



EUROPEAN COMMISSION
DIRECTORATE GENERAL
ECONOMIC AND FINANCIAL AFFAIRS

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Assessment of the actual or potential financing needs of Cyprus

In compliance with Article 13 of the ESM Treaty, this note has been prepared by the European Commission in liaison with the ECB.

1. Total financing needs

At its meeting of 16 March 2013, the Eurogroup agreed to provide financial assistance to Cyprus – in principle – for a total amount of up to EUR 10bn, i.e. the remaining financing needs over the three-year programme period stretching from 2Q2013 until 1Q2016 after inclusion of proceeds from burden-sharing measures adopted by the Cypriot government. This programme envelope has been reconfirmed in the Eurogroup meeting of 25 March 2013.

An overview of estimated quarterly financing needs to be covered by official lenders during the programme period is provided in Annex 1, an annual overview up to 2020 in Annex 2.

a. Financial sector

The annex to the Eurogroup statement of 25 March 2013 emphasises that external financial assistance shall not be granted for the resolution and restructuring of Cyprus Popular Bank and Bank of Cyprus using the recently adopted resolution law in Cyprus. **Hence, the European Commission, in liaison with the ECB, estimates that total needs for the recapitalisation of the remainder of the restructured banking sector amount to around EUR 2.5bn.**

This amount also includes a buffer to cover for worse macro-economic developments, in particular an increase in non-performing loans (NPLs), and recapitalisation needs of Hellenic Bank in case this cannot be achieved fully via private sources. The buffer also reflects the as yet unknown results of the requested due diligence on the cooperative banks which were not covered by the PIMCO exercise.

The EUR 1.9bn bond issued by the government to recapitalise Cyprus Popular Bank in June 2012 is not foreseen to be replaced by an ESM bond and thus does not figure in the financing envelope.

b. Medium- and long-term debt redemption

Over the programme period, around EUR 4.1bn are required for the redemption of medium- and long-term debt maturing over the programme period and the amortisation of government loans, taking into account the roll-over of marketable debt held by domestic investors.

Regarding the redemption of bonds a distinction needs to be made between foreign-law bonds (so-called Euro Medium Term Notes, EMTNs) and domestic-law bonds (so-called Government Registered Development Stocks, GRDS).

Over the programme period EMTNs worth about EUR 3bn mature. Almost half of this amount needs to be provided in June 2013 as an EMTN worth EUR 1.4bn will have to be redeemed. Two EMTNs worth a total of EUR 0.6bn will mature in June and July 2014, EUR 0.9bn in November 2015 and EUR 0.2bn during the first quarter of 2016.

Regarding GRDS, the redemption profile is more evenly spread over the programme period, with a total of EUR 0.7bn maturing in July 2013, EUR 0.4bn in 2014 (of which around 80% during the first quarter), EUR 0.4bn in 2015, and about EUR

0.2bn during the first quarter of 2016. It is foreseen that out of total GRDS redemptions of EUR 1.7bn only EUR 0.7bn are covered by official lenders. The Cypriot authorities intend to roll-over the remainder with the domestic investors holding these bonds.

Loan amortisations amount to a total of around EUR 0.4bn, with on average EUR 0.1bn per year in 2013, 2014 and 2015 and only very small payments during the first quarter of 2016.

c. Fiscal needs

Over the programme period up to EUR 3.4bn are required to cover fiscal needs.

Based on the underlying macro-fiscal assumptions deficit financing needs over the programme horizon are estimated at around EUR 3.5bn. This amount also includes a one-off payment of EUR 0.4bn in 2013 to compensate all pension funds for part of their losses on deposits in Cyprus Popular Bank and put them at par with pension funds that held deposits in Bank of Cyprus.

Cumulative below-the-line transactions reduce financing needs by around EUR 0.1bn as privatisation proceeds of about (EUR 0.6bn) and the envisaged use of the allocation of future central bank profits (EUR 0.4bn) – subject to the principle of central bank independence and provided such profit allocation is in line with CBC rules and does not undermine the CBC duties under the Treaties and the Statute – offset a buffer included to cover currently unforeseen expenditures, e.g. state guarantees for local-government and state-owned enterprises' loans (up to EUR 0.5bn), capitalised interest on the CPB bond (around EUR 0.3bn)¹ and capital contributions to the ESM and EIB (around EUR 0.1bn).

2. Financing sources

a. ESM

The ESM is expected to provide EUR 9bn of external financial assistance, subject to IMF's contribution. This amount should allow to fully cover needs identified for the recapitalisation of the banking sector (EUR 2.5bn) in a cashless transaction and EUR 6.5bn for debt redemption and fiscal purposes. An indicative break down of total quarterly financing needs which will have to be covered by official funds is provided in Annex 1.

b. IMF

¹ The statistical treatment of the CPB recapitalisation bond is currently subject to assessment by Eurostat in context of Cyprus' April 2013 fiscal notification.

The Eurogroup statement invites the IMF to contribute to the financing of the programme. The IMF has signalled its willingness to participate in the programme financing (except for financial sector recapitalisations) under the "normal access" procedure. This would imply an IMF contribution of up to EUR 1bn.

The IMF contribution is expected to take the form of a 3-year extended fund facility (EFF).

3. Burden sharing

- a. Following the Eurogroup decision of 25 March, the Cypriot authorities have committed to take the following additional steps: *Additional bail in of creditors in Laiki bank and Bank of Cyprus*

The bail in of uninsured depositors of Laiki and Bank of Cyprus will provide an estimated contribution to recapitalization of EUR 8.3bn. ².

- b. *Gold sales*

It is envisaged to use the allocation of future central bank profits of approximately EUR 0.4bn, subject to the principle of central bank independence and provided such profit allocation is in line with CBC rules and does not undermine the CBC duties under the Treaties and the Statute.

- c. *Roll-over of marketable debt held by domestic investors*

Cypriot authorities will encourage domestic investors (banks, insurance companies and state-owned enterprises) to roll over up to EUR 1.0bn of GRDS that arrive at maturity over the programme horizon, thus reducing external financial assistance for debt redemption by the same amount.

- d. *Privatisations*

Cypriot authorities will launch a privatisation programme, estimated to yield proceeds of EUR 0.5bn until end-2015, another EUR 0.5bn in the course of 2016 and an additional EUR 0.4bn thereafter.

- e. *Change of terms on the outstanding loan from the Russian Federation*³

² This is a maximum estimate. The final amount will depend inter alia on the conversion under the debt for equity swap in Bank of Cyprus and the recoveries of Laiki Bank.

³ Under the current loan agreement between Cyprus and the Russian Federation, repayment of the loan falls outside the programme period. Hence, the change of the repayment period of the loan does not have an impact on the financing needs under the adjustment programme, but rather improves the maturity profile of Cyprus's public debt shortly after the end of the programme.

Cypriot authorities will endeavour to change the terms on the outstanding EUR 2.5bn loan from the Russian Federation, i.e. repayment in five instalments of EUR 0.5bn between 2018 and 2022 and possibly a reduction of the current interest rate of 4.5% . A reduction of the interest rate could yield up to EUR 0.1bn.

Moreover, it is foreseen that Cyprus will roll-over the outstanding stock of Treasury Bills (around EUR 1bn) on the market, i.e. without ESM / IMF support. This is in line with the working assumption of other euro area macroeconomic adjustment programmes.

4. Conclusion

The European Commission, in liaison with the ECB, estimates that Cyprus's net financing needs amount to EUR 10bn over the three-year programme horizon, i.e. 2Q2013-1Q2016. This includes needs for the recapitalisation of the banking sector, the redemption of maturing medium- and long-term debt including loans, and fiscal needs after taking into account the extensive burden sharing measures adopted by the Cypriot authorities.

This programme envelope, which rests on plausible growth and fiscal assumptions, includes buffers in case of worse than expected macroeconomic and financial sector outcomes.

Annex 1: Overview of estimated financing needs to be covered by ESM/IMF over the programme period

	programme period																			
	2013					2014					2015					2016				
	Q1	Q2	Q3	Q4	year	Q1	Q2	Q3	Q4	year	Q1	Q2	Q3	Q4	year	Q1	Q2	Q3	Q4	year
<i>mln EUR, negative = surplus / revenue</i>																				
Amortisation of existing market debt excl. short-term	7.7	1438.2	346.3	38.6	1830.8	26.7	111.7	560.1	93.7	792.2	17.6	49.7	146.4	927.6	1141.3	363.1	64.2	161.9	99.6	688.8
medium & long-term bonds	0.0	1416.9	714.6	1.0	2132.4	319.0	90.0	500.0	55.3	964.3	209.9	127.7	85.4	888.6	1311.7	358.0	42.6	102.5	58.2	561.4
loans	0.0	13.7	24.1	30.0	67.8	0.0	14.0	52.5	30.7	97.3	0.0	14.3	53.3	31.3	98.9	0.0	16.6	54.4	36.4	107.4
foreign loans - excluding Russia	0.0	13.7	0.9	30.0	44.6	0.0	14.0	0.9	30.7	45.7	0.0	14.3	0.9	31.3	46.5	0.0	16.6	1.1	36.4	54.2
foreign loans - Russia	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
domestic loans	0.0	0.0	23.2	0.0	23.2	0.0	0.0	51.5	0.0	51.5	0.0	0.0	52.4	0.0	52.4	0.0	0.0	53.3	0.0	53.3
local government loans	5.0	5.0	5.0	5.0	20.0	5.0	5.0	5.0	5.0	20.0	5.0	5.0	5.0	5.0	20.0	5.0	5.0	5.0	5.0	20.0
saving certificates	2.7	2.7	2.7	2.7	10.7	2.7	2.7	2.7	2.7	10.7	2.7	2.7	2.7	2.7	10.7	0.0	0.0	0.0	0.0	0.0
bond roll-over by domestic investors	0.0	0.0	-400.0	0.0	-400.0	-300.0	0.0	0.0	0.0	-300.0	-200.0	-100.0	0.0	0.0	-300.0	0.0	0.0	0.0	0.0	0.0
Amortisation new market debt	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Amortisation of official lenders	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
ESM	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
IMF	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial sector recapitalisation	0.0	0.0	1400.0	200.0	1600.0	125.0	125.0	125.0	125.0	500.0	100.0	100.0	100.0	100.0	400.0	0.0	0.0	0.0	0.0	0.0
<i>of which:</i>																				
total recapitalisation estimate	0.0	0.0	11500.0	0.0	11500.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
debt-equity swap for uninsured BoC deposits and CPV resolution	0.0	0.0	-10300.0	0.0	-10300.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
contingency buffer	0.0	0.0	200.0	200.0	400.0	125.0	125.0	125.0	125.0	500.0	100.0	100.0	100.0	100.0	400.0	0.0	0.0	0.0	0.0	0.0
Fiscal financing needs	251.2	343.2	810.2	366.3	1770.9	-1.7	447.9	384.3	366.1	1196.5	168.5	195.6	134.6	140.1	638.7	17.3	56.6	-12.6	-40.8	20.5
headline deficit (including one-offs)	245.6	219.1	700.2	224.9	1389.8	340.5	264.0	329.3	311.1	1244.9	265.7	193.1	234.6	240.1	933.4	142.3	73.8	112.4	84.2	412.8
of which one-off measures /1	0.0	0.0	400.0	0.0	400.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<i>of which:</i>																				
primary balance	98.5	98.5	98.5	98.5	394.1	169.6	169.6	169.6	169.6	678.3	86.0	86.0	86.0	86.0	343.9	-50.9	-50.9	-50.9	-50.9	-203.8
interest	147.1	120.6	201.7	126.3	595.8	170.9	94.4	159.8	141.5	566.6	179.7	107.1	148.6	154.1	589.5	193.2	124.8	163.3	135.2	616.5
additional financing needs / below the line																				
privatisations of SOEs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-125.0	-125.0	-125.0	-125.0	-500.0	-125.0	-125.0	-125.0	-125.0	-500.0
ESM & EIB capital contributions	5.6	31.4	0.0	31.4	68.4	2.8	31.4	0.0	0.0	34.2	2.8	0.0	0.0	0.0	2.8	0.0	0.0	0.0	0.0	0.0
called guarantees	0.0	0.0	110.0	110.0	220.0	55.0	55.0	55.0	55.0	220.0	25.0	25.0	25.0	25.0	100.0	0.0	0.0	0.0	0.0	0.0
future central bank profits	0.0	0.0	0.0	0.0	0.0	-400.0	0.0	0.0	0.0	-400.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
capitalised interest on CPB bond /2	0.0	92.7	0.0	0.0	92.7	0.0	97.5	0.0	0.0	97.5	0.0	102.5	0.0	0.0	102.5	0.0	107.8	0.0	0.0	107.8
net financing needs	258.9	1781.5	2556.5	604.9	5201.8	150.0	684.5	1069.5	584.8	2488.8	286.1	345.2	381.0	1167.7	2180.0	380.4	120.8	149.3	58.9	709.3

/1: One-off measures include compensation for provident and retirement funds in Cyprus Popular Bank to ensure equal treatment with such funds in Bank of Cyprus following the conversion of deposits into equity. Given the social welfare nature of provident and retirement funds, the Cypriot authorities will use the necessary amount out of programme financing.

/2: The statistical treatment of the CPB recapitalisation bond is currently subject to assessment by Eurostat in context of Cyprus' April 2013 fiscal notification.

Annex 2: Annual overview of estimated financing needs for the period 2013-2020

<i>mIn EUR, negative = surplus / revenue</i>	2013	2014	2015	2016	2017	2018	2019	2020
Amortisation of existing market debt excl. short-term	1 830.8	792.2	1 141.3	688.8	417.9	656.9	655.0	1 586.8
medium & long-term bonds	2 132.4	964.3	1 311.7	561.4	287.4	19.6	10.9	949.8
loans	67.8	97.3	98.9	107.4	110.5	617.2	624.1	617.0
foreign loans - excluding Russia	44.6	45.7	46.5	54.2	56.4	62.1	68.0	60.0
foreign loans - Russia	0.0	0.0	0.0	0.0	0.0	500.0	500.0	500.0
domestic loans	23.2	51.5	52.4	53.3	54.2	55.1	56.1	57.1
local government loans	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0
saving certificates	10.7	10.7	10.7	0.0	0.0	0.0	0.0	0.0
bond roll-over by domestic investors	-400.0	-300.0	-300.0	0.0	0.0	0.0	0.0	0.0
Amortisation new market debt	0.0	0.0	0.0	0.0	164.5	0.0	0.0	0.0
Amortisation of official lenders	0.0	0.0	0.0	0.0	3.6	50.0	114.3	167.8
ESM	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
IMF	0.0	0.0	0.0	0.0	3.6	50.0	114.3	167.8
Financial sector recapitalisation	1 600.0	500.0	400.0	0.0	0.0	0.0	0.0	0.0
<i>of which:</i>								
total recapitalisation estimate	11 500.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
debt-equity swap for uninsured BoC deposits and CPV resolution	-10 300.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
contingency buffer	400.0	500.0	400.0	0.0	0.0	0.0	0.0	0.0
Fiscal financing needs	1 770.9	1 196.5	638.7	20.5	-185.4	30.7	37.9	85.1
headline deficit (including one-offs)	1 389.8	1 244.9	933.4	412.8	101.3	-88.5	-87.4	-46.6
<i>of which one-off measures /1</i>	400.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<i>of which:</i>								
primary balance	394.1	678.3	343.9	-203.8	-530.8	-736.8	-764.8	-793.8
interest	595.8	566.6	589.5	616.5	632.1	648.3	677.4	747.2
additional financing needs / below the line	288.4	-145.8	-397.2	-500.0	-400.0	0.0	0.0	0.0
privatisations of SOEs	0.0	0.0	-500.0	-500.0	-400.0	0.0	0.0	0.0
ESM & EIB capital contributions	68.4	34.2	2.8	0.0	0.0	0.0	0.0	0.0
called guarantees	220.0	220.0	100.0	0.0	0.0	0.0	0.0	0.0
future central bank profits	0.0	-400.0	0.0	0.0	0.0	0.0	0.0	0.0
capitalised interest on CPB bond /2	92.7	97.5	102.5	107.8	113.3	119.2	125.3	131.7
net financing needs	5 201.8	2 488.8	2 180.0	709.3	400.6	737.5	807.1	1 839.8

/1: One-off measures include compensation for provident and retirement funds in Cyprus Popular Bank to ensure equal treatment with such funds in Bank of Cyprus following the conversion of deposits into equity. Given the social welfare nature of provident and retirement funds, the Cypriot authorities will use the necessary amount out of programme financing.

/2: The statistical treatment of the CPB recapitalisation bond is currently subject to assessment by Eurostat in context of Cyprus' April 2013 fiscal notification.