

Rating-Agentur Expert RA GmbH assigned 'BB-' ratings to Cyprus

Rating-Agentur Expert RA GmbH assigned 'BB-' sovereign government credit rating (SGC) to Cyprus in national currency (Sufficient level of creditworthiness of the government) and 'BB-' in foreign currency (Sufficient level of creditworthiness of the government).

Rating-Agentur Expert RA GmbH assigned 'BB-' country credit environment rating (CCE) to Cyprus in national currency (Sufficient quality of credit environment of the country) and 'BB-' in foreign currency (Sufficient quality of credit environment of the country).

MAJOR FACTORS THAT INFLUENCED BOTH TYPES OF RATINGS:

Positive factors:

- Short-term debt was low in 2015 at 3% of GDP and 7,7% of budget revenues. Additionally, it represented only 2% of total government debt, 2p.p. less than in 2014, and was covered 1,2x by FX reserves;
- The fiscal deficit remained narrow in 2015. The General government balance, as reported by the Ministry of Finance, was as low as 0,5% of GDP;
- GDP per capita at PPP was USD 32 785 and real GDP grew by 1,6% in 2015 as compared to a contraction of -2,5% in 2014 driven by private consumption and general overall expansion on the supply side;
- Government plans for privatization agreed as a part of the IMF-ESM bail-out program, are expected to raise EUR 1,4 bn for the budget. The plan includes privatization of inter alia, CyTA (telecoms), EAC (electricity), CPA (commercial activities of ports), as well as land assets. CyTA and CPA will be privatized within the programme period, while EAC by mid-2018;
- High level of institutional development. Cyprus was ranked 47th in the Doing Business ranking. Additionally, it has a Human Development Index (adjusted for inequality) of 0,758 which is considered a very high level of human development.

Restricting factors:

- Private credit and banks' assets to GDP declined by 14,4p.p. and 12,1p.p. respectively in 2015 from 2014. Even though these figures are already high (294% and 419% respectively in 2015), they have been decreasing due to the high level of NPLs and not enough viable projects;
- The economy appears to be diversified in different sub-sectors (35% in wholesale and retail trade, 11% in real estate and 9% in insurance and financial activities), however, around 87% of the economy is originated from the services sector;
- The economy is moderately competitive. Cyprus ranked 72nd out of 159 countries in the latest Global Competitiveness Index report prepared by the World Economic Forum. Moreover, the country recorded a trade deficit of 1,4% of GDP in 2015.

Negative factors:

- High government debt load at 107% of GDP and 274% of budget revenues at the end of 2015. However Cyprus' government debt to GDP ratio is lower than other "peripheral Eurozone" peer countries and is likely to remain so in the mid-term as a result of continued austerity measures;

- The banking sector still presents risks for Cypriot economy. The level of non-performing loans is still the main concern for the system. Even though the ratio of NPLs to total loans was reduced marginally by 0,02p.p. from 2014 to 2015, it remains at 44%. Additionally, ROA was negative in 2015 and the average capital adequacy ratio went from 10,3% in 2014 to 9,7%;
- FX reserves were as low as 3,8% of gross government debt at end-2015;
- Government guarantees were up to 15,9% of GDP in 2014, among the highest in the European Union;
- The inflation rate remained negative in 2015 at -0,45%. Nonetheless, it has constantly increased and remained stable for the last three years;
- Reported unemployment for 2015, despite improving from a year ago, remains high at 15,9%;
- Underdeveloped stock market with 85 listed companies and a market capitalization of 14,1% of GDP.

Support factors:

- Participation in a strong currency and political union. Cyprus is part of the European Economic and Monetary Union (EMU) since 2004 (strong support factor);
- The country has a very strong and important reserve currency (EUR) (weak support factor).

Stress factors:

- Increased dependence on partner-countries for provision of financial support in crisis situations (weak stress factor).

ADDITIONAL FACTORS THAT INFLUENCED CCE RATINGS:

Negative factors:

- Negative performance of the Cyprus Stock Exchange. The index has been constantly declining for the past six years reaching 86,2 points in 2015;
- Marginal quality and quantity of instruments offered in the financial market of the country;
- Extremely high level of domestic and external private sector debt to GDP at 732% in 2015.

Positive factors:

- Narrow spread between interest rates on loans and deposits at 3,52p.p. in 2015.

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Continued improvement in banking system metrics;
- Further consolidation of public finances;
- Stable and broad-based economic growth.

The following developments could lead to a downgrade:

- Deterioration of the banking system metrics driven by the high level of NPLs;
- Destabilization of public finances causing higher debt and wider budget deficits.

“Cyprus ‘BB-’ ratings are mainly supported by its outstanding fiscal and economic turnaround since the IMF and the European Stability Mechanism (ESM) program was introduced in 2013. Public finances have substantially improved showing stabilized government debt levels as well as a narrow budget deficit. In addition, real GDP growth exceeded expectations in 2015 and banks’ capitalization and liquidity metrics improved vastly. These factors allowed the country to exit the adjustment program earlier than expected.

However, the steep levels of NPLs in the banking system and the still significant amount of government debt, combined with high domestic and external private debt and a negative net external investment position contributed negatively to the rating.” - Clarified Hector Alvarez, Expert of Rating-Agentur Expert RA GmbH.

Responsible expert: Hector Alvarez, Expert of Rating-Agentur Expert RA GmbH

Reviewer: Gustavo Angel, Expert of Rating-Agentur Expert RA GmbH

Research report on Cyprus is available at:

http://raexpert.eu/reports/Research_report_Cyprus_22.04.2016.pdf

Next scheduled rating publication: 14 October 2016. The full sovereign rating calendar can be found at <http://raexpert.eu/sovereign.php#conf-tab-5>.

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Minute's summary

The rating committee for Cyprus was held on 20 April 2016. The quorum for the rating committee was present. After the responsible expert presented the factors, which influenced the rating assessment, the members of the committee expressed their opinions and suggestions within the framework of the Sovereign methodology. The chairman of the rating committee ensured that every member of the committee expressed his/her opinion before proceeding to the voting.

The following methodology was used for the rating assessment: Methodology for Assigning Sovereign Government Credit Ratings and Country Credit Environment Ratings. Short Public Version (from April 2015) can be found under the following link: <http://raexpert.eu/files/methodology/Methodology-Short-Sovereign.pdf>. Descriptions and definitions of all rating categories can be found under the following link: <http://raexpert.eu/index.php> under the "Rating scale" section. The user of the rating shall read the methodology in order to have a full understanding of the rating procedure.

These ratings are unsolicited. The rated entity did not participate in the rating process.

Main sources of information: International Monetary Fund, World Bank, World Federation of Exchanges, World Economic Forum, Doing Business, United Nations, Central Bank of Cyprus, European Central Bank, Ministry of Finance of Cyprus, Cyprus Stock Exchange (CSE).

Limits of the Credit Rating

During the rating assignment process, Rating-Agentur Expert RA GmbH (the Agency) used publicly available information that was considered to be reliable, complete and non-biased. The responsible expert performed the rating assessment of the country with information considered as the most reliable and up to date in accordance to the overall position of the country and the Agency's internal criteria for selecting data providers. The information and data used for this specific assessment can be considered as of sufficient quality.

Despite similar methodologies, credit ratings of Cyprus from RAEX (Moscow) (both SGC and CCE) may be different from those assigned by Rating-Agentur Expert RA GmbH due to:

- Possible differences in expert assessments of individual factors;
- Some differences in methodologies (methodologies are similar but not identical);
- Differences in the date/period of assessment for individual factors.

Conflict of interest

The responsible expert was neither influenced nor biased by third parties during the rating assessment. All employees involved in the rating assessment and revision of the rated entity have reported absence of conflicts of interests before initiation of the rating process.

Rating-Agentur Expert RA GmbH is completely independent from the activities of other agencies of the RAEX group.

Risk warning

The Agency disclaims all liability in connection with any consequences, interpretations, conclusions, recommendations and other actions directly or indirectly related to the conclusions and opinions contained in the Agency's Research Reports.

This Report represents the opinion of Rating-Agentur Expert RA GmbH and is not a recommendation to buy, hold or sell any securities or assets, or to make investment decisions.

Office responsible for preparing the rating

The office responsible for the preparation and issuance of this credit rating is the office of Rating-Agentur Expert RA GmbH in Frankfurt am Main, Germany.

Rating-Agentur Expert RA GmbH is a credit rating agency established in Germany and therefore shall comply with all applicable regulations currently in force in the European Union.

The European Securities and Markets Authority (ESMA), the EU's direct supervisor of credit rating agencies (CRAs), has registered Rating-Agentur Expert RA GmbH as a CRA under Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies, with effect from 1 December 2015.

Rating-Agentur Expert RA GmbH applies the Code of Conduct Fundamentals for credit rating agencies issued by the International Organization of Securities Commissions (IOSCO Code) and includes the basic principles of IOSCO Code in its Code of Conduct.