

The Success Story through the Eyes of the IMF

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1. *Do you consider the implementation of the stabilization program for Cyprus a “success story”? Why do you think that is the case?*

The adjustment program has delivered an impressive turnaround during the past three years. The economy returned to growth last year and has accelerated further in 2016, well beyond expectations. Tourism and professional services have been the main engines of the recovery, but the expansion in economic activity has been broad-based across all sectors. The unemployment rate has fallen rapidly. The country has regained the trust of foreign investors and managed to access international capital markets four times in just over two years. This is the success story of a country that has taken full control of its reform agenda and addressed unprecedented economic and financial difficulties. The people of Cyprus should be given full credit for that.

2. *On which pillars do you think this “success story” is based?*

First of all, the banking system is on a much more solid footing. Cypriot banks are now adequately capitalized and liquidity conditions have eased considerably as confidence has been returning. Next, the fiscal position has been restored to a sustainable path, and public debt is now on a downward trajectory. Finally, an ambitious structural reform agenda has been developed and gradually implemented. A few notable examples include the adoption of the legal framework for fiscal responsibility and budget systems, the merger of inland revenue and VAT into a single department of taxation, the reform of the insolvency and foreclosure framework; the privatization of the commercial activities of Limassol port; and the development of an extensive “action plan for growth” aimed at improving the business environment.

3. *What other challenges the Cypriot economy still faces?*

The country is still grappling with the legacies of the crisis. Despite a faster pace of restructuring, at 48 percent of all facilities, non-performing loans remain stubbornly high. Lowering NPLs not only would be good for the banks, but it would also have implications for the economy at large. Currently, banks are forced to commit a large amount of capital against these “red” loans, thus constraining their ability to extend new credit to families and firms. By dealing with their NPLs, banks could free up at least part of this capital and lend on better terms. In turn, firms could invest and create new jobs. It is rather encouraging to see that: i) banks have built significant capacity in tackling this problem; ii) the country is equipped a modern insolvency and foreclosure legal

framework; and iii) the Central Bank of Cyprus, in its role of supervisor, monitors NPLs much more proactively. These are all steps in the right direction.

Another major legacy of the crisis is the large stock of public debt. At nearly 109 percent of GDP, public debt is still high. The primary balance – the difference between revenue and expenditure net of interest payments – will have to be kept at around 3 percent of GDP to maintain public debt on a sustained downward path. Ensuring sustainable public finance would free up room – we call it fiscal space – for public investment, which in turn would support growth and jobs in the long run. Again, the prudent management of public finance over the last three years is reassuring. Legislating a public administration reform aimed at controlling the growth of the public sector wage bill and increasing the efficiency of the civil service would help crystallize the good results achieved so far.

4. Do you consider the bail-in as a successful method for rescuing the banking sector of a country that is in trouble compared to the bail-out one? If yes, on what do you base this conclusion?

Each country faces different circumstances and a one-size-fits-all approach is never advisable. It is also difficult to say how things would have gone, had a different course of action been chosen. In the case of Cyprus there were certainly no easy options. Had upfront steps to deal with the banking system not been taken, then taxpayers would have been asked to foot the bill. This would have entailed harsh measures to correct imbalances and Cyprus might still be confronting questions about the sustainability of its public finances. This might have weighed adversely on the economy and perhaps discouraged foreign capital. We believe that the path chosen was the least bad option. The reality is that there is no quick fix to the economic crisis the country has gone through. Only steady and resolute implementation of structural reforms along the path already started can ensure a sustained return to jobs and prosperity. It is now simply a matter of continuing along the same path.

5. At which stage is the IMF's report in relation to the economic aspects of the reunification in Cyprus? There is different information that the Turkish Cypriots "authorities" do not allow European and International experts to examine the banking sector in the north. Is it true? Can you tell us when the report/reports will be out?

As it has been known for a while, the IMF, alongside other international institutions, has been asked to provide technical assistance in support of an economically viable settlement of the "Cyprus problem". Various teams are focusing on several aspects of the solution, including the financial sector health and sustainability, the changeover to the euro in the Turkish-Cypriot community, the design of the new federal fiscal structure, an assessment of the macroeconomic statistics and the development of a consistent macroeconomic and fiscal framework for a united Cyprus. There is no single report and no

predefined timeline. Some of these workstreams have approached completion or are about to; others are at an earlier stage and will rely on critical inputs going forward. The work on the banking system is one such case.

6. You have been to many countries. What is your impression about Cypriots? Do you think they follow the rules?

I don't like stereotypes. What I can say is that the way the civil society responded to the financial crisis has been truly extraordinary. Maybe that doesn't say much about Cypriots' readiness to follow the rules, but it reveals an ability to cope with hardship that I rarely encountered in other countries.

7. You have been to Cyprus for three years now. What do you like most and what would you like to change if you had the authority to do it?

Let me start from what I would like to change. Sometimes I wish discussions in Cyprus were a bit more forward looking. We would all benefit greatly from thinking more about the next generation as opposed to spending so much time looking in the rearview mirror. As for what I like most, I am really struck by the generosity and kindness of the Cypriot people. It has made me feel welcome from the very moment I moved to this country.