



**CENTRAL BANK OF CYPRUS**

EUROSYSTEM

## **The Cypriot Banking Sector and a Promising Outlook for the Future**

**Speech by Mrs Chrystalla Georghadji, Governor of the Central Bank of Cyprus, at the 2015 Cyprus Investors Summit organized by the Cyprus Investment Promotion Agency (CIPA)**

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### **Introduction**

Ladies and gentlemen,

It is my pleasure to address this summit before such a prominent audience. I would like to thank the Cyprus Investment Promotion Agency for their kind invitation, and for giving me the opportunity to share with you our renewed belief that Cyprus will slowly but steadily emerge stronger from the recent downturn.

The Central Bank of Cyprus as well as domestic and international banks operating on the island, have expressed their commitment and determination to enhance the leading role our banking system plays in our economy. Without doubt, a solid banking sector is imperative in supporting Cyprus as a financial centre.

A series of reforms have taken place following the unprecedented and challenging events our banking system and the wider

economy faced during 2013. Important steps towards fully restoring confidence and stability have been taken, in cooperation with our European partners (the ECB, the IMF, and the European Commission).

In November last year, a historic new journey commenced for all banks across Europe with the launch of the Single Supervisory Mechanism, known by its acronym SSM. It is a key mechanism under the European Central Bank and one of the most important steps towards a strengthened Economic and Monetary Union, aiming at ensuring safety and soundness in the European banking sector.

As regards Cyprus, the four most significant banks (Bank of Cyprus, Cooperative Central Bank, Hellenic Bank and Russian Commercial Bank) are now directly supervised by the European Central Bank. In addition, less significant institutions which include smaller banks registered in Cyprus are indirectly supervised by the SSM.

A new era has thus begun for both Cyprus and Europe in terms of bank supervision.

### **Recent macroeconomic developments**

Before I proceed with a more detailed analysis of the developments in the banking sector, let me briefly say a few words about the progress achieved so far on the macroeconomic

front. A brief overview will help set the context in which our banks are operating as well as their prospects.

Initially, it should be noted that developments in the real economy have been generally better than predicted by Cyprus' international lenders. This indicates that the Cypriot economy and society in general, have exhibited considerable flexibility and endurance, keeping the country resilient even after the recent dramatic developments. In particular, while Troika in its fifth assessment of the Cyprus economic adjustment programme last July, predicted a real GDP decline of approximately 4.2% for 2014, the most recent revised forecasts by the IMF and the European Commission project a real GDP decline of 3.2% and 2.8%, respectively. Even better, according to the latest available data, the Central Bank of Cyprus expects a decline of around 2.5%. For 2015 the economy is expected to do better and rebound with a marginal positive growth.

Secondly, the developments regarding public finances were significantly better than expected compared to past estimates by our international lenders. In its fifth assessment Troika forecasts a budget deficit of 4.7% of GDP for 2014. However, most recent estimates suggest that the budget deficit will be substantially smaller. This revision enables a relatively more optimistic fiscal outlook for 2015, provided of course that the consistent and prudent implementation of the state budget continues.

## **Developments in the banking sector**

During 2013, our banking sector experienced its most challenging period to date. Several Cypriot banks were faced with an urgent need to reconsider their strategies and steps had to be taken within the context of the Memorandum of Understanding with the Troika, to refocus and restructure the sector.

Unfortunately, for many years, the banking sector in Cyprus adopted poor risk and credit management practices. The sector was dominated by asset based lending and a strong focus on the real estate market, leading to an overexpansion of the banks' balance sheets.

Although the consequences of such practices may initially be disguised and even appears successful during a growing and booming economy, eventually such recipes lead to serious imbalances. The aftermath is a high number of non-performing loans as part of the ripple effects of the global financial crisis. With falling demand, the economy in recession and prices of real estate and other assets decreasing, banks have had to reconsider their strategies.

In the past two years, a series of corrective measures and reforms have taken place, aimed at strengthening the foundations of the sector following the loss in confidence and the severe shocks experienced after March 2013. Cyprus embarked on an economic adjustment programme with the Troika. In the banking sector, an assessment was made of the immediate

priorities with the aim of restoring the health of our banks and the wider financial system.

As already mentioned, a milestone in the restoration of confidence has recently been achieved with the successful completion of the EU-wide comprehensive assessment exercise, conducted jointly by the European Banking Authority and the European Central Bank. This was aimed at rigorously examining the balance sheets and solvency of Europe's 130 systemic banks prior to the SSM's launch, which placed them under the ECB's direct supervision.

The exercise applied the same methodology to all 130 banks tested, including the four significant banks incorporated in Cyprus. It is important to note that the starting reference date to which the series of stress scenarios were applied was 31<sup>st</sup> December 2013. This was at the end of the most turbulent year in the history of Cyprus banking, effectively presenting our banks with the additional challenge of conducting the stress test at the very bottom of our economic cycle. Despite this additional challenge and the fact that the tests applied to the four Cypriot banks were the same as those applied to the major banks of Europe, our banks delivered successful and encouraging results.

It is important for the wider economy and public finances that the €1 billion buffer provided within the €10 billion Troika programme will not be needed to cover any capital shortfalls in the banking system. The improving capital position of the banks, provides the

opportunity to either reduce the lending required from the programme and the national debt by €1 billion, or consider whether this may be allocated to other areas.

A further positive development is the high level of foreign investment injected across our banking sector by renowned international investors and institutions. In the past 18 months, experienced foreign investors have participated with significant funds and have taken substantial positions in several banks incorporated in Cyprus.

These capital injections constitute some of the largest foreign investments seen in the history of our economy. This provides encouragement and affirm indication that the confidence of the international community is returning to the Cyprus banking sector. It is pleasing to see that the recent restructuring work and reforms made in the sector and the wider economy are already delivering promising results, and the sector is coming out of this difficult juncture in a strong and healthier condition.

The banks have been restructured and recapitalised and are refocusing their operations with a prudent risk-based approach to lending and investing, devoting their capital and liquidity to servicing local and international businesses wishing to invest in Cyprus.

## **Concluding remarks**

Restructuring and cleaning up a bank's balance sheet is not easy, and market conditions remain challenging. However, this also provides opportunities. We remain fully committed to the implementation of the programme agreed with the international lenders and in re-establishing a thriving banking sector that can effectively meet the needs of businesses and households.

For us this is the only way that will eventually enable the island to once again have access to adequate borrowing from the markets and return to sustained growth and prosperity.

Overall, the developments so far in the banking sector, the ongoing fiscal consolidation process and the better management of the economy as a whole are creating the conditions for the island's exit from the crisis. With sound infrastructure, expertise in financial services, a strong legal and regulatory framework and a wide network of double tax treaties, Cyprus is setting the stage for a sustainable recovery. This includes regaining its role as an attractive financial centre but in a more prudent and robust way.

I remain positive that the Cyprus economy will come out stronger from the current crisis. Cyprus is a European Union member state; it has a strategic location between three continents, well performing industries such as tourism and shipping and is expecting further investment in the energy sector. Moreover, it maintains a strong financial services infrastructure, experience and know-how.

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A stronger banking sector will provide opportunities for businesses to flourish. Our banks are well capitalised and are in a strong position to provide support and to continue servicing their clients.

Thank you.