INTERNATIONAL MONETARY FUND

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CYPRUS

January 2016

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

In the context of the Ninth Review Under the Extended Arrangement Under the Extended Fund Facility and Request for Waiver of Applicability 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 January 22, 2016, following discussions that ended on November 13, 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 January 11, 2016.
- 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

COMMUNICATIONS DEPARTMENT

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January 27, 2016

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Washington, D.C. 20431 USA

IMF Completes Ninth Review of Cyprus' EFF and Approves €126.3 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the ninth review of Cyprus's economic adjustment program supported by the Extended Fund Facility (EFF) arrangement. The completion of the review would make SDR 99 million (about €126.3 million) available to disbursement, which brings total disbursements under the program to SDR 792 million (about €1 billion). One more review remains to be completed.

The three-year 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:

"Macroeconomic achievements under the Fund-supported program have been favorable. Economic and fiscal outcomes are better than expected, non-performing loans have stabilized, and bank liquidity has continued to improve. However, with recent delays in implementing structural reforms, there is a need to re-energize reform implementation to protect confidence and longer-term growth. At the same time, public debt and non-performing loans need to be reduced from their current high levels.

"Accelerated workout of non-performing loans is critical to reviving lending and improving growth prospects. Following the recent passage of key legislation, the toolkit for debt restructuring is now largely in place. However, progress on the legal framework to facilitate securitization of loans and transfer of property title deeds in non-legacy cases should be accelerated.

"The updated restructuring plan for the cooperative banking sector provides a sound basis for bolstering its long-term health. More generally, efforts to enhance financial sector oversight should continue by strengthening the Central Bank of Cyprus's governance and supervisory capacity.

"Sustaining fiscal prudence over the medium term is necessary to securely place the high public debt-to-GDP ratio on a downward path, ensure room for investment and social safety net spending, and cope with contingent liabilities. Prompt adoption of overdue reforms in tax administration, civil service employment, public financial management, and governance of state enterprises will strengthen fiscal performance and safeguard sustainability.

"Implementation of other growth-enhancing reforms also needs to be accelerated. Pressing ahead with a comprehensive privatization program and concrete actions to improve the business environment, while abstaining from relying on tax incentives, would stimulate investment and improve efficiency," Mr. Furusawa said.

INTERNATIONAL MONETARY FUND

CYPRUS

January 11, 2016

NINTH REVIEW UNDER THE EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY AND REQUEST FOR WAIVER OF APPLICABILITY OF PERFORMANCE CRITERIA

EXECUTIVE SUMMARY

The economic recovery has continued to gain strength even as progress on the structural reform agenda has been modest. Economic activity through September continued to exceed expectations; fiscal outturns are running ahead of projections; non-performing loans have stabilized; and bank deposits are rising. All end-September performance criteria were met. However, the implementation of the structural reform agenda has suffered delays.

Discussions focused on key remaining policy priorities envisaged under the program and for the period beyond. The emphasis was on policies to accelerate reductions in non-performing loans (NPLs) in order to revive lending and boost growth. These included expanding the range of legal instruments available to banks and stepping up implementation of the new private debt restructuring framework. Discussions also stressed the need to lock in fiscal gains given still-high public debt, and avoid further delays in implementing structural reforms that are essential to sustainably re-invigorate growth and create employment.

Risks to the economic outlook remain, but are manageable. Recent positive indicators, together with approaching parliamentary elections, could weaken the resolve to pursue pending sensitive reforms that are necessary to durably raise growth prospects. Uncertainties in the regional and global outlook have the potential to adversely affect the Cypriot economy through their impact on tourism, business services, confidence, and ease of access to market financing. However, there are also upside risks.

Completion of this review would make available SDR 99 million (about €124 million). Total access under the arrangement is SDR 891 million (about 563 percent of quota, €1 billion), and SDR 693 million (about €0.8 billion) has already been disbursed. The European Stability Mechanism has released €6.3 billion (of €9 billion initially committed), and disbursement of an additional €275 million is expected in the first quarter of 2016.

Approved By
Philip Gerson and Vikram Haksar

Discussions took place in Nicosia during November 3–13, 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 R. van Elkan (head), S. Chen, V. Crispolti, A. Hajdenberg, A. Luca, N. Rendak, A. Simone, and O. Wuensch. V. Guzzo and M. Heracleous (IMF resident representative office) assisted the mission. S. Matei (OED) attended some of the meetings, and Y. Lu and C. El Khoury contributed from headquarters. A. Myaing provided assistance from headquarters.

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BACKGROUND

1. **The macro-economy continues to improve despite lingering vulnerabilities in the banking sector and implementation delays in structural conditionality**. Economic growth and fiscal outturns have continued to surpass expectations. Non-performing loans (NPLs) have stabilized, the pace of loan restructuring is picking up, and deposits are rising modestly—both system-wide and in the Greek subsidiaries. Nevertheless, the banking sector remains vulnerable, with very high NPLs also contributing to anemic credit growth. Cypriot sovereign debt has received a series of upgrades by credit rating agencies, facilitating issuance of a 10-year €1 billion Eurobond in October, although credit ratings remain several notches below investment grade. All end-September quantitative and continuous performance criteria (PCs) were met. However, delays were experienced in meeting all structural benchmarks (SBs). To some extent, these delays reflect the authorities' focus during late 2015 on steps to comply with unanticipated banking sector measures, which have no associated program conditionality but which have strengthened the system. The greater-than-expected technical complexity of several of the reforms has also slowed progress.

Conditionality for the Ninth Review Approved in Previous Reviews

Measures	Timing	Status
Adoption by Parliament of legislation to allow the sale of loans, which retains the protections of borrowers offered under the Code of Conduct	End-September 2015	Implemented in November
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	Not met. Expected for end-January 2016
Parliamentary approval of a public administration reform package including a revision of the wage setting framework for the general government.	End-December 2015	Not met. Expected for end-February 2016
Adoption by Parliament of legislation to remove existing impediments to the securitization of assets	End-December 2015	Not met. Expected for end-February 2016

2. **The government has committed to an ambitious policy agenda for the remaining period under the program, which expires just prior to scheduled parliamentary elections**. With the program ending on May 14, 2016, this is the penultimate program review.[1] The minority government is facing parliamentary elections on May 22, 2016, with Parliament's pre-election recess expected to start in mid-April. The authorities have committed to adopt numerous measures before then (see section on policy discussions), but proximity to the elections could complicate their efforts. Separately, talks between the Greek and Turkish Cypriot Communities have continued in recent months, with the goal of seeking a comprehensive and economically sustainable settlement.

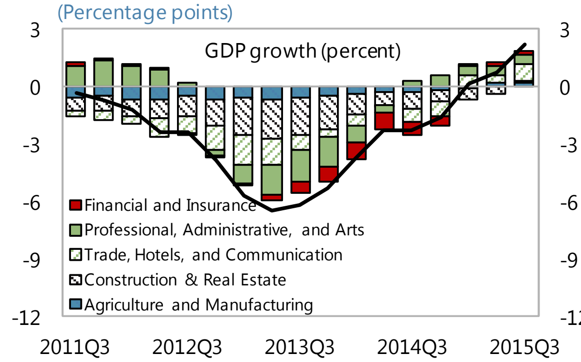
[1] The ESM program ends on March 31, 2016.

RECENT DEVELOPMENTS AND OUTLOOK

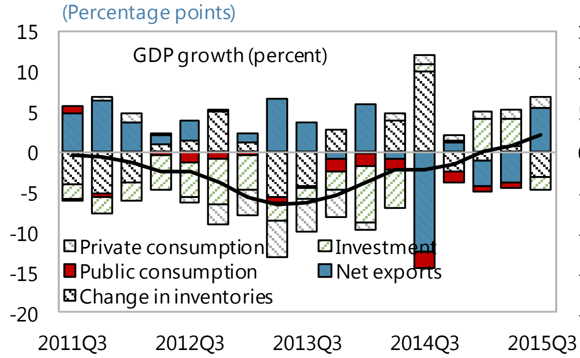
A. Recent Developments

3. The economic recovery continued into the third quarter (Figures 1–3). Real output expanded by 2.2 percent year-on-year (y-o-y; 0.4 percent quarter-on-quarter in Q3), bringing growth during the first three quarters of 2015 to 1 percent, compared to 0.5 percent that was expected at the time of the eighth review. The expansion remained broad based, with positive growth in manufacturing and most services. Notably tourist arrivals increased by 7 percent (y-o-y) during June–October, with 90 percent of the increase coming from the UK market, helped by the depreciation of the euro. Also, construction grew for the first time in seven years. On the expenditure side, growth was driven by private consumption, which contributed 1.3 ppts to GDP growth, and was supported by the boost to real incomes from falling prices. The price level fell by 1.5 percent (y-o-y), reflecting declining energy and tourism prices. While still high, unemployment is falling gradually from its peak of 16.9 percent in October 2013, and reached 15.1 percent in September.

Contributions to GDP Growth-Supply Side
(Percentage points)



Contributions to GDP Growth-Demand Side
(Percentage points)



Sources: Cystat; Eurostat; and IMF staff estimates.

4. The fiscal position through September was better than expected on account of the improved economic conditions (Figure 4). At 1.9 percent of GDP, the primary cash surplus was 0.2 percentage points larger than programmed. The over performance was largely due to the payment of lower than anticipated unemployment and redundancy benefits, reflecting some improvement in the labor market. Moreover, the underlying position vis-à-vis the targets is

General Government, January-September 2015 1/

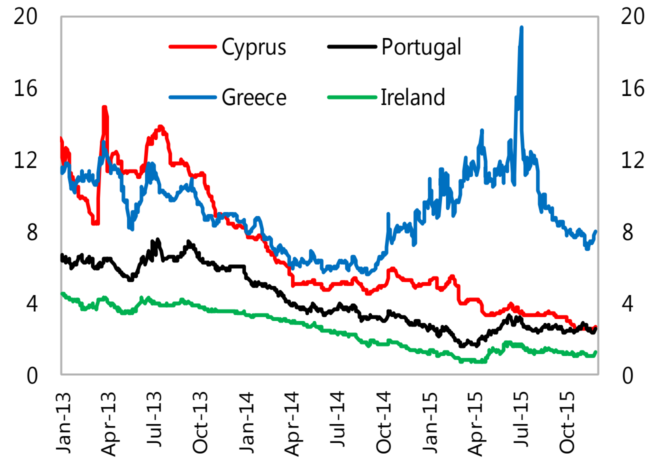
	(Millions of Euros)		(Percent of GDP)	
	8R 2/	Prelim.	8R 2/	Prelim.
Revenue	**4958**	**4921**	**28.5**	**28.3**
Taxes on production and imports	1914	1921	11.0	11.0
Current taxes on income and wealth, etc	1189	1168	6.8	6.7
Social contributions	1153	1161	6.6	6.7
Other revenue	702	671	4.0	3.9
Expenditure	**5058**	**4997**	**29.0**	**28.7**
Current expenditure	4773	4718	27.4	27.1
Intermediate consumption	422	417	2.4	2.4
Compensation of employees	1557	1556	8.9	8.9
Social transfers	1883	1819	10.8	10.4
Interest	400	400	2.3	2.3
Subsidies and other current expenditure	512	527	2.9	3.0
Capital Expenditure	285	279	1.6	1.6
General Government balance	**-100**	**-76**	**-0.6**	**-0.4**
General Government primary balance	**300**	**323**	**1.7**	**1.9**
General Government primary spending	**4659**	**4598**	**26.7**	**26.4**

Sources: Ministry of Finance; and IMF staff estimates.
1/ ESA 2010 classification, cash data.
2/ Eighth Review Projections.

stronger, as some negative temporary factors—bringing forward payments to the EU budget from Q4 to Q3 and a change in timing of property tax collections—will dissipate in the fourth quarter.

5. Government bond yields have declined further and their average maturity continues to lengthen. In October, Cyprus tapped international capital markets for the third time since the onset of the crisis, raising €1 billion through the issuance of a 10-year Eurobond at a yield of 4.25 percent. About half the proceeds were used to buy back existing debt scheduled to mature in the next few years, thereby extending maturities and reducing refinancing risk. Secondary market yields on long-term bonds have continued to moderate, reflecting the strong fiscal performance and the impact of the ECB's asset purchase program.[2] Yields on 3-month treasury bills have fallen to 0.65 percent in November compared to about 2 percent in August.

Long-Term Government Bond Yields 1/
(Percent)



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

6. Notwithstanding vulnerabilities, as underscored by the very large stock of NPLs, progress has been made in strengthening the banking sector (Figures 5 and 6).

- **Deposits.** Despite the complete removal of restrictions on deposit withdrawals in April 2015 and moderating interest rates, aggregate bank deposits were stable from end-2014 to mid-2015, and have risen in recent months. Deposits in core domestic banks (Bank of Cyprus (BoC), Hellenic Bank, and the Coops) increased by 6 percent during the first 11 months of 2015. Although Greek subsidiaries experienced deposit outflows during the first half of 2015, the core domestic banks were recipients of some deposit inflows. Moreover, since the Euro-summit agreement on Greece in July, the deposits of Greek subsidiaries have been steadily recovering.

- **Liquidity**. Liquidity buffers of domestic banks (i.e. all banks for which the CBC is the home supervisor) at end-October were about 10 percent (€0.9 billion) higher than at end-2014[3]. BoC reduced its reliance on emergency liquidity assistance to €3.8 billion (about 22 percent of GDP) as of mid-December, compared to €5.9 billion at end-June (and a peak of €11.2 billion),

[2] Cypriot government Eurobonds in the amount of €285 million have been purchased by the ECB as of November 30, 2015, just below 50 percent of the maximum estimated purchase amount the ECB has set for Cyprus (€600 million). Once the EU program ends, Cypriot government bonds would not be eligible for the ECB's asset purchase program or qualify as collateral for regular ECB financing operations because of their below investment grade rating.

[3] Liquidity buffer refers to cash, balances at the CBC, interbank balances, securities and other Eurosystem-eligible assets, and other assets with a maturity of up to 30 days.

supported by deposit inflows, the full redemption by the government of the Laiki recapitalization bond held by the BoC (€1.1 billion) completed in mid-December, and the recent eligibility of BoC's covered bonds as collateral for regular ECB financing. However, liquidity buffers of foreign-owned locally active banks (mostly Greek-owned subsidiaries) eased somewhat over the same period.

- **Credit.** The aggregate stock of bank credit to the domestic nonfinancial private sector has been broadly stable since July 2015, following two years of contraction. Credit to the corporate sector continued to grow modestly (0.6 percent y-o-y in September), offsetting a further decline in credit outstanding to households (-0.5 percent y-o-y in September). However, new lending flows have increased, with banks providing €1.2 billion in new loans in the first 9 months of 2015, while existing loans decreased mainly through repayment.

- **NPLs and provisioning levels.** NPLs in the core banks at end-August were about 60 percent of gross loans (150 percent of GDP) while provision coverage of NPLs stood at 37 percent; both have remained broadly unchanged since end-2014.[4] However, the cash collection rate (i.e., actual versus contracted cash collection) across restructured NPLs was an adequate 63 percent at end-September. In addition, the pace of NPL restructuring has accelerated in recent quarters, with total restructured fixed term loans amounting to €6.2 billion (25 percent of NPLs) at end-September, compared to €5.6 billion at end-June.[5] The average cure rate of restructured NPLs (i.e., no arrears since restructuring) has also improved to 80 percent at end-September compared to 76 percent at end-June.

- **Capitalization and profitability.** The core tier 1 equity ratio at domestic banks has continued to improve, reaching 14.3 percent at end-June 2015 compared to 13.9 percent at end-December 2014. Aggregate profits before tax for locally active banks (i.e. banks active in the local Cypriot market, even if foreign owned or a subsidiary) was €152 million in the first half of 2015, reflecting a return on assets and on CT1 equity of 0.5 and 4.7 percent, respectively. Profits declined from €182 million in the first half of 2014 due a narrowing interest margin, which was partially offset by a decrease in operating costs.

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[4] Consistent with the standard European Banking Association definition of nonperforming exposures, loans are defined as nonperforming if: (a) an exposure is more than 90 days past due; or (b) the debtor is assessed to be unlikely to pay his credit obligations in full without realization of collateral, regardless of any past due amount or the number of days past due. A minimum one year probation period is required before a restructured loan is considered to be performing.

[5] Restructured loans are those for which concessions have been granted to borrowers who are experiencing or are about to experience difficulties in meeting their financial commitments.

B. Outlook

7. The macroeconomic framework has been modified to reflect the favorable recent developments:

- ***The real GDP growth forecast for 2015 has been revised up to 1.4 percent, with a small carry-over to 2016.*** The revision for 2015 from the previous 0.5 percent reflects better-than-expected outturns in the second and third quarters. Recent high-frequency indicators (in particular, tourism and retail sales) suggest a continuation of this trend into Q4. For 2016, growth is expected to increase modestly to 1.5 percent (from a previously projected 1.4 percent) reflecting the expected slow normalization of the banking sector and high levels of private sector indebtedness. During 2017-20, growth is projected to average 2 percent, supported by strengthening external demand and some further recovery in investment. However, the growth contribution of investment is expected to remain low reflecting its post-crisis collapse (Box 2).

- ***The unemployment and inflation projections have been adjusted downward.*** The unemployment rate for 2015 has been revised down slightly to 15.5 percent, in line with the outturn to date and the upward revision to the growth forecast, with continued gradual decline expected in subsequent years. Inflation was revised down to -1.6 percent for 2015, given the outturn to date. Inflation is still projected to turn positive in 2016, but to a slightly lower level than previously forecast due to the further downward revision in world oil prices.

Selected Economic Indicators
(Percent change, unless otherwise indicated)

	2014	2015	2016	2017	2018	2019	2020
		Projections					
Real GDP	-2.5	1.4	1.5	2.0	2.2	2.1	1.8
Consumption	-1.5	0.7	0.9	1.1	1.3	1.2	0.9
Private consumption	0.6	1.3	1.3	1.4	1.5	1.2	1.0
Public consumption	-9.0	-2.1	-0.9	0.2	0.5	0.9	0.9
Fixed investment	-18.0	2.2	3.6	4.0	4.5	4.2	3.6
Inventory accumulation 1/	2.9	0.0	0.0	0.0	0.0	0.0	0.0
Foreign balance 1/	-1.5	0.5	0.3	0.5	0.5	0.6	0.6
HICP (period average)	-0.3	-1.6	0.6	1.3	1.5	1.8	1.9
Unemployment rate (EU standard; percent)	16.1	15.5	14.5	13.2	11.9	10.6	9.6

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

8. Risks to this outlook are two-sided:

- *Domestic risks.* Upside risks to near-term growth from continued positive surprises on consumption and employment are possible. However, the stronger-than-expected macroeconomic recovery together with the upcoming elections could reduce the perceived urgency for reform, thereby precluding the introduction of important reforms, which would damage confidence and growth in the longer term. In addition, slow workout of NPLs would impede the flow of new credit, holding back investment and constraining medium-term growth.

- *External risks.* Very high external debt—projected at 574 percent of GDP at end-2015, but down from a peak of 727 percent of GDP in 2009—renders Cyprus sensitive to external interest rate and growth shocks (Figure 7 and Box 3).[6] Despite significantly reduced direct real and financial links with Greece, continued uncertainty may still affect Cyprus through confidence effects and the cost of external financing. However, positive spillovers are also possible, including if some Greek business activities migrate to Cyprus. The economic outlook for Russia—an important source for tourism and business services revenue—will also impact the Cypriot economy. Continued de-risking by foreign banks may weaken domestic banks' access to correspondent banking, affecting in particular sectors that rely on dollar-denominated settlements (e.g., shipping).

POLICY DISCUSSIONS

9. Discussions focused on key policy priorities for the remainder of the program and the period beyond. The emphasis was on: (i) further strengthening the banking sector and accelerating the reduction in NPLs; (ii) the 2016 budget and the medium-term fiscal framework; and (iii) the structural reform agenda.

A. Financial Sector Policies

NPLs and the Debt Restructuring Framework

10. Addressing banks' high NPLs remains essential to revive lending and raise economic growth prospects (MEFP ¶3)**.** With the recent approval of a law allowing banks to sell their loans, the infrastructure to clean-up banks' balance sheets has now been largely put in place. Banks have set up internal loan restructuring operations and are refining policies and practices on the basis of experience to date. The legal frameworks for foreclosure and insolvency, along with the relevant institutions and processes, have been established, and these are starting to operate. The Central Bank of Cyprus (CBC), in its financial stability function, is taking an increasingly active role in

[6] The time series on external statistics were revised in line with the BPM6 methodology, and released in October. Revisions reflect mainly the reclassification of Special Purpose Entities (SPEs) as residents, resulting in significantly higher external debt and more negative IIP, but with little effect on GDP. The revised external debt is expected to remain elevated over the projection period and is highly vulnerable to macroeconomic shocks. These unfavorable debt dynamics are largely driven by SPEs' debts—external debt without SPEs is expected to decline over the projection period reflecting the external adjustment underway.

encouraging and monitoring progress with reducing NPLs. Yet, the NPL ratio remains stubbornly high (Figure 8), and efforts should focus on utilizing the tools at hand.

11. Discussions focused on the following areas:

- ***Divestment of assets.*** A law was adopted in November allowing banks to sell individual loans or segments of their loan portfolio, while preserving the safeguards for small borrowers mandated under the Code of Conduct even if their loans are sold (Box 4) **(end-September SB)**.[7] Importantly, given the high concentration of distressed assets, the law allows large (above €1 million) loans to be sold with few obligations imposed on the selling bank or the purchaser. In the case of smaller loans, the law does not materially affect incentives for restructuring or materially increase moral hazard concerns (i.e., that borrowers would stop servicing their loans in order to buy them back at a discount). A draft law on asset securitization, with the aim of facilitating bank deleveraging and, eventually, unlocking additional sources of funding for the economy, has been prepared. However, due to its technical complexity, finalization has taken longer than expected, leading to delay in Parliamentary adoption **(end-December SB)**, which is now envisaged by end-February **(modified SB)**.

- ***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 quarterly bank-by-bank targets for NPL restructuring since June, and began publishing the aggregate targets for the first time in September. Preliminary results for end-September show that, while in the aggregate the banks did not meet their targets, the pace of restructuring has further increased, greater use has been made of long-term restructuring agreements, and re-default rates were satisfactorily low (Annex I). Based on these results, the CBC has identified supervisory priorities and bank-specific actions to address deficiencies. It will also project the future path of system-wide loan restructuring and recovery.

- ***Financial situation of borrowers.*** Understanding the financial capacity of borrowers is key to designing effective macro-prudential policies and to further fine-tuning the loan restructuring strategy. Anecdotal evidence suggests that a nontrivial portion of household NPLs is held by borrowers with the financial capacity to make all their loan payments—i.e., strategic, rather than economic, defaulters. This highlights the importance of strengthening banks' internal arrears management mechanisms and fully utilizing the tools provided by the new debt restructuring framework, including the foreclosure law, and sharing information across lenders on borrower credit-worthiness to limit strategic defaults and to realize the actual repayment capacity of borrowers.

[7] The Code of Conduct applies to loans to individuals and micro-enterprises, and obliges the bank to treat the borrower in a fair and transparent manner by adhering to well-defined procedural steps and timelines. In turn, the borrower is required to cooperate during the entire restructuring process to enable the lender to accurately assess the borrower's financial situation.

12. Implementation of the new insolvency and foreclosure frameworks has begun, but should be accelerated in order to have a stronger impact on NPL reduction (MEFP ¶13).

- ***Implementation.*** The new Insolvency Service (IS) is operational and has received a handful of applications for the new procedures, primarily for simplified debt relief for relatively small unsecured debts. Progress has been made in several areas: (i) the first group of insolvency professionals (IP), who will assist debtors developing restructuring plans, has been authorized; (ii) a new IT system to facilitate processing insolvency applications and communication with the courts is being developed; (iii) training of judges and insolvency professionals has started. However, more needs to be done to operationalize the insolvency framework, including increasing staffing at the IS, completing the roll-out of the new IT system, adopting courts rules for the new personal insolvency procedures, and addressing teething issues related to the rules for licensing of IPs. Moreover, court rules for the new corporate reorganization procedure should be prepared without delay. In addition, review of the Civil Procedure and other related laws should be accelerated to ensure that courts are in a position to effectively implement the new legal framework. With regard to foreclosures, banks have indicated their intention to sell a number of foreclosed commercial and non-primary residences. In addition, the authorities have reported that the necessary elements required to hold real estate auctions according to the law have been put in place.

- ***Framework review.*** Staff and the authorities agreed that the new insolvency and foreclosure laws should be periodically reviewed to ensure smooth implementation and to continue aligning the regime with international best practices. Accordingly, the authorities will review the initial implementation experiences by end-January, with a view to inform necessary legislative changes to be adopted by the Council of Ministers by end-February **(modified SB)** instead of end-January as previously anticipated to allow the gathering of additional experience.[8] In addition, close coordination of the insolvency reform implementation is needed among all government stakeholders, to leverage the expertise developed by the insolvency project team under the Ministry of Finance.

13. Reforms that facilitate the transfer of title deeds need to be finalized to improve the functioning of the property market and the debt restructuring framework (MEFP ¶13). A new law was adopted in September to facilitate title transfers for legacy cases. The law provides a mechanism whereby encumbrances resulting from developers' mortgages can be lifted and the title can be transferred provided that the buyer has paid the purchase price for the property. The implementation of the law has started, with over a thousand applications for title transfers filed and currently being processed by the Department of Land and Surveys. The authorities are preparing legislation to enable the swift transfer of titles in transactions not covered by the earlier legislation (non-legacy cases). The legislation represents a substantial overhaul of the current system and envisages mandatory use of an escrow institution in property transactions to ensure that all the

[8] These would include provisions to encourage non-viable debtors to promptly engage with the insolvency framework and to ensure that guarantors maintain their payment obligations with due regard to their payment capacity.

encumbrances are lifted and the title is transferred, once the purchase price has been paid in full.
encumbrances are lifted and the title is transferred, once the purchase price has been paid in full.
Due to the legal complexity, additional time is needed to finalize the new laws, thus delaying the implementation of the end-October 2015 SB to end-January 2016 (modified SB). Going forward, the authorities should assess whether additional measures, such as the development of other legal or contractual standards for property transactions, are warranted.

ECB Capital Review Exercise

14. The recent SSM assessment of capital adequacy, finalized in December, identified provisioning shortfalls in the core domestic Cypriot banks. The assessment by the ECB's Single Supervisory Mechanism (SSM), which was conducted using end-2014 data, identified a provisioning shortfall in the coops. In response, the coops raised provisions by about €525 million (3 percent of GDP) in the third quarter.[9] Staff has not been granted access to data necessary to review the SSM's assessment.[10] BoC and Hellenic have indicated publicly that the SSM, based on preliminary findings, has identified provisioning shortfalls in their banks. To address any identified shortfalls, the banks will be required to adopt capital plans approved by the SSM. Progress on NPL restructuring will be key to protecting the banks' capitalization, taking into account lackluster profitability and limited potential to attract material amounts of additional private funding.

15. The authorities implemented in late 2015 an action plan to recapitalize the coops (Box 1). In line with SSM requirements, the government provided an upfront injection of €175 million (1 percent of GDP) of additional public funds into the coops in late December, following Parliamentary approval of a five-piece package of needed legislation. The coops also agreed an updated restructuring plan with the European competition authority (DG COMP)—a requirement under the European state aid framework—which, inter alia, accelerates and strengthens the centralization of governance operations, risk management and NPL workout within the coop sector. The aim of the restructuring plan, which builds on progress to date (see below), is to ensure the long-term viability of the coop sector without future recourse to public funds. BoC and Hellenic have indicated publicly that they expect to address any SSM requirements through existing capital buffers and future profits.

Other Financial Sector Issues

16. The Coop sector has undergone substantial restructuring, but additional progress is warranted to strengthen its governance (MEFP ¶4)**.** The Cooperative Central Bank (CCB; the central body of the cooperative credit sector and majority owner of the 18 regional cooperative

[9] This follows a €1.5 billion (8.6 percent of GDP) recapitalization of the coops, carried out in 2014 as part of the program.

[10] Given only modest changes in the balance sheets of the three banks between the ECB's 2014 Comprehensive Assessment and the updated SSM assessment, and the improvements in macroeconomic conditions and house prices, the different conclusions regarding capital adequacy would seem to reflect differences in methodologies and assumptions. Staff's analysis suggests that, for Cyprus, the capital needs assessment is very sensitive to assumptions on house prices, cure rates, and time to restructure or liquidate.

credit institutions) has begun operationalizing its responsibility for managing the NPLs of the individual coops by recently centralizing customer contact centers and the debt recovery function. Work is also underway to better analyze and segment the NPL portfolio, in order to develop targeted restructuring policies. Measures to strengthen the sector's financial control and reporting functions have already led to improvements in reporting quality and timeliness and will be completed during 2016. Nevertheless, limited centralization continues to pose challenges for an effective turnaround. Staff emphasized that strong and well equipped central functions are vital for the sector. Accordingly, effective centralization of finance, risk, compliance and audit functions requires strengthening of their staffing and capacity. Staff reiterated calls for a strong risk function, to ensure adequate oversight of borrowing decisions and other risk-taking activities. The risk function will be upgraded in terms of structure, procedures, and tools by June 2016.

Box 1. The New Restructuring Plan for the Coops

On December 18, 2015 the government announced key elements of an updated restructuring plan for the cooperative banking sector agreed with the EC's DG COMP in support of a €175 million injection of state aid. As a result of the capital injection, the tier 1 capital ratio of the coops was raised to 14 percent, while augmentation of provisions in Q3 boosted provisioning coverage of 90-day past-due loans to 50 percent. The aim of the restructuring plan is to ensure the long-term viability of the coop sector without future recourse to public funds. This updated plan supersedes and goes beyond the previous plan agreed in 2013 in the context of the earlier capital support for the coops. Elements of the new plan include:

Operational restructuring. While preserving the basic structure of the coop sector—with its 18 individual Cooperative Credit Institutions (CCIs) (reduced through mergers from the earlier 93 in 2013–14) and the Cooperative Central Bank (CCB)—the plan envisages further centralizing key managerial and "back-office" functions. The CCIs will retain several banking functions that directly relate to interfacing with customers, including accepting deposits and extending loans, under strict adherence with the policies defined by the CCB. However, most other functions, including NPL management, financial management and control, credit risk management, and audit, will be further centralized at the CCB. The CCB will also oversee the balance sheet of the entire coop sector, and will be responsible for the management of capital and liquidity. All employees of the individual CCIs will become staff of the CCB, and ownership of all CCIs' nonfinancial assets will be transferred to the CCB. The graduated wage reductions (ranging from zero for low wage employees to 25 percent for the highest paid employees) that were part of the previous restructuring plan carry over to the current plan.

Privatization. The updated plan also foresees the gradual dilution of the current 99 percent public ownership of the CCB by raising new capital. As a first step, measures to support an initial listing on the Cyprus Stock Exchange are expected by 2017, and by September 30, 2018, the CCB is expected to sell on the Exchange new shares equal to at least 25 percent of existing capital. Two additional share issuances—by June 30, 2019 and a year later—are also planned. Shares will also be offered to strategic investors. At the end of this process, the Republic of Cyprus is expected to see its stake in the CCB fall to 25 percent or less.

17. Adequate capitalization of Greek bank subsidiaries needs to be ensured (MEFP ¶6)**.** With 13 percent of system deposits, the Greek subsidiaries are systemic as a group. Since late 2014, the subsidiaries have significantly reduced their exposure to their parents and to Greek risk more broadly. These subsidiaries are supervised by the SSM as the parent banks are systemic in their home country, with a limited role for the CBC. The recent capital assessment exercise by the SSM in

Greece identified capital needs for the Greek parent banks on a consolidated basis. These gaps were filled at the level of the consolidated bank group. It is critical that this exercise results in the continued proper capitalization of the subsidiaries to ensure their stability and viability, including in the event they are sold by their parents.

18. Further reforms are needed in the CBC to address some outstanding issues identified by the safeguards assessment.[11] While the CBC has implemented most of its recommendations, remaining items that need to be implemented relate to governance reforms (see below), improved disclosures in the financial statements, and strengthening the legal compliance function.

19. Continued efforts in several other financial sector areas are needed:

- ***Strengthening supervision*** (MEFP ¶6)**.** Supervision of the core Cypriot banks is now a responsibility of the SSM, with work performed by joint supervisory teams consisting of the ECB and the CBC. To strengthen the CBC's contribution, in particular in the area of NPL supervision, the CBC has set up a central unit to coordinate NPL issues across departments and on-boarded additional personnel. Staff stressed the need for the CBC to intensify its engagement with the banks, including through regular monitoring of banks' key operational metrics on NPL performance and obtaining a good understanding of the drivers of banks' restructuring performance, as well as frequent and targeted on-site visits.

- ***Central bank governance and organization.*** Strengthening governance is essential to increase the effectiveness and accountability of the CBC's decision making. To this end, the CBC has recently undertaken a governance review aimed at reinforcing the independence of the institution and its key officials. In addition, the CBC is also implementing a comprehensive reorganization of the bank and ensuring that staffing and functional responsibilities are adequately aligned.

- ***Resolution of Laiki*** (MEFP ¶6)**.** The disposal of legacy Laiki's operations abroad is expected to be finalized in the next few months. However, the sale of Laiki's stake in BoC has been further delayed. This had prompted political initiatives to suspend resolution measures and distribute the remaining assets among Laiki's creditors. As Laiki is a cross-border bank, responsibility for its resolution will be taken over by the European Single Resolution Board in 2016.

20. The implementation of international initiatives requiring knowledge by banks of their customers needs to be strengthened, including to prevent de-risking by correspondent banks (MEFP ¶8). The CBC is finalizing the inspections of 13 financial institutions under the 2015 inspection program and the design of the 2016 program while, in December, it fined the local branch of a foreign bank for failing to meet its AML/CFT obligations, some 18 months after the on-site inspection. Sanctions related to other 2014 bank inspections have not yet been issued. The time lag between on-site inspections, finalization of reports, and imposition of sanctions needs to

[11] For additional information, see https://www-inttrep.imf.org/safeguards/

be reduced urgently. Additional efforts are also needed to strengthen supervision of banks and professions to mitigate AML/CFT risks, and to implement the action plan to enhance the transparency of companies. In the area of tax transparency and exchange of information for tax purposes, Cyprus was rated largely compliant by the Global Forum review and committed to begin automatically exchanging information during 2017. This progress, together with a further strengthening of the AML/CFT framework and enhanced dialog with foreign regulators and other stakeholders, should help prevent de-risking by correspondent banks.

B. Fiscal Policy

21. The primary surpluses projected for 2015 and 2016 were revised up reflecting year-to-date over-performance (MEFP ¶10).[12] For 2015, the cash-based projection was revised to 1.5 percent of GDP from 1.3 percent of GDP mainly to reflect lower social transfers and goods and services expenditure, partly offset by a one-off guarantee payment reflected in capital expenditure.[13] For 2016, the projection was revised up by only 0.1 percent of GDP to 2.5 percent of GDP mainly because 0.2 percent of GDP from a bank levy expected to have been diverted in 2015 to the National Resolution Fund will now be diverted in 2016, as per BRRD requirements. The projected 2016 primary surplus is consistent with the 2016 budget, requires no new measures, and implies an unchanged underlying fiscal position compared with 2014 (as envisaged in the eighth review staff report). Automatic stabilizers would be allowed to operate if economic performance is worse than forecasted.

Accounts of the General Government, 2015-2016 1/
(Percent of GDP)

	2015		2016	
	8R	Proj. 2/	8R	Proj. 2/
Revenue	**39.6**	**39.5**	**39.1**	**38.8**
Taxes on production and imports	14.9	14.8	14.6	14.6
Current taxes on income and wealth, etc	9.8	9.7	9.8	9.6
Social contributions	9.0	9.1	9.0	9.1
Other revenue	5.9	6.0	5.7	5.6
Expenditure	**40.9**	**41.1**	**38.9**	**38.8**
Current expenditure	37.7	37.6	35.7	35.7
Intermediate consumption	3.6	3.5	3.5	3.5
Compensation of employees	13.0	13.0	12.7	12.7
Social transfers	14.9	14.6	14.6	14.3
Interest	2.7	3.0	2.2	2.5
Subsidies and other current expenditure	3.6	3.6	2.6	2.7
Capital Expenditure	3.2	3.4	3.2	3.1
General Government balance	**-1.3**	**-1.5**	**0.1**	**0.0**
General Government primary balance	**1.3**	**1.5**	**2.4**	**2.5**
General Government primary spending	**38.2**	**38.1**	**36.7**	**36.3**

Sources: Ministry of Finance; and IMF staff estimates.
1/ 8R refers to the 8th review staff report figures. The 2015 projection excludes the coop recapitalization.
2/ Taxes on production and imports and other current expenditure are both 0.1 percent of GDP lower compared to the eigth review due to a methodological change in the statistical treatment of EU budget flows.

22. The previously-agreed 2017–18 primary surplus targets were kept unchanged at 3 percent and 3–4 percent of GDP, respectively, in order to maintain public debt on a strong downward path (MEFP ¶11; Table 2).[14] The medium-term primary balance targets aim to reduce

[12] Given that the Board meeting for this review occurs after the December test date, targets for end December 2015 will be maintained as per the eighth review.

[13] The 2015 projected primary surplus excludes the impact of the €175 million (1 percent of GDP) December 2015 coop recapitalization in order to facilitate comparison with the underlying fiscal position. The transaction was financed from the government's cash buffer in 2015. Thus, the recapitalization of the coops can be seen as raising public debt in 2016, but does not materially affect public debt sustainability (Figures 8–12).

[14] For the purpose of the macroeconomic framework, the primary surplus from 2018 onwards is assumed to be

public debt from 109 percent of GDP in 2015 to around 70 percent of GDP by 2022, while also allowing adequate space for public investment spending. Achieving this path requires maintaining the primary surplus at about 3.5 percent of GDP beyond 2017. However, if the envisaged debt-to-asset swap with the CBC (currently expected to yield 3.4 percent of GDP) and privatization transactions (expected to yield around 6 percent of GDP, 2 percent of GDP less than previously expected given the removal of the state power company (EAC) from the list of companies to be privatized) are completed and realize the expected amounts, at that point, the primary surplus target may be lowered to 3 percent of GDP without compromising the 2022 debt objective.

C. Structural Reforms

23. Discussions focused on reforms still pending under the program:

- **Fiscal structural reforms.** Reform implementation is experiencing delays mostly on revenue administration and public financial management. Additional details on the status of the reform agenda are shown in Table 11.

    - **Revenue Administration** (MEFP ¶13)**.** Preparation of the first quarterly performance assessment report (covering Q3 2015) and allocating a unique taxpayer number to each individual payer across all taxes indicates progress. However, delays have emerged in strengthening the large taxpayer office (LTO), establishing an integrated legal framework for tax procedures, identifying tax assessment backlogs, and reducing collectible arrears on which no collection actions had been taken (1.2 percent of GDP at end-June 2015). Lengthy decision-making by the executive management team, severe staff and IT constraints, and resource allocation issues have contributed to these delays. Staff advised (i) adequately resourcing the new organizational structures of the integrated tax department; (ii) tackling tax assessment backlogs by focusing first on the most recent un-assessed tax returns and calibrating collection of back taxes to individual taxpayers' ability to pay; and (iii) targeting arrears collection efforts to the largest debtors, including through the use of new collection enforcement tools, such as garnishment of deposits.

    - **Public Financial Management** (MEFP ¶14). Delays in adopting the secondary legislation of the Fiscal Responsibility and Budget System Law (FRBSL), now expected for end January, have emerged due to a crowded end-2015 legislative agenda.[15] However, parliamentary approval of the law regulating the creation and functioning of

about 3½ percent of GDP.

[15] The secondary legislation of the FRBSL includes procedures for budget preparation, requirements for within-year budgetary adjustments, and responsibilities of the commitment control officer, among other public financial management procedures.

state-owned enterprises (SOEs) has faced strong opposition from vested interests and is not expected to be approved before end-March. Staff stressed the importance of this law to improve the oversight and governance of SOEs and urged the authorities to approve it as soon as feasible.

- **Privatization** (MEFP ¶15)**.** Preparations for the privatization of the commercial activities of the Limassol port are proceeding and the transaction is expected to be finalized by end-April. However, privatization of the state-owned telecom company (Cyta) has suffered further setbacks, largely due to protracted discussions with the unions on the future status of current employees and political debate about the benefits of privatization. The laws on corporatization of CyTA and on employment issues are now expected to be adopted by end-January, paving the way to seek expressions of interest by future potential buyers soon thereafter. Staff stressed the importance of selling a majority stake in CyTA to attract a high-quality strategic investor who would efficiently manage the company and allow it to benefit from economies of scale. As an important step to enhance the efficiency of the electricity sector, the government intends to proceed with the legal unbundling of the state power company (EAC) into two separate companies—one for transmission and distribution, and one for generation and supply. However, EAC was removed from the list of companies slated for privatization, which may preclude further efficiency gains.

- **Growth Strategy** (MEFP ¶16)**.** The authorities' action plan for growth seeks to improve the business environment by focusing on reducing red tape through simplified licensing requirements and regulatory frameworks. To that end, the authorities are conducting an assessment of existing impediments in key areas—e.g., tourism, building permits, e-government. In the case of tourism, any necessary legal amendments are expected to be approved by the Council of Ministers in March 2016. The authorities are also aware of the need to strengthen the enforcement of contracts and simplify judicial procedures. Staff agreed with this approach, and cautioned against providing tax incentives, which experience has shown are not a key determinant for investment but could have significant fiscal costs. Staff re-iterated the need to accelerate implementation of the action plan.

- **Public Administration Reform** (MEFP ¶16)**.** Parliamentary discussions have commenced on legislation to reform the wage-setting framework for the general government and facilitate mobility of staff across the civil service. Passage of the law is now expected by end-February 2016 **(modified SB; previously end-December SB)** given the busy end-2015 legislative agenda. Staff encouraged the authorities to pass this legislation as soon as possible given its role in ensuring an affordable wage bill and reallocating staff to meet resource needs, including in the revenue administration.

PROGRAM MODALITIES

24. Quantitative conditionality was comfortably met, but slippages occurred on several structural benchmarks. All end-September 2015 performance criteria (PCs) and continuous PCs were met. However, actions corresponding to one SB were implemented with a delay, while those of three others are expected to be implemented by end-January and end-February 2016 as noted below (text table). Final data for all end-December quantitative PCs for the 10th review will be available only after January 30, which is subsequent to the scheduled Board discussion for this review. A waiver of applicability is therefore required for all end-December PCs, which staff expects to have been met.

25. Updated conditionality under the arrangement is being proposed:

- **Structural benchmarks.** As outlined in the previous sections, four structural benchmarks were modified through a change in deadline (text table).

Updated Conditionality Proposed During the Ninth Review

Measures	Timing
Modified Structural Benchmarks	
Approval by the Council of Ministers of legislation for the issuance and transfer of title deeds in non-legacy and new property transactions	End-January 2016
Parliamentary approval of a public administration reform package including a revision of the wage setting framework for the general government.	End-February 2016
Adoption by Parliament of legislation to remove existing impediments to the securitization of assets	End-February 2016
Adoption by the Council of Ministers of any necessary adjustments to correct deficiencies of the insolvency and foreclosure frameworks, including legislative changes	End-February 2016

26. Risks to program implementation remain, although there are some mitigating factors. Downside risks to the program center on those discussed in ¶8, notably the proximity to elections, differences of view within Parliament, potential for the improving macroeconomic situation to exacerbate reform fatigue, challenges related to reducing NPLs, and spillover risks from Greece. However, the track record on program implementation accumulated over eight completed reviews has been adequate overall, and the recent acceleration in NPL restructuring and passage of the law on sale of loans signals continued commitment by the authorities and banks to tackling Cyprus's NPLs problem. Regarding risks from Greece, the authorities have a range of tools at their disposal and are closely monitoring the Greek-owned subsidiaries.

27. 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 were about €1.5 billion at end-November, some €0.1 billion is expected from the transfer of the coin-minting function from the CBC to the Treasury in early-2016, CBC profits are expected to yield the government €0.1 billion in 2016, and the expected ESM/IMF disbursement of €0.4 billion under the current review cover the projected financing needs through May 2016 (including the recapitalization of the coops) (€0.6 billion), even if the final ESM/IMF tranches are not disbursed. Given the strong fiscal performance and successful issuances to the markets, the authorities do not envision drawing on the program buffer for debt management operations, as had been previously anticipated, and therefore the program buffer is no longer expected to be disbursed.

28. Capacity to repay the Fund remains good. The macroeconomic outlook and public finances have strengthened since the completion of the eighth review, further reducing repayment risk. The sovereign has demonstrated a strong track record of access to international capital markets, aided by numerous upgrades to its credit rating, and further tapping markets would facilitate repayment to the Fund. Moreover, with the third Eurobond issuance since the crisis in October, buy-back of debt maturing in 2019–20, and repayment of the remainder of the Laiki bond in December, the debt repayment profile has been smoothed, reducing immediate post-program financing needs. However, absent a successor program or an investment grade rating, Cypriot sovereign bonds will likely lose eligibility for ECB financing, including QE purchases. This could lead to some widening of spreads on Cypriot debt, but is not expected to result in increased liquidity pressure for Cypriot core banks given their limited sovereign holdings and otherwise ample liquidity buffers, while the effect on interest rate levels would be mitigated by continued accommodative monetary policy by the ECB. Moreover, debt service requirements to the Fund relative to GDP and to exports remain manageable. Upon completion of the final review, as shown in Table 8, peak Fund exposure to Cyprus would occur in 2016 at 563 percent of quota or 6 percent of GDP.

STAFF APPRAISAL

29. Policies under the program are continuing to produce tangible results. Economic activity has continued to strengthen, unemployment is moderating gradually, fiscal outturns are running ahead of projections, non-performing loans have stabilized and recourse to sustainable restructuring is increasing, while bank liquidity is improving on growing system-wide deposits. These favorable developments have led to ratings upgrades that facilitated for the third time since the crisis the successful tapping of the international bond market in October, while extending the yield curve to the 10-year horizon.

30. Nevertheless, there is a need to consolidate these achievements while avoiding complacency. Although macroeconomic outcomes have been favorable and some progress towards implementing structural benchmarks has been achieved, the implementation of structural reforms has suffered delays in many areas. While some recent delays may be partly attributed to unexpected demands on policymakers' attention to address issues in the banking sector, unless rectified, delays in the reform agenda could damage confidence and growth in the longer term. Moreover, risks to the program remain in the form of a challenging political environment and uncertainties in the regional and global outlook which have the potential to adversely affect the Cypriot economy. In this setting, it is crucial that the authorities continue with their sound macroeconomic management and further demonstrate program ownership by re-energizing the momentum of structural reform to overcome delays and complete the reforms envisaged for the remainder of the program. These reforms are critical to ensure that sustained growth, coupled with fiscal and financial stability, are attained and durably maintained.

31. Accelerating progress in reducing banks' high NPLs remains essential to revive lending and raise economic growth prospects. Despite delays, recent progress by means of passing legislation allowing the sale of loans and the stepped up pace of debt restructuring is encouraging. Nevertheless, more needs to be done to significantly improve payment discipline and reduce strategic defaults so that loan performance reflects the borrower's true capacity to repay, thereby avoiding the "tax" on all borrowers from a higher than necessary cost of capital and reduced of access to financing. To achieve these goals, implementation of the debt restructuring framework should be accelerated and supporting legislation to facilitate loan securitization and swift transfer of non-legacy title deeds should be passed. To ensure adequate continuous progress, implementation of the insolvency and foreclosure frameworks needs to be monitored closely and any deficiencies addressed, including by making necessary legislative adjustments and taking timely supervisory action.

32. The recently agreed restructuring plan for the coop banks provides a good basis for strengthening governance to enhance financial stability and reduce fiscal risks. While the coops have been significantly restructured, limited centralization has continued to pose challenges to an effective turnaround. In line with the new restructuring plan, efforts should focus on effective centralization of finance, compliance, audit and risk functions. The latter is needed to ensure adequate oversight of lending decisions and other risk-taking activities.

33. Efforts to enhance financial regulation and supervision should continue, within the SSM framework. In this context, the CBC should continue to strengthen its governance and supervisory capacity while intensifying its engagement with the banks. In particular, close attention should be paid to ensuring that Greek-owned subsidiaries are capitalized adequately.

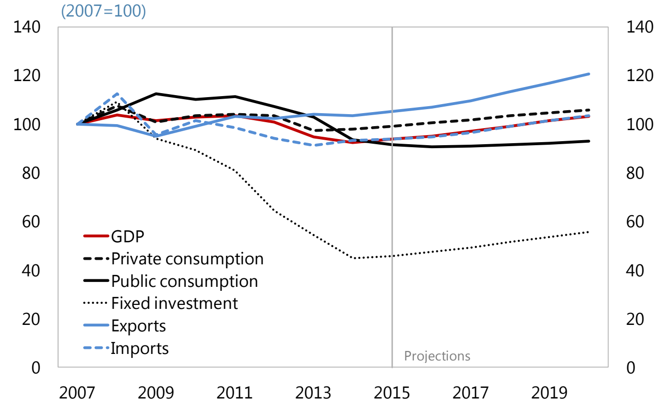
34. The gains from strong fiscal performance should be locked in while addressing delays with fiscal structural reform implementation. Locking in fiscal gains allows the creation of fiscal space to address potential risks from high public debt and contingent liabilities while ensuring support for growth-enhancing public spending and the social safety net. Delays in the passing the public administration reform, the secondary legislation for the fiscal responsibility and budget system law, and the law regulating the creation and functioning of SOEs should be addressed. These reforms are critical to ensure an affordable wage bill, efficient public expenditure management, strengthened SOE governance, and the reduction of fiscal risks. In addition, revenue administration reform efforts should be stepped up to help broaden the tax base and improve horizontal equity across taxpayers while protecting revenue collection.

35. Implementation of growth enhancing reforms should be stepped up. The authorities should press ahead with a comprehensive privatization program, which is important to help support investment and efficiency in the economy. In addition, to lessen the weight of the regulatory burden on economic activity, the authorities should move forcefully to implement concrete actions to improve the business environment while avoiding the pitfalls of tax incentives.

36. On the basis of the continued progress under the program and policy commitments going forward, staff supports the completion of the ninth review and the authorities' request for waivers of applicability on the end-December performance criteria.

Box 2. The Role of Fixed Investment in GDP Dynamics

Dynamics of GDP Components
(2007=100)



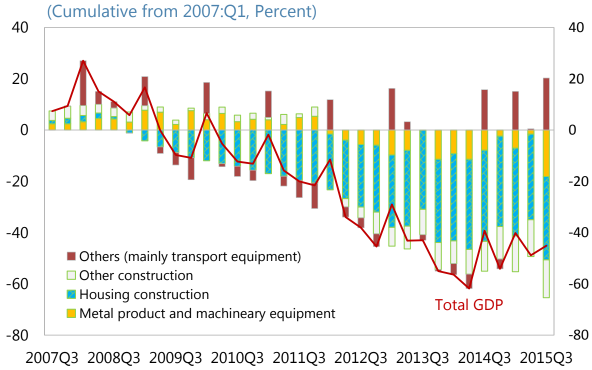
Sources: Cystat; and IMF staff estimates.

Cyprus suffered a double dip drop in GDP since the onset of the global financial crisis (GFC). GDP declined modestly in 2009, recovered in 2010–11, only to fall back into a deeper and more persistent recession during 2012–14 as Cyprus underwent its own banking crisis. While GDP growth returned to positive territory in 2015, GDP remains 6½ percent below its 2007 level.

Fixed investment suffered the steepest drop among the various expenditure components. It fell by more than half relative to its 2007 level, before bottoming out in 2014. As a result, the share of fixed investment in GDP fell from 27 percent in 2008 to around 12½ percent in 2015. Reduced investment contributed to a sharp compression of imports. Relative to 2008, the contraction in fixed investment has withdrawn more than 15 percentage points from GDP.

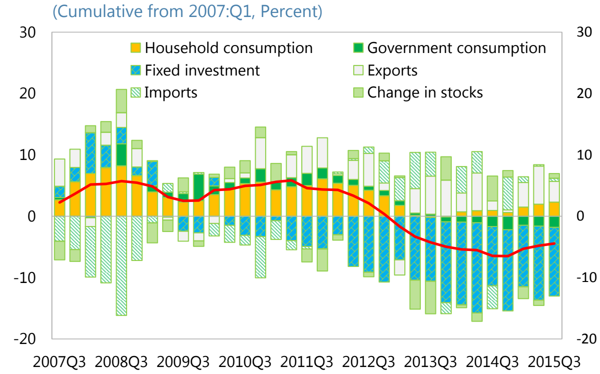
The behavior of fixed investment reflects primarily developments in housing construction, which accounted for more than three-quarters of the decline since 2008. Prior to the GFC, a boom in housing construction was fueled by ample capital inflows which led to a bank lending boom. When inflows reversed beginning in 2009, credit dried up and housing construction fell precipitously. The high import content of housing helps explain the subsequent compression of imports. On the other hand, investment in machinery was much less affected.

Contributions to Fixed Capital Formation
(Cumulative from 2007:Q1, Percent)



Sources: Cystat; and IMF staff estimates.

Contributions to Real GDP Growth—Expenditure Side
(Cumulative from 2007:Q1, Percent)



Sources: Haver; and IMF staff estimates.

Going forward, some revival in fixed investment is expected, but its share in GDP is not anticipated to recover to pre-crisis levels. Housing construction growth prior to the GFC was not sustainable, and contributed to very high private sector indebtedness. Going forward, medium-term output growth is expected to be more balanced and to average 1¾ percent per year, with private consumption being restrained by deleveraging and with continued fiscal prudence expected to dampen public consumption. While fixed investment is projected to grow at 4 percent per year—faster than total GDP—by 2020, it would have only reached about 55 percent of its 2007 level.

Box 3. Revisions to External Statistics

Cyprus: International Investment Position, 2008-13
(Percent of GDP)

	Average 2008-12		2013	
	BPM6	BPM5	BPM6	BPM5
Net Position	-111	-43	-137	-78
Assets	1216	472	1063	326
Liabilities	1327	514	1200	404
Direct Investment	-55	-31	-53	-52
Assets	689	42	663	33
Liabilities	743	73	716	85
Portfolio Investment	153	125	28	27
Assets	212	161	77	47
Liabilities	59	36	49	20
Other Investment	-215	-142	-116	-58
Assets	302	258	311	234
Liabilities	517	400	427	293

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

Cyprus: External Debt, 2008-13
(Millions of Euro)

	Average 2008-12		2013	
	BPM6	BPM5	BPM6	BPM5
General Government	4,395	4,360	10,614	10,579
Short-term	281	281	0	0
Medium and Long-term	4,114	4,079	10,614	10,579
Monetary Authorities	7,437	7,197	7,623	7,363
Short-term	7,341	7,191	7,504	7,363
Long-term	96	6	119	0
MFIs (excluding Central Banks)	60,080	66,317	24,870	27,592
Short-term	42,449	48,382	19,265	21,891
Long-term	17,631	17,936	5,605	5,701
Other Sectors	35,689	3,864	40,766	9,778
Short-term	11,061	938	13,261	2,083
Long-term	24,628	2,926	27,505	7,694
Gross External Debt	121,135	83,453	95,938	57,435
as a percentage of GDP	635	438	531	318

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

Cyprus: Balance of Payments, 2008-13
(Percent of GDP)

	Average 2008-12		2013	
	BPM6	BPM5	BPM6	BPM5
Current Account Balance	-8.7	-8.5	-4.5	-1.6
Trade Balance (Goods and Services)	-5.8	-5.6	1.1	1.7
Goods Balance	-22.7	-23.8	-16.3	-16.3
Exports	14.1	6.5	15.0	8.3
Imports	36.8	30.3	31.3	24.6
Services Balance	16.9	18.3	17.4	18.0
Exports	37.0	32.3	43.2	31.8
Imports	20.1	14.0	25.9	13.8
Primary Income	-1.9	-1.9	-3.5	-2.5
Financial Account	-8.0	-8.3	25.8	24.1
Direct Investment	5.0	-2.9	6.7	-0.9
Portfolio Investment	10.4	22.6	-70.8	-65.0
Other Investment	-23.7	-28.7	90.3	89.7

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

The CBC published in October 2015 revised balance of payments (BoP), international investment position (IIP), and external debt statistics data for the period 2008–13. The revisions reflect the adoption of the methodology of the sixth edition of the Balance of Payments and International Investment Position Manual of the IMF (BPM6), recommendations of an EU special task force handling specific methodological issues, and improved data coverage due to new data sources. The revised external statistics are now consistent with the national accounts data, published by the Statistical Service of Cyprus according to the methodology of the European System of National and Regional Accounts 2010 (ESA 2010).

The main change in external accounts is due to the inclusion of ship-owning and financial Special Purpose Entities (SPEs) registered in Cyprus, which have been reclassified as residents according to the BPM6 methodology. This reclassification has a large negative impact on Cyprus' external debt, reflecting substantial external liabilities of the ship-owning and financial SPEs—more than a quarter of external debt (about 150 percent of GDP). The large deterioration of Cyprus' *net* external position (IIP) is due mainly to the ship-owning SPEs, which have large external financial liabilities (mostly equity and loans), but no external financial assets (although they have large real assets in the form of ships).

The SPE reclassification has also a significant impact on most BoP accounts, in particular imports and exports of goods, reflecting periodic registration and de-registration of ships; imports and exports of services, reflecting services provided to and by ship-owning and financial SPEs; and the primary income and financial accounts, reflecting investment income and capital flows related to SPEs. Overall though, the historical current account balance for the most part did not change significantly.

Box 4. The New Law on the Sale of Loans

The new Law "On the Sale of Credit Facilities and Other Related Issues" ("Law") adopted by Parliament on November 12, 2015 has the following key features described below.

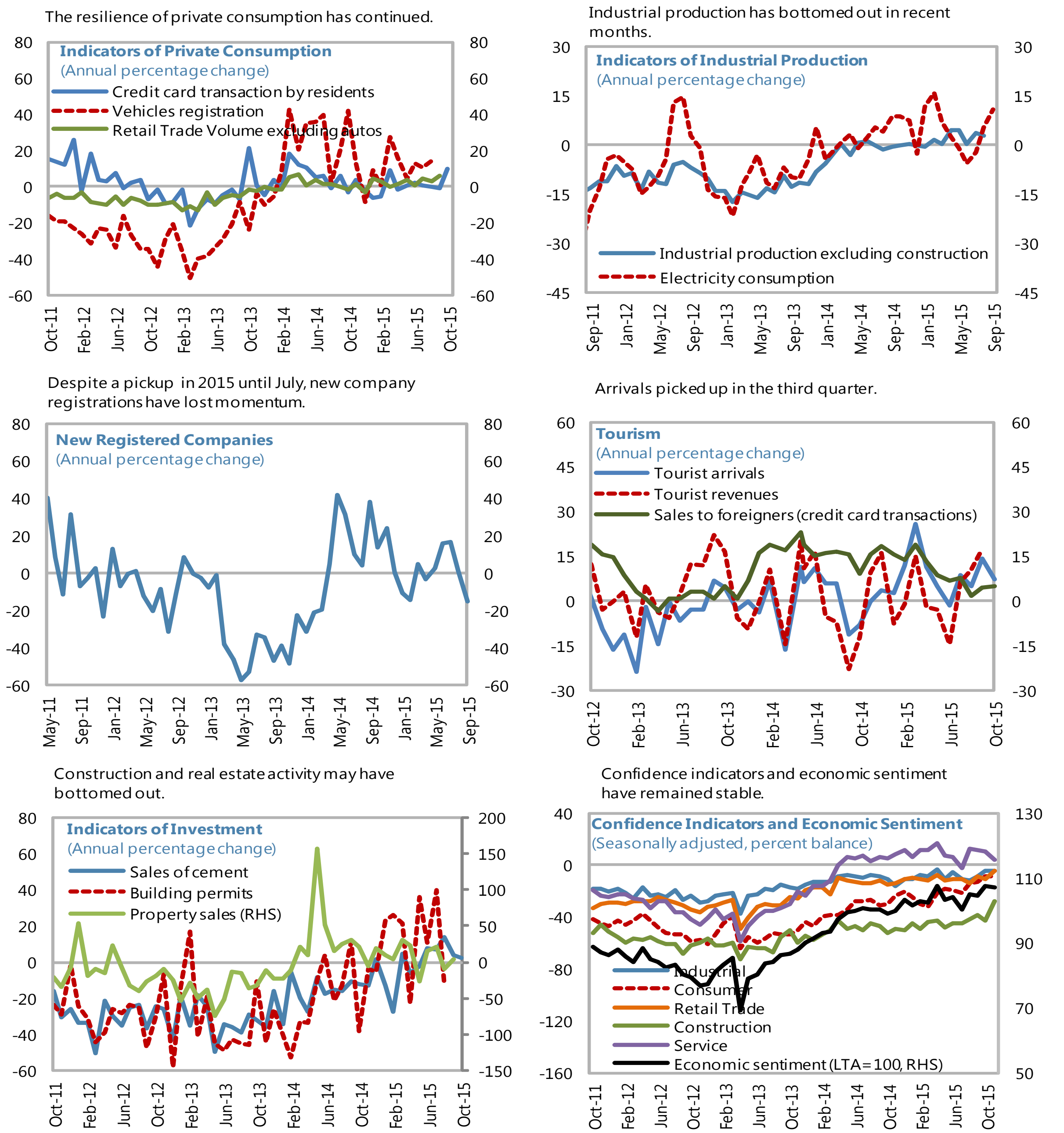
1. Scope: The Law applies to loans to individuals and micro- and small SMEs not exceeding €1 million. Specifically exempt from the scope of the law are loans to non-residents, loans to finance operations and/or investments outside Cyprus, loans secured by property located outside of Cyprus, and loans governed by foreign law. However, the provisions concerning notification of the borrower by the original creditor and the acquiring party (see 3 below) also apply to loans in excess of €1 million ("big loans").

2. Licensing and regulation of loan acquiring companies: Loans of less than €1 million mentioned in 1 can be sold to: (i) Cypriot authorized credit institutions, (ii) subsidiaries or branches of credit institutions authorized by the EU that operate in Cyprus, or (iii) non-bank "credit acquiring companies". Further re-sale is allowed to any of the above mentioned institutions, or to other persons with the prior written approval of the CBC. A non-bank company wishing to buy loans should be incorporated in Cyprus and obtain a license from the CBC. The licensing conditions include a minimum capital requirement (€100,000), "fit and proper" requirements for shareholders and directors, and an assessment that the company can provide proper services and that its operations plan does not pose risks to financial stability in Cyprus. The CBC is required to supervise on an ongoing basis the company's management, the books and records, and financial reporting. In addition, all credit institutions should report to the CBC semi-annually on their sale of loans activities. Violations of the Law are subject to administrative and criminal liability.

3. Other Conditions: In addition to the conditions mentioned in 2 above, the sale of loans covered by the law is also subject to several conditions: *First*, prior to the sale of all or part of the loan portfolio, the credit institution should notify its intention to sell either (i) through a publication in the Official Gazette and in three daily newspapers, or (ii) by a letter to the borrower and its guarantors. In both cases the borrower and the guarantors may (but are not required to) submit, within 45 days, a proposal to purchase the loan. Such a proposal is not binding on the creditor. *Second,* the acquirer should notify the borrower within five days of the acquisition and provide new contact and payment information. In the case of small loans, borrowers retain the protections under the Code of Conduct.

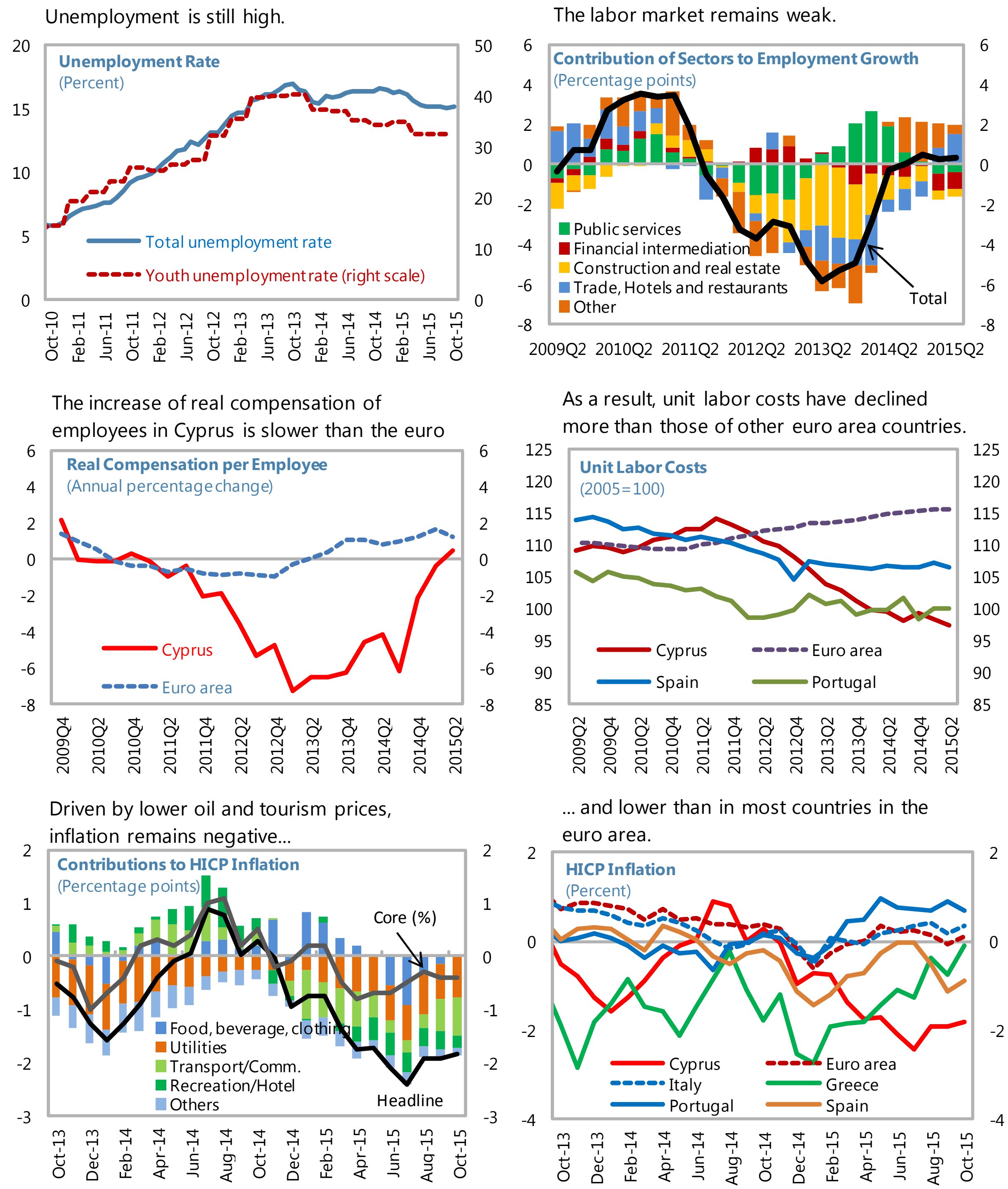
While the Law now allows loans to be sold, it remains to be seen whether it will be used actively to facilitate the clean-up of banks' balance sheets. So far, banks indicated publicly that they do not foresee selling mortgage loans related to primary residences. In addition, in the case of small loans, the discount needed to attract potential buyers may make sales unappealing for banks. It is therefore expected that the law would be applied more frequently in the case of big loans, and to buyers with demonstrated expertise in recovering value. Nonetheless, some of the provisions of the Law could reduce the attractiveness of loan purchases due to concerns about legal and compliance risks.

Figure 1. Cyprus: High Frequency Indicators



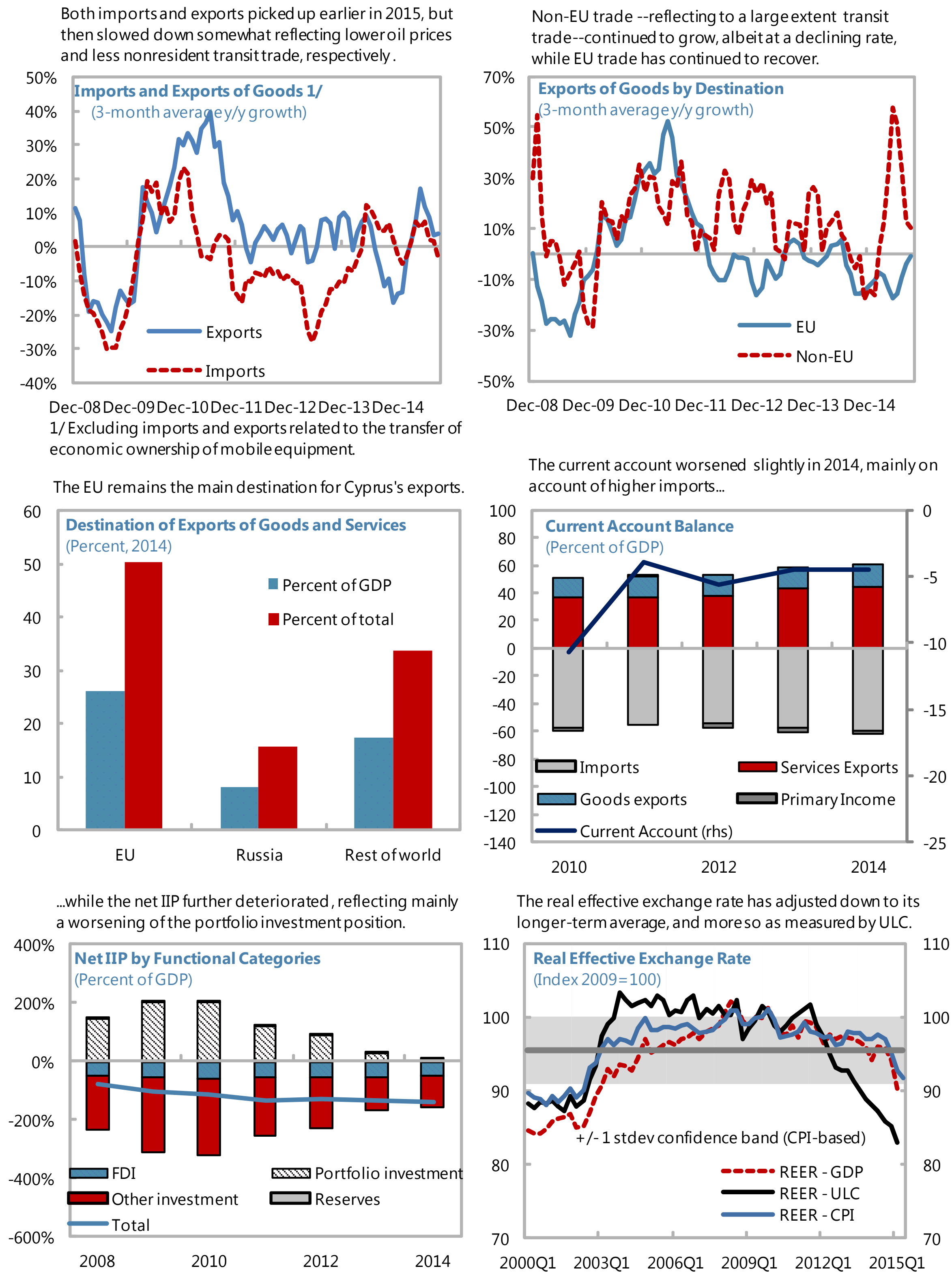
Sources: Cystat; Eurostat; MoF; and IMF staff estimates.

Figure 2. Cyprus: Employment and Inflation Developments



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

Figure 3. Cyprus: External Indicators

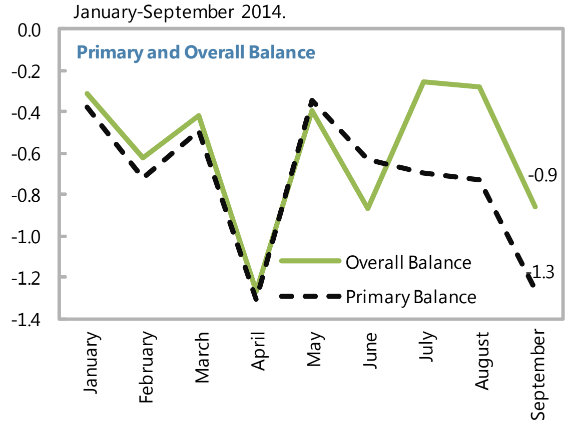


Sources: Eurostat; Haver; Central Bank of Cyprus; and IMF staff estimates.

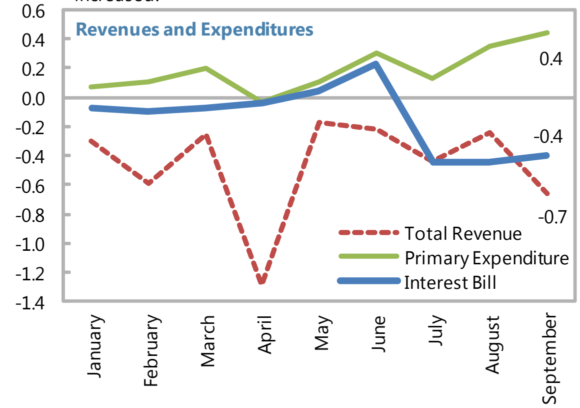
Figure 4. Cyprus: Fiscal Developments in 2015 1/

(Cumulative percent of GDP difference relative to previous year)

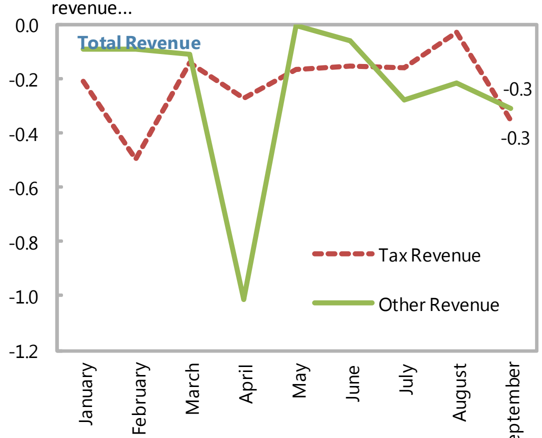
The primary balance is lower compared to the period January-September 2014.



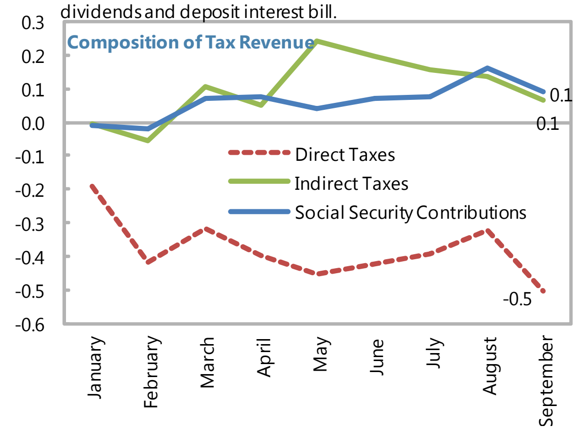
...as total revenue has declined and primary expenditure increased.



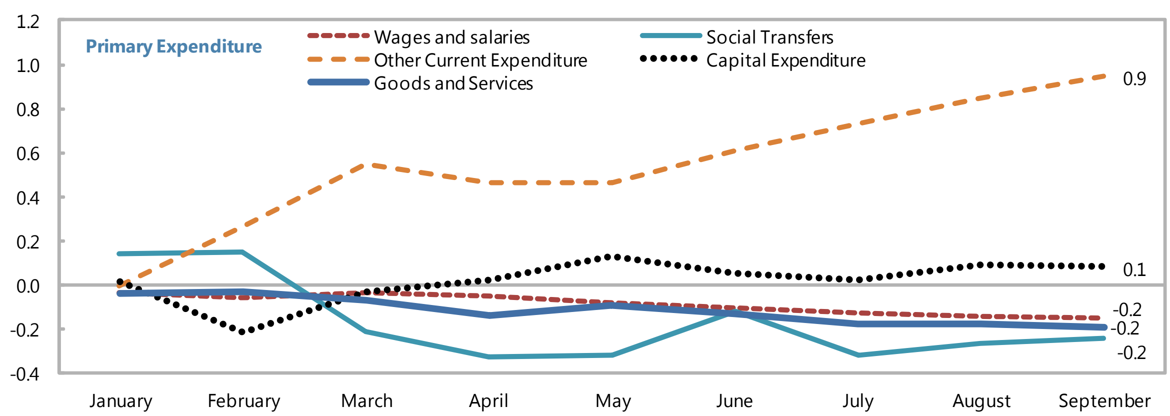
The decline in total revenue reflects lower tax and other revenue...



...while tax revenue composition is shifting, reflecting improving consumption and employment and declining dividends and deposit interest bill.



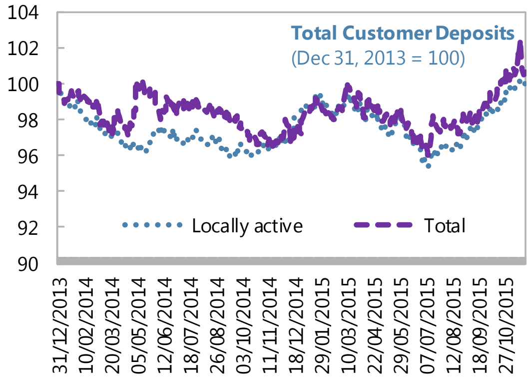
The increase in primary spending reflects the payment of most of the remaining compensation to pension funds for bank restructuring and other one-offs (other current expenditure) offset by lower outlays in goods and services, wages and salaries, and social transfers. The latter reflects falling unemployment and redundancy benefits consistent with a stabilization in the labor market .



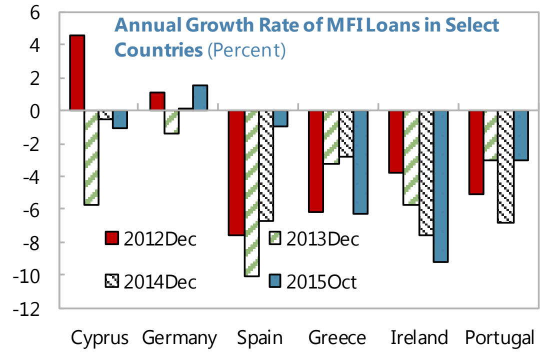
Sources: Ministry of Finance; and IMF staff estimates.
1/ ESA 2010, cash basis data.

Figure 5. Cyprus: Banking Sector Developments

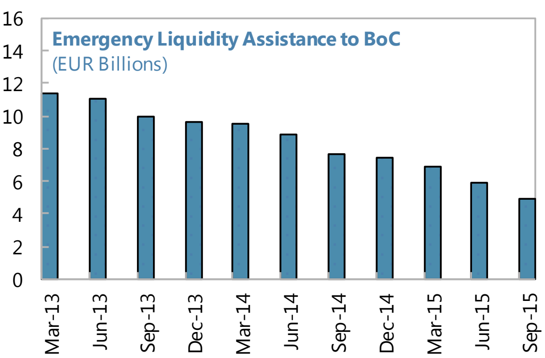
Total deposits started to increase in the last quarter of 2015.



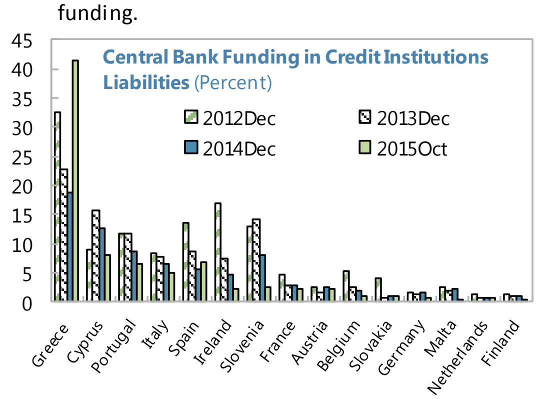
In 2014-15, the credit contraction in Cyprus was less than that experienced by its peers.



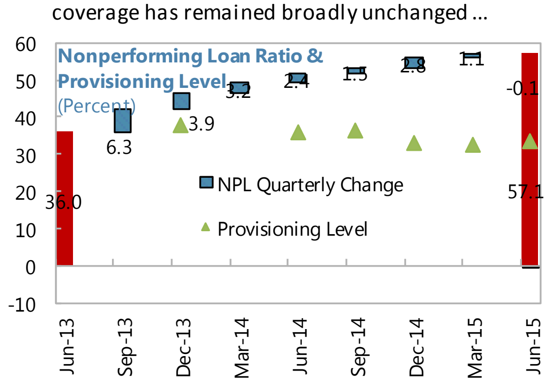
ELA funding in BoC has declined considerably ...



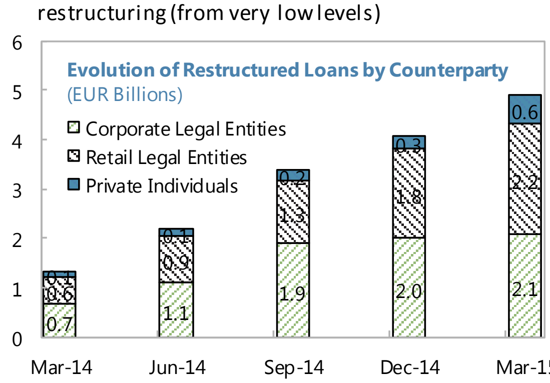
...reducing dependence on central bank funding.



Growth of NPLs is slowing down and provision coverage has remained broadly unchanged ...



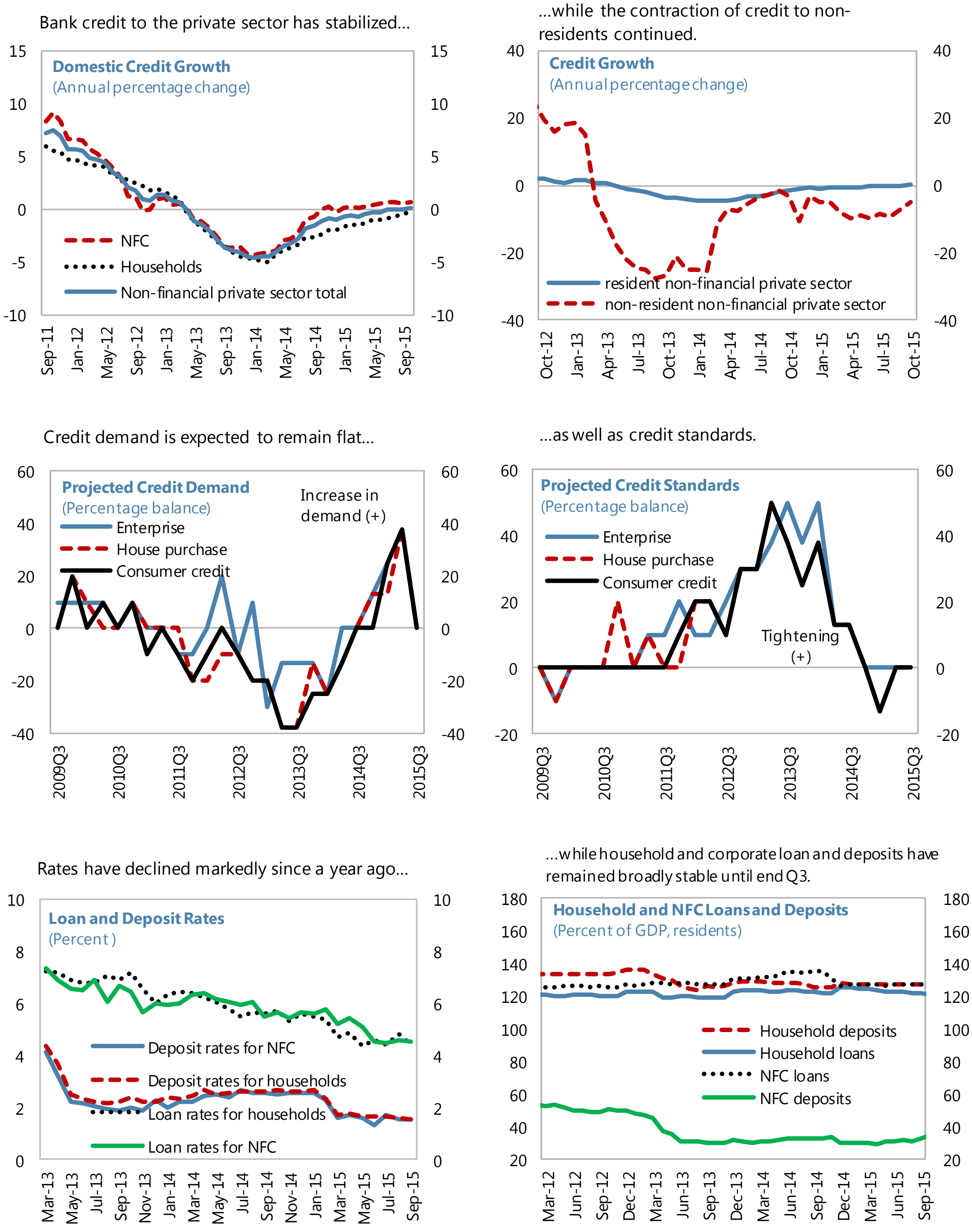
...accompanied by a pick up in the rate of restructuring (from very low levels)



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.

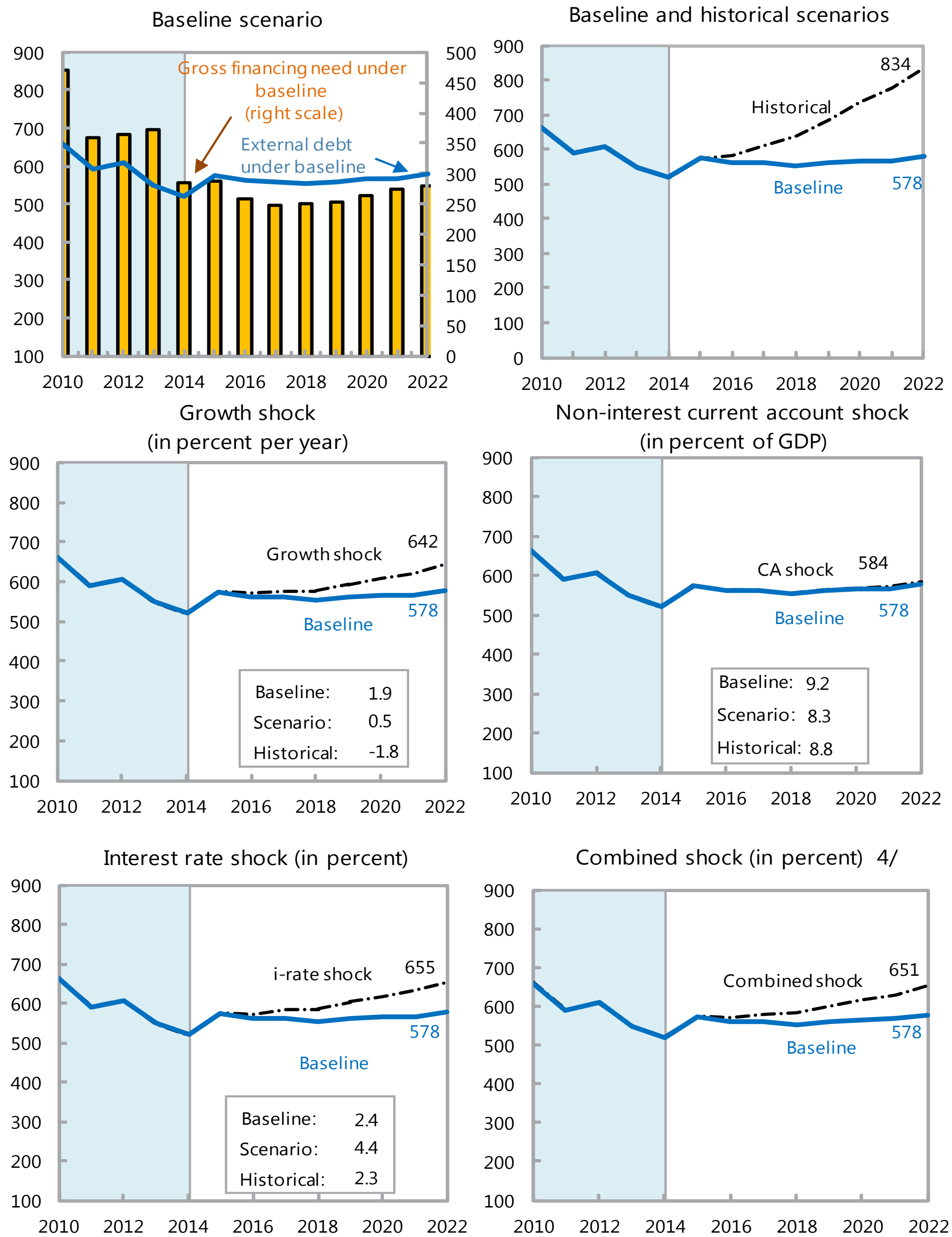
Figure 6. Cyprus: Credit Developments



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

Figure 7. Cyprus: External Debt Sustainability – Bound Tests 1/ 2/ 3/

(Percent of GDP)



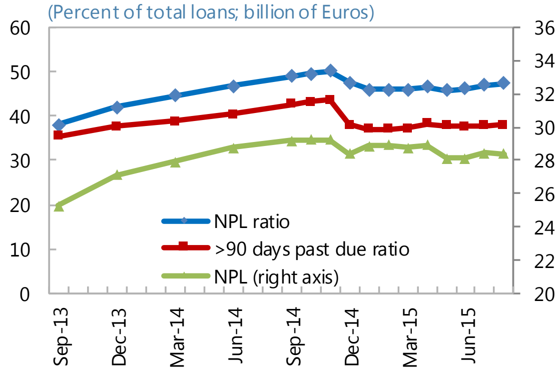
Sources: Ministry of Finance; CBC; and Fund staff estimates.

1/ External statistics were revised in line with the BPM6 methodology.
2/ 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.
3/ 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.
4/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

Figure 8. Cyprus: Non-Performing Loans

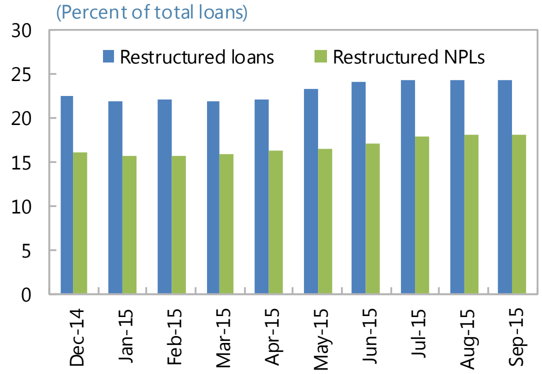
NPLs remain at very high levels,

Nonperforming Loans in Banks
(Percent of total loans; billion of Euros)



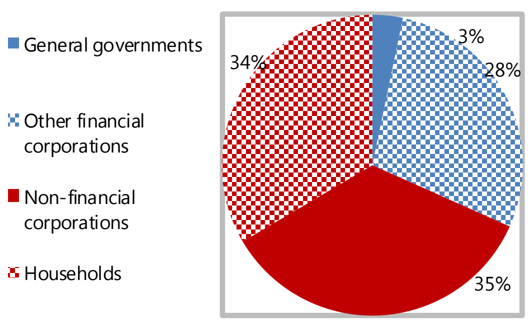
but the pace of restructuring has picked up since 2015:Q2.

Restructured Loans
(Percent of total loans)



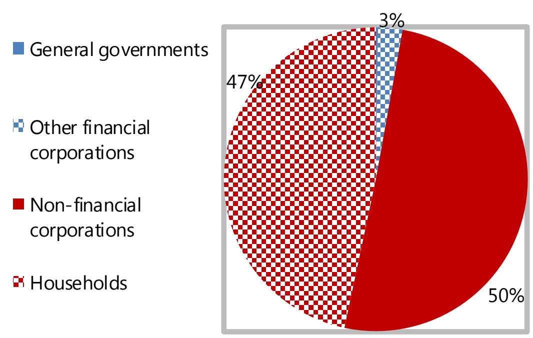
Performing loans are about evenly distributed across households, and financial and non-financial corporations,

Composition of Performing Loans by Sector
(Percent of total loans, September 2015)



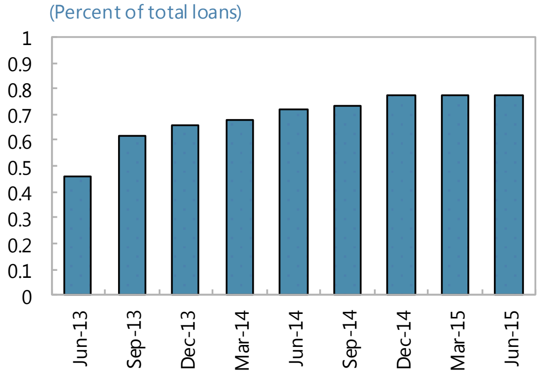
while the majority of non-performing loans are due to non-financial corporations and households.

Composition of Non-Performing Loans by Sector
(Percent of total loans, September 2015)



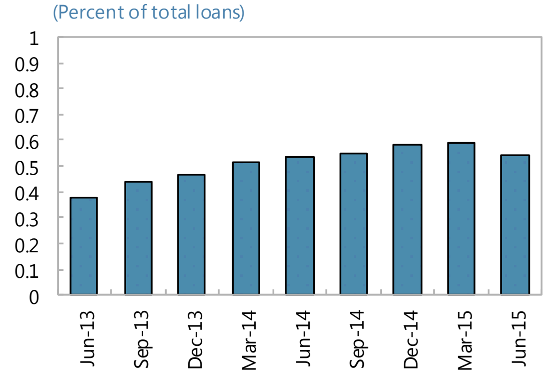
NPL ratio in the construction sector is extremely high but has stablized.

NPL Ratio in the Construction Sector
(Percent of total loans)



NPL ratio in the real estate sector decreased mildly in 2015:Q2.

NPL Ratio in the Real Estate Sector
(Percent of total loans)



Source: Central Bank of Cyprus, and IMF staff estimates.
Notes: All data are consolidated accounts of all banks. At end-2014 the CBC changed its definition of NPLs to be consistent with the European Banking Authority's definition.

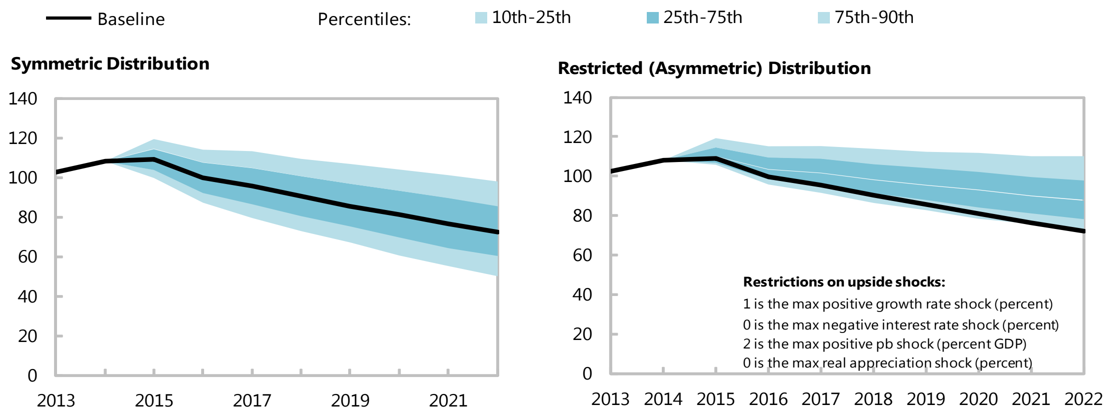
Figure 9. Cyprus: Public Debt Sustainability Analysis – Risk Assessment

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

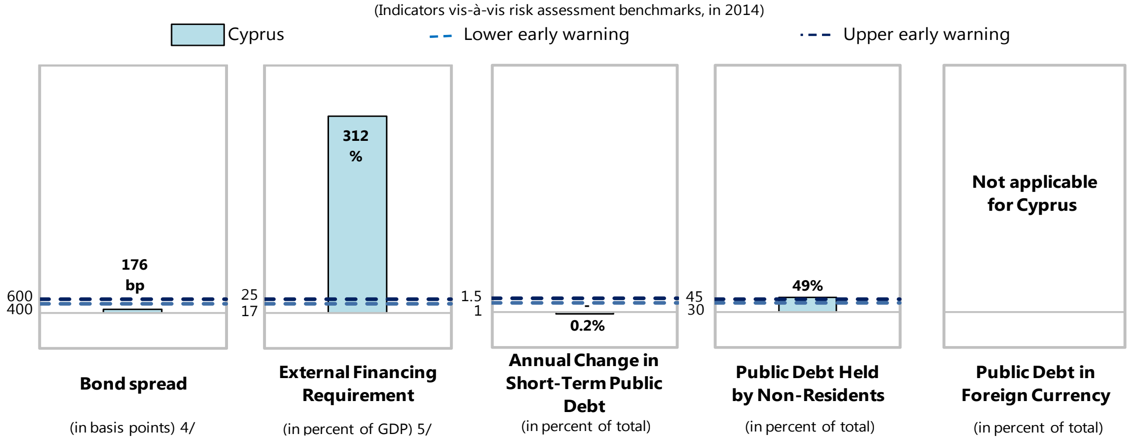
Evolution of Predictive Densities of Gross Nominal Public Debt

(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.

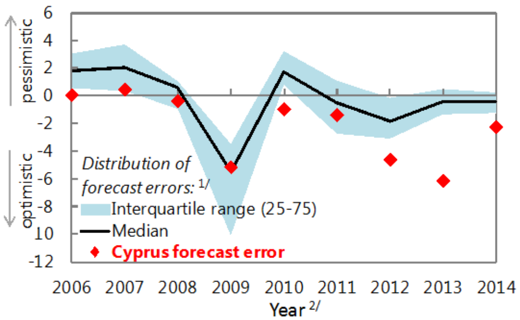
4/ Long-term bond spread over German bonds, an average over the last 3 months, 04-Oct-15 through 05-Jan-16.

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.

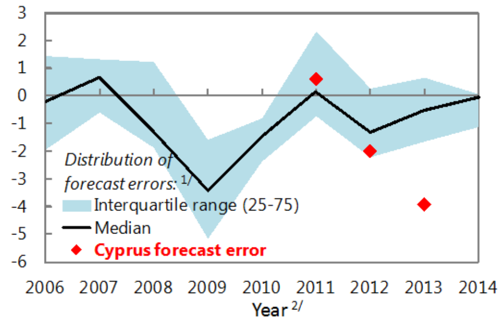
Figure 10. Public Debt Sustainability Analysis – Realism of Baseline Assumptions

Forecast Track Record, versus program countries

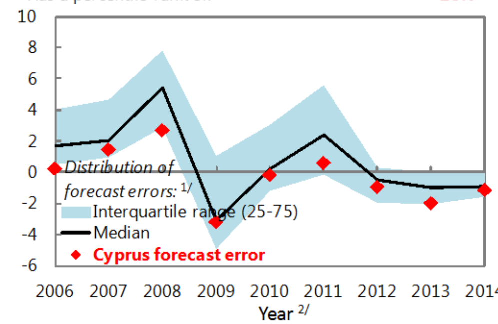
Real GDP Growth
(in percent, actual-projection)
Cyprus median forecast error, 2006-2014: **-1.39**
Has a percentile rank of: **14%**



Primary Balance
(in percent of GDP, actual-projection)
Cyprus median forecast error, 2006-2014: **-2.00**
Has a percentile rank of: **16%**

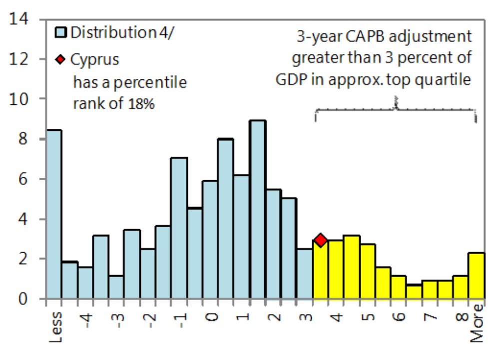


Inflation (Deflator)
(in percent, actual-projection)
Cyprus median forecast error, 2006-2014: **-0.18**
Has a percentile rank of: **28%**

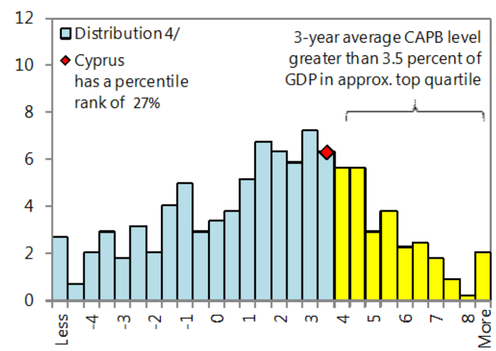


Assessing the Realism of Projected Fiscal Adjustment

3-Year Adjustment in Cyclically-Adjusted Primary Balance (CAPB)
(Percent of GDP)

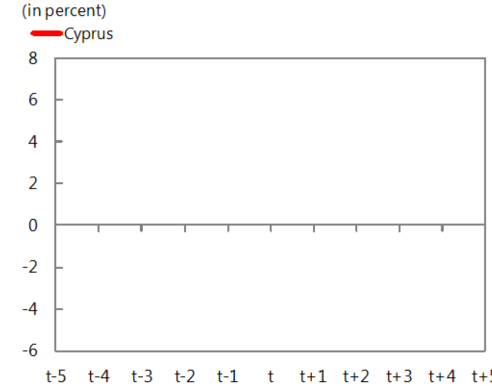


3-Year Average Level of Cyclically-Adjusted Primary Balance (CAPB)
(Percent of GDP)



Boom-Bust Analysis 3/

Real GDP growth
(in percent)



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.The boom-bust analysis tool is triggered automatically when the output gap has been positive for at least 3 years in the last 4 years of history, or the 3-year cumulative change in credit-to-GDP ratio exceeds 30 percent for advanced economies. Neither of these conditions are met 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 11. Cyprus: Public Debt Sustainability Analysis – Baseline Scenario

(In percent of GDP unless otherwise indicated)

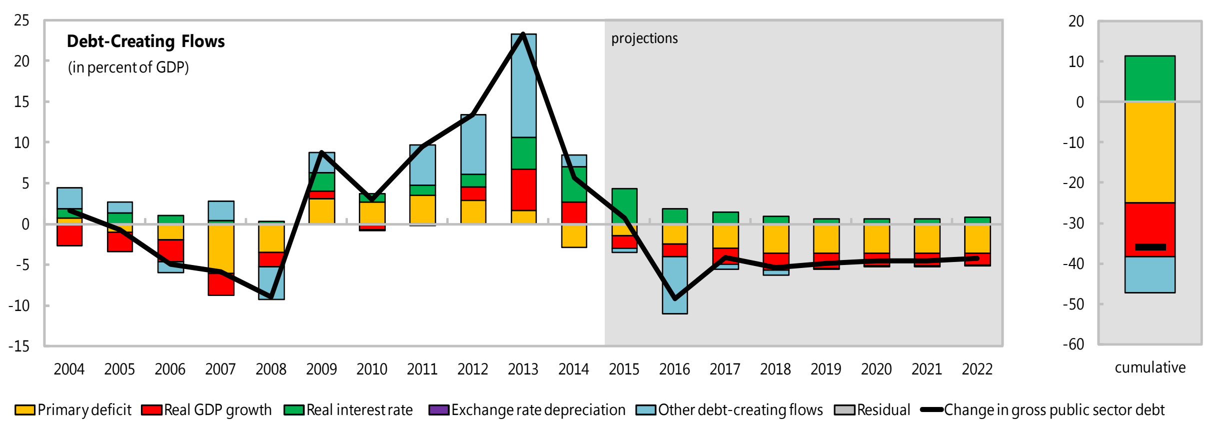
Debt, Economic and Market Indicators [1/]

	Actual			Projections							
	2004-2012 [2/]	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Nominal gross public debt	60.2	102.5	108.2	109.0	99.8	95.7	90.4	85.6	81.1	76.6	72.3
Public gross financing needs	12.4	17.5	16.1	13.0	6.4	3.8	5.1	11.4	9.7	6.3	6.5
Real GDP growth (in percent)	2.1	-5.9	-2.5	1.4	1.5	2.0	2.2	2.1	1.8	2.0	2.0
Inflation (GDP deflator, in percent)	2.7	-1.4	-1.2	-1.2	0.7	0.8	1.3	1.7	1.7	1.7	1.5
Nominal GDP growth (in percent)	4.9	-7.2	-3.7	0.1	2.2	2.8	3.6	3.8	3.6	3.7	3.5
Effective interest rate (in percent) [4/]	4.9	3.3	2.9	2.7	2.4	2.3	2.4	2.5	2.5	2.6	2.7

As of January 05, 2016		
Sovereign Spreads		
EMBIG (bp) 3/		193
5Y CDS (bp)		250
Ratings	Foreign	Local
Moody's	B3	B3
S&Ps	BB-	BB-
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
Change in gross public sector debt	1.8	23.3	5.7	0.8	-9.2	-4.1	-5.3	-4.8	-4.5	-4.5	-4.3	-27.1	primary
Identified debt-creating flows	1.8	23.3	5.7	0.8	-9.2	-4.1	-5.3	-4.8	-4.5	-4.5	-4.3	-27.1	balance [9/]
Primary deficit	0.0	1.6	-2.8	-1.5	-2.5	-3.0	-3.6	-3.6	-3.6	-3.6	-3.6	-17.8	-0.7
Primary (noninterest) revenue and grants	37.8	37.7	40.3	39.5	38.8	38.5	38.6	38.5	38.4	38.4	38.4	232.3	
Primary (noninterest) expenditure	37.9	39.3	37.5	38.1	36.3	35.5	34.9	34.9	34.8	34.8	34.8	214.5	
Automatic debt dynamics [5/]	0.0	8.9	7.0	2.8	0.2	-0.5	-1.1	-1.2	-0.8	-0.9	-0.6	-0.6	
Interest rate/growth differential [6/]	0.0	8.9	7.0	2.8	0.2	-0.5	-1.1	-1.2	-0.8	-0.9	-0.6	-0.6	
Of which: real interest rate	1.1	3.9	4.4	4.3	1.8	1.4	0.9	0.7	0.7	0.7	0.9	9.8	
Of which: real GDP growth	-1.2	5.1	2.7	-1.5	-1.6	-2.0	-2.1	-1.9	-1.5	-1.5	-1.5	-10.4	
Exchange rate depreciation [7/]	0.0	0.0	0.0	...	...	...	...	...	...	...	...	...	
Other identified debt-creating flows	1.8	12.7	1.5	-0.6	-6.9	-0.6	-0.6	0.0	0.0	0.0	0.0	-8.7	
Net privatization/asset sales proceeds (negative)	0.0	0.0	0.0	0.0	-4.5	-0.5	-0.5	0.0	0.0	0.0	0.0	-5.6	
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	12.7	1.5	-0.6	-2.4	0.0	0.0	0.0	0.0	0.0	0.0	-3.2	
Residual, including asset changes [8/]	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	



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.

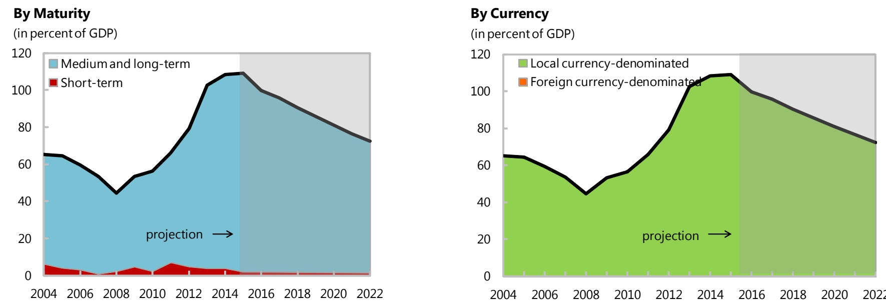
7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

8/ For projections, includes exchange rate changes during the projection period. In 2016, the residual refects primarily the Euro 0.6 billion asset swap and a debt buy back with privatization receipts.

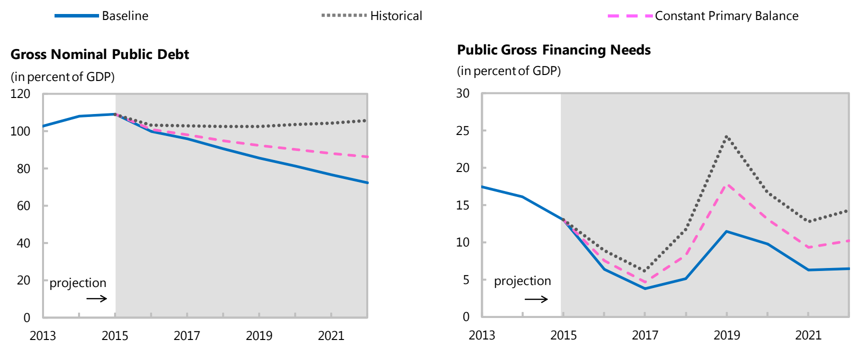
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Figure 12. Cyprus: Public Debt Sustainability Analysis – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt



Alternative Scenarios



Underlying Assumptions
(Percent)

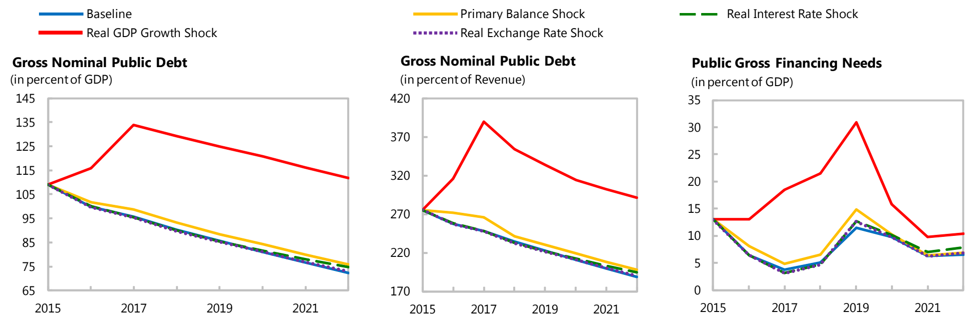
Baseline Scenario	2015	2016	2017	2018	2019	2020	2021	2022
Real GDP growth	1.4	1.5	2.0	2.2	2.1	1.8	2.0	2.0
Inflation 1/	-1.2	0.7	0.8	1.3	1.7	1.7	1.7	1.5
Primary Balance	1.5	2.5	3.0	3.6	3.6	3.6	3.6	3.6
Effective interest rate	2.7	2.4	2.3	2.4	2.5	2.5	2.6	2.7
Constant Primary Balance Scenario								
Real GDP growth	1.4	1.5	2.0	2.2	2.1	1.8	2.0	2.0
Inflation 1/	-1.2	0.7	0.8	1.3	1.7	1.7	1.7	1.5
Primary Balance	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5
Effective interest rate	2.7	2.5	1.7	1.8	1.8	2.3	2.4	2.4

Historical Scenario	2015	2016	2017	2018	2019	2020	2021	2022
Real GDP growth	1.4	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Inflation 1/	-1.2	0.7	0.8	1.3	1.7	1.7	1.7	1.5
Primary Balance	1.5	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Effective interest rate	2.7	2.5	1.7	1.8	1.9	2.6	2.8	2.9

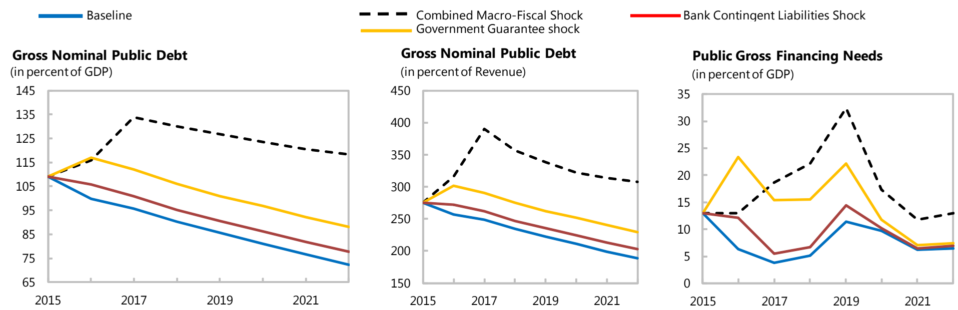
Source: IMF staff estimates.
1/ GDP deflator growth.

Figure 13. Cyprus: Public Debt Sustainability Analysis – Stress Test 1/

Macro-Fiscal Stress Tests



Additional Stress Tests



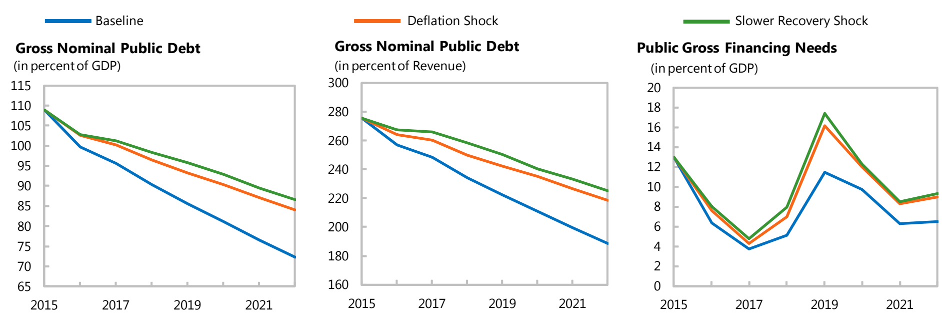
Underlying Assumptions

(Percent)

Primary Balance Shock	2015	2016	2017	2018	2019	2020	2021	2022
Real GDP growth	1.4	1.5	2.0	2.2	2.1	1.8	2.0	2.0
Inflation	-1.2	0.7	0.8	1.3	1.7	1.7	1.7	1.5
Primary balance	1.5	0.8	1.3	3.6	3.6	3.6	3.6	3.6
Effective interest rate	2.7	2.5	1.7	1.8	1.8	2.2	2.3	2.2
Real Interest Rate Shock								
Real GDP growth	1.4	1.5	2.0	2.2	2.1	1.8	2.0	2.0
Inflation	-1.2	0.7	0.8	1.3	1.7	1.7	1.7	1.5
Primary balance	1.5	2.5	3.0	3.6	3.6	3.6	3.6	3.6
Effective interest rate	2.7	2.5	1.7	1.8	1.9	2.7	3.1	3.3
Combined Shock								
Real GDP growth	1.4	-5.9	-5.4	2.2	2.1	1.8	2.0	2.0
Inflation	-1.2	-1.2	-1.0	1.3	1.7	1.7	1.7	1.5
Primary balance	1.5	-3.2	-8.5	1.6	2.6	3.6	3.6	3.6
Effective interest rate	2.7	2.5	1.8	2.1	2.3	3.3	3.8	4.0
Bank Contingent Liabilities Shock								
Real GDP growth	1.4	1.5	2.0	2.2	2.1	1.8	2.0	2.0
Inflation	-1.2	0.7	0.8	1.3	1.7	1.7	1.7	1.5
Primary balance	1.5	-3.1	3.0	3.6	3.6	3.6	3.6	3.6
Effective interest rate	2.7	2.5	1.6	1.7	1.8	2.2	2.2	2.2

Real GDP Growth Shock	2015	2016	2017	2018	2019	2020	2021	2022
Real GDP growth	1.4	-5.9	-5.4	2.2	2.1	1.8	2.0	2.0
Inflation	-1.2	-1.2	-1.0	1.3	1.7	1.7	1.7	1.5
Primary balance	1.5	-3.2	-8.5	1.6	2.6	3.6	3.6	3.6
Effective interest rate	2.7	2.5	1.6	1.7	1.7	2.3	2.4	2.4
Real Exchange Rate Shock								
Real GDP growth	1.4	1.5	2.0	2.2	2.1	1.8	2.0	2.0
Inflation	-1.2	1.0	0.8	1.3	1.7	1.7	1.7	1.5
Primary balance	1.5	2.5	3.0	3.6	3.6	3.6	3.6	3.6
Effective interest rate	2.7	2.5	1.7	1.8	1.9	2.2	2.3	2.2
Government Guarantee shock								
Real GDP growth	1.4	1.5	2.0	2.2	2.1	1.8	2.0	2.0
Inflation	-1.2	0.7	0.8	1.3	1.7	1.7	1.7	1.5
Primary balance	1.5	-14.5	3.0	3.6	3.6	3.6	3.6	3.6
Effective interest rate	2.7	2.4	1.6	1.6	1.7	2.3	2.4	2.3

Additional Stress Tests



Underlying Assumptions

(Percent)

	2015	2016	2017	2018	2019	2020	2021	2022
Deflation Shock								
Real GDP growth	1.4	1.5	2.0	2.2	2.1	1.8	2.0	2.0
Inflation	-1.2	-0.7	-0.5	0.4	1.2	1.4	1.6	1.5
Primary balance	1.5	1.5	2.0	2.6	2.6	2.6	2.6	2.6
Effective interest rate	2.7	2.5	1.7	1.8	1.8	2.2	2.3	2.3

	2015	2016	2017	2018	2019	2020	2021	2022
Slower Recovery Shock								
Real GDP growth	1.4	0.5	0.8	1.0	1.2	1.5	2.0	2.0
Inflation	-1.2	0.4	0.5	1.0	1.4	1.6	1.7	1.5
Primary balance	1.5	1.1	1.5	2.2	2.4	2.8	2.6	2.6
Effective interest rate	2.7	2.5	1.7	1.8	1.8	2.3	2.4	2.4

Source: IMF staff estimates.

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

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
						Projections					
Real Economy	(Percent change, unless otherwise indicated)										
Real GDP	1.4	0.4	-2.4	-5.9	-2.5	1.4	1.5	2.0	2.2	2.1	1.8
Domestic demand	2.5	-3.4	-4.3	-8.5	-1.1	0.9	1.2	1.5	1.7	1.6	1.3
Consumption	1.6	0.7	-1.4	-5.5	-1.5	0.7	0.9	1.1	1.3	1.2	0.9
Private consumption	2.6	0.5	-0.8	-5.9	0.6	1.4	1.3	1.4	1.5	1.2	1.0
Public consumption	-2.1	1.3	-3.7	-4.1	-9.0	-2.1	-0.9	0.2	0.5	0.9	0.9
Fixed investment	-5.1	-9.3	-20.5	-15.2	-18.0	2.2	3.6	4.0	4.5	4.2	3.6
Inventory accumulation 1/	2.6	-2.1	0.9	-1.5	2.9	0.0	0.0	0.0	0.0	0.0	0.0
Foreign balance 1/	-1.3	4.0	1.9	2.7	-1.5	0.5	0.3	0.5	0.5	0.6	0.6
Exports of goods and services	4.3	4.1	-1.1	1.8	-0.5	1.5	1.6	2.7	3.3	3.2	3.1
Imports of goods and services	6.2	-3.1	-4.4	-3.0	2.0	0.7	1.2	1.9	2.4	2.3	2.2
Potential GDP growth	1.7	1.7	-1.6	-5.9	-2.4	0.8	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	-1.6	0.6	1.3	1.5	1.8	1.9
HICP (end of period)	1.9	4.2	1.5	-1.3	-1.0	-1.6	0.6	1.3	1.5	1.8	1.9
Unemployment rate (EU standard, percent)	6.3	7.9	11.9	15.9	16.1	15.5	14.5	13.2	11.9	10.6	9.6
Employment growth (percent)	1.4	-1.5	-2.4	-6.1	-0.1	0.3	0.6	1.2	1.5	1.5	1.2
Public Finance	(Percent of GDP)										
General government balance	-4.8	-5.7	-5.8	-4.4	-0.2	-1.5	0.0	0.8	1.5	1.5	1.5
Revenue	37.6	36.9	36.2	37.7	40.3	39.5	38.8	38.5	38.6	38.5	38.4
Expenditure	42.4	42.6	42.0	42.1	40.5	41.1	38.8	37.8	37.1	37.0	36.9
Primary Fiscal Balance	-2.7	-3.5	-2.9	-1.6	2.8	1.5	2.5	3.0	3.6	3.6	3.6
General government debt	56.3	65.8	79.3	102.5	108.2	109.0	99.8	95.7	90.4	85.6	81.1
Balance of Payments 2/	(Percent of GDP)										
Current account balance	-10.7	-4.0	-5.6	-4.5	-4.6	-4.7	-4.4	-3.8	-3.7	-3.7	-3.7
Trade Balance (goods and services)	-6.6	-3.1	-1.1	1.1	0.7	1.5	2.0	1.9	2.1	2.4	2.8
Exports of goods and services	50.4	52.3	53.0	58.2	60.0	59.4	59.3	60.1	60.7	61.3	62.0
Imports of goods and services	57.1	55.4	54.1	57.2	59.3	57.9	57.4	58.2	58.6	58.8	59.2
Goods balance	-23.1	-20.3	-18.0	-16.3	-16.2	-14.4	-13.7	-13.9	-13.9	-13.9	-13.9
Services balance	16.5	17.2	16.9	17.4	16.9	15.9	15.6	15.8	16.0	16.3	16.7
Primary income, net	-3.0	0.3	-3.1	-3.5	-2.8	-3.9	-4.0	-3.3	-3.4	-3.8	-4.1
Secondary income, net	-1.0	-1.1	-1.4	-2.1	-2.4	-2.4	-2.4	-2.4	-2.4	-2.4	-2.4
Capital account, net	0.3	0.4	0.2	1.4	0.8	0.8	0.8	0.8	0.8	0.7	0.7
Financial account, net	-9.2	-0.7	-2.9	25.8	2.7	1.9	0.0	-3.0	-3.2	-3.5	-3.8
Direct investment	-5.5	15.9	14.1	6.7	4.1	-0.7	-6.2	-1.3	-3.5	-4.0	-4.0
Portfolio investment	29.1	-67.3	-32.0	-70.8	-18.4	-14.4	1.2	-4.7	-6.3	-13.1	-9.7
Other investment and financial derivatives	-31.5	50.7	15.3	90.2	17.0	17.0	4.9	3.0	6.7	13.6	9.8
Reserves (+ inflow; - outflow)	-1.2	0.0	-0.2	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Program financing	0.0	0.0	0.0	26.8	7.3	5.8	3.5	0.0	-0.3	-0.5	-0.9
European Union	0.0	0.0	0.0	25.4	6.3	3.4	2.1	0.0	0.0	0.0	0.0
IMF	0.0	0.0	0.0	1.4	1.0	2.3	1.4	0.0	-0.3	-0.5	-0.9
Errors and omissions	1.2	2.8	2.6	2.2	-0.9	0.0	0.0	0.0	0.0	0.0	0.0
Savings-Investment Balance											
National saving	13.1	15.0	10.4	8.7	8.6	8.3	8.9	9.8	10.3	10.5	10.8
Government	0.8	-1.1	-2.0	-1.5	2.7	1.9	3.0	3.9	4.5	4.6	4.6
Non-government	12.4	16.1	12.3	10.1	5.9	6.4	5.9	6.0	5.7	5.9	6.1
Gross capital formation	23.8	18.9	16.0	13.1	13.1	13.1	13.3	13.6	13.9	14.2	14.5
Government	5.5	5.5	5.8	6.5	5.4	6.6	5.4	5.1	4.9	4.9	4.8
Private	18.4	13.4	10.2	6.6	7.8	6.5	7.9	8.5	9.0	9.3	9.7
Foreign saving	-10.7	-4.0	-5.6	-4.5	-4.6	-4.7	-4.4	-3.8	-3.7	-3.7	-3.7
Memorandum Item:											
Nominal GDP (billions of euros)	19.1	19.5	19.5	18.1	17.4	17.4	17.8	18.3	19.0	19.7	20.4

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

1/ Contribution to growth.

2/ External statistics were revised in line with the BPM6 methodology.

Table 2. Cyprus: Fiscal Developments and Projections, 2010–20 1/

(Percent of GDP)

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
						Projections					
Revenue	37.6	36.9	36.2	37.7	40.3	39.5	38.8	38.5	38.6	38.5	38.4
Current revenue	37.5	36.8	36.1	37.7	40.3	39.5	38.8	38.5	38.5	38.4	38.4
Tax revenue	24.4	24.4	23.9	24.2	25.0	24.5	24.1	24.3	24.4	24.5	24.5
Indirect taxes	14.5	13.9	14.0	13.8	14.8	14.8	14.6	14.8	14.8	14.8	14.9
Direct taxes	9.9	10.6	9.9	10.4	10.2	9.7	9.6	9.5	9.6	9.6	9.6
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	9.1	9.1	9.1	9.2	9.1	9.0
Other current revenue	5.0	4.4	4.4	5.8	6.4	5.9	5.6	5.1	4.9	4.9	4.9
Sales	2.4	2.2	2.5	2.5	2.8	2.9	2.9	2.9	2.9	2.9	2.9
Other	2.6	2.2	2.0	3.3	3.5	3.1	2.7	2.2	2.0	2.0	2.0
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	42.4	42.6	42.0	42.1	40.5	41.1	38.8	37.8	37.1	37.0	36.9
Current expenditure	36.8	38.0	38.1	39.2	37.6	37.6	35.8	34.7	34.0	33.9	33.8
Wages and salaries	14.5	14.7	14.5	14.2	13.2	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	3.5	3.5	3.3	3.2	3.2	3.2
Social Transfers	13.1	13.5	13.4	13.9	14.8	14.6	14.3	13.9	13.6	13.6	13.6
Subsidies	0.3	0.4	0.5	0.5	0.5	0.5	0.4	0.4	0.4	0.4	0.4
Interest payments	2.1	2.2	2.9	2.8	3.1	3.0	2.5	2.2	2.2	2.1	2.1
Other current expenditure	2.5	2.7	2.7	3.6	2.3	3.1	2.3	2.0	1.9	1.9	1.9
Capital expenditure 2/	5.5	4.6	3.8	2.9	2.9	3.4	3.1	3.1	3.1	3.1	3.1
Overall balance 3/	-4.8	-5.7	-5.8	-4.4	-0.2	-1.5	0.0	0.8	1.5	1.5	1.5
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	-4.7	-5.7	-5.8	-4.4	-0.2	-1.5	0.0	0.8	1.5	1.5	1.5
Net financial transactions	-4.7	-5.7	-5.8	-4.4	-0.2	-1.5	0.0	0.8	1.5	1.5	1.5
Net acquisition of financial assets	-0.5	4.9	7.9	13.0	1.9	-0.6	-6.9	-0.5	-0.5	0.0	0.0
Currency and deposits 4/	-1.1	4.3	-3.3	4.3	2.1	-0.6	1.0	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	-4.5	-0.5	-0.5	0.0	0.0
Other assets	0.0	-0.4	0.0	0.0	0.0	0.0	-3.4	0.0	0.0	0.0	0.0
Net incurrence of liabilities	4.3	10.7	13.7	17.4	2.1	0.9	-6.8	-1.3	-2.0	-1.5	-1.5
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	-4.9	-4.2	-7.1	-0.5	2.3	2.8	3.3
Loans	-0.1	3.7	11.5	26.0	6.9	5.1	0.3	-0.8	-4.3	-4.3	-4.8
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	-3.5	-2.9	-1.6	2.8	1.5	2.5	3.0	3.6	3.6	3.6
Public debt	56.3	65.8	79.3	102.5	108.2	109.0	99.8	95.7	90.4	85.6	81.1

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 2015 includes payments of government loan guarantees which are recorded as capital transfers under ESA.

3/ The overall balances in 2014 and 2015 exclude recapitalizations of the cooperative sector of 1.5 and 0.175 billion euros respectively. 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 and the cash drawdown used to recapitalize the cooperative sector in 2014 and 2015 respectively are excluded from these lines consistent with the exclusion of the recapitalization operations of the cooperative sector in the overall and primary balance.

5/ The primary fiscal balances in 2014 and 2015 exclude recapitalizations of the cooperative sector of 1.5 and 0.175 billion euros respectively. The primary fiscal balance in 2016 includes expected dividends of €0.1 billion, to be distributed by the CBC in line with CBC's duties under the Treaties and the Statute.

Table 3. Cyprus: General Government 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**	**3,019.0**	**3,969.3**	**1,928.4**	**783.9**
Government	3,400.3	2,855.6	3,794.3	1,128.4	683.9
Fiscal deficit ("+" = financing need)	828.0	73.9	270.1	6.5	-141.3
Debt maturities	2,572.3	2,781.7	3,524.3	1,121.9	825.2
Medium- and long-term	1,596.2	2,031.4	2799.9	721.9	425.2
Domestic	138.3	1,353.1	1,407.6	445.6	361.1
Foreign	1,457.9	678.3	1,392.2	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	175.0	0.0	0.0
Additional Debt Repayments 2/	0.0	0.0	0.0	800.0	100.0
Market financing	**776.2**	**1,715.9**	**2,679.2**	**580.6**	**683.9**
Government	776.2	1,715.9	2,679.2	580.6	683.9
Fiscal deficit	0.0	0.0	0.0	0.0	0.0
Debt maturities	776.2	1,715.9	2,679.2	580.6	683.9
Medium- and long-term 1/	25.9	991.5	2,279.2	180.6	283.9
Short-term	750.3	724.4	400.0	400.0	400.0
Net financing requirement	**5,063.6**	**1,303.1**	**1,290.2**	**1,347.9**	**100.0**
Government	2,624.2	1,139.7	1,115.2	547.9	0.0
Fiscal deficit	828.0	73.9	270.1	6.5	-141.3
Debt maturities	1,796.1	1,065.8	845.1	541.3	141.3
Medium- and long-term	1,570.4	1,039.9	520.7	541.3	141.3
Short-term	225.7	25.9	324.4	0.0	0.0
Official Financing Sources and Financial Buffers	**5,063.6**	**1,303.1**	**1,290.2**	**1,347.9**	**100.0**
Domestic Financing Sources	**225.7**	**25.9**	**287.5**	**725.0**	**100.0**
Use of cash balances	225.7	25.9	287.5	-175.0	0.0
Coinage	0.0	0.0	0.0	100.0	0.0
Privatization Proceeds	0.0	0.0	0.0	800.0	100.0
Official financing sources	**4,837.8**	**1,277.2**	**1,002.7**	**622.8**	**0.0**
IMF	252.8	177.2	402.7	247.8	0.0
ESM	4,585.0	1,100.0	600.0	375.0	0.0

Source: IMF staff estimates.

1/ 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 and the two bond issuances in April and October 2015.

2/ Refers to additional debt repayments that would be made in 2016 and 2017 assuming the full materialization of privatization proceeds.

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

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
						Projections					
					(Millions of Euros)						
Current Account Balance	-2,039	-772	-1,096	-808	-792	-826	-775	-694	-693	-735	-753
Trade Balance (Goods and Services)	-1,266	-608	-215	196	121	270	352	343	397	482	567
Goods Balance	-4,411	-3,978	-3,512	-2,939	-2,812	-2,499	-2,431	-2,543	-2,643	-2,736	-2,831
Exports	2,686	3,027	3,040	2,714	2,808	2,876	2,951	3,072	3,217	3,372	3,530
Imports	7,097	7,005	6,552	5,653	5,620	5,375	5,381	5,615	5,859	6,108	6,362
Services Balance	3,145	3,370	3,297	3,134	2,933	2,769	2,782	2,886	3,039	3,218	3,398
Exports	6,958	7,202	7,274	7,808	7,630	7,469	7,608	7,922	8,295	8,696	9,104
Imports	3,813	3,832	3,977	4,673	4,697	4,700	4,826	5,036	5,255	5,478	5,705
Primary Income	-581	57	-600	-628	-489	-678	-703	-604	-641	-752	-839
Secondary Income	-191	-222	-281	-375	-423	-417	-423	-433	-448	-466	-482
Capital Account	57	82	36	245	146	146	146	146	146	146	146
Financial Account	-1,753	-140	-561	4,666	476	323	-6	-555	-601	-689	-782
Direct Investment	-1,058	3,110	2,746	1,207	721	-131	-1,103	-246	-669	-788	-816
Portfolio Investment	5,558	-13,157	-6,238	-12,794	-3,207	-2,506	222	-862	-1,195	-2,570	-1,972
Financial Derivatives	205	163	456	-21	293	0	0	0	0	0	0
Other Investment	-6,235	9,753	2,524	16,311	2,663	2,960	875	553	1,262	2,668	2,005
Reserves (+ inflows, - outflows)	-223	-9	-48	-36	6	0	0	0	0	0	0
Errors and Omission	228	550	499	391	-156	0	0	0	0	0	0
Program Financing	0	0	0	4,838	1,277	1,003	623	-8	-54	-101	-176
						(Percent of GDP)					
Current Account Balance	-10.7	-4.0	-5.6	-4.5	-4.6	-4.7	-4.4	-3.8	-3.7	-3.7	-3.7
Trade Balance (Goods and Services)	-6.6	-3.1	-1.1	1.1	0.7	1.5	2.0	1.9	2.1	2.4	2.8
Goods Balance	-23.1	-20.3	-18.0	-16.3	-16.2	-14.4	-13.7	-13.9	-13.9	-13.9	-13.9
Exports	14.0	15.5	15.6	15.0	16.1	16.5	16.6	16.8	17.0	17.1	17.3
Imports	37.1	35.8	33.7	31.3	32.3	30.9	30.2	30.7	30.9	31.0	31.2
Services Balance	16.5	17.2	16.9	17.4	16.9	15.9	15.6	15.8	16.0	16.3	16.7
Exports	36.4	36.8	37.4	43.2	43.9	42.9	42.8	43.3	43.7	44.2	44.6
Imports	19.9	19.6	20.4	25.9	27.0	27.0	27.1	27.5	27.7	27.8	28.0
Primary Income	-3.0	0.3	-3.1	-3.5	-2.8	-3.9	-4.0	-3.3	-3.4	-3.8	-4.1
Secondary Income	-1.0	-1.1	-1.4	-2.1	-2.4	-2.4	-2.4	-2.4	-2.4	-2.4	-2.4
Capital Account	0.3	0.4	0.2	1.4	0.8	0.8	0.8	0.8	0.8	0.7	0.7
Financial Account	-9.2	-0.7	-2.9	25.8	2.7	1.9	0.0	-3.0	-3.2	-3.5	-3.8
Direct Investment	-5.5	15.9	14.1	6.7	4.1	-0.8	-6.2	-1.3	-3.5	-4.0	-4.0
Portfolio Investment	29.1	-67.3	-32.0	-70.8	-18.4	-14.4	1.2	-4.7	-6.3	-13.1	-9.7
Financial Derivatives	1.1	0.8	2.3	-0.1	1.7	0.0	0.0	0.0	0.0	0.0	0.0
Other Investment	-32.6	49.9	13.0	90.3	15.3	17.0	4.9	3.0	6.7	13.6	9.8
Reserves (+ inflows, - outflows)	-1.2	0.0	-0.2	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Errors and Omission	1.2	2.8	2.6	2.2	-0.9	0.0	0.0	0.0	0.0	0.0	0.0
Program Financing	0.0	0.0	0.0	26.8	7.3	5.8	3.5	0.0	-0.3	-0.5	-0.9

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

1/ External statistics were revised in line with the BPM6 methodology.

Table 5. Cyprus: External Financing Requirements and Sources, 2012–20 1/
(Millions of euros)

	2012	2013	2014	2015	2016	2017	2018	2019	2020
				Projections					
GROSS FINANCING REQUIREMENTS	**69,613**	**68,128**	**48,399**	**45,825**	**46,385**	**45,324**	**47,793**	**50,036**	**53,937**
Current account deficit ("-" = CA surplus)	1,096	808	792	826	775	694	693	735	753
Medium- and long-term debt amortization	10,661	9,876	7,577	7,580	8,075	7,266	7,961	8,154	8,803
Public sector	593	1,458	678	493	988	180	744	801	1,253
Banks	5,134	4,091	1,397	1,530	1,530	1,530	1,549	1,572	1,596
Other private	4,934	4,327	5,501	5,556	5,556	5,556	5,668	5,781	5,954
Short-term debt amortization	57,857	57,444	40,030	37,419	37,536	37,357	39,085	41,046	44,205
Public sector	8,438	7,650	7,504	2,874	1,791	1,612	1,451	1,306	1,175
Central Bank	8,140	7,650	7,504	2,874	1,791	1,612	1,451	1,306	1,175
General government and SOEs	298	0	0	0	0	0	0	0	0
Banks	37,309	35,384	19,265	18,055	19,255	19,255	19,495	19,788	20,084
Other private	12,110	14,410	13,261	16,490	16,490	16,490	18,139	19,952	22,945
EU and IMF	0	0	0	0	0	8	54	101	176
SOURCES OF FINANCING	**69,613**	**63,290**	**47,121**	**44,822**	**45,763**	**45,324**	**47,793**	**50,036**	**53,937**
Capital account (net)	36	245	146	146	146	146	146	146	146
Foreign direct investment (net)	-2,746	-1,207	-721	131	1,103	246	669	788	816
CYP investment abroad	8,682	-8,254	1,531	261	356	549	569	591	612
Foreign investment in CYP	5,936	-9,461	810	392	1,458	795	1,238	1,378	1,427
New borrowing and debt rollover	62,428	43,569	46,037	46,679	44,484	47,067	49,467	54,357	57,923
Medium and long-term borrowing	4,984	3,538	8,618	9,144	7,127	7,982	8,422	10,153	10,093
General government	2,120	26	910	2,057	41	264	546	1,839	1,554
Banks	963	-6,683	1,930	1,530	1,530	1,606	1,642	1,666	1,691
Other private	1,901	10,196	5,778	5,556	5,556	6,112	6,234	6,648	6,847
Short-term borrowing	57,444	40,030	37,419	37,536	37,357	39,085	41,046	44,205	47,830
Public sector	7,650	7,504	2,874	1,791	1,612	1,451	1,306	1,175	1,058
Central Bank	7,650	7,504	2,874	1,791	1,612	1,451	1,306	1,175	1,058
General government	0	0	0	0	0	0	0	0	0
Banks	35,384	19,265	18,055	19,255	19,255	19,495	19,788	20,084	20,385
Other private	14,410	13,261	16,490	16,490	16,490	18,139	19,952	22,945	26,387
Other	9,895	20,683	1,659	-2,134	30	-2,135	-2,489	-5,256	-4,948
Of which: Net errors and omissions	499	391	-156	0	0	0	0	0	0
FINANCING GAP	**0**	**4,838**	**1,277**	**1,003**	**623**	**0**	**0**	**0**	**0**
ESM	0	4,585	1,100	600	375	0	0	0	0
IMF	0	253	177	403	248	0	0	0	0
ROLLOVER RATES									
General government 1/	238%	2%	134%	417%	4%	147%	73%	229%	124%
Central bank	94%	98%	38%	62%	90%	90%	90%	90%	90%
Private	89%	62%	107%	103%	100%	106%	106%	109%	109%
Banks	86%	32%	97%	106%	100%	102%	102%	102%	102%
Non-financial corporates	96%	125%	119%	100%	100%	110%	110%	115%	115%

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

1/ External statistics were revised in line with the BPM6 methodology.

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	90.9	90.9	91.2	92.3	93.2	94.6
Claims on Central Bank of Cyprus	2.3	2.9	3.9	2.7	4.2	6.5	6.6	6.7	6.9	7.0	7.2
Claims on Cypriot resident other MFIs	5.6	5.0	4.6	3.3	4.1	4.7	4.8	4.9	5.1	5.3	5.5
Claims on Cypriot resident non MFIs	54.0	58.2	60.6	55.0	53.5	52.0	51.5	51.3	51.7	51.4	51.7
General government	4.5	5.3	6.5	5.4	4.5	3.4	3.2	3.1	3.1	3.0	3.0
Private sector excluding brass plates 1/	46.5	48.6	49.3	46.5	45.3	45.0	44.7	44.5	44.5	44.7	45.1
Households	22.5	23.5	23.9	22.3	21.9	21.2	20.8	20.4	20.3	20.4	20.5
Non-financial corporations	23.3	24.1	24.4	23.4	21.8	22.8	22.9	23.1	23.2	23.3	23.5
Non-bank financial intermediaries	0.7	1.0	1.0	0.8	1.7	1.0	1.0	1.0	1.0	1.0	1.0
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	23.6	24.2	24.7	25.4	26.3	27.0
Other assets	3.8	3.9	3.2	3.9	3.8	4.1	3.8	3.6	3.1	3.1	3.1
Liabilities	135.0	131.6	128.1	90.3	91.1	90.9	90.9	91.2	92.3	93.2	94.6
Liabilities to the Central Bank of Cyprus and Eurosystem	5.5	5.5	9.8	11.2	8.5	5.0	4.0	3.1	2.7	2.2	2.1
Liabilities to Cypriot resident other MFI	5.5	4.9	4.5	3.1	3.6	4.1	4.2	4.3	4.5	4.6	4.8
Deposits of Cypriot resident non MFIs	45.4	43.7	43.3	33.0	32.3	32.4	32.9	33.5	34.5	35.3	36.2
General government	0.5	0.5	0.5	0.4	0.5	0.4	0.4	0.4	0.4	0.4	0.4
Private sector excluding brass plates	36.8	37.4	37.5	29.9	29.3	29.6	30.0	30.6	31.6	32.4	33.2
Households	25.4	26.0	26.4	23.3	22.3	22.3	22.6	23.1	23.8	24.4	25.1
Non-financial corporations	6.7	6.7	5.7	3.9	3.8	4.2	4.3	4.4	4.5	4.6	4.7
Non-bank financial intermediaries	4.7	4.6	5.4	2.7	3.2	3.0	3.1	3.1	3.2	3.3	3.4
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	24.7	24.9	25.2	25.5	25.9	26.3
Debt securities	2.4	2.6	1.7	0.5	0.4	1.3	1.4	1.4	1.4	1.4	1.4
Capital and reserves	12.8	11.3	15.1	16.4	20.8	21.9	22.1	22.3	22.3	22.3	22.3
Other liabilities	2.8	7.1	2.4	1.6	1.5	1.4	1.4	1.4	1.4	1.4	1.4
Money and Credit											
General government sector credit, net 2/	5.2	5.3	7.2	5.5	4.3	2.8	2.6	2.6	2.5	2.4	2.4
Cypriot resident broad money (M2)	46.6	45.0	44.6	34.5	34.1	34.2	34.5	35.1	36.2	37.0	38.0
Cypriot resident narrow money (M1)	10.6	11.1	11.5	10.4	11.4	11.6	12.0	12.4	12.9	13.3	13.8
						(Percent of GDP)					
General government sector credit, net	27.4	26.9	36.8	30.6	24.7	16.3	14.8	14.1	13.2	12.4	11.8
Private sector credit excluding brass plates	243.3	248.9	253.1	257.6	260.8	258.4	251.3	243.3	234.9	227.1	221.0
Brass plates credit	15.8	22.3	24.6	17.0	20.7	20.7	20.3	19.8	19.3	18.7	18.1
Cypriot resident broad money (M2)	243.5	230.2	229.3	190.8	196.0	196.7	193.9	191.7	190.7	188.1	186.2
Cypriot resident narrow money (M1)	55.7	56.9	59.0	57.6	65.4	66.8	67.3	67.8	68.2	67.8	67.6
						(Annual percentage change)					
General government sector credit, net	-1.6	0.4	36.2	-22.9	-22.2	-33.7	-7.7	-2.1	-2.9	-1.9	-2.1
Private sector credit excluding brass plates	8.8	4.6	1.3	-5.6	-2.5	-0.8	-0.6	-0.4	0.0	0.4	0.8
Brass plates credit	2.3	44.0	9.9	-35.7	17.0	0.0	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	0.5	0.8	1.7	3.1	2.5	2.5
Cypriot resident narrow money (M1)	2.3	4.4	3.2	-9.4	9.4	2.2	2.9	3.7	4.1	3.2	3.3
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	0.8	1.5	1.8	3.3	2.6	2.6
Brass plates deposits (y-o-y percent change)	33.8	-28.3	-9.4	-50.4	-5.2	0.1	0.5	0.7	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 Q2 1/

(Percent, unless otherwise specified)

	2010	2011	2012	2013	2014	2015 Q1	2015 Q2
Capital Adequacy							
Regulatory Capital ratio	12.4	12.1	7.3	14.0	15.4	15.5	16.2
Tier I capital ratio	10.9	11.0	6.3	12.8	14.6	14.8	15.5
Risk weighted assets (billions of euro)	80.3	51.7	71.0	45.0	45.6	45.8	43.6
Asset Quality							
Non-performing loans to total gross loans 2/	5.8	10.0	18.4	38.6	44.9	44.8	44.7
Provisions to nonperforming loans	29.6	29.2	30.0	31.0	31.2	32.2	33.1
Non-performing loans to total gross loans (local operations) 3/	12.4	16.2	25.5	46.2	56.1	57.1	57.0
Earnings and Profitability							
Return on assets	0.6	-3.9	-3.7	-2.9	0.1	0.8	0.7
Return on equity	12.0	-59.4	-62.3	-39.8	0.8	8.4	7.3
Interest margin to gross income ratio	74.3	83.7	76.8	82.7	78.3	79.2	66.9
Liquidity							
Liquid assets to total assets	29.1	22.3	19.6	18.6	15.6	19.0	18.7
Customer deposits to total (non-interbank) loans	94.5	81.7	81.5	69.9	73.6	71.3	72.2

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.

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/ 2/

(Millions of SDRs)

	2012	2013	2014	2015	2016	2017	2018	2019	2020
Existing and prospective Fund credit									
Disbursement	0.0	222.8	148.5	321.8	198.0	0.0	0.0	0.0	0.0
Stock	0.0	222.8	371.3	693.0	891.0	884.8	841.5	761.1	629.1
Obligations	0.0	1.6	3.8	8.0	16.9	23.9	61.9	99.5	147.3
Repurchase	0.0	0.0	0.0	0.0	0.0	6.2	43.3	80.4	132.0
Charges	0.0	1.6	3.8	8.0	16.9	17.7	18.6	19.1	15.3
Stock of existing and prospective Fund credit									
In percent of quota	0.0	140.8	234.7	438.1	563.2	559.3	531.9	481.1	397.6
In percent of GDP	0.0	1.4	2.5	5.0	6.3	6.1	5.6	4.8	3.9
In percent of exports of goods and services	0.0	2.4	4.2	8.4	10.6	10.1	9.2	7.9	6.2
Obligations to the Fund from existing and prospective Fund credit									
In percent of quota	0.0	1.0	2.4	5.1	10.7	15.1	39.1	62.9	93.1
In percent of GDP	0.0	0.0	0.0	0.1	0.1	0.2	0.4	0.6	0.9
In percent of exports of goods and services	0.0	0.0	0.0	0.1	0.2	0.3	0.7	1.0	1.5

Source: IMF staff estimates.

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

2/ Exports statistics were revised in line with the BPM6 methodology.

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

Availability Date	Amount of Purchase: Millions of SDR	Amount of Purchase: 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. External Debt Sustainability Framework, 2010–22 1/

(Percent of GDP, unless otherwise indicated)

	Actual							Projections								Debt-stabilizing non-interest current account 7/
	2010	2011	2012	2013	2014			2015	2016	2017	2018	2019	2020	2021	2022	
Baseline: External debt	661.6	590.9	607.9	548.0	519.2			**574.2**	**562.0**	**559.8**	**552.0**	**559.8**	**564.7**	**567.1**	**578.0**	**0.6**
Change in external debt	-65.7	-70.7	17.0	-59.9	-28.7			55.0	-12.2	-2.2	-7.9	7.9	4.9	2.3	10.9	
Identified external debt-creating flows (4+8+9)	21.1	-43.0	49.1	38.2	24.9			-0.2	3.2	-4.2	-2.9	-0.9	-0.1	-2.2	-2.2	
Current account deficit, excluding interest payments	-8.5	-10.6	-9.7	-9.5	-6.0			-6.4	-7.0	-7.9	-8.7	-9.3	-9.8	-10.5	-11.2	
Deficit in balance of goods and services	6.6	3.1	1.1	-1.1	-0.7			-1.5	-2.0	-1.9	-2.1	-2.4	-2.8	-3.1	-3.5	
Exports	50.4	52.3	53.0	58.2	60.0			59.4	59.3	60.1	60.7	61.3	62.0	62.7	63.6	
Imports	57.1	55.4	54.1	57.2	59.3			57.9	57.4	58.2	58.6	58.8	59.2	59.6	60.1	
Net non-debt creating capital inflows (negative)	-0.3	-2.4	-7.7	7.5	-0.5			3.6	7.1	2.8	5.3	6.6	5.9	5.2	5.7	
Automatic debt dynamics 2/	29.9	-30.0	66.5	40.2	31.4			2.6	3.2	0.9	0.5	1.8	3.7	3.1	3.2	
Contribution from nominal interest rate	19.1	14.6	15.3	14.0	10.5			11.1	11.5	11.8	12.4	13.0	13.5	13.8	14.2	
Contribution from real GDP growth	-10.1	-2.5	15.7	37.7	14.2			-8.5	-8.2	-10.9	-11.9	-11.2	-9.8	-10.8	-10.9	
Contribution from price and exchange rate changes 3/	20.8	-42.0	35.5	-11.4	6.6			...	...	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 4/	-86.8	-27.7	-32.2	-98.1	-53.7			55.1	-15.4	2.0	-5.0	8.8	5.0	4.6	13.2	
External debt-to-exports ratio (in percent)	1311.5	1129.2	1147.5	940.8	865.3			966.6	947.2	931.9	909.1	913.3	911.4	904.5	909.3	
Gross external financing need (in billions of US dollars) 5/	119.6	97.3	91.4	89.6	66.0			55.5	51.7	51.0	54.4	57.4	62.6	67.9	71.7	
in percent of GDP	471.3	357.8	365.0	373.2	285.5			286.4	259.7	246.5	251.1	253.2	262.8	274.9	280.5	
Scenario with key variables at their historical averages 6/						5-Year Historical Average	5-Year Standard Deviation	**574.2**	**580.7**	**610.6**	**637.3**	**683.7**	**734.5**	**777.3**	**834.3**	**35.8**
Key Macroeconomic Assumptions Underlying Baseline																
Nominal GDP (US dollars)	25.4	27.2	25.0	24.0	23.1			19.4	19.9	20.7	21.6	22.7	23.8	24.7	25.6	
Real GDP growth (in percent)	1.4	0.4	-2.4	-5.9	-2.5	-1.8	2.9	1.4	1.5	2.0	2.2	2.1	1.8	2.0	2.0	
GDP deflator in US dollars (change in percent)	-2.8	6.8	-5.7	1.9	-1.2	-0.2	4.8	-17.3	1.2	1.9	2.4	2.5	3.2	1.7	1.5	
Nominal external interest rate (in percent)	2.6	2.4	2.4	2.2	1.9	2.3	0.3	1.8	2.0	2.2	2.3	2.5	2.5	2.5	2.6	
Growth of exports (US dollar terms, in percent)	1.0	11.2	-6.8	5.4	-0.7	2.0	6.8	-17.0	2.6	5.3	5.8	5.7	6.2	4.9	4.9	
Growth of imports (US dollar terms, in percent)	2.9	4.2	-10.2	1.3	0.0	-0.4	5.7	-18.2	1.8	5.5	5.4	5.1	5.7	4.4	4.4	
Current account balance, excluding interest payments	8.5	10.6	9.7	9.5	6.0	8.8	1.8	6.4	7.0	7.9	8.7	9.3	9.8	10.5	11.2	
Net non-debt creating capital inflows	0.3	2.4	7.7	-7.5	0.5	0.7	5.5	-3.6	-7.1	-2.8	-5.3	-6.6	-5.9	-5.2	-5.7	

Source: IMF staff estimates.

1/ External statistics were revised in line with the BPM6 methodology.

2/ 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.

3/ 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).

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

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

6/ 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.

7/ 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.

Table 11. Status of Fiscal Structural Measures Through June 2016

Measure	Objective	8th and 9th Review MEFP deadlines	Status
		Public Financial Management Reform	
Prepare updated risk assessment report based on improved risk assessment analysis.	Improve risk management and practices	End-Oct. 2015	Expected end-January 2016. Delay due to delayed provision of TA from the European Stability Mechanism.
Strengthen financial reporting by local governments and SOEs	Monitor fiscal risks from local governments and SOEs.	End-Jan. 2016	In progress.
Adopt a new budget classification and chart of accounts.	Follow international budgeting, accounting, and reporting standards and practices.	End-Feb. 2016	In progress.
		Revenue Administration Reform	
Establish a project team to identify the size and nature of the unassessed tax returns and determine the taxes and refunds due.	Improve compliance and mitigate risks of revenue loss.	End-Sept. 2015	Partially done. Team established in September 2015 but limited progress achieved in determining taxes and refunds due.
Establish a single registration process for all domestic taxes.	Reduce the costs of compliance.	End-Sept. 2015	Done at end-November 2015. Delay due to problems with IT systems.
Prepare quarterly implementation reports of the tax recovery plan,	Monitor progress and emerging challenges in reducing tax arrears.	End-Sept. 2015	Done.
Prepare an action plan to reduce the backlog of un-assessed tax returns.	Improve compliance and mitigate risks of revenue loss.	End-Oct. 2015	Delayed due to human and IT resource constraints.
Council of Ministries to approve the new tax procedures code.	Establish an integrated legal framework for tax procedures	End-Dec. 2015	Expected end-January 2016. More time is needed for the consultation process.
Finalize the cleansing of the taxpayer register	Strengthen the integrity of the taxpayer base	End-Dec. 2015	Delayed to end January 2016. Additional time needed to verify adequacy of taxpayer deletion from register.
Make LTO fully functional with the view to expanding gradually coverage of total revenue collections.	Strengthen revenue mobilization	End-Dec. 2015	Expected end-March 2016. Delay due to human and IT resource constraints.
Strengthen the legal framework governing the criminal tax investigations unit	Enhance oversight and coordination with other agencies.	End-June 2016	In progress.
Finalize integration of the new tax department (CTD)	Improve efficiency of the revenue administration.	End-June 2016	In progress.
		Welfare Reform	
Finalize an assessment report of the implementation of the GMI, including main outcomes, the number of applications, fiscal costs, targeting accuracy, and coverage.	Monitor implementation of GMI and draw preliminary lessons from its experience.	End-Sept. 2015	Partially done. Preliminary information was shared with the mission in November 2015 but no report was prepared.

Table 11. Status of Fiscal Structural Measures Through June 2016 (concluded)			
Measure	**Objective**	**8th and 9th Review MEFP deadlines**	**Status**
Prepare plans to unify the legislative and administrative framework for all disability benefits.	Improve targeting of disability benefits and reduce abuse.	Mid-Oct.2015	Done at end-November 2015; Delays due to longer stakeholder consultation process.
Parliament to adopt plan to consolidate education benefits.	Improve targeting of education benefits and reduce abuse.	End-Oct. 2015	Done in early December; Delays due to longer stakeholder consultation process.
Build a registry of benefits and cross-checked with other databases	Improve targeting of social benefits and reduce abuse.	End-Dec. 2015	Done.
Re-examine the overall welfare reform	Identify potential efficiency gains from the consolidation of all information on welfare programs.	End-Mar. 2016	Not initiated.
	Public Administration Reform		
Parliamentary approval of reform package including a revision of the wage setting framework for the general government.	Ensure an affordable wage bill and increase staff mobility in the general government.	End-February 2016	Legislation is in Parliament. Discussions already started.

Table 12. Cyprus: Selected Reforms—Measures Completed

Measures	Completion time	Macrofinancial implications
Fiscal Consolidation and fiscal structural reforms		
Implemented a reform of the COLA wage indexation mechanism in the public sector by extending its freeze to the end of the program and limiting its application to 50 percent of the price index thereafter	December 2012	Strengthen fiscal sustainability
Adopted the 2013 and medium term budget with consolidation measures of about 4.5 percent of GDP	December 2012	Strengthen fiscal sustainability
Reformed the General Social Insurance Scheme and to government pension scheme, and freeze public sector pensions	January 2013	Reduce implicit government liability
Rolled over and extended the maturity of €1 billion of domestic debt held by residents through a voluntary debt exchange covering maturities falling due in 2013-15 and rolled over the €1.9 billion recapitalization bond of Laiki	June 2013	Facilitate government financing
Adopted the 2014 budget with consolidation measures of about 2.3 percent of GDP	December 2013	Strengthen fiscal sustainability
Adopted a law on Fiscal Responsibility and Budget Systems	February 2014	Strengthen budget formulation and execution
Adopted the institutional and legal framework to govern the privatization process, including a unit within the Ministry of Finance to implement the privatization plan	March 2014	Provide the legal framework for the privatization process
Integrated by law the two tax authorities into a single Department of Taxation	June 2014	Harmonize procedures and increase efficiency
Adopted a welfare law	July 2014	Reduce poverty and increase efficiency
Implemented a common taxpayer database	September 2014	Improve efficiency of revenue administration
Report the stock of outstanding guarantees, risks, and how called guarantees have been addressed	September 2014	Address risks arising from government guarantees
Started paying benefits on guaranteed minimum income	October 2014	Reduce poverty and increase efficiency
Resolving, recapitalizing, and restructuring financial institutions		
Independently assessed banking sector capital needs	February 2013	Identify capital shortfall
Adopted a modern bank resolution law	March 2013	Minimize fiscal costs
Resolved Laiki bank and disposed of Greek operations	March 2013	Strengthen financial sector stability
Completed BoC recapitalization and exit from resolution	July 2013	Strengthen financial sector stability
Recapitalized Hellenic Bank from private sources	October 2013	Strengthen financial sector stability
Recapitalized and consolidated the coop sector	March 2014	Strengthen financial sector stability
Prepared an action plan to strengthen the cooperative credit sector	September 2014	Strengthen financial sector stability
Strengthening supervision and regulation and restructuring private sector debt		
Harmonized NPL classification to best practice	September 2013	Strengthen financial sector stability
Unified supervision of CCIs and banks under the CBC	September 2013	Protect consumers
Passed legislation to prohibit banks and coops from lending to their independent board members and removing board members in arrears on debts to their banks	September 2013	Strengthen oversight of bank credit-risk management practices
Finalized a code of conduct for banks and an arrears management framework	September 2013	Assist debt restructuring
Completed the operationalization of the credit register	September 2014	Allow banks to make informed loan decisions
Enacted amendments to the foreclosure law to streamline the foreclosure process	September 2014	Provide incentives for debt restructurings
Adopted a package of laws to reform the insolvency framework	April 2015	Provide incentives for debt restructurings
Strengthening the AML framework		
Amended legislation to provide the widest possible range of cooperation to foreign counterparts	December 2012	Strengthen business model
Conducted an audit by Deloitte and assessment by Moneyval of AML implementation practices by the banks	August 2013	Strengthen business model
Amended legislation to improve transparency of companies and trusts	September 2013	Strengthen business model

Table 13. Cyprus: MEFP Commitments Proposed During the Ninth Review

Measures	Deadline	Rationale
	Financial Sector Policies	
Addressing High NPL Levels - legal framework		
Authorities to take all actions necessary for real estate auctions to be held under the new foreclosure law	End-November 2015	Operationalize foreclosure framework
Authorities to assess the need for further legislative measures necessary to incentivize the swift transfer of title deeds	End-November 2015	Ensure that the ownership of titles reflects the economic ownership at all times
Authorities to recommend the adoption of court rules and adopt regulations for the effective functioning of the new insolvency framework	End-December 2015	Operationalize insolvency framework
CBC to deploy a tool on its website that will allow borrowers to compare quantified resolution options, based on concrete scenarios entered by the borrower	End-December 2015	Inform borrowers in financial difficulty about options for resolving NPLs
Council of Ministers to approve legislation to deal with non-legacy and new property transactions **(structural benchmark)**	End-December 2015	Ensure that the ownership of titles reflects the economic ownership at all times
Authorities to conduct an assessment of functioning and initial experiences with the implementation of the private sector debt restructuring and foreclosure frameworks	End-January 2016	Make adjustments to the foreclosure and insolvency frameworks
Parliament to adopt legislation to deal with non-legacy and new property transactions	End-January 2016	Ensure that the ownership of titles reflects the economic ownership at all times
Parliament to adopt legislation to remove existing obstacles to the issuance of title deeds	Mid-February 2016	Accelerate the issuance of title deeds
Council of Ministers to adopt any necessary adjustments to the insolvency and foreclosure frameworks **(structural benchmark)**	End-February 2016	Make adjustments to the foreclosure and insolvency frameworks
Council of Ministers to approve necessary amendments to the Civil Procedure law and related laws with a view of having them subsequently adopted by Parliament	End-March 2016	Allow courts to manage the expected increase in their workload
Addressing High NPL Levels - banks' arrears management		
CBC to publish the final results of a study on the financial situation of borrowers	End-December 2015	Inform macro-prudential policies and further adjust the loan restructuring strategy
Council of Ministers to approve draft legislation to remove existing impediments to the securitization of assets	End-December 2015	Facilitate the creation of a secondary market for loans
Parliament to adopt legislation to remove existing impediments to the securitization of assets **(structural benchmark)**	End-January 2016	Facilitate the creation of a secondary market for loans
CBC to agree with the banks new restructuring targets covering the first half of 2016	End-February 2016	Monitor banks' and coops' performance on arrears management
Authorities to adopt necessary steps to ensure timely submission of audited financial statements to the company registrar	End-February 2016	Increase availability of financial information on SME and corporate borrowers
CBC to review the treatment of accrued interest on NPLs for supervisory purposes	End-June 2016	Oversee effectively NPL resolution
Restructuring the cooperative credit sector		
Authorities to reinforce the cooperative sector including, if necessary, through recapitalization with public funds, in line with supervisory requirements	End-December 2015	Strengthen the coop sector
Authorities to submit an updated restructuring plan	End-December 2015	Increase the efficiency and simplify the structure of the sector
CCB to review the sector's NPL portfolio to tailor resolution strategies to the various types of NPLs	End-December 2015	Improve the sector's capacity to resolve NPLs
Sector to establish a single contact center to manage early arrears	End-February 2016	Improve the sector's capacity to resolve NPLs
CCB to complete the new structure of the financial control division	End-March 2016	Strengthen financial control and reporting processes
CCB to implement an action plan detailing necessary changes to the risk function's structure, procedures, capacity, and tools in line with its responsibilities	End-June 2016	Strengthen financial control and reporting processes
Strengthening financial sector supervision		
Authorities to streamline the directive on loan origination	End-December 2015	Review regulatory framework against European best practices and recent experience
Authorities to determine the additional data needs	End-December 2015	Strengthen the credit registry by establishing a credit scoring system available to banks and
Authorities to prepare an action plan to integrate the insurance sector and pension fund supervision, and submit draft legislation to Parliament	End-March 2016	Reinforce supervision of insurance and pension funds
Strengthening the AML framework		
CBC Governor to approve the 2016 inspection plan and continue to rely on the assistance of external auditors	End-November 2015	Strengthen the implementation of the AML/CFT framework
Authorities to strike off the Registrar of Companies the backlog of companies non-active and non-compliant with the requirement to submit annual reports	End-December 2015	Restructure the Registrar of Companies
Authorities to begin the reorganization of the Registrar of Companies with a view to modernize its operations in line with the new company law	End-March 2016	Restructure the Registrar of Companies

Table 13. Cyprus: MEFP Commitments Proposed During the Ninth Review (concluded)

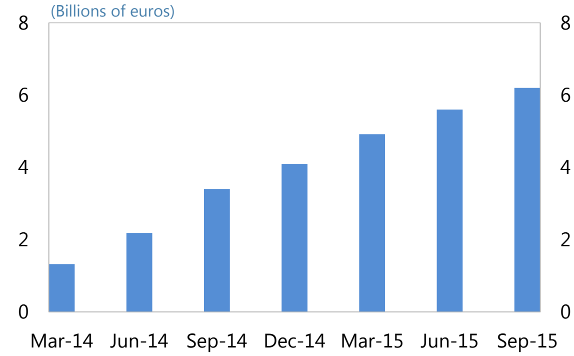
Measures	Deadline	Rationale
Fiscal Policy		
Parliament to adopt the 2016 budget documents, including a medium term fiscal framework encompassing the described fiscal targets for the period 2016-18	End-December 2015	Maintain public debt on a sustained downward path
Structural Reforms		
Implementing a comprehensive welfare reform		
Authorities to adopt a law to unify the administration of education benefits	End-December 2015	Make benefit administration more efficient
Authorities to build a registry of benefits in line with our new welfare law and cross-checked with other databases	End-December 2015	Make benefit administration more efficient
Authorities to re-examine the overall welfare reform to realize efficiency gains from the consolidation of all information on welfare programs	End-March 2016	Make benefit administration more efficient
Implementing the integration of the revenue administration		
Authorities to put in place a single registration process for new taxpayers covering all domestic taxes	End-November 2015	Reform the revenue administration
Authorities to ensure existing taxpayers have a unique tax identification number for all taxes, in the process of finalizing the cleansing of the corporate taxpayer register	End-December 2015	Reform the revenue administration
Council of Ministers to approve a new tax procedures code	End-January 2016	Reform the revenue administration
Authorities to ensure adequate human resources for the LTO to cover all major tax administration functions	End-March 2016	Reform the revenue administration
Authorities to finalize the integration of the new tax department (CTD), while protecting revenue performance	End-June 2016	Continue implementing the integration of the revenue administration
Authorities to strengthen the legal framework governing the criminal tax investigations unit	End-June 2016	Reform the revenue administration
Implementing the Fiscal Responsibility and Budget Systems Law and managing fiscal risks		
Parliament to adopt the pending FRBSL regulations	End-January 2016	Implement the Fiscal Responsibility and Budget Systems Law
Authorities to prepare an updated risk assessment report incorporating a new methodology, and strengthen financial reporting by local governments and SOEs	End-January 2016	Implement the Fiscal Responsibility and Budget Systems Law
Authorities to adopt a new budget classification and chart of accounts in the context of the implementation of the new Enterprise Resources Planning System	End-February 2016	Implement the Fiscal Responsibility and Budget Systems Law
Parliament to adopt the law regulating the creation and functioning of state-owned enterprises (SOEs law)	End-March 2016	Implement the Fiscal Responsibility and Budget Systems Law
Reaching milestones in privatization agenda		
Authorities to amend the regulatory framework of the Cyprus Port Authority (CPA)	End-November 2015	Improve economic efficiency, help to reduce our public debt, and encourage FDI
Parliament to adopt legislation on CyTA's corporatization	End-December 2015	Improve economic efficiency, help to reduce our public debt, and encourage FDI
Parliament to adopt the bill on options for CyTA's employees following privatization	End-January 2016	Improve economic efficiency, help to reduce our public debt, and encourage FDI
Authorities to select the winning bidder for the concession of the commercial activities of the Limassol port	End-March 2016	Improve economic efficiency, help to reduce our public debt, and encourage FDI
Authorities to sign the concession agreement for the commercial activities of the Limassol port	End-April 2016	Improve economic efficiency, help to reduce our public debt, and encourage FDI
Boosting growth prospects and strengthening the public administration		
Authorities to finalize the assessment of the regulatory framework governing the tourism sector	End-December 2015	Improve the business environment
Authorities to prepare a framework to attract strategic investments, through fast-tracking administrative procedures for licensing	End-December 2015	Stimulate private investment
Parliament to adopt a reform including a revision of the wage setting framework and the opening of promotion posts to the wider civil service **(structural benchmark)**	End-December 2015	Enhance the effectiveness of the public administration, while ensuring its affordability
Program financing and monitoring		
Authorities to transfer the rights and liabilities associated with coins issuance from the CBC to the MoF and receive additional financing of €100 million	End-January 2016	Secure additional financing

Annex I. Banks' NPL Restructuring Targets and Performance

Cypriot banks have taken substantial steps to improve NPL management and quicken the pace of loan restructuring. The recently introduced targeting framework for loan restructuring further incentivizes banks to improve the pace and quality of restructurings. Aggregate data for end-September indicate satisfactory performance against targets for successful restructurings and early arrears management, while the volumes of proposed and concluded sustainable restructurings increased, but were below target.

Restructuring of banks' NPLs has picked up in recent months. Restructured fixed term loans (i.e. excluding revolving facilities)—defined as those loans for which concessions have been granted since January 2014 to borrowers who are experiencing or are about to experience financial difficulties—reached €6.2 billion (26 percent of NPLs) on a cumulative basis at end-September 2015. This compares to €5.6 billion at end-June 2015 and €4.1 billion at end-2014.

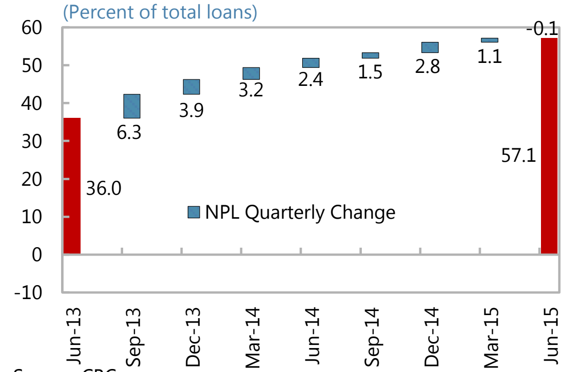
Evolution of Restructured Loans
(Billions of euros)



Source: CBC.

Despite the increase in restructured NPLs, NPLs have remained largely constant in recent months at just below 60 percent. To a large extent, this reflects interest accrued on existing NPLs and that restructured loans face a probation period of 12 months before they can be reclassified as performing even if, in the interim, the borrower has made all required payments.[1] Nevertheless, even if all NPLs that have been restructured so far did not re-default, NPLs would still be at the very high rate of 44 percent of gross loans.

Evolution of Nonperforming Loans
(Percent of total loans)



Source: CBC.

Banks have taken substantial steps to improve their internal management of distressed loans in order to further increase the pace of NPL restructuring. Each bank has created a centralized arrears management unit. These units are focusing on: (i) responding proactively in the case of early arrears to prevent short-term payment issues from migrating into NPLs; and (ii) using

[1] According to EBA definitions, when restructuring (i.e. forborne) measures are applied to NPLs, the loan will cease to be classified as a NPL one year after the application of the measures if there is not any past-due amount or concerns regarding the full payment of the loan. A restructured loan will cease to be classified as forborne when a minimum two year probation period has passed from the date the restructured loan was considered to be performing.

targeted strategies for different business segments to restructure loans that have been past due for at least several months, including debt-for-property swaps for major corporates, and new flexible products for small- and medium sized enterprises (SMEs).

The CBC has begun setting aggregate quarterly restructuring targets to incentivize banks to further increase the volume and quality of their NPL restructuring. The targets apply to the whole loan portfolio as well as to sub-portfolios, including loans to small and large corporates, residential mortgages, and other retail loans.

Targets are set for the following four indicators:

1. *Proposed sustainable solution*s measures loans for which sustainable modifications to the original terms have been proposed during a given quarter (as a percentage of the value of loans in arrears for more than 90 days).[2]

2. *Concluded sustainable solutions* measures loans for which modified terms have been agreed during a given quarter (as a percentage of the value of loans in arrears for more than 90 days).

3. *Successful restructurings* measures loans that have been restructured and have subsequently been in arrears for less than 8 days (as a percentage of the value of loans restructured since January 2014).

4. *Early arrears management* measures loans in arrears between 30 and 90 days at the beginning of the quarter but that were no longer in arrears at the end of the same quarter, either due to restructuring or other measures taken by the bank or the borrower (as a percentage of the value of loans in arrears between 30 and 90 days at the beginning of the quarter).

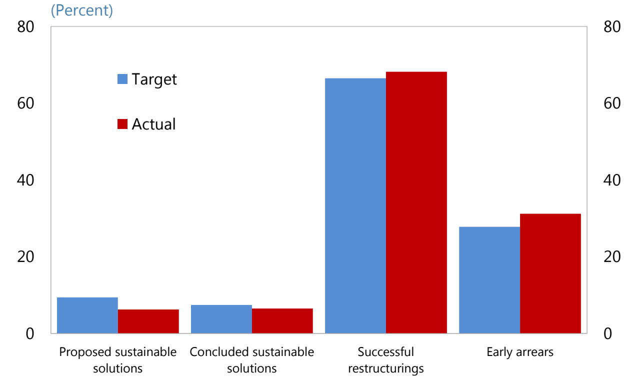
To monitor these targets, banks are required to submit quarterly reports to the CBC. The reports indicate actual performance at the end of each quarter and targets for the following two quarters. The CBC may revise up the banks' targets if it considers that the targets set by the banks are not sufficiently ambitious. In addition to performance under the targets described above, individual banks also report a detailed set of operational indicators such as restructuring rate, re-default rate, and cash collection rate by loan vintage and segment.

[2] Sustainable solutions are those intended to permanently reestablish the borrower's ability to service the loan throughout the life of the loan. Short-term solutions, such as grace periods and bullet payments, are not considered sustainable solutions, and are appropriate only if the borrower faces temporary payment difficulties.

Results for end-September published by the CBC indicate satisfactory performance against targets for successful restructurings and early-arrears management. At end-September 2015, the value of restructured loans that have subsequently been in arrears for less than 8 days amounted to €2 billion, or 68.2 percent of the loans restructured since January 2014. This was slightly better than the 66.5 percent target (indicator 3). Performance on early arrears in Q3 also exceeded the target of 27.8 percent (indicator 4), as 31.2 percent (amounting to €1.2 billion) of loans that were in early arrears at the beginning of the quarter exhibited no arrears at the end of the quarter.

Reliance on sustainable restructuring solutions has risen, although the pace has been slower than targeted. During Q3 2015, banks proposed sustainable restructuring solutions for €9.6 billion of loans, accounting for 6.3 percent of the value of loans in arrears for more than 90 days as of end-Q2 2015. Therefore, banks fell considerably short of the target rate of 9.4 percent (indicator 1). Concluded sustainable solutions during Q3 reached 6.5 percent of loans in arrears for more than 90 days as of end-Q2 2015, also underperforming the target rate of 7.5 percent (indicator 2). To compensate for this weaker-than-targeted performance in Q3, the Q4 targets for proposed sustainable solutions and for concluded sustainable solutions were revised up (from 11.5 percent to 12.5 percent, and from 10.1 percent to 11.6 percent, respectively).

Restructuring Targets and Actual Performance (Q3 2015)
(Percent)



Source: CBC.

Debt Restructuring Targets and Performance
(Percent)

	2015		
	June	September	December
Indicator 1 (Proposed sustainable solutions)			
Target	n/a	9.42	12.46
Actual	6.14	6.28	n/a
Difference between actual and target	n/a	-3.14	n/a
Indicator 2 (Concluded sustainable solutions)			
Target	n/a	7.45	11.64
Actual	4.69	6.53	n/a
Difference between actual and target	n/a	-0.92	n/a
Indicator 3 (Successful restructurings)			
Target	n/a	66.49	72.87
Actual	65.8	68.2	n/a
Difference between actual and target	n/a	1.71	n/a
Indicator 4 (Early arrears)			
Target	n/a	27.82	40.00
Actual	28.14	31.22	n/a
Difference between actual and target	n/a	3.4	n/a

Source: CBC.

Appendix I. Cyprus: Letter of Intent

Nicosia, January 11, 2016

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.

Results under our reform program remain encouraging. Despite a challenging external environment, our economy is recovering, posting three consecutive quarters of positive growth. Regarding the banking sector, the pace of loan restructuring has continued to accelerate, while the recent adoption of the law on sale of loans is an important addition to the toolkit to facilitate the cleaning of banks' balance sheets. In addition, we have taken measures to strengthen the cooperative credit sector, including reinforcing its capital base and deepening the ongoing restructuring process. In the fiscal area, performance has continued to exceed expectations and, as a result, we have met all end-September and continuous performance criteria (Table 1). We have also made progress on the program's structural reform agenda, although with some delays, which we are addressing. In this respect, we have met one of the structural benchmarks scheduled through end-December and are working towards the remaining three. Adoption by Parliament of a package of public administration reforms and of a securitization bill is envisaged by end-February. Similarly, work on new legislation for the issuance and transfer of title deeds in non-legacy and new property cases is well advanced and the council of ministers is expected to approve it by end-January. Finally, we are also seeking prompt parliamentary adoption of a package of laws to jump start the privatization process of the telecommunications company.

Looking forward, in support of our program objectives:

- In the financial sector, we will continue to prioritize reducing the high level of non-performing loans. Building on the reforms to date, our efforts will center on the effective implementation of the private debt restructuring framework; 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, and putting in place efficient court processes and post-court enforcement. We will also continue to strengthen financial sector supervision and the tools to encourage the restructuring of loans by the banking system. In addition, we will continue our efforts to strengthen the cooperative credit sector, focusing on governance, resolution of arrears, and financial management. Finally, we remain vigilant to 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 ninth review under the EFF arrangement and the purchase under this arrangement in the amount of SDR 99 million.
- A waiver of applicability for the end-December 2015 performance criteria, for which final data are not yet available.
- Modification of four structural benchmarks (Table 2).

We remain 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 Minister of Finance	Chrystalla Georghadji Governor of the Central Bank of Cyprus

Attachment I. Cyprus: Memorandum of Economic and Financial Policies

A. Recent Developments and Outlook

1. **Economic developments continue to move in the right direction.** Economic activity in the third quarter has maintained the positive trend started in early 2015. This reflects a modest pick-up in private consumption and a broader recovery across economic sectors. Although unemployment remains high, it has fallen by about 2 percentage points from a peak of about 17 percent in 2013. The price level fell by 1.5 percent in the 12 months to November, reflecting declining energy and tourism prices. The banking system continues to gain strength, attracting new deposits and withstanding the regional turbulence over the summer months; however, NPLs remain high and the pace of lending subdued. Meanwhile, the primary fiscal surplus has continued to exceed expectations. These developments have increased the attractiveness of our sovereign debt, which received upgrades from two rating agencies, while strong demand for the recently issued Eurobond (the third one since the 2013 crisis) pushed the yields to historically low rates.

2. **We continue to expect a gradual economic recovery**. In view of the brisker than expected activity through the third quarter, we have revised up considerably our growth forecast for 2015 to 1.4 percent (from 0.5 percent). Some further strengthening of domestic demand is projected to keep growth on an upward path, reaching 1.5 percent in 2016 and rising to 2 percent in 2017, in line with our previous forecasts. Further gradual progress in lowering unemployment is expected over the medium term. Given lower oil prices, we expect lower inflation this year (-1.6 percent) and next (0.6 percent). The outlook remains subject to risks. On the negative side, risks relate to slow progress in addressing the high level of NPLs in the banking system and the drag on private credit, the possibility of spillovers (largely through confidence effects) from Greece, and developments in Russia. On the positive side, continued recovery of domestic demand, the effect of depreciation of the euro on exports, and the potential for some positive spillovers from Greece provide some upside.

B. Financial Sector Policies

Addressing High NPL Levels

3. **We remain committed to reducing the high level of NPLs in our banking system as a matter of priority.** The NPL ratio of the core domestic banking sector has remained stable at 59 percent at end-August. We are committed to tackling this problem from three fronts. 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. This approach is 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.

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 and ensure that debt restructurings take place at an adequate pace. Second, we will make adjustments to the frameworks, including through any necessary amendments to the legislation.

    - ***Implementation.*** The Insolvency Service is now operational and has started to issue authorizations to insolvency practitioners. Also, we have taken all actions necessary for real estate auctions to be held under the new foreclosure law. Given the important role of the courts in the implementation of the new insolvency regime, we have recommended preparation of court rules with a view to having them adopted by end-March 2016, and have adopted regulations for the effective functioning of the new insolvency framework. Capacity building for the actors responsible for the implementation of the insolvency framework, including the courts, is high on our agenda, and initial training has already been conducted for insolvency practitioners. Efficient court processes and post-court enforcement will be essential to allow courts to manage the expected increase in their workload. To this end, we have initiated consultations for a review of the Civil Procedure Law and related laws. Necessary amendments identified by this exercise will be approved by the Council of Ministers by end-March 2016 with a view to having them subsequently adopted by Parliament. At a minimum, existing legislation will be modified 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-January 2016, we will conduct an assessment of functioning and initial experiences with the implementation of the private sector debt restructuring and foreclosure frameworks. Based on the assessment we will prepare a plan to remedy any deficiencies and identified tax disincentives (if any) to debt restructuring. On the basis of the review, by end-February 2016 (**modified structural benchmark**), the Council of Ministers will adopt any necessary adjustments to the insolvency and foreclosure frameworks, through inter alia (i) removing any impediments to the effectiveness of the procedures, including measures that weaken incentives for non-viable debtors to promptly engage with the insolvency framework; and (ii) ensuring that guarantors maintain their payment obligations with due regard to their payment capacity.

- ***Borrower education.*** The CBC is leading an inter-agency effort to inform borrowers in financial difficulty about options for resolving NPLs. To this end, by end-January 2016, the CBC will deploy a tool on its website that will allow borrowers to compare quantified resolution options, based on concrete scenarios entered by the borrower.

- ***Title deeds.*** We are taking steps to address the backlog of immovable properties that were purchased without proper transfer of title to restore the smooth functioning of the property market. We have started implementing the legislation to address legacy cases, including by issuing all necessary circulars. We have already received applications and will start transferring the titles in early 2016. In December, Parliament adopted a set of bills to facilitate the transfer of title deeds in cases involving loan restructurings. To ensure that the ownership of titles reflects the economic ownership at all times, legislation to deal with non-legacy and new property transactions will be approved by the Council of Ministers by end-January 2016 (**modified end-October 2015 structural benchmark**), and adopted by Parliament by end-February 2016. 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. To accelerate the issuance of title deeds, by mid-February 2016, Parliament will adopt legislation (where Parliament ratification is required) to remove existing obstacles, including regarding the enforcement and remedy periods regarding non-certified completed buildings, building compliance certificates, and certificates of completion by supervising engineers.

Banks' arrears management

- ***Supervision of bank's management of problem assets***. Effective oversight of NPL resolution is a key element of the CBC's role in banking supervision. Toward this objective, the CBC is intensifying monitoring on micro- and macro prudential level as well as on intensifying the CBC's engagement with the banks in coordination with the SSM, taking into account recommendations provided by recent IMF technical advice. In addition, to strengthen the CBC's analytical and policy capacity the CBC has established a central coordination function for NPL issues in order to improve the coordination between the supervisory teams, as well as with the financial stability and economics units of the CBC. Finally, by end-June 2016, the CBC will review the treatment of accrued interest on NPLs for supervisory purposes.

- ***Debt resolution reporting and targeting.*** We continue monitoring the banks' and coops' performance on arrears management through the recently introduced restructuring targets framework. Banks have begun submitting monthly data in line with the expanded institutional- and portfolio- specific requirements in September. Preliminary results for end-September show that the pace of restructurings has further increased and more restructurings have been achieved through long-term and sustainable solutions, with satisfactorily low rates of re-defaults. Based on a detailed analysis, including a benchmarking exercise across banks, we have identified bank-specific actions to address deficiencies. Building on this, by end-February 2016, the CBC will agree with the banks new targets covering the first half of 2016. In the course of 2016, we will gradually extend the horizon of the targets to four quarters ahead and expand the scope of the set of targets to adequately cover all relevant resolution activities. Based on these targets, the CBC will forecast the future path of system-wide loan restructuring and recovery.

- ***Financial situation of borrowers***. We continue to study the financial situation of borrowers to inform macro-prudential policies and to further adjust the loan restructuring strategy. Preliminary results show that a nontrivial portion of household nonperforming loans can be attributed to borrowers with the financial capacity to make loan payments. These results lend support to addressing the high level of NPLs by strengthening banks' internal arrears management. The CBC will publish the final results of this study by end-January 2016. To increase the availability of financial information on SME and corporate borrowers, by end-February 2016, we will adopt necessary steps to ensure timely submission of audited financial statements to the company registrar.

Sale of loans

- ***Secondary market for loans***. To facilitate the creation of a secondary market for loans, we have adopted a law on the sales of loans (**end-September structural benchmark**). The law, which retains protections of borrowers under the Code of Conduct, will be a useful addition to the toolkit to address the high levels of banks' NPLs. The CBC will promptly adopt regulations necessary for the implementation of the law. In addition, the Council of Ministers will approve by end-January 2016 draft legislation to remove existing impediments to the securitization of assets. The bill includes, inter alia, the removal of the requirement to obtain the prior consent of borrowers for inclusion in the securitization, as well as any changes to the tax system deemed necessary. The law will be adopted by Parliament by end-February 2016 (**modified end-December 2015 structural benchmark**).

Restructuring of the Cooperative Credit Sector

4. We continue our efforts to strengthen the coops sector. To reinforce the cooperative sector, we have completed its recapitalization with public funds, in line with supervisory requirements. Building on the extensive restructuring already undertaken by the sector, we have also identified the necessary actions to enhance the sector's financial prospects and shareholder value, including by reviewing its structure and operations. In parallel, our actions remain focused on strengthening the sector's capacity, including by speeding up loan restructuring, strengthening governance, increasing efficiency and improving management information systems. To this end, work is proceeding in the following areas, where the sector continues to regularly report to their shareholders and the CBC:

- ***Governance.*** We are working towards increasing the efficiency and simplifying the structure of the sector. To this end, we are implementing a time-bound action plan to consolidate the sector's control functions, namely risk, audit and compliance, and will take further steps to centralize operations. To further streamline management, the sector will review its delegation framework with a view to consolidate strategic decisions and oversight at the CCB, while delegating implementation to the relevant level within the sector. In December, we adopted an updated restructuring plan, including a schedule to reduce the state's stake in the coop sector over the medium term.

- ***Arrears management.*** Several initiatives are underway to improve the sector's capacity to resolve NPLs. To standardize and better target restructuring efforts, by end-January 2016, the CCB will review the sector's NPL portfolio to tailor resolution strategies to the various types of NPLs. By end-February 2016, the sector will establish a single contact center to manage early arrears. The CCB will also ensure that adequate resources are made available to equip the restructuring function with sufficient qualified staff.

- ***Financial control and risk processes.*** The CCB is implementing its plan to strengthen financial control and reporting processes, including by upgrading the management information system. The new structure of the financial control division, including to strengthen its staffing and capabilities, will be completed by end-March 2016. We will ensure that the sector's risk management function is adequately involved in risk taking decisions (commensurate with their materiality) and that it retains veto powers. The CCB will adjust the relevant policies, and develop an action plan detailing necessary changes to the risk function's structure, procedures, capacity, and tools in line with its responsibilities. Implementation of the plan will be completed by June 2016.

Maintaining Adequate Liquidity

5. We will continue to ensure adequate liquidity in our banking system. The CBC continuously monitors liquidity conditions and encourages banks to maintain adequate liquidity buffers to limit future liquidity risks. Liquidity has improved, and the CBC stands ready to take appropriate measures if needed, following the procedures and rules of the CBC and the Eurosystem. 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:

- ***Coordination with the SSM***. We will ensure sufficient resources are available at the CBC to effectively carry out its duties on supervision and resolution, in close coordination with the SSM. We are also reviewing our regulatory framework against European best practices and recent experience. To this end, by end-January 2016 we will streamline our directive on loan origination.

- ***Subsidiaries of Greek banks in Cyprus.*** Building on recent measures of the European institutions aimed at strengthening the parent banks, we will continue to work together to ensure that the Greek subsidiaries operating in Cyprus remain adequately capitalized.

- ***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-January 2016 and drawing on external expertise, we will determine the additional data needs.

- ***Resolution of Laiki***. Important steps have been taken to complete the resolution of Laiki. Led by an independent advisor, the disposal of Laiki's foreign assets held in Malta, Romania, Serbia, Russia and Ukraine is expected to be completed within the next few months. Starting in 2016, responsibility for resolution of Laiki will be assumed by the European Single Resolution Board.

7. We remain committed to reinforcing supervision of insurance and pension funds. As a first step, regarding insurance supervision, we will finalize the transposition of the European Solvency II Directive into national law. In addition, we will prepare an action plan to integrate the insurance sector and pension fund supervisions, and will submit to Parliament draft legislation to achieve this purpose by end-March 2016, ensuring that the resulting institutions will be adequately resourced. In order for the authority to strengthen its adequate supervision, a review of the insurance undertakings will be conducted during 2016, including a number of on-site inspections covering a high percentage of the insurance market, in the context of the planned 2016 EIOPA EU-wide stress test exercise.

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 finalizing the onsite inspections under the 2015 supervisory plan, in line with the new risk-based AML/CFT supervision methodology. The inspection plan for 2016 has been approved by the Governor and will continue to rely on the assistance of external auditors. The CBC recently fined the local branch of a foreign bank for the breach of AML/CFT obligations identified during the 2014 inspection, and intends to impose sanctions in those remaining cases where breaches were identified during the 2014-15 bank inspections, but punitive measures have not yet been applied. The CBC, as a matter of priority, will streamline procedures to the extent possible to reduce the time between the visit to a financial institution, the finalization of the report and, where appropriate, the imposition of sanctions.

- ***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. CBA and ICPAC will apply sanctions to lawyers and accountants respectively, when appropriate.

- ***Registrar of Companies**:* Work is underway to restructure the Department of the Registrar of Companies. The reorganization of the department will begin by end-March 2016 with a view to modernize its operations in line with the new company law. Having sent all the required notifications, in December, we struck off the registry more than 55,000 companies non-active and non-compliant with the requirement to submit annual reports.

C. Fiscal Policy

9. **The cash primary balance through September continued to exceed our target.** The general government accounts had a cash primary surplus of 1.9 percent of GDP, compared with a target of 1.7 percent of GDP. This outcome mainly reflects the improved economic environment, which resulted in lower unemployment and redundancy benefits and led to a reduction in social transfers. The better-than-expected primary balance was achieved despite temporary factors which resulted in lower revenues in the third quarter (i.e. the postponement of the deadline to pay the immovable property tax) and higher other current expenditure (specifically, accelerated payments to the EU budget) which will be reversed in the fourth quarter.

10. **Given the sustained overperformance, the cash primary balance targets for 2015 and 2016 are revised upwards.** The target for 2015 will be raised by 0.2 percent of GDP to 1.5 percent of GDP in line with our commitment to save any overperformance due to faster GDP growth. The target for 2016 will be raised by 0.1 percent (slightly less than the increase for 2015) to 2.5 percent of GDP mainly because a portion of the payment of the contribution to the National Resolution Fund expected in 2015 will now occur fully in 2016. Overall, the increase in the primary surplus in 2016 reflects the dissipation of a number of negative one-off factors in 2015, and hence will not depend on new fiscal measures. Given risks to the macroeconomic outlook, we will let automatic stabilizers operate if economic activity turns out worse than forecasted.

11. **The medium term fiscal targets remain unchanged.** We will continue to target a primary surplus of 3 percent of GDP for 2017 and a primary surplus of 3-4 percent of GDP for 2018 and beyond. These targets are consistent with our overarching objective of maintaining public debt on a sustained downward path. In December, Parliament adopted the 2016 budget documents, including a medium term fiscal framework encompassing the described fiscal targets for the period 2016-18.

D. Structural Reforms

12. We are committed to our comprehensive welfare reform that ensures a guaranteed minimum income (GMI) for all those in need and makes benefit administration more efficient. We will finalize by end-January 2016 an assessment of the implementation of the GMI, which will review the main outcomes, the number of applications, fiscal costs, targeting accuracy, and coverage. Based on the assessment, we will identify areas for further improvement. We will adopt a unified legislative framework to improve the targeting of disability benefits, while preserving budget neutrality. In December, we adopted a law to unify the administration of education benefits and established a registry of benefits in line with our new welfare law and cross-checked with other databases[1]. With the registry in place, we will re-examine the overall welfare reform by end-March 2016, so as to realize efficiency gains from the consolidation of all information on welfare programs.

13. We continue implementing the integration of our revenue administration. We are committed to finalize the integration of the new tax department (CTD) by end-June 2016, while protecting revenue performance. To this end, we will ensure strong leadership with a focus on reform and to make CTD's new organizational structures fully operational, providing them with adequate IT and human resources. Our efforts continue to be organized along two fronts:

- ***Reforming the revenue administration***. Since September, we have been preparing quarterly revenue performance reports on the basis of monthly indicators of key CTD functions. In November, we put in place a single registration process for new taxpayers covering all domestic taxes. For existing taxpayers, we will ensure they have a unique tax identification number for all taxes, in the process of finalizing the cleansing of the corporate taxpayer register planned for end-January 2016. Regarding the LTO, we will ensure adequate human resources to cover all major tax administration functions (i.e., taxpayer services, risk assessment, and compliance activities) by end-March 2016, with a view to gradually expanding the LTO's coverage to 50 percent of revenue. By end-January 2016, the Council of Ministers will approve a new tax procedures code. Finally, by end-June 2016, we will strengthen the legal framework governing the criminal tax investigations unit, including by introducing judicial oversight, and increasing coordination with relevant law enforcement agencies.

- ***Addressing assessment backlogs and tax arrears***. We will prepare an action plan to reduce the large backlog of un-assessed tax returns. The plan will allow us to identify the size and nature of the backlog of tax returns and determine taxes and refunds due. We will pursue a strategy that strikes a balance between collection speed and capacity to repay of taxpayers, so as to avoid excessive burden. We have adopted an arrears recovery plan that targets the largest

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

debts and uses new collection enforcement tools, such as garnishment. The plan will be implemented on a continuous basis.

14. Our public financial management reforms focus on implementation of the Fiscal Responsibility and Budget Systems Law (FRBSL) and management of fiscal risks. By end-January 2016, Parliament will adopt the pending FRBSL regulations. By end-February 2016, we will adopt a new budget classification and chart of accounts in the context of the implementation of the new Enterprise Resources Planning System. We will prepare by end-January 2016 an updated risk assessment report incorporating a new methodology, and strengthen financial reporting by local governments and SOEs in line with FRBSL requirements. Parliament will adopt the law regulating the creation and functioning of state-owned enterprises (SOEs law) by end-March 2016. Further, the Treasury will cooperate with the competent government bodies to improve timely reporting, and publication of audited general government entities' financial statements. Similarly, the Ministry of Finance will cooperate with the Auditor General to ensure the timely publication of SOEs audited financial statements.

15. We will reach important milestones in our privatization agenda in the coming months. Our privatization plan includes, among other, CyTA (telecoms), EAC (electricity), and the commercial activities of the port of Limassol Privatization is expected to improve economic efficiency, help to reduce our public debt, and encourage foreign direct investment. We will select the winning bidder for the concession of the commercial activities of the Limassol port by end-March 2016, with a view to signing the concession agreement by the end-April 2016. The regulatory framework of the Cyprus Port Authority (CPA) will be amended by end-January 2016 and implemented before the new concessioner is in place. Bills on CyTA's corporatization and on options for CyTA's employees following privatization will be adopted by Parliament by end-January 2016. The call for expression of interest will be launched immediately afterwards, with a view to finalizing CyTA's privatization within 9 months. Based on the recommendations of an independent energy advisor, and with a view to promote effective competition in the electricity market, we will submit to Parliament legislation for the effective and efficient unbundling of the Electricity Authority of Cyprus during 2016. The unbundling will be implemented no later than 2017.

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 eliminate red tape, we will implement the recently approved Smart Regulation plan, which will be monitored through semi-annual progress reports starting in May 2016. In this context, we have finalized the assessment of the regulatory framework governing the tourism sector and all necessary legal amendments to modernize the framework will be approved by the Council of Ministers by end-March 2016. We will develop a time-bound action plan to strengthen the enforcement of contracts, including streamlining judicial procedures. To stimulate private investment, by end-February 2016, we will prepare a framework to attract strategic investments, through fast-tracking administrative procedures for licensing. Legislation to implement the framework will be approved by the Council of Ministers by end-March 2016.

- To enhance the effectiveness of our public administration, while also ensuring its affordability, by end-February 2016, Parliament will adopt a reform package including a revision of the wage setting framework and the opening of promotion posts to the wider civil service (**modified end-December 2015 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. Our financing buffers have been boosted by the recent debt issuance in the international markets. In line with our debt management strategy, the proceeds have also been used to extend the duration of our debt, as well as to smooth maturities and minimize refinancing risk after the program. In addition, consistent 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-January 2016. 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.

18. We have now reached the penultimate program review and our performance under the program has been strong. Policy implementation under our program includes performance criteria and structural benchmarks defined in Tables 1 and 2 and in the Technical Memorandum of Understanding (TMU). 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. Quantitative Conditionality 1/
(Millions of euros unless otherwise specified)

	Performance Criteria			
	Sep-15			Dec-15 2/
	Target	Adjusted target	Actual	
Floor on the general government primary balance 3/	300		323	232
Ceiling on the general government primary expenditure 3/	4,659		4,598	6,660
Ceiling on the stock of general government debt 5/	19,269	19,249	19,114	18,532
Ceiling on the accumulation of new general government guarantees 3/ 6/	93	55	54	133
Ceiling on the accumulation of external arrears 3/ 4/	0		0	0
Ceiling on the accumulation of domestic arrears 3/	0		-2	0
Ceiling on the accumulation of tax refund arrears by the general government 3/	33		3	33

1/ As defined in the technical memorandum of understanding.
2/ Targets are unchanged relative to the 8th review as Board discussion of the 9th review occurs after the end-December test date.
3/ Cumulative since January of the corresponding year.
4/ Continuous performance criterion.
5/ Adjusted target down by €20 million due to the non disbursement of the Entrepreneurship Fund EIB loan as per the TMU.
6/ Adjusted target down by€ 38 million due to a disbursement of €53 million government guaranteed EIB loans compared to €91 million projected until end Q3 as per TMU.

Table 2. Structural Benchmarks

Measures	Timing
Approval by the Council of Ministers of legislation for the issuance and transfer of title deeds in non-legacy and new property transactions	End-January 2016
Parliamentary approval of a public administration reform package including a revision of the wage setting framework for the civil service	End-February 2016
Adoption by Parliament of legislation to remove existing impediments to the securitization of assets	End-February 2016
Adoption by the Council of Ministers of any necessary adjustments to correct deficiencies of the insolvency and foreclosure frameworks, including legislative changes	End-February 2016

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.

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 January 22, 2016

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

With only one review remaining, it is important to mention that the current program, underpinned by the authorities' firm commitment, brought back economic stability and lays the foundation for sustained growth and improved living standards for the people of Cyprus.

The economic recovery has continued and despite a challenging external environment, Cyprus posted three consecutive quarters of positive growth. In the financial sector, loan restructurings continued to accelerate, deposits are showing moderate growth and the liquidity buffers have improved. Moreover, the recent adoption of the law on the sale of loans is an important additional element in the toolkit to facilitate the cleaning up of banks' balance sheets. Furthermore, the authorities have taken measures to strengthen the cooperative credit sector, including reinforcing its capital base and deepening the ongoing restructuring process. Fiscal performance has continued to exceed expectations and, with that, all end-September and subsequent performance criteria have been met. Despite some delays, progress has been made on the program's structural reform agenda. One of the structural benchmarks scheduled through end-December was met and important work is being done to complete the three remaining benchmarks.

Macroeconomic developments

The economic performance continues to exceed expectations, maintaining the positive trend, in the third quarter. Economic indicators reflect a slow pick-up in private consumption and a broader recovery across economic sectors. Notwithstanding the high level of NPLs, the financial sector continues to strengthen, while the pace of lending is slowly accelerating. Together with the positive fiscal surplus, these developments have improved the sovereign debt situation, with upgrades from two rating agencies, while strong demand for the recently issued Eurobond (the third one since the 2013 crisis) pushed the yields to historically low rates. However, the unemployment rate remains elevated, at around 15 percent.

Fiscal policy

The program's fiscal performance continues to run ahead of expectations. This reflects the authorities' commitment to reform as well as a better economic environment that has contributed to reducing unemployment social transfers. These results should help Cyprus achieve its medium-term fiscal targets, a primary surplus of 3 percent of GDP for 2017 and 3-4 percent of GDP for 2018 and beyond. The already adopted 2016 budget documents also include a medium term fiscal framework encompassing the described fiscal targets for the period 2016-18.

Financial Sector

Notwithstanding the marked improvement of the economic environment, the authorities keep reducing the high level of NPLs high on their agenda. Three steps are envisaged: i) ensuring effective implementation of the recently established foreclosure and insolvency regimes; ii) enforcing the supervisory tools for arrears management, and iii) improving the legislation to facilitate banks' disposal of distressed assets. This approach aims to further encourage voluntary debt restructuring and increase the pace of durable solutions, with the ultimate objective of expediting the cleanup of private sector balance sheets and reviving credit growth. Moreover, the authorities are committed to monitoring the implementation and to adjust the legal framework as needed, to ensure an effective implementation of the new insolvency and foreclosure laws.

The authorities are also focusing on the secondary market for loans. To facilitate the creation of this market, a law on the sales of loans has been adopted end–September 2015. This law, which retains the protection of borrowers under the Code of Conduct, will be a useful addition to the toolkit to address the high levels of banks' NPLs. Also, the Council of Ministers is expected to approve -by the end of this month- a draft legislation to remove existing impediments to the securitization of assets. The bill includes, inter alia, removing the requirement to obtain the prior consent of borrowers for inclusion in the securitization, as well as any changes to the tax system deemed necessary. The law will be adopted by Parliament by the end of next month.

Structural reforms

The authorities have used the crisis as a window of opportunity to lay the foundation for a more viable and sustainable growth model. Important progress is being made, inter alia, in the goods and services market, public administration, public financial management, housing market, health, and energy. With the economy being stabilized and most urgent issues addressed, the reform effort is now focused on the remaining structural reforms to deal with longstanding inefficiencies that are hampering growth, reduce productivity incentives and foster unjustified social imbalances.

Significant efforts are made towards a comprehensive welfare reform that ensures a guaranteed minimum income for all those in need and that makes the administration of social benefits more efficient. The Cypriot authorities will continue to implement the reform of the revenue administration and the integration of the new tax department by mid 2016, while protecting revenue performance.

Despite a few delays, some progress with privatizing state-owned enterprises has been made and the process is moving ahead. The authorities' privatization plan includes, among others, CyTA telecommunication, EAC, and the commercial activities of the port of Limassol. In regards to the telecommunication company, the authorities are making efforts to have the bills on the corporatization process and on the employment options for current employees adopted by Parliament by end-January 2016. The call for expression of interest is expected to be launched immediately afterwards, with a view to finalize CyTA's privatization later this year. Regarding the energy company, the authorities appointed an independent energy advisor to assist with drafting legislation on the effective and efficient unbundling of the Electricity Authority of Cyprus during this year in order to promote effective competition in the electricity market. Regarding the port of Limassol, the announcement of the selected bidder for the concession of the commercial activities is expected by end-March 2016, with a view to sign the concession agreement by end-April 2016. The regulatory framework of the Cyprus Port Authority (CPA) will be amended by end-January 2016 and implemented before the new concessioner is in place.

Conclusion

After almost three years of difficult adjustments, there are clear signs that the efforts are finally being rewarded. While the Cypriot authorities are aware of the remaining significant challenges, we are happy to conclude that Cyprus has reached the penultimate program review with a strong performance.