

This newsletter is a quarterly email for OPC clients from our Head, Investment Advisor Alexandros Clappas CFA. Views expressed are his own and do not constitute official OPC views unless explicitly stated. This newsletter is market commentary and does not constitute investment advice.

June 2019

“Cyprus, the recovery is frail”

Dear Investors,

The start of the summer season has brought in more than just nostalgic feelings of beachside fun, longer days of relaxing wave sounds and wedding fireworks lighting up the night skies. Since the latest auction of CYPRUS, which we wrongly predicted was planned for a part to be raised locally, the international markets swayed the minister in to their direction much like Circe’s magic proved no match for Aphrodite’s in the persuasion department. When did bond markets get so sassy? Rightfully the yield demand from international markets was no match for local appetite. Since the last 5YR/30YR issuance in March totalling 1.25bn dual tranche the yield curve has taken a dive, scuba-deep-water type dive. Just for reference, I compare 3 financial instruments that are dissimilar, but well known.

- S&P 500 Stock Market Index Return (Jan – Jun ‘ 19) **18.82%**
- Germany 1.25% 15/08/2048 Return (Jan – Jun ‘ 19) **15.32%**
- Cyprus 2.75% 05/03/2049 Return (Mar – Jun ‘ 19) **25.48%**

CYPRUS CURVE

The list just keeps growing. A snapshot from our financial album we provide the yield chart from Oct 2014.

OCTOBER 2014

Issuer	Cpn	Moody's	S&P	Fitch	Maturity	Bid	Offer	YTM
Cyprus	3.750%		B		Nov 2015			4.19%
Cyprus	4.750%		B		Jun 2019			5.55%
Cyprus	4.625%		B		Feb 2020			5.63%

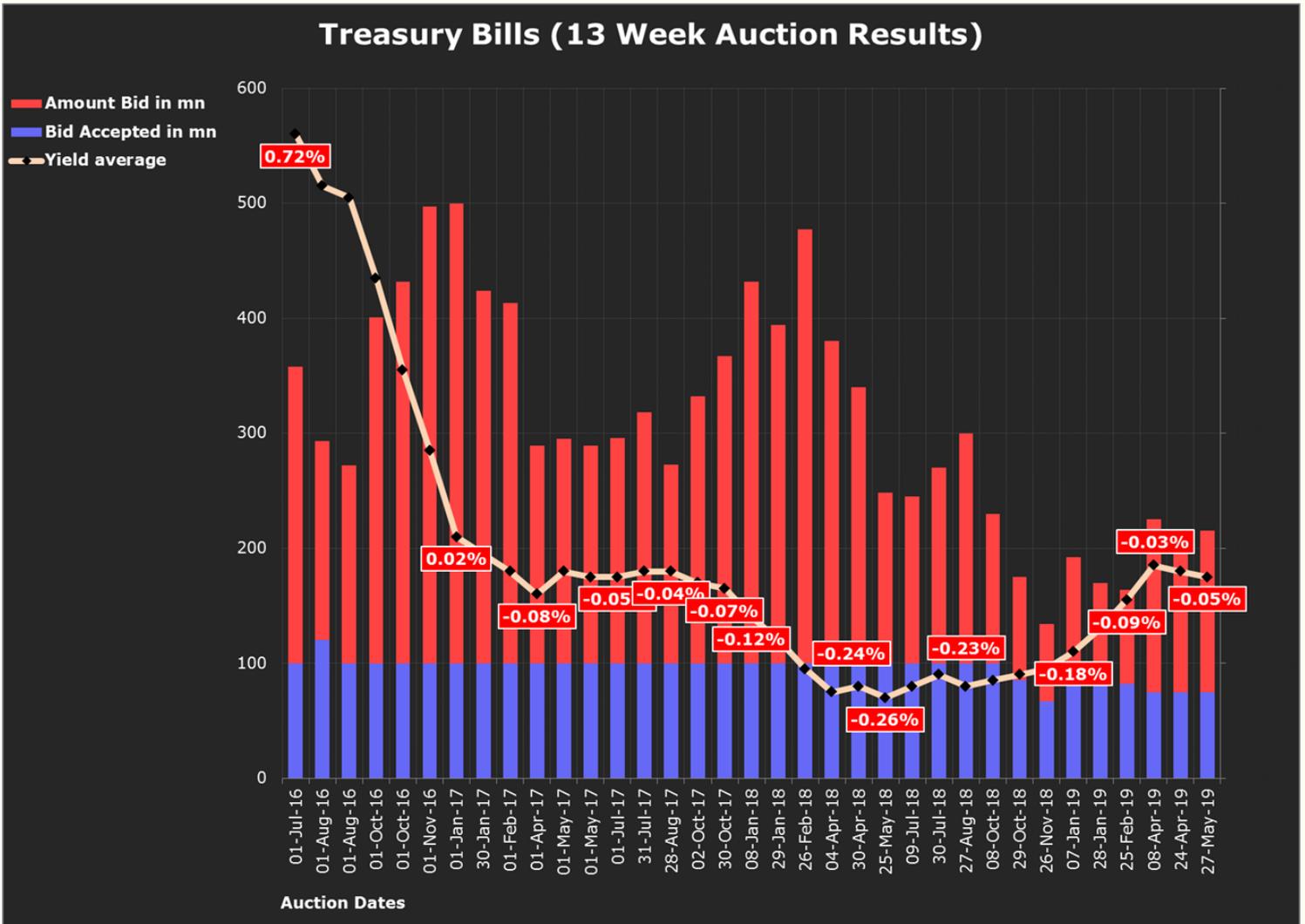
JULY 2019

Issuer	Cpn	Moody's	S&P	Fitch	Maturity	Bid	Offer	YTM
Cyprus	4.750%	Ba2	BBB-	BBB-	25 Jun 2019		PAID	
Cyprus	4.625%	Ba2	BBB-	BBB-	03 Feb 2020	102.600	102.950	-0.41%
Cyprus	3.875%	Ba2	BBB-	BBB-	06 May 2022	110.900	111.250	-0.09%
Cyprus	3.750%	Ba2	BBB-	BBB-	26 Jul 2023	115.100	115.400	-0.04%
Cyprus	2.750%	Ba2	BBB-	BBB-	27 Jun 2024	113.400	113.750	0.00%
Cyprus	0.625%	Ba2	BBB-	BBB-	12 Mar 2024	103.000	103.400	0.00%
Cyprus	4.250%	Ba2	BBB-	BBB-	04 Nov 2025	125.700	126.300	0.08%
Cyprus	2.375%	Ba2	BBB-	BBB-	25 Sep 2028	116.950	117.450	0.44%
Cyprus	2.750%	Ba2	BBB-	BBB-	26 Feb 2034	125.000	125.500	0.89%
Cyprus	2.750%	Ba2	BBB-	BBB-	05 Mar 2049	127.500	128.000	1.57%

TREASURY BILLS

Since the merger of HB and CCB, the liquidity offered on TBILLS has steeply withdrawn due to lack of demand from the CCB. This can be seen in CHART 1 where the amounts auctioned have been reduced to 75mn every run. The short duration market is dominated by banks. Given that HB is effectively full on local ROC exposure, the liquidity provided at current levels is basically recyclable demand and thus seizes higher premiums than the Central Bank rate (-0.05% vs -0.40%).

CHART 1.



THE ECONOMY

Key Stats

- Gross domestic product (GDP) for 2019 Q1 has been 3.5% up in comparison to 4% up for 2018.
- Unemployment reached a low of 7% in March 2019.
- Expected 2019 GDP 3.5%, 2020 expected 3.1% and for 2021 expected 3.2%.

Private consumption, which has been the strongest driver of GDP growth, is expected to slow down due to increase in expected loan repayments and increases in social measures such as the Public Health Care. Growth is expected to be derived from investment in infrastructure such as tourism, construction, renewables, transport and education. An important part of these investments includes foreign direct investment. The deceleration of global growth places Cyprus in a vulnerable position as the dependence on foreign investment creates uncertainty risk from those foreign markets. During 2018, inflation has been subdued at 0.8% and the same subdued rate is expected for 2019, irrespective of strong GDP growth. This is partially due to the unemployment gap that allows wage price pressures to abate. Tourism is slightly down, compared to the record year of 2018, by -3.2%

THE GOVERNMENT

Key Stats

- Fiscal budget expected for 2019 vs temporary deficit 4.8% registered for 2018.
- Debt / GDP % end of 2018 102.5% vs expected 2019.

Government fiscal balance is expected for 2019 to return to surplus after the temporary deficit of 4.8% registered for 2018 mainly from the sale of CCB and the support provided by the Government regarding the sale. Expected expenditure will remain under control, underpinning the performance of the state in producing positive surplus in financing. The jump in Debt/GDP at the end of 2018 is due to the large bond issuance deposited with CCB 3.19bn EUR for the successful completion of the deal. It is expected that the ratio will edge downwards to below 100% and closer to 90% by 2021. This is not inclusive of any negative outcomes regarding the payment of civil servants reimbursements due to salary increases, albeit Fitch states that "Court rulings on public sector wage cuts could lead to lower budget surpluses until 2022 but would not undermine the downward debt trajectory."

THE BANKS

Key Stats

- New Central Banker with a goal to clean up reputation, NPEs and AML.
- Bank of Cyprus announced the completion of Project Helix, €2.8 bn Gross Loans for €1.2 bn Cash.
- Bank of Cyprus end of Q1 2019 CET1 14.9% total capital ratio 17.9%.
- Bank of Cyprus end of Q1 2019 NPE ratio 35%.
- Hellenic Bank end of Q1 2019 CET1 18.5% total capital ratio 21.2%.
- Hellenic Bank end of Q1 2019 NPE ratio 26%.

It is blatantly obvious that the two major banks are strongly capitalised with liquidity in excess of territory. New loan origination data is not encouraging enough to organically reduce the NPE ratios to levels where dividend distribution can be expected, circa 10%. Changes in leadership are expected to bring new light to the largest publicly traded companies in Cyprus, albeit headwinds remain. Interest on housing loans was reduced to 2.20% (Mar 2019) compared to 2.52% (Mar 2018) with the equivalent deposit interest at 0.36% (Mar 2019) compared to 0.40% (Mar 2018).

THE TURKS

With a small note on Turkey, the latest elections in Turkey show that CHP (the main opposition party to AKP) now lead in the polls in 6/10 of the biggest cities. A change in leadership may provide hope for de-escalation in the EEZ. In my opinion, the EU is not in any position to impose bilateral sanctions against Turkey, without the blessing of the US.

PERSONAL FINANCE

Apologies for the non-Greek speakers; the below is only relevant to Cyprus, and the laws regarding the right of citizens for free access to the beaches of Cyprus. Have a great summer everyone.

Το δικαίωμα της παγωνιέρας

Η Αλεξία Σακαδάκη, ως μέλος της Πολιτικής Επιτροπής Κινήματος Οικολόγων – Συνεργασίας Πολιτών, τοποθετήθηκε με μια δημόσια επιστολή, η οποία αναφέρει, μεταξύ άλλων, πως η μεταφορά της παγωνιέρας είναι δικαίωμα των λουομένων. Συγκεκριμένα, λέει ότι «πολλοί λουόμενοι δεν γνωρίζουν ότι έχουν το δικαίωμα πρόσβασης στις παραλίες μας και πως η σχετική νομοθεσία – ο περί της Προστασίας της Παραλίας Νόμος, Κεφ.59 - προνοεί ότι οποιοδήποτε πρόσωπο με οποιονδήποτε τρόπο παρεμποδίζει την ελεύθερη διακίνηση στην παραλία ή την πρόσβαση προς αυτή είναι ένοχο αδικήματος και σε περίπτωση καταδίκης, υπόκειται σε φυλάκιση που δεν υπερβαίνει τους δώδεκα μήνες ή σε χρηματική ποινή που δεν υπερβαίνει τα περίπου 1.708 ευρώ ή και στις δύο αυτές ποινές». (Reference Sigmalive.com)

Kind Regards,

Alexandros Clappas, CFA

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