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CYPRUS
New 7Y bond issuance priced at a historically low yield

- On June 21th, Cyprus tapped international markets with a new 7Y-Eurobond for the second time after exiting from the Economic Adjustment Programme in March 2016. In the latest tender, the Public Debt Management Office (PDMO) sold an offered amount of €850mn of 7-year government bonds as part of its €9bn Euro Medium Term Note (EMTN) programme. Citigroup, Goldman Sachs and HSBC were appointed by the Cypriot government as lead managers. The issue was more than four times over-subscribed with total bids amounting to €3.7bn. The average accepted price was at 99.686 and the corresponding yield at 2.80%. The latter compares with an initial price target of 3.0% and guidance of 2.9%. The issue matures on June 27, 2024 and bears a 2.750% fixed annual coupon.

- From a historical point of view, this is the lowest coupon rate the Republic ever achieved in a benchmark bond debt issuance and reflects strong investor confidence towards the country's improving macroeconomic fundamentals. The previous 7-Y offer in July 2016 amounted to €1bn and was priced at 3.8% with a 3.75% coupon. Earlier, and within the first year of its MoU program, Cyprus was already a credible borrower and had made the fastest come-back to international markets among other Euro Area program countries. Cyprus had issued bonds three times in the international markets, once in June 2014 and then again in April 2015 and in October 2015.

- New bond issuance allows for streamlining of debt repayments in 2019-2020. The proceeds from the latest tender will be used to repay more expensive debt outstanding, including the buyback of three outstanding securities with a combined face value of €1.4bn and higher yields. In this context, the government simultaneously offered yesterday switch offers of 4.75% June 2019 notes, 4.625% February 2020 paper and 6.5% May 2020. The total aggregate amount accepted for the purchase of these securities by the Republic of Cyprus came in at €514.906mn, with the breakdown at €336.558mn, €101.994mn and €76.354mn, respectively.

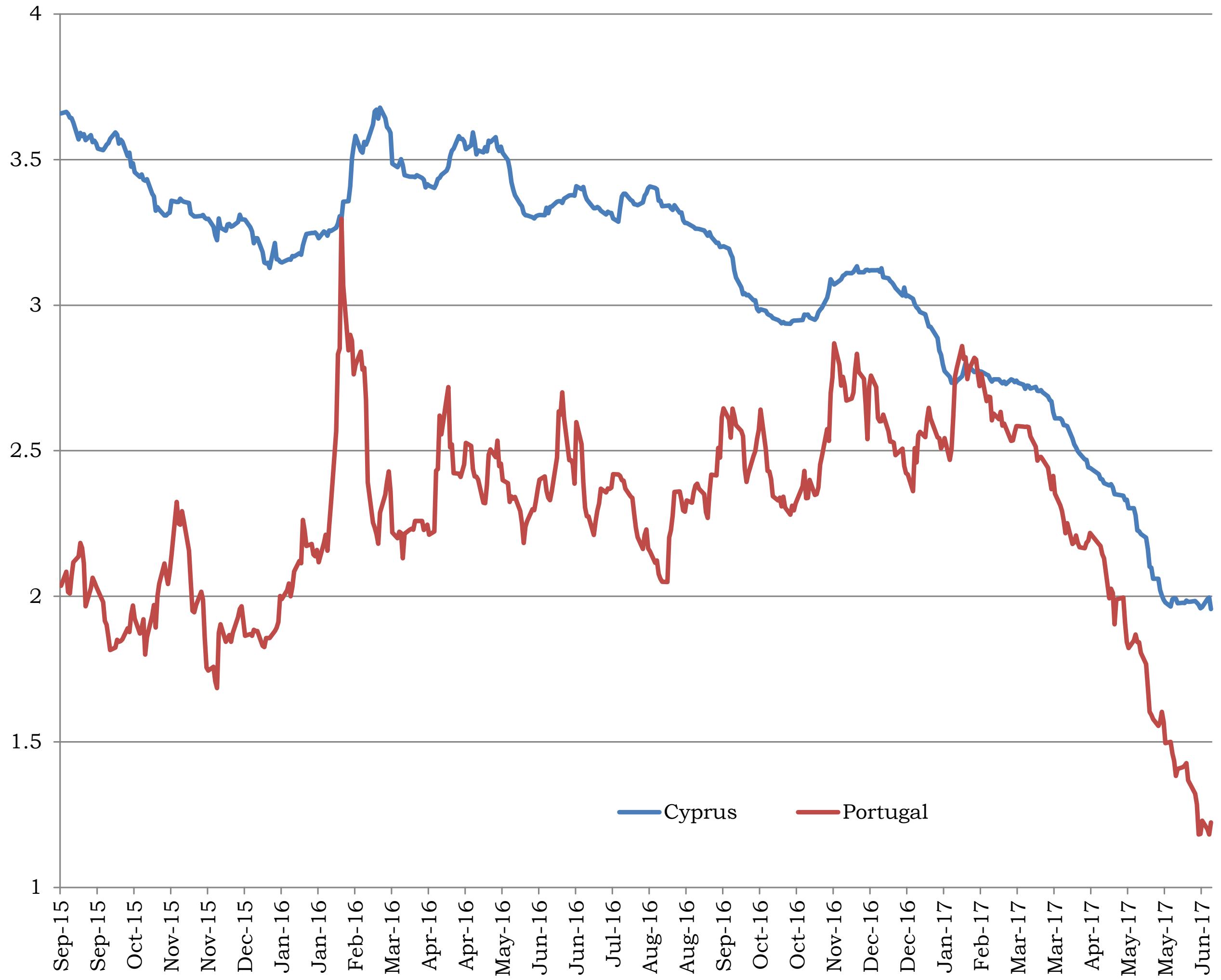
- We have always advocated that Cyprus is a solid turn-around economic story. After a three year recession in 2012-2014 and a cumulative drop of 10.5% of GDP, economic activity expanded by 1.7% YoY in 2015, accelerated to 2.8% YoY in 2016 and is expected to further gain momentum to above 3% in 2017-2018. The Q1-2017 GDP growth reading was the strongest since 2008. On a seasonally adjusted basis, growth expanded by 0.6% QoQ/3.3% YoY compared to 0.7% QoQ/2.9% YoY in Q4 vs. 0.3% QoQ/2.8% YoY in Q1-2016. The consumption rebound most probably continued in Q1 driven by strong sentiment improvement, a flourishing tourism sector, improved labor market conditions, further property market stabilization, the impact from the envisaged fiscal relaxation, and the further normalization of banking sector conditions. The strong sentiment improvement - the highest in EU-28 in the last three years - mirrors the lasting progress within the expired adjustment program. Tourist arrivals grew by 17.6% YoY in Jan-May2017, with the corresponding levels over that period heading for a new all-time record high in the history of the Republic. Unemployment in seasonally adjusted terms resumed its downward trend declining further to 11.6% in April 2017 down from 12.5% in March 2017 vs. 12.9% in April 2016.

- Following the latest round of sovereign rating assessments, major rating agencies appear to continue having divergent views on Cyprus. Currently, the distance from investment grade status is: one notch for S&P (currently at BB+, last upgrade in mid-March), four notches for Moody's (currently at B1), and three notches for Fitch (currently at BB-). The lack of investment grade status currently prevents Cyprus from joining the ECB's PSPP program. The medium-term Cypriot bond yields have been on a declining trend since March2016. Yet they have stopped outperforming those of Portugal in the Euroarea periphery since February 2017 (Figure 1).

- Even though Cyprus has made progress in a lot of areas, the risk of complacency following the exit from the Economic Adjustment Program is material. On the domestic front, the reform momentum seems to have stalled ahead of the Presidential elections in 2018. Still, a handful of unfinished structural reforms need to progress in the areas of privatizations, public and health sectors, while addressing the challenges of a still high bad loans stock (NPEs ratio at 47% in Dec2016, the second highest in EA). Particularly, parliamentary approval of the Bill setting a cap on the public sector wage bill, essentially linking the expenditure expansion with the GDP growth performance, is still pending. And as time moves on and the economy improves, it becomes increasingly unlikely the Bill will be voted into Law ahead of next year's Presidential elections.

Figure 1: Cypriot 5Y bond yields have declined by 100bps since the beginning of the year

(5-year generic government bond yields, %)



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