CENTRAL BANK OF CYPRUS
EUROSYSTEM

PORTFOLIO INVESTMENT

2015

1. INTRODUCTION

This annual report provides an overview of the main developments in portfolio investment (PI) statistics[1] for the year 2015, as published by the Statistics Department of the Central Bank of Cyprus (CBC).

The CBC compiles PI statistics in accordance with the new statistical standards[2], namely the Balance of Payments and International Investment Position Manual of the International Monetary Fund, Sixth Edition (BPM6) and the European System of Accounts, 2010 (ESA 2010), which were implemented in 2014 and included data from 2008. All publications and data releases prior to 2008 are, therefore, not comparable as they are based on the BPM5[3] methodology. The most important change concerns the enhanced incorporation of data on resident "special purpose entities" (SPEs)[4].

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.

In particular, the analysis concentrates on the main regions and institutional sectors related to PI made by non-residents in securities issued by residents and by PI of residents in securities issued by non-residents in 2015.

The main conclusions of the analysis are as follows:

- In 2015, total PI assets (securities issued by non-resident entities and held by residents) remained stable and amounted to €12,1 billion, unchanged from 2014.
- Total PI liabilities (securities issued by residents and held by non-residents) amounted to €13,1 billion in 2015, compared with €11,7 billion in 2014.
- More than 60% of PI stocks, for both assets and liabilities, were mainly associated with debt securities.
- The main PI counterpart countries for resident investors were: Russia, Luxembourg, Ireland, the UK and Greece.
- The majority of PI assets with regard to institutional sectors was concentrated in "other MFIs[5]", the CBC and "other financial institutions", while for PI liabilities the main concentration was in "other financial institutions" and "general government".
- Changes in stocks throughout the years, for both assets and liabilities, were caused mostly by transactions and to a lesser extent, price changes and exchange rate fluctuations.
- The main source of income for both assets and liabilities arose mainly from interest on debt securities.

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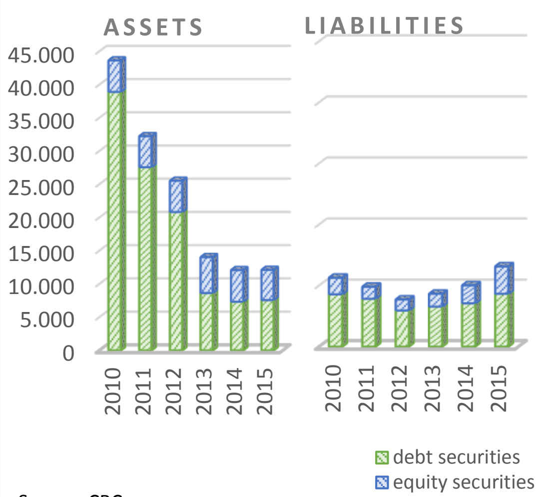
[1]For more information on the definition and scope of portfolio investment statistics please refer to the Appendix.
[2]More information on presentation and methodology is provided in the Appendix.
[3]Balance of Payments Manual of the IMF, 5th edition.
[4]The meaning of "resident" is based on the Definition of the Term "resident of Cyprus" for Statistical Purposes Directive of 2008. More information is provided in the Appendix.
[5] "Other MFIs": Monetary Financial Institutions, excluding the CBC.

2. PORTFOLIO INVESTMENT STOCKS

The main investment destinations related to PI assets are Russia, Luxembourg**,** Ireland**,** the UK and Greece.

As presented in **Chart 1**, total PI assets in 2015 amounted to €12,1 billion, remaining unchanged from 2014. This reflects a stable trend in investments made by residents abroad following the large decline from 2010 onwards.

CHART 1 PI stocks by instrument, 2010-2015 (€ million)



Source: CBC.

On the other hand, stocks of PI liabilities experienced an increase in 2015, from €11,7 billion in 2014 to €13,1 billion at the end of the reporting year.

In 2015 the asset to liability ratio was calculated at 0,9 compared with 1,0 in 2014.

2.1 PI STOCKS BY INSTRUMENT

2.1.1 Debt securities

The main component for both PI assets and liabilities is debt securities, as can be seen in **Chart 1**. This indicates the preferences of both resident and non-resident investors for lower risk investments through lending.

Debt securities totalled:

(a) €7,6 billion in assets in 2015, representing 62% of total portfolio assets, almost identical to 2014 (€7,3 billion) representing 61% of the total assets, and

(b) €8,7 billion in liabilities in 2015, accounting for 66% of total portfolio liabilities, compared with 70% in 2014 or €8,1 billion.

The majority of debt securities holdings for PI assets is undertaken with long-term maturity by "other MFIs", the CBC and "other financial institutions" (**Chart 2**). In particular, the long-term holdings of the CBC and "other financial institutions'" increased from €0,9 billion and €2,2 billion in 2014, to €2,1 billion and €2,7 billion in 2015, respectively. On the other hand, the investments of "other MFIs'" fell by €1,4 billion throughout the reporting period, reaching €2,1 billion, from €3,5 billion in 2014.

CHART 2 Long-term debt securities assets by largest sectors, 2010-2015 (€ million)

Source: CBC.

The overall increase in investments abroad from 2013 onwards, reflects the increase in investing activities of resident sectors, following the huge drop from 2010 to 2013. **Chart 2** highlights the significant impact caused by the crisis on the investing activities of "other MFIs", which fell from €28,4 billion in 2010 to €1,8 billion in 2013.

As with 2014, PI debt securities held by residents in 2015 were mostly issued by non-resident "other MFIs", "other financial institutions" and foreign governments.

On the liabilities side, debt securities are predominantly issued by "captive financial institutions" (i.e. holding companies owning subsidiaries abroad but not undertaking any management activities) and the "general government". The respective amounts totalled €4,3 billion and €3,2 billion, in 2015, compared with €5,2 billion and €2,3 billion in 2014.

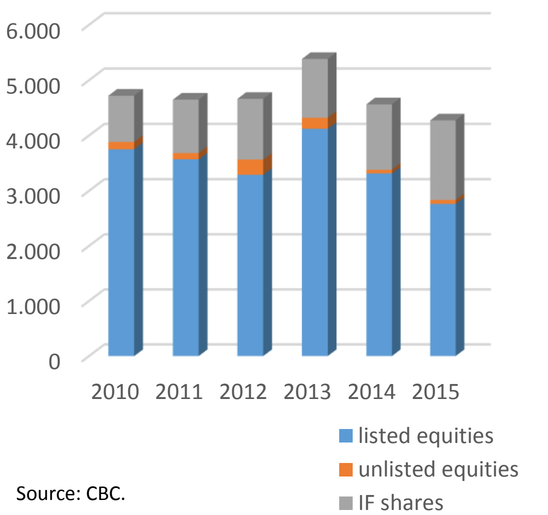
This indicates the increased financial needs of the general government for funding during 2015 through an additional issue of EMTN. It is also indicative of the increased interest by non-residents for investments in Cyprus after the financial crisis.

2.1.2. Equity securities

The shares of equity and investment funds in total assets and liabilities amounted to 38% and 34% in 2015, compared with 39% and 30%, respectively, in 2014.

Total equity assets in 2015 amounted to €4,5 billion, of which €2,9 billion represented listed equities (**Chart 3**). The respective amount for 2014 was €4,8 billion, of which €3,4 billion related to listed equities.

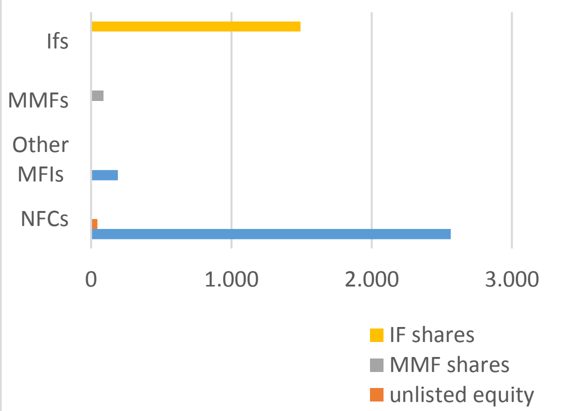
CHART 3 PI assets equity securities, 2010-2015 (€ million)



Source: CBC.

The main investment destinations for PI assets in 2015 were Russian and Greek "non-financial corporations", recording investments of €1,5 billion and €0,8 billion, respectively. The respective 2014 figures were €2,1 billion investments in equity securities issued by Russian residents and €1,0 billion equity securities issued by Greek residents.

CHART 4 Equity securities assets stocks by sector of issuer, 2015 (€ million)



Source: CBC.

Total equity liabilities, which in the majority comprise of listed equities, increased from €3,5 billion in 2014 to €4,5 billion in 2015 .

3. PORTFOLIO INVESTMENT FLOWS

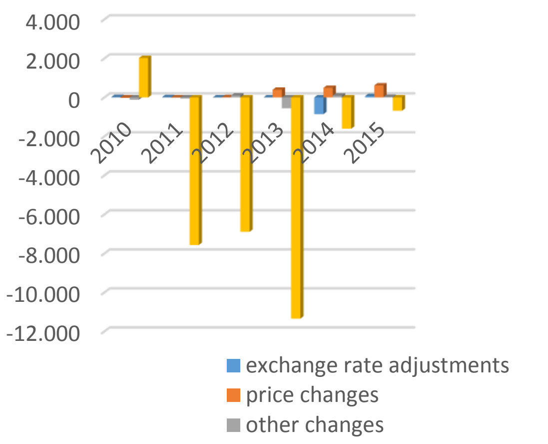
PI flows are examined based on resident institutional sector and instrument. Changes in assets stocks throughout 2015 were mainly due to transactions and price changes, whilst changes in liabilities stocks were related to transactions and exchange rate adjustments.

3.1 Flows in assets

The change in PI assets in 2015 was not significant. A net outflow of less than €0,1 billion resulted mainly from price adjustments of the order of €0,6 billion, which were mitigated by transactions of -€0,7 billion.

More specifically, transactions arose mainly from a decrease in listed equities held abroad of -€0,7 billion. Price adjustments totalling €0,6 billion mainly arose from investments in debt securities and listed equities (**Chart 5**).

CHART 5 PI assets flows, 2010-2015 (€ million)

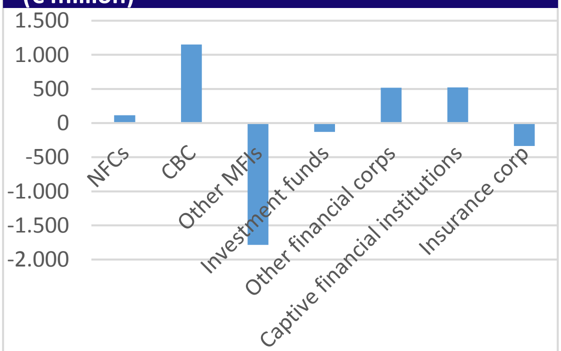


Source: CBC.

The main sectors contributing to the changes in assets during the year were, the CBC and "other MFIs" as regards transactions, and "captive financial institutions" as regards price adjustments (**Chart 6**).

Numerically, during 2015 the CBC experienced a net outflow of €1,2 billion in investment of debt securities abroad, whilst "other MFIs" experienced a net inflow of €1,8 billion from redemptions of debt securities abroad. Price adjustments arising from investments in debt securities and listed shares held by "captive financial institutions" abroad amounted to €0,3 billion each.

CHART 6 Portfolio investment flows in assets by sector, 2015 (€ million)



Source: CBC.

3.2 Flows in liabilities

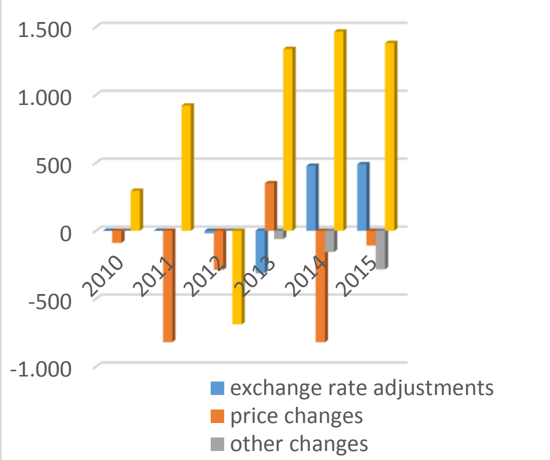
The increase in PI liabilities in 2015 is explained by a total inflow of €1,5 billion (**Chart 7**), which mostly concerns increases in stocks due to transactions amounting to €1,4 billion resulting from:

a) €1,0 billion increase in listed equities issued by resident "captive financial institutions",

b) €1,0 billion increase in debt securities issued by the "general government" and held by non-residents, and

c) €0,9 billion decrease in bonds issued by "other financial institutions" due to redemptions.

CHART 7 PI liabilities flows, 2010-2015 (€ million)



Source: CBC.

3.3 Income

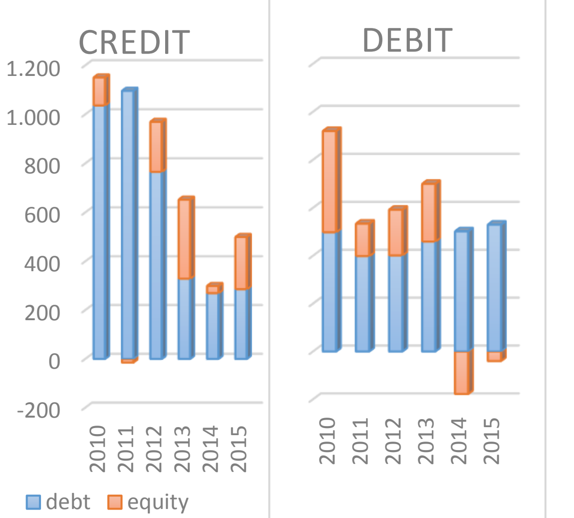
Income receivable on assets (credit) and income payable on liabilities (debit) generally derives from interest on debt securities (**Chart 8**).

3.3.1 Income receivable (credits)

Total credits in 2015 amounted to €499,8 million, increasing significantly from €299,6 million in 2014.

- Total income receivable from interest on debt securities stood at €285,5 million in 2015, rising from €270,0 million in 2014. Despite the decrease in stocks of debt securities, the increase in income receivable represents the higher coupon rates and interest received on maturity provided by bonds issued abroad.

CHART 8 PI income by instrument, 2010-2015 (€ million)



Source: CBC.

- Credit income from equity securities totalled €214,3 million in 2015, showing a significant increase from €29,6 million in 2014. The increase was mainly due to the dividends increase received from the "other financial sector".

3.3.2 Income payable (debits)

Total debits amounted to €489,8 million in 2015, which represents a significant increase from €324,7 million in 2014.

- As regards total income payable on debt securities, these amounted to €530,2 million, compared with €502,1 million in 2014. This increase concerns mainly debt securities by "general government", which issued an additional EMTN in 2015.
- In 2015, debit income on equity securities was -€40,4 million compared with -€177,4 million in 2014. Despite the negative figure, which resulted from the losses incurred by resident investment funds, these decreased throughout the year under review.

3.3.3 Return on Investment

The return on investment in debt securities was 3,8% for assets and 6,1% for liabilities in 2015, compared with 3,7% and 6,2%, in 2014, respectively. These figures clearly indicate that investments in debt securities issued by residents provide a higher return.

The higher returns in resident investments in debt securities were obtained from "other financial vehicle corporations" in Ireland, Luxembourg and Russia.

In 2015, the highest return for non-residents holding investments was 7,7% provided by debt securities issued by "other financial institutions" and 4,0% by the "general government", compared to 7,1% and 3,7% in 2014, respectively.

The return on investment in equities was 4,7% for assets and -0,9% for liabilities in 2015 indicating an increase from 2014, when the return was 0,6% and -5,0%, respectively.

The negative return on the equity liabilities was due to the losses of resident investment funds during 2014 and 2015.

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 is sub-divided into listed, unlisted and investment fund shares and debt securities are split 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.

METHODOLOGICAL TREATMENT AND PRESENTATION OF PORTFOLIO INVESTMENT

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.

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 (credit):

- 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 (debit):

- 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:

(1) 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.

(2) 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 full-time 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.