

No Time for Complacency

Vincenzo Guzzo, IMF Resident Representative for Cyprus

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1. Cyprus has exited the Memorandum and while the market is filled with feelings of positivity and optimism, many challenges still remain. What is your opinion regarding the local economic development and achievements so far?

Cyprus has made a solid comeback from an unprecedented financial crisis. The economy has returned to growth in 2015 and the recovery has gained further momentum during the first half of this year. The unemployment rate has fallen sharply and the number of jobs is rising again. Banks are now adequately capitalized and their liquidity conditions have stabilized. Full market access has been regained. This was not easy to imagine just three years ago. However, several challenges remain. Non-performing loans are very high; the stock of public debt is also very high; and the reform agenda is delayed in several areas.

2. For now and then which is the role of IMF in Cyprus and how can we turn this stay to a beneficial challenge?

The interaction between the IMF and the Republic of Cyprus will continue spanning the whole spectrum of core functions of the Fund. In addition to the usual Article IV consultations, the annual engagement of IMF staff with each member country, Cyprus will also enter a process called Post-Program Monitoring (PPM). This process applies to all member countries that have substantial IMF credit outstanding at the end of their programs. This enhanced type of monitoring is intended to ensure the continued viability of the country's economic framework and, should it become necessary, advice on policy actions to correct imbalances. Last but certainly not least, the IMF will continue to support Cyprus extensively in designing its economic policies and managing its financial affairs more effectively by strengthening its human and institutional capacity through technical assistance and training.

3. Please number the areas that we need to focus more as to see further improvement and create more stability in our economy?

More work is needed both in the private and the public sector. NPLs are very high, largely reflecting private sector overleverage. Dealing with the NPL problem

effectively not only would have an impact on the balance sheet and the capital of the banks, but it would also have broader implications for the economy. By lowering NPLs, banks could increasingly extend new targeted credit to families and corporations, and do that on better terms, thus supporting investment and jobs. In turn, stronger growth would increase borrowers' ability to repay, thus reinforcing the case for further reduction in NPLs. Banks' improved lending capacity would affect especially SMEs that are more dependent on bank financing. This is very important for Cyprus, where SMEs play a critical role in the economy.

Public sector debt is also still high. Ensuring sustainable public debt would allow adequate fiscal space for productive public investment spending, which in turn would support long-lasting growth. Controlling the growth of the public sector wage bill and increasing the efficiency of the public sector through promotions and mobility across the civil service would be a critical step in this direction. Overcoming vested interests and strengthening the functioning, oversight and governance of state-owned enterprises would further improve fiscal sustainability and contribute to ensuring a more dynamic and just society.

4. Creativity, fresh ideas, alternative business perspectives and startups boom from young Cypriots entrepreneurs locally and abroad in a period that was very hard for Cyprus. How do you comment on this?

This is very encouraging and bodes well for the long-run growth prospects of the country. However, a more business-friendly environment would help attract even more foreign direct investment, which again would bring jobs and increase liquidity in the economy. Reducing labor market redundancy costs; opening up closed professions by streamlining licensing restrictions; removing barriers to competition, including protection of firms and price controls; reducing red tape; strengthening the legal system and fostering innovation would all have a significant impact on medium-term growth.

5. Generally which are the sectors that in your opinion are our strongest assets and how can we better take advantage of them?

The recovery in economic activity has been broad-based, but tourism and professional services have been the main contributors to growth and going forward will likely remain driving sectors for the Cypriot economy. These are sectors in which the country appears to retain a comparative advantage and, in a credit-less recovery, they benefitted significantly from being less dependent on credit. Over time, Cyprus should try to reach out to higher productivity-enhancing activities, but, given the large deleveraging needs of the corporate sector, investment will recover only gradually.

6. What is your opinion about the role of Cyprus as an international investment and services center?

Deeper capital markets and a broad-based investment fund industry would be a positive development for the island, as it would reduce over-reliance on bank credit. Of course, this would have to happen within an appropriate regulatory framework, and with the aim of eventually channeling capital towards productive investment.

7. Please comment briefly as concern Cyprus' case:

- The biggest challenge and opportunity for Cyprus now: it takes an average 1,100 days to enforce a contract. More efficient legal procedures would make Cyprus an easier place to do business.
- The biggest problem and its solution: certainly the NPL problem. There is no silver bullet. All tools in the arsenal should be used, from restructuring of early arrears to foreclosure of assets.
- High debt of public sector: at nearly 109 percent of GDP in 2015, public sector debt is certainly high. Primary surplus will have to be kept close to 3 percent of GDP to maintain public debt on a sustained downward path.
- Privatizations of state-owned organizations: continuing to privatize state-owned enterprises would allow better and less expensive services for the population. It would also act as a catalyst to attract foreign direct investment.
- NPLs: At over €25 billion, non-performing loans are nearly 150 percent of GDP. Only resolute efforts in addressing the NPL problem will support a sustainable economic recovery.

8. Generally which are your forecasts for the future of Cyprus?

According to current IMF staff projections, growth is expected to remain at around 2 percent during 2017-2020. This would be far better than the nearly -2 percent recorded in the crisis years 2009-2014, but well below the average growth rate of 5 percent seen during 1988-2008.