CENTRAL BANK OF CYPRUS

EUROSYSTEM

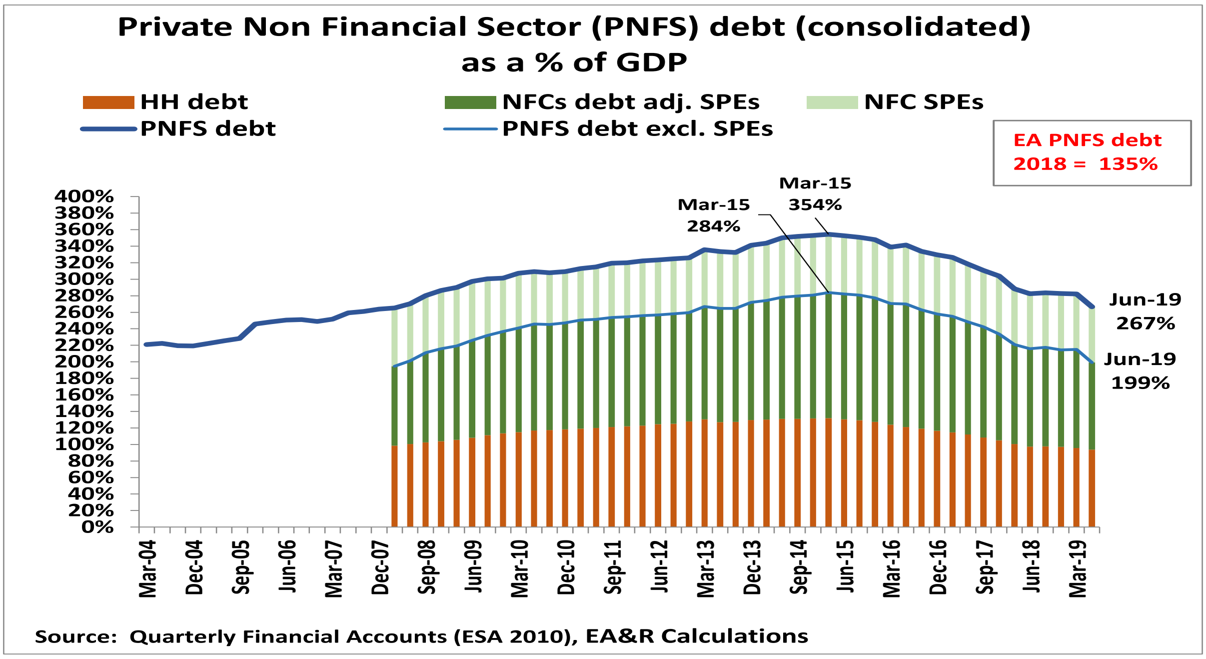
PRIVATE INDEBTEDNESS IN CYPRUS

Background information

Current developments

Non-financial Private sector debt, though still high at 267% as at 2019Q2, has been on a downward trajectory since 2015 (when peaked at 354% in 2015Q1) amid:

- Continuous deleveraging both by Households and NFCs mainly through loan write offs and debt to asset swaps agreements (numerator effect).
- Increase in nominal GDP level (i.e. increase in both real GDP and inflation) (denominator effect).
- The further reduction in PNFS debt in 2019Q2 was mainly driven by the sale of loans at a discounted value by one domestic bank to an asset management company. The difference between nominal value and discounted value was treated as a revaluation and thus had an impact on the level of the PNFS debt (numerator effect).



It should be noted that, NFCs and thus PNFS debt includes the debt of non-financial Special Purpose Entities (SPEs) amounting to around 70% of GDP as at 2019Q2. These SPEs are ship owning companies that have limited or no physical presence in Cyprus and thus have no impact on the Cyprus economy. The rest of the NFCs debt relates mostly to the debt of SMEs with limited access to other sources of financing other than bank lending.

In relation to households, the bulk of HH debt relates to the purchase of real assets e.g. given the high proportion of primary residence ownership in Cyprus. Furthermore, prior to the domestic financial crisis of 2013, there was a tendency for HHs to save for the future and borrow to finance current consumption needs. The accumulation of precautionary savings was related to the lack of good welfare pension scheme, the until recently lack of a national health system and to a cultural practice to hold a safety net in times of hardship. When netted off with the corresponding financial assets, HH debt as a % of GDP turns negative at -39% as at 2019Q2.

NON- FINANCIAL PRIVATE DEBT OF CYPRUS	2014	2015	2016	2017	2018	2019Q2
Private non financial sector debt, million euro	**61.421**	**62.011**	**62.183**	**60.918**	**59.741**	**57.190**
of which SPEs	12.543	12.552	13.509	14.078	14.428	14.450
Private non financial sector debt excluding SPEs, million euro	48.877	49.458	48.675	46.840	45.313	42.740
Non-financial corporations debt, million euro	**38.519**	**39.325**	**40.185**	**39.857**	**39.230**	**37.113**
of which SPEs	12.543	12.552	13.509	14.078	14.428	14.450
Households debt, million euro	**22.902**	**22.685**	**21.998**	**21.062**	**20.512**	**20.077**
Private non financial sector debt, % of GDP	**353%**	**348%**	**329%**	**304%**	**283%**	**267%**
of which SPEs	72%	70%	72%	70%	68%	67%
Private non financial sector debt excluding SPEs, % of GDP	281%	277%	258%	234%	214%	199%
Non-financial corporations debt, % of GDP	**221%**	**221%**	**213%**	**199%**	**186%**	**173%**
of which SPEs	72%	70%	72%	70%	68%	67%
Households debt, % of GDP	**132%**	**127%**	**117%**	**105%**	**97%**	**94%**

Sources: Cystat (Annual Financial Accounts); CBC (Quarterly Financial Accounts)

Possible socioeconomic effects of households' over-indebtedness

Below find abstracts from the Commonwealth Discussion Paper "Mitigating the Consequences of Rising Household Debt" presented at the Commonwealth Finance Ministers Meeting in October 2019. We find the conclusions of the paper to be reasonable.

"*Where over-indebtedness occurs, the high level of debt repayment relative to disposable income can make it difficult for households to maintain acceptable living standards, causing them to cut back on consumption or to default on household bills. Depending on their severity, these financial pressures can contribute to relationship breakdown, poor health, including mental health, and loss of housing. Over-indebtedness has also been found to create disincentives and barriers to employment, and negatively impact on the productivity of employees.*

It should be noted that a range of additional negative welfare impacts have also been identified in respect of children living in over-indebted households.

With household over-indebtedness often concentrated demographically and geographically, these negative impacts can also reduce community cohesion and increase the demand for public services and welfare assistance, thus exerting upward pressure on public expenditure. As such, the economic externalities of over-indebtedness, can be significant[1]".

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[1] In the UK, the debt advice charity StepChange estimated the wider social costs of debt problems to cost around £8.3 billion in 2014.