

Bruegel Conference in Cyprus

Cyprus: Financing the Recovery

Cyprus: Banking sector lessons from restructuring and current challenges

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The Banking Sector in Cyprus: A Brief History

- The Cypriot banking sector has increased substantially especially between 2000 and 2012.
- Has expanded rabidly not only in Cyprus but also in Greece and other countries.
- In December 2012, the Cypriot banking sector was approximately five times the country's GDP.

The Banking Sector in Cyprus: A Brief History

- Excess Liquidity after the middle of the decade of 2000
 - Inflow of deposits from Russia and other countries of Eastern Europe.
 - After 2000, we experienced a real estate boom and the Cypriots have deposited the revenue from sales of real estate in Cypriot banks.

The Banking Sector in Cyprus: A Brief History

- In response to this excess liquidity the Cypriot banks
 - Expand their operations in Greece and elsewhere
 - Increase the provision of loans in Cyprus primarily for real estate by reducing the loan standards.
- Recycling of real estate euros.

The collapse of the Cypriot banking sector: History

- The Cypriot banks bought around 5 billions euro of Greek debt. The haircut of this debt in October 2012 resulted in a loss of approximately 4 billions euros.
- The economic crisis in Greece and later on in Cyprus increased substantially the percentage of nonperforming loans.
- The Cypriot banks were unable to raise from the private markets the estimated needed capital of seven billion euros for their recapitalization.

The collapse of the Cypriot banking sector: History

- The Cypriot government was unable to borrow to finance the recapitalization of the Cypriot banks
- An agreement with troika in March 2013 which resulted in
 - Closing the Marfi-Laiki Bank
 - Recapitalizing the bank of Cyprus using deposits over 100 thousands euros
 - Selling the operations of Cypriot banks in Greece.
 - Capital controls.

The collapse of the Cypriot banking sector: The causes

- Quick expansion in Greece and in the risky markets of Eastern Europe.
- The purchase of a large amount of Greek debt relative to their size.
- The very low lending standards they use, especially in the real estate sector.
- Their lending practices which were based primarily on the value of the collateral and not on the ability of the borrower to make the monthly payments.

Problems of the Cypriot banking sector after the deposit haircut

- Lack of confidence of local and foreigners to the sector
- High interest rates to keep deposits and thus high interest rates for loans.
- The Bank of Cyprus depends a lot on Emergency Liquidity assistance (ELA)
- Very high percentage of Non Performing Loans
- The economy was in deep recession

Restructuring of the Cypriot banking sector

- New and very strict lending standards based primarily on the ability to make the payments of the loan.
- Downsizing by selling their operations abroad and offering incentives for early retirement.
- Inflow of new private capital into the Bank of Cyprus and Hellenic Bank.
- Reduction in deposit and lending rates in 2014 and more in 2015 (mainly induced by the policy of the Central Bank).

Current Situation and Challenges

➤ Negative

- Very high ratio of private Debt to GDP
- Very high ration of Non performing loans to total loans especially for small and medium size enterprises and households. The highest in the Eurozone.

➤ Positive

- The real estate market shows signs of stability.
- The economy is out of recession. It is expected to grow between 1.0-1.5% in 2015 and between 1.5-2.0% in 2016.

Deposits and Loans (%GDP)

	Households		Enterprises	
	Deposits	Loans	Deposits	Loans
Eurozone	63	52	20	40
Cyprus	136	126	33	134
Greece	75	62	11	54

Non Performing Loans, All banks and Co-op, Local operations

Date	Total credit facilities Million euros	NPLs including fully secured Million euros	NPLs including fully secured to total Credit facilities %
31/12/2010	60,471	8,587	14,2%
31/12/2011	67,177	10,950	16,3%
31/12/2012	68,862	15,563	22,6%
31/12/2013	62,725	26,005	41,46%
31/12/2014	57,224	27,328	47,7%
31/6/2015	58,278	27,004	46,3%
31/7/2015	57,784	27,390	47,4%
31/8/2015	57,304	27,379	47,7%

Non Performing Loans, All banks and Co-op, Local operations on 31/8/2015

	Total credit facilities Million euros	NPLs including fully secured Million euros	NPLs including fully secured to total Credit facilities %
Total	57,304	27,379	47,7%
Non-financial corporations	24,220	13,858	57,2%
Of which small and medium enterprises	13,997	9,214	65,8%
Households	22,812	12,733	55,8%

Non Performing Loans

- **Strategic defaults:** Up to 20% of NPLs are due to strategic defaults. Moody's (October 2015) estimates the strategic defaults between 10-20%.
- According to KPMG Property Lending Barometer for 2015, For Cyprus only 30% of the real estate loans are fully compliant, 11% minor impairment and 59% serious impairment.
- Bank representatives in Cyprus think that through restructuring they can successfully manage the 58% of the impaired real estates loans.

Real Estate Market in Cyprus: 2015

➤ Residential Property Prices:

According to Central Bank of Cyprus Residential Property Price Index, real estate prices continue to decline but in the last two quarters the decrease was marginal

-2014Q4 75,6

-2015Q1 74,8

- 2015Q2 74,5

Real Estate Market in Cyprus: 2015

➤ Number of sale contracts:

According to data published by the Department of Lands and Surveys the number of sale contracts to Cypriot and foreigner buyers

- 2015Q1 increase by 15,8%
- 2015Q2 decrease by 1.2%
 - increase by 15,6% by foreigners
 - decrease by 7,2 % by Cypriots

Real Estate Market in Cyprus: 2015

- Local sales of cement increase in 2015Q2 by an annual rate of 9,8% for the first time since 2008Q4.
- Cypriot Data from 2002 and 2014 show very strong positive correlation between real GDP real Residential Property Price Index (RPPI).
- ❖ Thus the increase in real GDP in 2015 and in the following years is expected to lead in real growth in RPPI.

Loans Market in Cyprus (based on Euro area bank lending survey by ECB)

➤ Enterprises

- Credit standards have eased even more during the first quarter of 2015 and remain the same during the second.
- The demand for loans has increased in the first two quarters of 2015.

Loans Market in Cyprus (based on Euro area bank lending survey)

- Households -House purchase/Consumer credit
 - The credit standards declined considerably during the first quarter of 2015 but remain the same during the second .
 - The demand for loans increased in the first and second quarters of 2015.
 - Note that the net demand for loans for house purchases increase for the first time since 2010 Q2 and for consumer credit since 2008.

Concluding Remarks

The biggest challenge of the Cypriot banking sector is to restructured a good part of the Non Performing Loans. The recovering of the Cypriot economy and the stabilization of the real estate sector is expected to help the banking sector significantly in this effort. However,

- The government and the parliament must help the banks to reduce the strategic defaults.
- The Central Bank must help the banks to accelerate the speed of restructuring the NPLs. As it is now, it can take years to restructure all the NPLs.