PORTFOLIO INVESTMENT

2008-2014

1. INTRODUCTION

This report provides an overview of the main developments in portfolio investment (PI) statistics[1] for the years 2008 to 2014, 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. 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 and publication of data on "special purpose entities" (SPEs) registered in Cyprus.

PI constitutes a direct way to access financial markets and can thus provide liquidity and flexibility through the negotiability of securities.

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 throughout the years 2008 to 2014.

The main conclusions of the analysis are as follows:

- In 2014 total PI assets (securities issued by non-resident entities and held by residents) were €12,0 billion, following a declining trend from €40,5 billion in 2008. This significant drop is associated with the liquidity problems faced by resident MFIs as a result of the financial crisis.
- Total PI liabilities (securities issued by residents and held by non-residents) were €10, 8 billion in 2014, remaining relatively stable compared with the previous years.
- PI stocks, both assets and liabilities, were mainly associated with debt securities.
- The main destinations for resident investors were: United Kingdom, Greece and Russia, while the majority of non-resident investors come from Russia and United Kingdom.
- The majority of PI assets with regard to institutional sectors was concentrated in "other MFIs[4]" and "other financial institutions", while for PI liabilities the main concentration was in "other sectors" and the "general government".
- Changes in stocks throughout the years, for both assets and liabilities, were caused mostly by transactions.
- Income for both assets and liabilities for all years arose mainly from interest on debt securities and declined significantly year-by-year from 2008.

[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 and International Investment Position Manual of the International Monetary Fund, Fifth Edition.

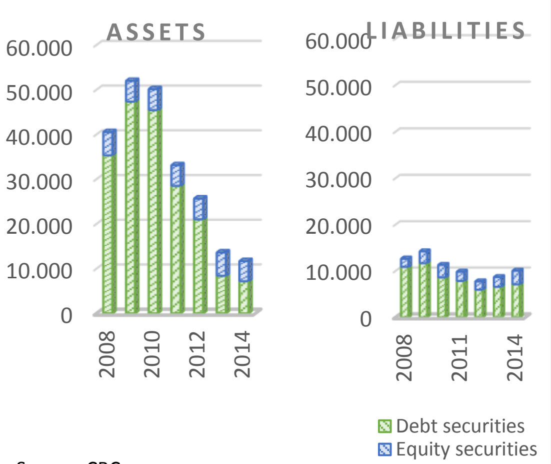
[4] "Other MFIs": Monetary Financial Institutions, excluding the CBC.

2. PORTFOLIO INVESTMENT STOCKS

The main investment destinations related to PI assets are associated with positions in Russia, United Kingdom and Greece, while PI liabilities are undertaken by investors from Russia and United Kingdom.

As presented in **Chart 1**, total PI assets in 2014 reached €12,0 billion, recording significant yearly decreases from its peak in 2009, when PI asset stocks totalled €52,0 billion. The marked decrease was due to reductions in debt securities. This reflects the reduced capacity of residents to invest in securities issued by non-residents due to the financial crisis, with the highest drop in assets experienced in 2011.

CHART 1 PI stocks by instrument 2008-2014 (€ million)



Source: CBC.

On the other hand, PI liabilities stocks were relatively stable during the reporting period. Total PI liabilities amounted to €10,8 billion in 2014, thus recording an increase during the reporting period from €8,9 billion in 2013, resulting mainly from debt securities issues. This indicates that non-resident investors started to invest more in resident securities after 2009, when total PI liabilities stood at €14,2 billion and decreased year-by-year thereafter.

Effectively, the asset to liability ratio dropped to 1,1 compared with 1,6 in 2013 and 4,4 in 2010.

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,** where PI assets and liabilities are decomposed. This indicates the preferences of both resident and non-resident investors for lower risk investments through lending as well as the trend of enterprises funding their operations through borrowing.

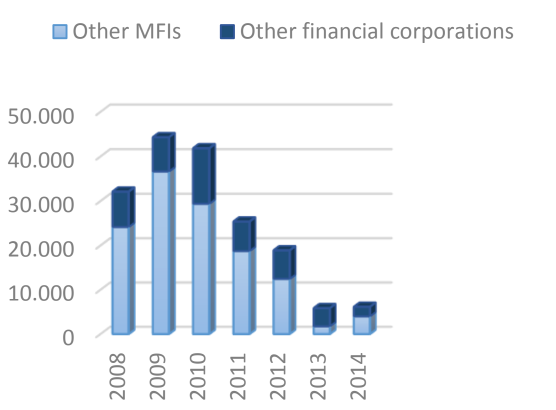
Debt securities totalled:

(a) €7,3 billion in assets in 2014, representing 62% of total assets, down from 85% in the period 2008-2012, and

(b) €8,0 billion in liabilities in 2014, accounting for 71% of total liabilities, compared to an average of 80%, for the period 2008-2012.

The majority of debt securities holdings for PI assets is undertaken by "other MFIs" and "other financial sectors" (**Chart 2**). In particular, other MFIs' and other financial sectors' holdings dropped throughout the reporting period, reaching €4,0 billion and €2,2 billion in 2014, respectively.

CHART 2 PI assets debt securities by highest sectors 2008-2014 (€ million)



Source: CBC.

With reference to the period 2008-2012, there were significant decreases in PI asset stocks of the aforementioned sectors amounting to €24,2 billion and €7,9 billion, respectively. This drop highlights the liquidity problems faced by resident "other MFIs" as a result of the financial crisis.

PI assets of "other MFIs" in 2014 were mostly held in debt securities provided by the European Stability Mechanism (ESM) and in foreign government bonds.

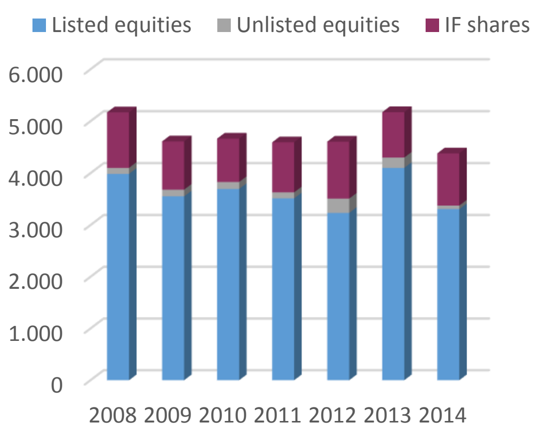
On the liabilities side, debt securities are predominantly issued by the "general government" and "captive financial institutions" (i.e. holding companies owning subsidiaries abroad but not undertaking any management activities). The respective amounts totalled €2,3 billion and €4,8 billion in 2014, increasing from €1,8 billion and €4,2 billion in 2013. This indicates the increased financial needs of resident entities for funding during 2014 but also 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 were 38% and 24% in 2013 and 2014, respectively, recording annual increases of the order of 26% and 10%, respectively, from 2008.

Total equity assets in 2014 amounted to €4,5 billion, of which €3,3 billion, represented listed equities (**Chart 3**). Total equity assets have remained relatively stable at approximately €4,6 billion during the period 2008-2012 but decreased from €5,2 million in 2013, with the majority concerning listed equities.

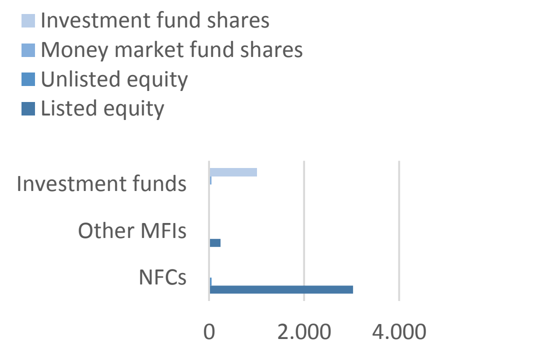
CHART 3 PI assets equity securities 2008-2014 (€ million)



Source: CBC.

The main investment destinations for PI assets in 2014 were Russian and Greek "non-financial corporations", recording investments of €1,2 billion and €0,9 billion, respectively.

CHART 4 Equity securities asset stocks by sector of issuer 2014 (€ million)



Source: CBC.

Total equity liabilities have remained relatively stable throughout the reporting period, with the highest stock of €2,9 billion recorded in 2014. During the years 2008-2011, equity securities were mostly made up of listed equities, while from 2010 onwards they consisted mainly of investment fund shares.

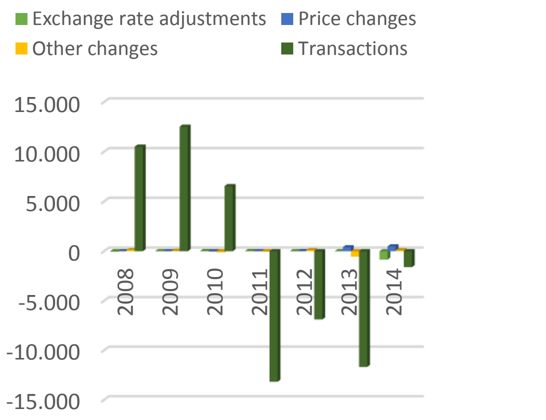
3. PORTFOLIO INVESTMENT FLOWS

PI flows are examined based on resident institutional sector and instrument. Changes in stocks throughout the period under review, for both assets and liabilities, were mainly due to transactions, exchange rate adjustments and other changes.

3.1 Flows in Assets

Regarding PI assets in 2014, a total net inflow of €1,6 billion resulted from the decrease in stocks, mainly from redemptions of debt securities of €1,4 billion. Other flows in PI assets related mostly to exchange rate adjustments of -€853,9 million. Asset flows from debt securities in Greece totalled €1,5 billion in 2014(**Chart 5**).

CHART 5 PI assets flows 2008-2014 (€ million)

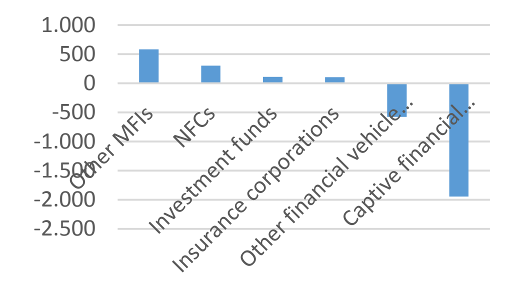


Source: CBC.

For the years 2008-2010, increases in assets were mainly due to transactions resulting in outflows from investments in debt securities issued by non-residents, while from 2011 onwards, decreases in assets were caused by inflows due to redemptions of debt securities issued by non-residents.

The main sector affected by the inflow during the year was "captive financial institutions", experiencing an inflow of €1,9 billion (**Chart 6**). On the other hand, "other MFIs" experienced an outflow of €0,6 billion.

CHART 6 Portfolio investment flows in assets by sector 2014 (€ million)

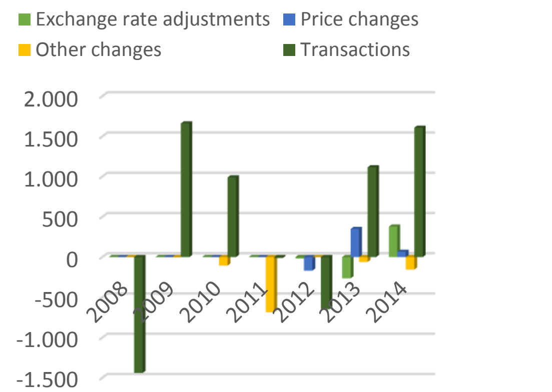


Source: CBC.

3.2 Flows in Liabilities

The growth in PI liabilities in 2014 is explained by the inflow of €1,6 billion (**Chart 7**), which mainly represents the increase in the share capital of resident MFIs, totalling €1,0 billion. Other flows related mostly to exchange rate adjustments of €378,5 million.

CHART 7 PI liabilities flows 2008-2014 (€ million)



Source: CBC.

3.3 Income

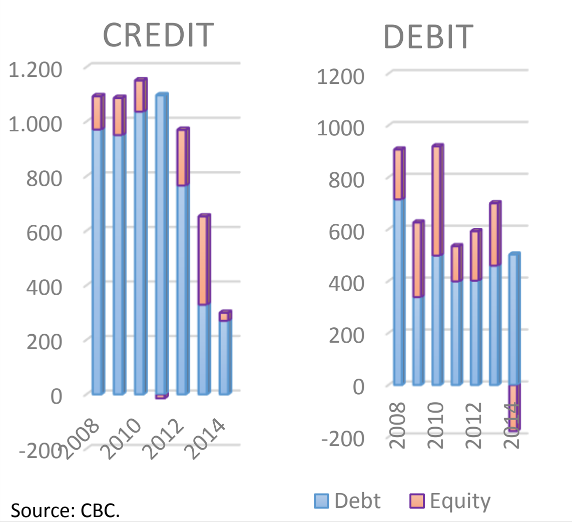
Income receivable on assets (credit income) and income payable on liabilities (debit income) derives mainly from interest on debt securities for all years (**Chart 8)**.

3.3.1 Income receivable (credits)

Total credits in 2014 were €299,3 million, a significant reduction from €1.092,8 million in 2008.

- Total income receivable from interest on debt securities stood at €269,8 million in 2014, down from €328,9 million in 2013. In line with the decrease in stocks, there was a large decrease in credit income from €1.096,2 million in 2011 to €765,6 million in 2012, reflecting the impact of the financial crisis on the Cyprus economy.

CHART 8 PI income by instrument 2008-2014 (€ million)



Source: CBC.

- Credit income from equity securities in 2014 totalled €29,6 million, down from €323,3 million in 2013. This significant decrease was mainly due to decreases in reinvested earnings of investment funds, which, apart from 2008, accounted for the highest proportion for PI credit income.

3.3.2 Income payable (debits)

Total debits amounted to €324,8 million in 2014, following a marked decrease throughout the reviewed period.

- As regards total income payable on debt securities, these amounted to €502,1 million, representing the highest amount from 2009 onwards. This increase concerns debt securities issues by “other sectors” and the “general government”.
- In 2014 debit income on equity securities was -€177,5 million compared with €240,7 million in 2013. The negative figure resulted from the losses incurred by resident investment funds during 2014.

3.3.3 Return on Investment

The return on investment in debt securities was 3,8% for assets and 6,6% for liabilities in 2014, compared to 3,9% and 7,0% in 2013. 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 Luxembourg, Ireland and United Kingdom.

On the other hand, for PI by non-residents in Cyprus, the higher return was provided by debt securities totalling €378,3 million issued by “other sectors” and €85,5 million generated by the “general government” in 2014.

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.