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# Cyprus Rogue Borrowers Pose Threat to Sustained Growth

By

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October 16, 2017, 1:00 AM GMT+3

- *No political will to pressure banks ahead of presidential vote*
- *Faster bad-loan resolution necessary for Cyprus rating upgrade*

When [Hellenic Bank Pcl](#) tried to auction a foreclosed luxury house in September in the upscale Nicosia neighborhood of Egnomi, Cypriot politicians from across the political spectrum attended -- to protest the bank's action.

The auction drew no buyers.

Emboldened by support from politicians eyeing elections early next year, Cypriot borrowers are resisting foreclosures or choosing not to repay loans. That is turning into a major headache for lenders struggling to shrink bad loans, eroding their profits, damping the outlook for the country's growth and its possibility of regaining investment grade status. Cyprus holds the first round of presidential elections on Jan. 28.

“There isn't the political will to pressure banks, especially now that we are entering the presidential elections period, while legislation on non-performing loans hasn't been seriously tested and this alone is problematic,” said Sofronis Clerides, a professor of economics at the University of Cyprus. He said many Cypriots blame the banks for having encouraged people to borrow beyond their means and now feel it's legitimate not to repay.

Economic growth in Cyprus, the island nation that was forced to seek a bailout and impose a levy on bank deposits in 2013, outstrips the euro-area average. Still, the country's lenders need to substantially step up

reduction of NPLs, as part of Cyprus's efforts to sustain growth over the medium term, according to the International Monetary Fund, the European Commission and the European Central Bank.

“The very high level of NPLs remains a key vulnerability of the Cypriot economy and banking system, and weighs on the ability of banks to carry out their credit intermediation function,” ECB Banking Supervision Head Daniele Nouy said. The high level weighs on profitability as it may lead to additional provisioning requirements or write-downs and makes the banks less likely to provide new financing to the real economy, she said.

### **‘Deliberate Default’**

“We would entreat Cyprus society to more universally regard as unacceptable the deliberate default on obligations to repay borrowings,” Bank of Cyprus Chief Executive Officer John Hourican told shareholders in August. As part of NPL resolution efforts, the lender will examine portfolio sales and structured solutions across the loan book and real-estate portfolio as well as the potential to accelerate and syndicate certain aspects of loan servicing, he said.

Cypriot banks have cut their total non-performing exposures, or NPEs, by almost 5 billion euros (\$5.9 billion) since the end of 2014, or by around 17 percent, but this has been mainly because they've tackled “low-hanging fruit” or large companies with property that can be swapped for debt, said Fiona Mullen, director of Nicosia-based Sapienta Economics.

“Making inroads into small business and retail loans will be much tougher and will happen at a time when regulators are turning up the thumb-screws,” Mullen said.

For now, the slow pace of the drop in NPEs, hasn't hit growth, which has surpassed expectations. Cyprus's economy grew 2 percent in 2015, and 2016 output was revised upwards on Oct. 10 by the Cyprus Statistical Service to 3 percent from a previous estimate of 2.8 percent. But that may not last.

## Growth Hit

Cyprus's economy has fared better than initially anticipated following the banking crisis because Cypriots chose to stop paying loans in order to sustain their living standards, according to Clerides.

“If the banks pressure these people, then we would see a decrease in the country's growth rate though it wouldn't turn negative,” he said.

In the short term, pressure on banks to take on strategic defaulters to cut their NPEs will hit growth, said Sapia's Mullen. “Banks will have to ratchet up their pursuit of NPLs and this will have a negative impact on confidence and the economy in general,” she said, forecasting growth to slide to 2.7 percent next year from 3.5 percent in 2017.

Still, sustained growth will be possible only when banks can lend easily to grease the wheels of the economy, Cyprus's creditors say. And currently, their NPEs are too high to make that possible.

## Debt Servicing

The NPE ratio as a percentage of gross loans of Bank of Cyprus Plc fell to 50 percent on June 30 from 55 percent at Dec. 31, 2016. The island's largest lender has cut the value of NPLs from a peak of just over 15 billion euros in 2014 to 9 billion euros today.

At Cyprus Cooperative Bank Ltd, the second-largest, the NPE ratio was 60.07 percent at end June 30 compared with 60.13 percent at end March while at the third-biggest, Hellenic Bank, the NPE ratio fell to 56 percent at end-June from 58 percent at end Dec. 2016.

Hellenic Bank in July sold its NPL and real-estate management business to APS Debt Servicing Cyprus, a venture 49 percent-owned by the bank and 51 percent by Prague-based APS Holding SE, that is managing its NPLs with a value of around 2.3 billion euros and real-estate assets worth around 150 million euros.

“Such service companies do speed up NPL resolution and will help with the overall bad loan market in Cyprus,” Martin Machon, chief executive officer of APS Holding, said in an interview in Athens. While Hellenic Bank is currently the only client of the Cypriot venture, it would be possible to get more business and more lenders, he said.

S&P Global Ratings said Sept. 15 it would consider lifting its country rating for Cyprus over the next 12 months if credit and monetary conditions continue to converge with those of the euro zone, via a material reduction in its unusually high NPEs. S&P currently rates Cyprus ‘BB+’, one notch below its investment grade.

For **Yiangos Demetriou**, head of banking supervision at the Central Bank of Cyprus, **the current state of affairs is unacceptable.**

Four years after the country’s 2013 banking crisis, “it’s time to start seeing results on non-performing exposures,” he said in an interview.