transactions that may be excluded from the balance include loans to financial institutions and investments in equity of financial institutions (requited recapitalization); unrequited recapitalization and purchases of troubled assets. However, any financial operation by central government to support banks, including the issuance of guarantees or provision of liquidity, will be immediately reported to IMF, European Commission and ECB staff.

6. The floor on the GGPCB will be adjusted as follows:

- The 2015 targets will be adjusted downwards by the payments to compensate pension funds for the losses related to the resolution of Laiki Bank up to €0.5 million.

- The 2015 targets will be adjusted upwards by the dividends received from the CBC in excess of €133 million and in excess of €58 million from the semi-government organizations.

- The 2015 targets will be adjusted downwards by the dividends received from the CBC below €133 million and below €58 million from the semi-government organizations.

- The 2015 targets will be adjusted downwards by the payments to cover called government guarantees up to €80 million.

Ceiling on the General Government Primary Expenditure (performance criterion)

7. General government primary expenditure (GGPE) includes compensation of employees, goods and services, subsidies, social benefits, other recurrent expenditure, and capital expenditure.

- The ceiling on the GGPE will be adjusted upwards by the payments related to bank support, when carried out under the program's banking sector support and restructuring strategy. Transactions that may be excluded from the balance include loans to financial institutions and investments in equity of financial institutions (requited recapitalization); unrequited recapitalization and purchases of troubled assets. However, any financial operation by central government to support banks, including the issuance of guarantees or provision of liquidity, will be immediately reported to IMF, European Commission and ECB staff.

8. The 2015 ceilings on the GGPE will be adjusted upwards by the payments to compensate pension funds for the losses related to the resolution of Laiki bank up to €0.5 million.

9. The 2015 ceilings will be adjusted upwards by the payments to cover called government guarantees up to €80 million

Ceiling on the stock of General Government Debt (performance criterion)

10. The general government debt constitutes total outstanding gross liabilities as defined by ESA 2010. This includes the debt of all institutions included in the general government as defined above and other ESA 2010 adjustments. Debt will be measured at nominal value. The program exchange rate will apply to all non-euro denominated debt.

11. The ceiling on the general government debt will be adjusted:

- Upwards (downward) by the amount of any upward (downward) revision to the stock of end-December 2014 general government debt.
- Upwards (downwards) by the amount of any increase (decrease) to the disbursement of the Cyprus Entrepreneurship fund EIB loan, currently projected at €20 million for 2015.
- Upwards, by debt arising from payments for bank restructuring carried out under the program's banking sector support and restructuring strategy. These payments may include loans to financial institutions and investments in equity of financial institutions (requited recapitalization); unrequited recapitalization and purchases of troubled assets. However, any financial operation by central government to support banks, including the issuance of guarantees or provision of liquidity, will be immediately reported to IMF, European Commission and ECB staff.
- Upwards by the amounts disbursed under the EIB loan to finance projects authorized in the 2015 budget under the National Strategic Reference Framework.

- Upwards by €600 million if the debt-to-asset swap between the government and the central bank is not finalized according to the current timeline.

- Upwards by the size of the revision of the stock of general government debt due to methodological changes in the definition of the government sector.

Ceiling on the Accumulation of new General Government Guarantees (performance criterion)

12. The ceiling on new general government sector guarantees shall include domestic and external guarantees granted during the test period, as well as guarantees for which the maturity is being extended beyond the initial contractual provisions. The ceiling shall exclude guarantees granted under a risk sharing instrument of the EU structural funds (see COM (2011) 655 final) that do not create contingent liabilities for the Cypriot State. Government entities outside of the general government (e.g. state owned enterprises) but within the non financial public sector are not permitted to grant guarantees. The stock of guarantees at end December 2014 was €2.95 billion. For reporting purposes, the stock of guarantees within the year will be derived on the basis of material fluctuations. Guarantees provided by the Central Agency of Equal Distribution of Burdens (newly added to the general government) will not exceed €2 million.

13. The ceiling on the accumulation of new general government guarantees will be adjusted:

- Upwards for the issuance of government guaranteed bonds to be used in monetary policy operations to boost BoC's liquidity up to €2.9 billion.

- Upwards (downwards) by the amount of any increase (decrease) of the disbursement of EIB and/or Council of Europe Development Fund loans to be guaranteed by the government in 2015 relative to the amounts presented in Table 1 of the MEFP.

Ceiling on the Accumulation of External Arrears (continuous performance criterion)

14. External payment arrears are defined as payments on debt to non-residents contracted or guaranteed by the general government, which have not been made within seven days after falling due. The stock of external payment arrears as of end-December 2014 was €0.

Ceiling on the Accumulation of Domestic Arrears (performance criterion)

15. Domestic expenditure arrears are defined as unpaid invoices that have past the due date by 90 days by the budgetary central government, extrabudgetary funds, semi-government organizations, and local governments excluding village communities. In case no due date is specified on the supplier contract, an unpaid commitment is considered to be in arrears 90 days after the initiation of the invoice. The stock of domestic expenditure arrears as of end 2014 was €9.6 million. Increases below €1 million will not be considered a breach of the performance criterion.

Ceiling on the Accumulation of VAT Refund Arrears by the General Government (performance criterion)

16. VAT refund arrears consist of unpaid VAT refunds that have past the due date for payment established in the tax legislation and/or the corresponding regulations. The stock of VAT refund arrears as of end-December 2014 was €117.3 million. The stock of VAT refund arrears shall not exceed 150 million euros.

B. Monitoring of Structural Benchmarks and MEFP Commitments

17. AML supervision's implementation:

- On a quarterly basis, in the context of program reviews, the supervisory competent authorities will, on a confidential and anonymized basis grant Fund staff access to supervisory assessments and information about enforcement actions applied for non-compliance and/or violations of laws and regulations.

- With regard to the CBC, in line with the 2015 annual inspection program, onsite supervision missions will start in the first quarter and step-up during the year. The total number and quarterly profile of these inspections, as well as staffing objectives and levels will be subject to periodic review by the CBC and the Fund in light of experience.

18. Exchange of financial intelligence:

- The Financial Intelligence Unit (FIU) will communicate to Fund staff, on a quarterly basis, detailed statistics on financial information exchanged with other FIUs, both upon request and spontaneously, with a breakdown by country

C. Reporting Requirements

19. Performance under the program will be monitored using data supplied to the IMF by the Ministry of Finance, Cystat, and the Central Bank of Cyprus. The authorities will transmit to the IMF staff any data revisions in a timely manner. Table 1 describes the supporting data needed for monitoring of the quantitative targets, the required frequency of the data, the institution/department responsible for providing the data, and the timing for provision of the data.

Table 1. Cyprus: Reporting Requirements

Information required	Data Frequency	Institution/Department responsible for providing information	Maximum time lag for submission after the end of the reporting period
Detailed execution of revenues, expenditure and financing provided in EDP reporting format	Monthly	MOF. Budget Department/Cystat Government Financial Statistics	27 days after the end of the month, except end-December data which will be provided 30 days after the end of the month
Debt Issuance, Amortization, and interest cost details by type of debt instrument, maturity, currency, type of debt holder (resident, non-resident). Details on any financial balance sheet transactions	Monthly	MOF. Public Debt Management Unit	27 days after the end of the month
Central Government Debt stock by type of debt instrument, maturity, currency, type of debt holder. Interest bill for each type of debt instrument on a monthly basis for the current year and the next year, and annual for each year thereafter until 2020	Monthly	MOF. Public Debt Management Unit	27 days after the end of the month
Budgetary Central Government deposits in the Consolidated Fund and in the Banking System	Monthly	MOF. Public Debt Management Unit	5 days after the end of the month
Stock of expenditure arrears and their corresponding monthly flows (i.e. inflows, outflows) by type of expenditure	Monthly	MOF. Treasury Department	15 days after the end of the month
Stock of VAT refund arrears	Quarterly	Tax Department	15 days after the end of the quarter
Stock of government guarantees and their monthly flows by institution	Quarterly	MOF Treasury Department	27 days after the end of the month
Stock of external arrears	Monthly	MOF. Treasury Department.	15 days after the end of the month
Assets and liabilities of the central bank	Monthly	Central Bank of Cyprus	30 days after the end of the month
Assets and liabilities of the domestic operations of the banking system – aggregate monetary balance sheet of credit institutions by institutional category	Monthly	Central Bank of Cyprus	30 days after the end of the month
Assets and liabilities of the banking system (consolidated, including foreign operations), aggregate balance monetary balance sheet of credit institutions by institutional category	Quarterly	Central Bank of Cyprus	45 days after the end of the reporting period

Table 1. Cyprus: Reporting Requirements (Concluded)			
Individual operational balance sheet of the domestic operations of the largest banks and coops with detailed information on deposits (by maturity, currency, and type of depositor), central bank funding, interbank funding, debt securities, loans provided to the public and the private sector, 1/	Monthly	Central Bank of Cyprus	30 days after the end of the month
Details for the largest banks and coops on liquid assets (cash and securities), liquidity position (i.e. the pool of assets eligible for ELA but not already encumbered), other assets and liabilities, 1/	Daily	Central Bank of Cyprus	Next working day
Deposits by institution, currency, and residency and end-of-day liquidity buffers	Daily	Central Bank of Cyprus	Next working day
Financial soundness indicators—core set, deposits, NPLs, capital adequacy ratios	Quarterly	Central Bank of Cyprus	60 days after the end of the month

1/ Reporting requirements for cooperative.

**Statement by Mr. Menno Snel, Executive Director for Cyprus,
and Mr. Serban Matei, Senior Advisor to the Executive Director
September 23, 2015**

We thank staff for their constructive assessment of the eighth review under the Extended Fund Facility for Cyprus. The paper appropriately captures the economic developments since the last reviews and also covers topics of relevance for future reforms during the remainder of the program and beyond.

With two reviews remaining, it is important to mention that the current program, underpinned by the authorities' firm commitment, is bearing results and laying the foundation for sustained growth and improved living standards for the people of Cyprus. Evidently, political ownership of and commitment to the program objectives, supported by broad social support remains strong, as the authorities share their international partners' vision for a strategy to render the Cyprus economy in a healthy state.

The economic recovery that started earlier this year has continued, despite a challenging external environment. The financial situation of the three largest banks has strengthened; with encouraging evidence that loan restructuring is proceeding at a faster pace. The improved macroeconomic environment together with comprehensive reform of the insolvency and foreclosure laws will support a further acceleration of restructuring, in line with bank specific targets.

Fiscal performance has exceeded expectations and, with that, all end-June and continuous performance criteria have been met. Despite some delays, progress has been made on the program's structural reform agenda, with all but one of the structural benchmarks implemented in full. The only partial implementation refers to the legislation to accelerate the transfers of title deeds, which has already been adopted by Parliament, and a decision by the Council of Ministers to address title deed transfers in non-legacy and new property transactions is expected to be adopted by end-October.

Macroeconomic developments

The economic performance continues to exceed expectations. Economic indicators point to a moderate expansion in the second quarter of 2015, following positive growth in the first quarter, after almost four years of recession. It is important to mention that there have been no appreciable spillovers to the real economy from the events in Greece. On the financial sector, the three largest banks continue on the path to normalization and sovereign debt yields have declined further, benefitting from purchases by the Euro system's bond-buying program started in July. However, the unemployment rate remains elevated, but has stabilized at around 16 percent over the first half of 2015.

Fiscal

In spite of the delicate environment, the program's fiscal performance continues to be strong. As staff confirms, the fiscal adjustment continues to advance well ahead of schedule. For the first half of the year, the primary surplus stood at 0.7 percent of GDP ahead of the program target. This has also allowed Cyprus to tap into the international bond market in April 2015, the second market issuance since the country was shut out of international financial markets as from May 2011, totaling 1,750 million.

For 2015, the authorities increased the primary balance target to 1.3 percent of GDP, locking in fiscal savings that resulted from the stronger performance in the first half of the year. Despite the favorable revenue outturn through June, the authorities will maintain a prudent stance in light of the temporary nature of some of the factors behind this outturn, and the uncertainty associated with the external environment. Nevertheless, there remains an unwavering commitment to keep up with the strong track record observed since the inception of the program for 2015 and the coming years as well.

The public debt and contingent liabilities are still significant. Improving the public debt position therefore represents a priority for the authorities, who are committed to continue their prudent budget execution, while ensuring support for both growth-enhancing public spending and the social safety net. It should be noted that the debt trajectory could turn out to be significantly more favorable than now forecasted by staff due to the fact that the substantial program buffer will be used for liability management operation and will not lead to a debt increase.

Financial Sector

Notwithstanding the marked improvement in the economic environment, the authorities deem the program's level of success to ultimately run through the financial sector's revival. Since the adoption of the insolvency and foreclosure regimes earlier this year, the authorities have made encouraging progress on the next steps in the roll-out of the new private debt restructuring framework.

Capitalization of the core banks is appropriate, as per the ECB's comprehensive assessment. The average common equity tier 1 capital level for the domestic bank currently stands at 14.3 percent (end-June 2015), ensuring that the banking system can withstand significant headwinds.

After abolishing all capital controls in April 2015, deposits in core domestic banks increased by 3 percent in the first eight months of 2015, despite a moderation of the deposit rates. This is noteworthy because this pattern was not observed for deposits in the Greek-owned subsidiaries which experienced significant outflows from the beginning of 2015 to early July 2015 but this outflow largely stopped following the Euro-summit agreement on Greece in July.

Measured at end-June liquidity buffers of domestically-owned banks have increased since end-2014. Those of foreign-owned locally active banks (mostly Greek-owned subsidiaries) were 30 percent (€1.2 billion) lower over the same period. Notwithstanding this, substantial buffers remained at these banks even though in certain cases there was a breach of the regulatory liquidity requirements. ELA funding in the Bank of Cyprus has further declined to €5.4 billion at end-August compared to €7.4 billion at end-2014.

Addressing the high level of NPLs in the banking system is a priority for the authorities. They have a comprehensive approach to address it, aimed at encouraging voluntary debt restructuring and increasing the pace of durable solutions, with the ultimate objective of expediting the cleanup of private sector balance sheets and reviving credit growth.

Structural reforms

The authorities have always tried to use the crisis as a window of opportunity to lay the foundations for a more viable and sustainable growth model. As such, the authorities continue to implement difficult, yet necessary structural reforms that span across the whole economy. Much has already been done, inter alia, in a wide range of the goods and services market, public administration, public financial management, housing market, health, and energy. With the economy stabilized and its urgent needs having been addressed, the attention is now shifting towards the remaining structural reforms that will address longstanding inefficiencies that historically hampered growth, reduced productivity incentives and fostered unjustified social imbalances.

In their effort to further improve the management of fiscal risks, in particular those arising from guarantees (currently equivalent to about 20 percent of GDP), the authorities have adopted a new government guarantee management framework. The Council of Ministers has also recently approved public investment guidelines. Parliament will adopt pending regulations and the law regulating the functioning, oversight, and governance of the SOEs by end-October, in order to ensure the full implementation of the Fiscal Responsibility and Budget System Law.

To better control the growth of the public sector wage bill (after conclusion of the program) and to increase the efficiency of the public sector, the authorities are now performing a significant public administration reform. The draft legislation ruling on public wage increases, promotions, and mobility has been approved by the Council of Ministers and is expected to be adopted by Parliament by the end of this year.

Special attention is given to the privatization of state-owned enterprises and the process is moving ahead despite some delays. The Council of Ministers has approved legislation to corporatize the telecommunication company CyTA. The transfer of the company to private hands is envisaged to happen within a few months after the end of the program. Bids for the commercial activities of the Limassol Port are due by the end of the year, with the goal to finalize the transaction in early 2016.

Conclusion

Cyprus will continue much of the adjustment program, which for the previous two and a half years has yielded positive momentum. Through decisive action to address its economic difficulties and restore stability, the authorities continue to meet their commitments to the international partners despite their strained capacity. After almost four years of recession and the embarkation upon a difficult adjustment program, the economy recorded positive growth as from the first half of 2015. The latest indicators are pointing towards continuous steady growth, rendering staff's forecasts somewhat pessimistic. Fiscal performance continues to exceed expectations, the financial system is now stable and, absent all domestic restrictions as from April 2015, international debt markets have opened up a second time for Cyprus.

Notwithstanding this generally positive backdrop, the authorities are aware that significant challenges remain. Determined to leave the crisis behind and ensure that the emerging recovery gathers pace, the Government will keep working through the necessary reforms that will in turn ensure that the return to market-based funding is durable and sustainable in a post program setting.