Conclusion of ESM programme for Cyprus: an overview

31 March 2016
Cyprus’s clean exit possible thanks to strong commitment to reforms

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

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

Source: European Commission, Bloomberg
The origins of Cyprus’s crisis

- Banking sector became oversized, with very poor lending practices, weak supervision, and concentrated exposure to Greece
- Macro and fiscal imbalances led to loss of market access

**Fiscal imbalances**

![Graph showing fiscal imbalances from 2004 to 2012]

**Oversized banking sector**

![Graph showing oversized banking sector from 2008 to 2013]

Source: European Commission

Source: ECB, Eurostat, ESM calculations
Cyprus financial assistance programme agreed by ESM and IMF in April/May 2013

- Initial programme amount: up to €10 billion; €6.3 billion was disbursed by ESM and around €1 billion by IMF
- ESM loan disbursements from May 2013 to October 2015

**Breakdown of total financial assistance for Cyprus (€ billion)**

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

European Stability Mechanism
Financial assistance

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

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

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

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

- Cyprus’s decision of a ‘clean’ exit is supported by the Institutions

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

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

Source: European Commission
Growth is better than expected

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

Source: Eurostat and European Commission (EC)
The Cypriot banking system is now well capitalised

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

Source: ESM
Reform agenda does not end with the programme

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

![Non-performing loans and provisions graph](image)

Source: IMF, ESM calculation
Next steps: Early Warning System and post-programme surveillance

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

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