



CENTRAL BANK OF CYPRUS
EUROSYSTEM

PORTFOLIO INVESTMENT REPORT 2019

INTRODUCTION

The *Portfolio Investment Report* provides an overview of the main developments in portfolio investment (PI) statistics¹, as published by the Statistics Department of the Central Bank of Cyprus (CBC). This edition of the report concentrates on the annual period of 2019.

The CBC compiles PI statistics in accordance with the statistical standards², namely the IMF's Balance of Payments and International Investment Position Manual, 6th Edition (BPM6) and the European System of Accounts, 2010 (ESA 2010). Data compiled on the basis of BPM6 methodology, which covers the period from 2008³ onwards, is based on the new residency definition of Cyprus, for statistical purposes⁴, and includes, inter alia, data of "special purpose entities" (SPEs)⁵, which are registered in Cyprus and thus classified, by definition, as residents. In order to present PI statistics in a more objective manner for Cyprus, however, this report also presents some supplementary series, adjusted for the impact of SPEs, that is, treating them as non-residents.

PI constitutes a direct way to access financial markets and can thus provide liquidity and

flexibility. Additionally, the negotiability of securities allows investors to diversify their portfolios and withdraw their investment at any time.

The analysis that follows also concentrates on the regional and sectoral analysis of the PI investments made by residents abroad and by non-residents in Cyprus throughout the year 2019.

The main conclusions of the analysis are summarised as follows:

- Both, PI assets and PI liabilities increased in 2019 when compared with 2018, with PI assets increasing the most.
- In 2019, the main holder of PI assets was "Other Sectors"⁶ while the main issuers of PI liabilities were "Other Sectors" and "General Government".
- The main PI counterpart countries for resident investors were Russia, Luxembourg, Ireland and the United States.
- Changes in stocks throughout the year for assets, were caused mostly by transactions in contrast with liabilities for

¹ For more information on the definition and scope of portfolio investment statistics please refer to the Appendix.

² More information on presentation and methodology is provided in the Appendix.

³ In the content of Macroeconomic Imbalance Procedure, starting from 2004, the CBC estimated longer time series in BPM6 format for the main external statistics indicators, for the period 2004-2007.

⁴ Please refer to the Appendix for the definition of "resident" for statistical purposes.

⁵ Please refer to the Appendix for the criteria under which an entity is considered an SPE.

⁶ "Other Sectors": This category includes financial corporations apart from the Central Bank and other monetary financial institutions, non-financial corporations, non-profit institutions and households.

which movements were related to price changes as well as transactions.

- Income for PI assets in 2019 arose mainly from equity and investment fund shares whereas for liabilities it mainly arose from interest on debt securities.
- When treating SPEs as non-residents, both PI assets and liabilities decreased with liabilities being impacted the most for the year.

1. PORTFOLIO INVESTMENT ASSETS

1.1 PI assets stocks

As presented in **Table 1**, total PI assets stocks in 2019 amounted to €24.611,1 million, increasing significantly from €19.414,6 million in 2018. This is reflected by an increasing trend in both equity and investment fund shares and debt securities investments made by residents abroad.

TABLE 1: Total PI assets by sector and instrument						
(€ million)	2018		2019			
PI ASSETS	Amounts Outstanding	Transactions	Exchange rate changes	Price changes	Other volume changes	Amounts outstanding
TOTAL ASSETS	19.414,6	2.583,4	802,6	1.688,3	122,3	24.611,1
Total assets by sector						
Central Bank	4.935,8	-368,4	0,2	79,6	4,9	4.652,1
MFIs	2.352,2	1.556,2	34,3	-0,1	9,7	3.952,3
General Government	0,0	0,0	0,0	0,0	0,0	0,0
Other Sectors	12.126,5	1.395,6	768,1	1.608,8	107,8	16.006,7
Total assets per instrument						
Equity and investment fund shares	8.472,0	1.026,5	670,9	1.506,3	82,2	11.758,0
Short-term debt securities	553,5	-50,1	17,1	-5,6	22,2	537,1
Long-term debt securities	10.389,1	1.606,9	114,5	187,6	18,0	12.316,0

Source : CBC

The majority of PI assets is held by resident investors in the category of “Other Sectors”.

The main component of PI assets is debt securities but as shown in **Table 1**, in 2019 debt is only slightly higher than equity and investment fund shares. This indicates that preferences of resident investors vary between debt and equity during the reporting period. In particular:

- Debt securities assets totalled €12.853,1 million in 2019, representing 52% of total portfolio assets compared with 56% in 2018, and
- Equity and investment fund shares totalled €11.758,0 million in assets in 2019, accounting for 48% of total portfolio assets, compared to 44% for 2018.

As regards debt securities holdings, the vast majority is undertaken with long-term maturity (96% in 2019) with main holders being the CBC and “Other Sectors”. Specifically, in 2019, the long-term holdings of the CBC dropped slightly by €245,8 million, whilst investment from “Other Sectors” increased by €719,1 million.

The increase in equity and investment fund shares in 2019 was due to the increase recorded in the holdings of the “Other Sectors” (€3.283,3 million). In particular, this was attributed to the holdings in listed shares by “other financial institutions” and “captive financial institutions”⁷.

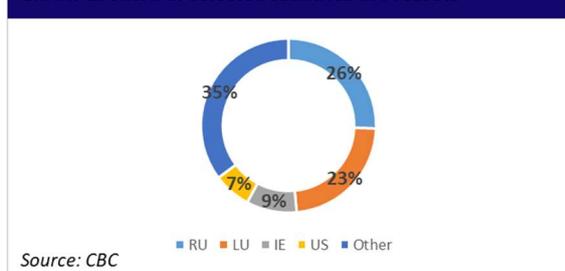
Chart 1 depicts the share of selected countries in PI assets in 2019. As per the chart, the main investment destinations related to PI assets, for the year 2019, are Russia, Luxembourg, Ireland and the United States.

A look at the securities in the key investment destinations shows that for Russia and the United States, securities made up the majority of the portfolio whilst for Luxemburg and Ireland both, debt securities and investment fund shares constitute the major part of the investment.

⁷ Captive financial institutions consists of all financial corporations and quasi-corporations which are neither engaged in financial intermediation nor in providing

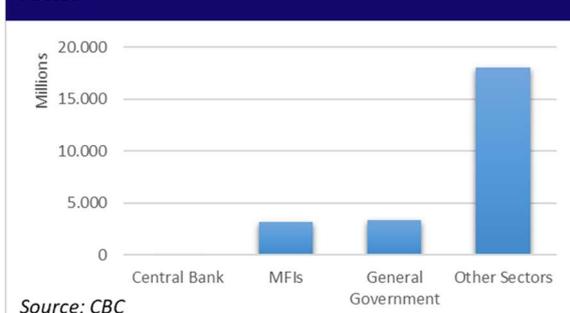
financial auxiliary services, and where most of either their assets or their liabilities are not transacted on open markets (e.g. holding companies, trusts, other financial SPEs).

CHART 1: Share of selected countries in PI assets



The main counterpart sector in which resident investors invested in 2019, as shown in **Chart 2**, was “Other Sectors”. More specifically, resident investors preferred the sub-categories “non-Financial Corporations” which accounted for 34% of the total PI assets in 2019 followed by “other financial institutions” with 21% of total PI assets.

CHART 2: Analysis of total PI assets per counterparty sector



1.2 Flows in PI assets

PI flows are examined based on resident institutional sector and instrument. Half of the increase in assets stocks throughout 2019 was due to transactions and the other half to flows other than transactions, with price changes being the most important (**Table 1**).

The main sectors contributing to the changes in assets during the year were the MFIs with flows of €1.600,1 million and the “Other Sectors” with flows of €3.880,2 million (**Table 1**). As regards the flows of MFIs, the increase was mainly due to transactions in debt securities of €1.415,5 million, while the increase in “Other Sectors” was due to both, price changes of equity holdings (these are more prone to price fluctuations than debt securities) and transactions of the same instrument category.

1.3 Income on PI assets

Income receivable on assets (credit) derived mostly from dividends from equity and investment fund shares in 2019, in contrast to 2018 when most of the income related to interest on debt securities (**Table 2**).

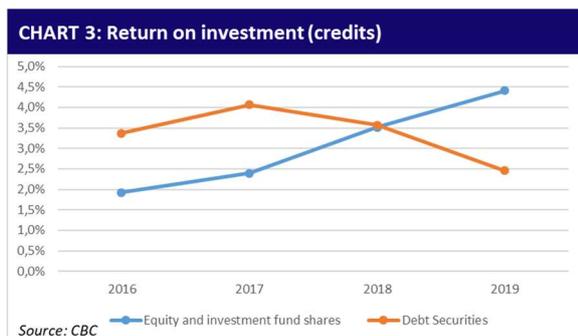
TABLE 2: Total PI income receivable per instrument and sector		
(€ million)	2018	2019
TOTAL PI INCOME RECEIVABLE	688,3	833,8
PI income receivable per instrument		
Equity and investment fund shares	298,0	517,9
Debt securities	390,3	315,9
PI income receivable per sector		
Central Bank	67,8	60,4
MFIs	47,0	60,2
Other Sectors	573,5	713,2

Source: CBC

Total income in 2019 amounted to €833,8 million, increasing from €688,3 million in 2018. In particular:

- Total income receivable from debt securities stood at €315,9 million in 2019, decreasing from €390,3 million in 2018 despite the increase in stocks of debt securities. This is in line with the recent trend of falling interest rates in the global economy, resulting in lower coupon rates and interest received on bonds issued abroad.
- Income from equity securities totalled €517,9 million in 2019, thus recording a significant increase from €298,0 million in 2018.

Income receivable on assets was mainly derived from the “Other Sectors”, in both, 2018 and 2019 (**Table 2**).



Return on investment in PI assets is shown in **Chart 3**. The return on investment in debt securities was 2,5% in 2019, compared to an increased rate of 3,6% in 2018.

The highest returns in debt securities were obtained from the holdings of the “other financial vehicle corporations” in Ireland, Netherlands, Russia and Great Britain.

The return on investment in equities and investment fund shares was 4,4% in 2019 indicating an increase from 2018, when the return was 3,5%. The higher return in 2019 was mostly due to the holdings of “captive financial institutions” in Russian listed shares investments.

2. PORTFOLIO INVESTMENT LIABILITIES

2.1 PI liabilities stocks

As presented in **Table 3**, total PI liabilities stocks in 2019 amounted to €26.835,6 million, increasing slightly from €25.880,5 million in 2018. The increase reflects an increasing interest of non-residents for investing in long-term debt securities.

The majority of PI liabilities is issued by resident investors in the category of ‘Other Sectors’ for 2018 and 2019 although concentration in this sector diminishes in 2019 as PI liabilities of the General Government increased.

TABLE 3: Total PI liabilities by sector and instrument

(€ million)	2018		2019			
PI LIABILITIES	Amounts Outstanding	Transactions	Exchange rate changes	Price changes	Other volume changes	Amounts outstanding
TOTAL LIABILITIES	25.880,5	476,8	42,3	591,2	-155,2	26.835,6
Total liabilities by sector						
Central Bank	0,0	0,0	0,0	0,0	0,0	0,0
MFIs	122,4	-11,5	0,1	3,0	4,2	118,3
General Government	5.783,1	2.355,7	0,0	631,2	0,0	8.770,0
Other Sectors	19.975,0	-1.867,5	42,2	-43,1	-159,4	17.947,3
Total liabilities per instrument						
Equity and investment fund shares	10.725,5	508,2	-52,35	-40,03	-160,03	10.981,3
Short-term debt securities	967,3	-63,9	-1,2	0,0	5,0	907,2
Long-term debt securities	14.187,7	32,5	95,9	631,2	-0,15	14.947,1

Source: CBC

The main component for PI liabilities was long-term debt securities but as shown in **Table 3**, equity and investment fund shares also constitute a significant part of the total PI liabilities. Specifically:

- Debt securities held by non-residents totalled €15.854,3 million in 2019 and €15.154,9 million in 2018, representing 59% of total portfolio liabilities in both, 2018 and 2019, and
- Equity and investment fund shares totalled €10.981,3 million and €10.725,5 million in 2019 and 2018 respectively, accounting for 41% of total portfolio liabilities in both, 2018 and 2019.

Debt securities are predominantly issued by “captive financial institutions” and the “General Government”. The respective amounts totalled €7.032,3 million and €8.770,0 million, in 2019, compared with €9.294,0 million and €5.783,1 million in 2018.

The developments in the “General Government”, during 2019, correspond to the additional issue of EMTN at a lower coupon rate with a purpose of refinancing existing high-rate debt.

The slight increase in total equity liabilities was due to the issues of the “Other Sectors”, in particular, listed shares issued by resident “captive financial institutions”.

2.2 Flows in PI liabilities

As depicted in **Table 3**, increases in liabilities in 2019 stocks are mainly attributed to price

changes adjustments and, to a lesser extent, transactions.

The increase in PI liabilities in 2019 is explained by a total inflow of €955,1 million, which mostly concerns adjustments in stocks due to transactions and price changes. In particular:

- a) €2.355,7 million increase in transactions of debt securities issued by the “General Government”,
- b) €631,2 million increase in price changes of debt securities issued by the “General Government”,
- c) €2.323,2 million decrease in transactions of long-term debt securities issued by resident “captive financial institutions”, and
- d) increase in transactions of investment fund shares.

2.3 Income on PI liabilities

Income payable on liabilities (debit) derived mainly from interest on debt securities during 2019 and 2018 (**Table 4**).

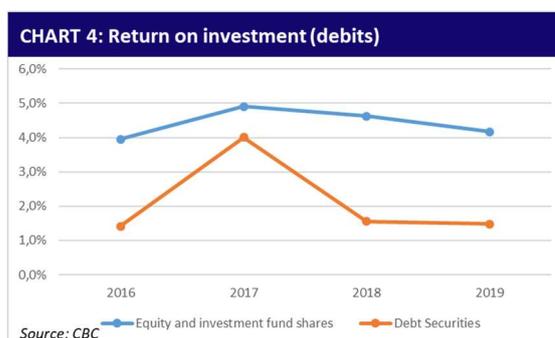
Total income payable amounted to €823,3 million in 2019, which remained relatively steady from €867,9 million in 2018 (**Table 4**).

- As regards income payable on debt securities, these amounted to €661,4 million in 2019, compared with €700,5 million in 2018. This decrease mainly relates to the decrease in stocks of foreign investment in debt securities issued by “captive financial institutions”.
- In 2019, income payable on equity and investment fund shares was €162,0 million compared with €167,5 million in 2018. The overall decrease from 2018 was mainly due to the lower return of the investments of non-residents in equity shares issued by “captive financial institutions”.

TABLE 4: Total PI income payable per instrument and sector		
(€ million)	2018	2019
TOTAL PI INCOME PAYABLE	867,9	823,3
PI income payable per instrument		
Equity and investment fund shares	167,5	162,0
Debt securities	700,5	661,4
PI income payable per sector		
MFIs	0,7	0,4
General Government	169,9	224,9
Other Sectors	697,3	598,0

Source : CBC

As shown in **Table 4**, PI liabilities income mostly derives from issues of residents in the “Other Sectors” and in particular from resident “captive financial institutions”.



Return on investment in PI liabilities is shown in **Chart 4**. The return on investment in debt securities for liabilities was 4,2% in 2019, compared to a rate of 4,6% in 2018.

As regards debt securities, the highest return in 2019 was provided by long-term debt securities issued by “Other Sectors” at 6,9%, compared to 6,2% in 2018.

The return on investment for equity and investment shares in liabilities was 1,5% in 2019 following a marginal decrease from 1,6% in 2018.

3. IMPACT OF SPEs ON PI STATISTICS

SPEs are considered residents of their country of registration/incorporation, for statistical purposes, albeit their transactions and stocks may, in their entirety, be “cross border”. They have played and continue to play an important role in financial markets. However, their number and complexity of their structure have increased considerably in recent years, contributing to the distortion of the main macroeconomic statistics.

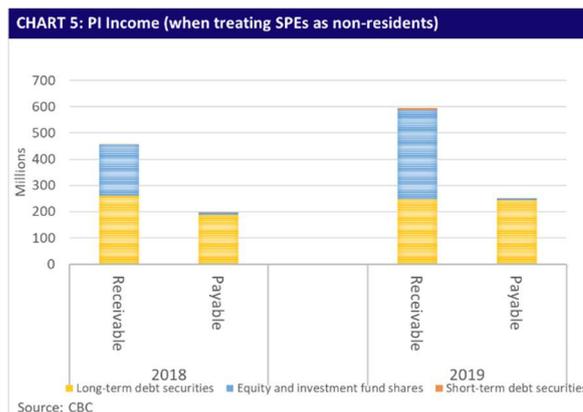
Cyprus hosts a large number of SPEs whose assets and liabilities strongly influence amongst others the PI statistics of the country, even though their interaction with the domestic economy is limited. The majority of SPEs with PI instruments are used as financing vehicles to channel funds within a global group on behalf of a non-resident parent company. The analysis that follows treats SPEs as non-residents so as to remove the impact those entities have on the overall PI statistics. It should be also noted that SPEs belong in the “Other Sectors” category and thus only this sector is affected.

When treating SPEs as non-residents, total PI assets decrease by approximately 13% for 2019 and 17% for 2018 compared to when treating SPEs as residents. The highest impact is located in equity and investment fund shares, which fall to €9.743,7 million in 2019 (Table 5) compared with €11.758,0 million when treating SPEs as residents (Table 1).

TABLE 5: PI stocks (when treating SPEs as non-residents)		
(€ million)	2018	2019
TOTAL ASSETS	16.059,6	21.401,1
Per Instrument		
Equity and investment fund shares	6.035,4	9.743,7
Short-term debt securities	548,7	532,3
Long-term debt securities	9.475,5	11.125,1
TOTAL LIABILITIES	8.368,9	12.301,2
Per Instrument		
Equity and investment fund shares	2.242,3	2.713,4
Short-term debt securities	86,0	48,1
Long-term debt securities	6.040,6	9.539,6

Source : CBC

Total PI liabilities are impacted the most from SPEs. In particular, they fall to €12.301,2 million in 2019 (Table 5) when treating SPEs as non-residents as opposed to total liabilities of €26.835,6 million when including SPEs as residents (Table 3). For the years 2019 and 2018 the impact of SPEs is mostly seen in the category of equity and investment fund shares with a drop of 75% and 79% respectively.



As regards income, most of the impact when treating SPEs as non-residents is observed on payable income, and more specifically, in long-term debt securities. This follows the fact that the stocks of PI liabilities decrease the most when treating SPEs as non-residents. In 2019, when treating SPEs as non-residents, total income payable decreased to €250,2 million and income from long-term debt securities fell to €243,4 million (Chart 5) which constitutes 37% of the total interest payable of this instrument when treating SPEs as residents.

APPENDIX

DEFINITION OF PORTFOLIO INVESTMENT

According to the IMF’s definition, portfolio investment is defined as cross-border positions and transactions in debt and equity securities, other than those included in direct investment or reserve assets. Securities are negotiable instruments, of which the legal ownership is readily capable of being transferred from one unit to another by delivery or endorsement. They include shares (equity securities) as well as bonds, notes and money market instruments such as treasury bills (debt securities). However, listed financial instruments such as warrants, swaps, forward contracts and options, considered as securities, are classified as financial derivatives.

Equity participation of less than 10% is also classified as PI, otherwise it is classified as direct investment, with the exception of investment funds’ holdings, in which case they are classified

as PI irrespective of the percentage of the holding.

Equity and debt securities are separately presented, where equity constitutes of listed, unlisted and investment fund shares and debt securities are sub-divided into short-term and long-term debt securities.

- Equity securities are instruments in the form of shares representing participation in a company's capital and acknowledging the holders' claims to its residual value by the provision of dividends as share of the profits.
- Long-term debt securities are debt instruments issued mainly with original maturities of more than one year and give the holder the unconditional right to fixed money income or contractually variable money income together with an unconditional right to a fixed sum as repayment of the principal on specific dates.
- Short-term debt securities are securities issued with original maturities of one year or less and give the unconditional right to the holder to receive the principal amount on maturity.

SOURCES

Cypriot PI data are compiled using various sources as follows:

- Security Holdings Statistics (SHS) survey conducted by the CBC on a monthly basis.
- Mirror data related to investments of resident households abroad.
- Securities Issues Statistics and ECB's Centralised Securities Database.
- Survey on External Financial Statistics conducted by the CBC on a quarterly basis. The aforementioned survey collects data for all types of investments and not only for the PI category, giving the opportunity to gather comprehensive data for each specific company.
- Annual financial statements of resident entities.
- Banks' Monthly Balance Sheet Items (BSI).
- CBC's Market Operations Department for data on the Bank's investments.
- Ministry of Finance/ Public Debt Management Office for data regarding the

General Government's issues of debt securities.

- Investment Funds Survey conducted by the CBC.
- Cyprus Stock Exchange for holdings of other sectors' listed equity by non-residents.

METHODOLOGICAL TREATMENT AND PRESENTATION OF PI

Based on the definitions described above, PI can be separated into:

- (a) PI assets representing investments in securities issued by non-residents, and
- (b) PI liabilities representing investment in securities issued by residents.

In line with the definitions and scope of the balance of payments and the international investment position of a country, two forms of time series variables are generated from PI transactions: stocks and flows.

Stocks refer to the balances of PI assets and liabilities at a specific point in time. They form part of a country's International Investment Position, representing the total amount of PI assets owned by residents and the total amount of PI liabilities owned by non-residents.

PI flows consist of the transactions carried out during a specific period of time. PI stock positions reflect the accumulation of transactions combined with the changes due to price (price revaluations), exchange rate fluctuations and other changes (reclassifications, write-offs).

PI flows also include PI income. Credit income is made up of dividends declared and interest receivable from overseas investments, as well as reinvested earnings of foreign investment funds attributable to resident investors. Debit

income comprises of dividends payable and interest expense by resident entities to non-resident investors and also, reinvested earnings of resident investment funds attributable to non-resident investors.

Flows are recorded in the financial account, portraying the inflows and outflows of funds in relation to the financial transactions between residents and non-residents of an economy. Income is recorded in the current account. The changes in each category are interpreted by the following principles:

PI flows

- Sign convention for the flows are consistent with those for the stocks, i.e. a positive sign represents an increase and a negative sign denotes a decrease in the asset or the liability.

PI income receivable:

- Positive sign refers to an increase in PI income receivable by residents from investments in non-resident entities arising from dividends and/or interest receivable, reinvested earnings of investment funds attributable to residents.
- Negative sign refers to distributable losses of non-resident investment funds attributable to resident investors.

PI income payable :

- Positive sign is explained by the increase in PI expenditure payable to non-resident investors such as dividends and interest payable as well as reinvested earnings of investment funds.
- Negative sign is explained by the realisation of distributable losses of resident investment funds attributable to non-resident holders.

Definition of the Term “resident of Cyprus” for Statistical Purposes

"Resident" has the meaning assigned to it in the Definition of the Term "resident of

Cyprus" for Statistical Purposes Directive of 2008.

In this directive:

- A **legal entity** is resident in the economic territory under whose laws the entity is incorporated or registered. This applies also to legal entities with little or no physical presence, e.g. investment funds (as distinct from their managers), securitisation vehicles, and some special purpose entities (SPEs). If the entity is not incorporated, it is considered to be resident in the country whose legal system governs the creation and continued existence of the entity.
- A **natural person** is a resident in the country that has a centre of economic interest. A centre of economic interest exists when a unit engages, and intends to continue engaging, either indefinitely or over a finite but long period of time, in economic activities and transactions on a significant scale in or from a location, dwelling, place of production or other premises within a territory.
- For practical reasons, actual or intended location for one year or more is used as an operational threshold. However, the following are examples of borderline cases in the determination of residency:
- Students who go abroad to study fulltime generally continue to be resident in the territory in which they were resident prior to studying abroad. This treatment is adopted even though their course of study may exceed a year.
- Patients who go abroad for medical treatment maintain their predominant centre of interest in the territory in which they were resident before they received the treatment, even if the treatment lasts one year or more.
- Crews of ships, aircraft, oil rigs, space stations or other similar equipment which operate outside a territory or across several territories are treated as being resident in their home country.
- National diplomats, peacekeeping and other military personnel, and other civil servants employed abroad in government enclaves, as well as members of their households are considered to be residents of the economic territory of the employing government.

- Staff of international organisations, including those with diplomatic status and military personnel are resident in the territory of their principal dwelling.
- Border workers, seasonal workers and other short-term workers who cross borders for a short period to undertake a job are considered residents in the economic territory in which they maintain a dwelling used by members of the household as their principal dwelling.

Definition for the identification of Special Purpose Entities (SPEs)

According to the “Final Report of the Task Force on SPEs”⁸, an entity is considered as an SPE if it meets the criteria listed below:

- It is resident in an economy, i.e. it is a formally registered and/or incorporated legal entity recognized as an institutional unit, with:
 - no or little employment up to maximum of three⁹ employees,
 - no or little physical presence and
 - no or little physical production in the host economy.
- It is directly or indirectly controlled by non-residents.
- It is established to obtain specific advantages provided by the host jurisdiction with an objective to:
 - grant its owner(s) access to capital markets or sophisticated financial services; and/or
 - isolate owner(s) from financial risks; and/or
 - reduce regulatory and tax burden; and/or
 - safeguard confidentiality of their transactions and owner(s).
- It transacts almost entirely with non-residents and a large part of their financial balance sheet typically consists of cross-border claims and liabilities.

⁸ Prepared by the Statistics Department of the International Monetary Fund.

⁹ Although the Task Force decided to set the threshold for the number of employees to five, this upper limit is not

representative in the case of Cyprus, since there is no legal provision for minimum employment in the CY law. Thus, the threshold for the said criterion is set to three employees