

SU/18/165

November 28, 2018

**The Acting Chair's Summing Up  
Cyprus—2018 Article IV Consultation  
Executive Board Meeting 18/101  
November 28, 2018**

Executive Directors agreed with the thrust of the staff appraisal. They welcomed the strong post-crisis economic recovery, which has supported large fiscal surpluses and lowered the unemployment rate. Directors also welcomed the recent reforms undertaken to address key vulnerabilities in the banking sector, including the resolution of a large systemic state-owned bank. Directors observed, however, that private and public debt remain large while NPL ratios are still among the highest in Europe. They encouraged the authorities to make further efforts to address these legacy problems and strengthen economic growth over the medium term.

Directors emphasized the importance of further measures to facilitate a steady decline in NPLs on a durable basis. They called for steadfast implementation of the amended legislative framework on foreclosure, insolvency, sale of loans, and securitization, supplemented by a strengthening of the court system and removal of uncertainties related to title deeds. Directors also stressed the need to enhance the governance and supervisory framework for the recently-established asset management company. They recommended that to limit moral hazard, the proposed *Estia* scheme aimed at encouraging distressed borrowers to begin servicing their loans be better targeted and based on appropriate assessment of borrowers' capacity to repay.

Directors highlighted the need for banks to continue efforts to strengthen their balance sheets. They urged banks to diversify income sources and consolidate operations to improve cost-income ratios and better position themselves against increased competition. Directors recommended strengthening regulatory guidance on loan restructuring and exercising vigilance over bank lending policies, the adequacy of provisioning, and debt-to-asset swap policies.

Directors welcomed Cyprus's robust fiscal performance and emphasized that strict spending discipline should be maintained. They cautioned against relying on transitory revenues from cyclical gains and one-off measures to finance permanent spending initiatives, and took positive note of the authorities' commitment to cap expenditure increases, including the public wage bill, in line with the medium-term GDP growth rate, in order to create room for growth-enhancing spending. Directors noted that the transition to public insurance in the health sector should be carefully managed. They agreed that fiscal structural reforms are

needed, and recommended strengthening public financial management, monitoring risks from local governments and the state-owned sector, and improving the corporate governance of commercial state-owned enterprises.

Directors stressed the need to undertake institutional reforms and further enhance the investment climate and raise medium-term growth potential. They agreed that reforms to increase the efficiency of the courts, speed up the enforcement of commercial claims, and clear the backlog of cases should continue. They also recommended expediting legislation to strengthen the governance and autonomy of the Central Bank of Cyprus and encouraged further efforts to mitigate AML/CFT risks. Directors noted that active labor market policies and investment in higher value-added sectors can help reduce high youth unemployment and skills mismatch, thereby promoting more inclusive growth.

It is expected that the next Article IV consultation with Cyprus will be held on the standard 12-month cycle.