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May 23, 2022

**Joint Statement by Ms. Kashima, Mr. Mochtar, Mr. Parkyn, Ms. Fukuda, Mr. Hteik,
and Ms. Karl on Cyprus
(Preliminary)
Executive Board Meeting
May 25, 2022**

We thank staff for the report and Mr. Dresse and Mr. Ghalanos for their informative Buff statement.

We commend the Cypriot authorities for their successful management of the pandemic and sizeable policy support, which has enabled output to recover to its pre-pandemic level and unemployment to decline. However, the war in Ukraine poses additional challenges given Cyprus's trade exposures to Russia, in addition to the lingering effects of the financial crises of 2012-2013 and the pandemic. Looking ahead, the risks are tilted to the downside due to the possibility of prolonged war and sanctions, abrupt global tightening, and uncontrolled and more severe Covid outbreaks. **We broadly agree with the thrust of the staff appraisal and would like to offer the following comments for emphasis.**

We agree with staff that the government's fiscal plan is consistent with generating a small fiscal surplus in the medium term and a steady decline in public debt. In the near-term, fiscal policy could be recalibrated as needed to address significant uncertainties arising from war-related shocks. If automatic stabilizers are enabled, Cyprus's substantial social safety net would shield the most vulnerable from the shock. We concur with staff that any additional support measures should be strictly targeted and timebound to remain consistent with fiscal consolidation efforts. Public investment management should be enhanced to strengthen fiscal discipline and to allow smooth absorption of the financing from the NGEU. Further, we encourage the authorities to address irregularities in NHS procurements and swiftly implement plans to achieve financial self-sufficiency of public health services.

While noting Cypriot banking sector has remained sound, the elevated level of non-performing loans (NPLs) requires close attention. We are encouraged by the authorities' efforts to lower NPLs to total gross loans ratio from 2019 to 2021 (Table 6). However, we agree with staff that more forceful implementation of the NPL reduction strategy, including enhancement of the foreclosure framework is necessary to expedite the process. We also note the envisaged expansion of the public Asset

Management Company (KEDIPES) to support vulnerable borrowers. To this end, as too much easing could deplete fiscal buffers and erode market confidence, we see merit in refining the plan. *As Table 6 shows that the provisions to NPLs ratio was declining over the last few years, we would be interested to know further the background for the drop and possible way forward for the recovery of the ratio.*

We encourage the authorities to step up implementation of the Recovery and Resilience Plan (RRP). We see huge merit in accelerating efforts to address structural impediments to growth, including the rule of law, anti-corruption, education, and digital infrastructures. In particular, the judicial reforms would help address financial stability risks through enhanced NPL resolution. *Aside from training judges and improved processing, it would be interesting to know if there is any reform that could contribute to reducing backlogs of resolution cases under the RRP.* We also support the staff comment that continuous progress in enhancing the AML/CFT and governance frameworks is likely to help Cyprus manage its reputational risks in the current geopolitical setting.

Finally, we agree with staff that meeting the national climate target would enhance the economy's sustainability and energy security. We commend the authorities for their plans for energy diversification and green tax reform. Continued policy focus will be required to achieve the national mitigation targets and support adaptation and economic transition.

With these comments, we wish the authorities every success in their economic endeavors.