Newsletter

April 2017

Table of Contents

Cyprus: Investments driven by foreign interests could set the tone for a new expansion period.

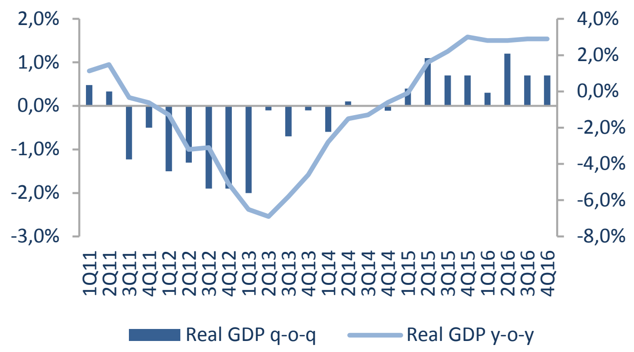
By Ms. Damiani Papatheodotou

AXIA Ventures Group Ltd, Research Analyst

Three years after the near collapse of its banking system, the first depositors' bail-in in the Eurozone, ailing public finances and a three-year Economic Adjustment Programme, Cyprus seems to be back on track for a new expanding era.

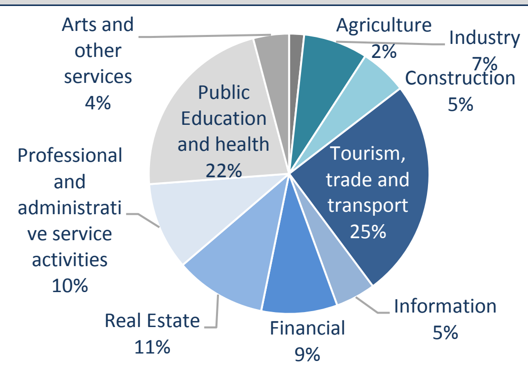
The Cypriot economy has been rebounding faster than initially anticipated by any international organization, returning to positive real GDP growth levels in 2015 (+1.7% y-o-y) and further accelerating in 2016 (+2.8% y-o-y), following three years of contraction (Figure 1). The healthy pace of growth that accelerated in 2016 and looks set to be maintained at similar levels in 2017 is primarily assisted by private consumption (+2.0% y-o-y), investments (Gross Fixed Capital Formation; +26.0% y-o-y) and tourism (Figure2). As a result of the stronger economy and the better management of public finances, the general government balance turned positive for the first time (0.1% of GDP) since 2008, while the country faces no significant repayment obligations at least until 2019, allowing the government to maneuver around its state budget.

Figure 1: Real GDP q-o-q vs. y-o-y (%)



Source: Eurostat, CySTAT

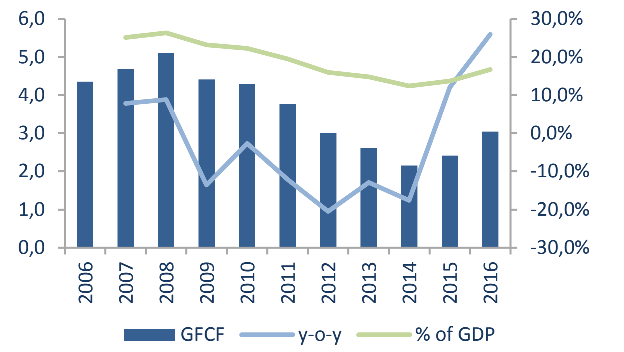
Figure 2: Gross Value Added by industry



Source: Eurostat, CySTAT

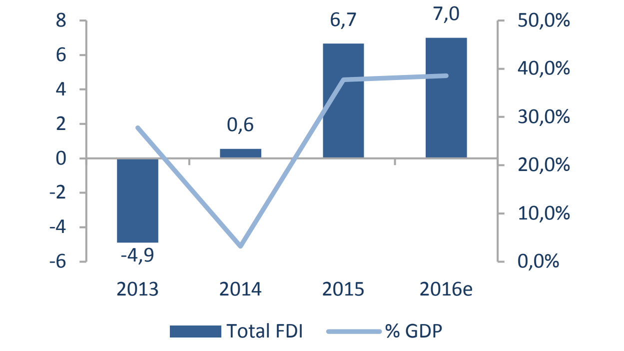
Although it is difficult to assess in a few words the drivers that precede the economy's turnaround, one point is undeniable. Investments (Figure 3) primarily led by foreign interests (FDI) in various sectors including tourism, real estate, energy and shipping, form a new dynamic which could set the tone for stronger economic growth that could lead to further expansion of the country's GDP level and reduction of the current unemployment rate (13.3% in 2016). What should be noted is that, according to data released by the Central Bank of Cyprus, total FDI reached EUR 6.7bn in 2015 vs. just EUR 0.6bn in 2014 (Figure 4), pointing to an accelerating trend that is expected to be maintained going forward.

Figure 3: Gross Fixed Capital Formation (EUR/bn)



Source: Eurostat, Central Bank of Cyprus

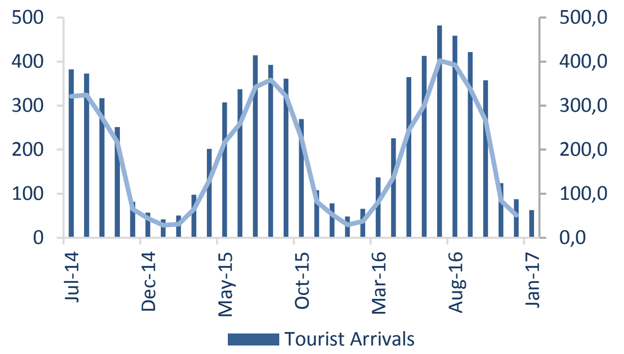
Figure 4: Total FDI (EUR/bn; % of GDP)



Source: Eurostat, Central Bank of Cyprus

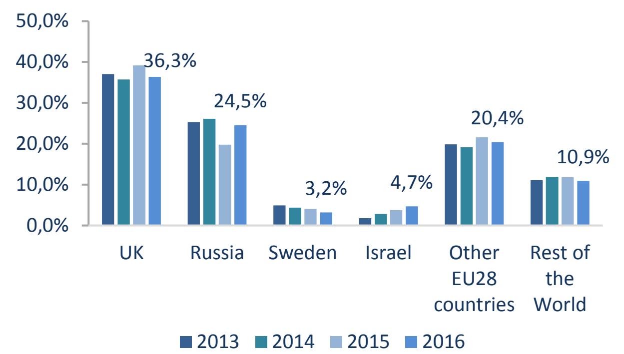
Tourism has traditionally been a major source of income and a driver of economic growth in Cyprus, with significant contribution to the country's GDP (19.3% in 2015 according to the World Travel & Tourism Council). Being one of the country's most resilient and strong sectors, the tourism season of 2016 portrayed the best year of the Cyprus' tourism product ever. Tourist arrivals reached 3.2mn in 2016 vs. 2.7mn in 2015 whereas tourism revenues increased by 11.9% y-o-y to EUR 2.4bn (Figures 5 and 6). Interestingly, with a number of large-scale development projects in the pipeline, such as the EUR 500mn first Integrated Casino Resort in Cyprus, the EUR 220mn Ayia Napa marina and numerous luxury hotels, tourism is now gaining renewed momentum. Moreover, the implementation of the National Strategy of tourism which aims at extending the seasonality and promoting the advancement of new tourism sub-sectors, such as religious and cultural tourism, sports tourism and health and wellness, could open the door to new prospects that could enhance and diversify the tourism product with the ultimate scope of maximizing the island's potential.

Figure 5: Tourist arrivals vs. revenues



Source: CySTAT

Figure 6: Tourist arrivals by country (% of total)



Source: CySTAT

After taking a severe hit since 2008 the real estate market is now back in the limelight. Acquiring property in Cyprus, either as an investment or a second home, has traditionally been a popular choice among foreign investors. Robust signs of recovery have been observed during the last two years with new contracts of sale, as a measure of demand, increasing by 42.6% y-o-y in 2016 to 7,063 contracts. At the same time, real estate prices (according to the Central Bank of Cyprus' Residential Property Price Index) recorded a positive quarterly growth rate in 3Q16 of the magnitude of 0.1%, while on a yearly basis the index dropped by 1.2%, the lowest rate of decline since 2010. With the steady reversal of property prices and the economy picking up speed, supply tends to rise providing a considerable impetus to the construction industry, while a number of sizeable residential and commercial buildings are underway (e.g. the 16-floor commercial building OVAL, the tallest seafront residential building in the Mediterranean, ONE, etc.).

Overall, Cyprus has come a long way and what was once considered impossible is another chapter in the island's history book. Despite non-investment sovereign ratings, the continuous upgrades by global assessment agencies have enabled the country to regain much of its credibility and to be better equipped, through lessons obtained from past mistakes, to build a brighter and more prosperous economic future.

In conclusion, economic prospects and opportunities are now clearly visible. What remains is the big question of whether Cypriots are capable of rising above the short term considerations associated with a perplexed political landscape and a continuously changing business environment, which could jeopardize the healthy economic recovery and the positive momentum. As always, the choice lies in our hands.

Ms. Damiani Papatheodotou joined AXIA in January 2016 as an Analyst in the Research Division, after successfully completing a three month-internship during the period July to September 2015. Damiani primarily focuses on macroeconomic and political research vis-à-vis Cyprus and is the author of AXIA's Cyprus weekly research note. At the same time, she actively monitors a number of European banks in Cyprus, Greece and Portugal with the help of AXIA's Financial Institutions research team. Damiani holds a BSc in International, European and Economic Studies from the University of Cyprus and is due to complete her MSc in Finance.

Cyprus as an Investment Funds Hub

By University of Cyprus, Faculty of Economics and Management, MBA Programme

Efstathiou Thalia
Papaeracleous Elena
Papoula Pantelitsa
Tritas Anastasios
Tsoulli Andri

The financial crisis has caused significant changes to the worldwide economy during the last eight years. Established economies have collapsed and successful organizations have ceased operations, thus creating a domino effect all over the world.

Since 2013, Cyprus' economy has been going through a difficult period, which resulted to the banking system's significant shrinkage, as well as the declaration of the Cypriot wealth as illusory. However, the parameters of the financial sector have shown substantial improvements and are now based on sounder foundations in terms of capitalization and liquidity. Thanks to the disciplined and careful actions taken by all authorities, the island has managed to successfully exit the adjustment program and establish a more resilient economy while improving the investors' confidence in it. Cyprus is taking steps towards restoring its credibility, to find its place in the worldwide economy map as a trustworthy and reliable jurisdiction for foreign investments again, aiming to further improve its International Credit Rating Agencies ratings.

The Cypriot government has as a primal aim, amongst its other financial sector development schemes, the further development of the investment funds industry in Cyprus, therefore it has taken significant actions to contribute to the effective and efficient operation of the Cyprus Securities and Exchange Commission (CySEC). To that effect, the human resources available for CySEC have been substantially increased. At the same time, CySEC has developed a Risk Based Supervision Framework, implemented in 2015, which has considerably improved the application of supervisory activities.

Since 2010, the government has been methodically working in cooperation with the CySEC and the industry to prepare a modern legal framework for collective investments schemes. The framework that was created comprises three laws, one on UCITS (2012), one on Alternative Investment Fund Managers (2013), and one on Alternative Investment Funds (2014). This legal framework is periodically reviewed in order to meet new challenges of the sector thus further enhancing it, with an overall goal to help establish in Cyprus a funds industry in a well-regulated and supervised environment, while offering alternative means of financing to SMEs and other organizations.

This study deals with the investment funds industry in Cyprus. Its main aim is to determine the ways that the Regulatory Authority affects the growth and development of the investment funds industry in a country. In particular, it aims to perform an assessment on whether the operation of the CySEC as the responsible regulatory and supervision authority body over the investment funds sector in Cyprus is efficient and effective. Based on the research findings, recommendations for the effective operation of the CYSEC and the investment funds industry in general are proposed.

The project includes a comparison study of the competitor countries, which are established and successful investment fund jurisdictions throughout the world, in order for it to trace their competitive advantages and endorse their better practices. Moreover, a specific analysis of the Cypriot Fund Industry and the Cypriot Regulator is made. As a qualitative tool, surveys and interviews with people working in the industry were performed, so as to identify the factors that the users currently consider as obstacles for the further expansion of the investment funds industry in Cyprus.

One of the main findings of the research relates to the lack of expertise, knowhow and specialization for the investment fund industry amongst all parties involved. It is a relatively new sector that deals with complicated instruments and structure, for which there is no previous expertise. So, starting with the regulator and expanding to the Ministry of Finance, the Law Office of the Republic, the House of Representatives, lawyers and auditors, all parties need to be properly trained in order to be proactive and aligned with the needs of the economy. Furthermore, another significant finding is that the bureaucratic structure of CySEC causes lengthy procedures, delays in authorization of applications and long response time.

The actions and work performed by CySEC, in collaboration with the relevant organizations (Cyprus Investment Funds Association, CIFA and Cyprus Investment Promotion Agency, CIPA) are headed towards the right direction. The government of Cyprus, CySEC and all other parties involved, should keep offering their support to this effort, as well as be alert in order to take the necessary actions for the streamlining of the needs of the economy to the product offered, the users and the investors.

Some of this project's concluding recommendations for CySEC, regarding the further development of the investment funds sector in Cyprus, include the recruitment of additional and specialized staff within CySEC, the creation of a knowledge center as part of the Ministry of Finance, the further embrace of technology, the creation of strategic alliances with European and International Parties, and the pursue of education in the investment funds industry through the introduction of academic schemes in both undergraduate and postgraduate levels in Cypriot Universities.

Currently, CYSEC, as well as all other stakeholders of this industry, is at an early learning stage, therefore some time is needed for the Cypriot economy to be established as an investment funds jurisdiction. However, by taking advantage the geographical location of the island and by establishing all the appropriate mechanisms that will help the regulator to overcome the current obstacles, Cyprus has the potential to become the link between Eastern Mediterranean, Middle East and Europe, as well as be established as an investment Funds Hub in the Mediterranean Area.

In conclusion, the success of the fund industry in Cyprus requires the endorsement of a culture of continuous change so as to make the island an onshore transparent jurisdiction with the best practices.

Applied Business Project submitted to the faculty of the MBA program as a partial fulfilment of the requirements for the title MBA (Master in Business Administration) at the Department of Public and Business Administration and the Department of Accounting and Finance of the University of Cyprus.

The Emergence of FinTech and its Implications for Financial Services and Investment Funds

By Dr. Antonis Houry

Eurobank Cyprus Ltd
Manager, Strategy and Business Development, Wealth Management

The digital revolution is transforming the way customers access financial products and services, with technology driven applications constantly penetrating every segment of the financial industry. Financial Technology (FinTech) is an umbrella term used for the emergence of financial technology for the financial services sector covering any technological innovation, including financial literacy and education, banking, investment and cryptocurrencies. FinTech is a dynamic segment at the intersection of financial services and technology that has been growing at an exponential rate. It has resulted in reshaping the financial industry and causing a digital disruption in the status quo in the financial services landscape. While the impact of this disruption cannot yet be quantified, the ability to create better, faster and cheaper services that will become an essential part of everyday life for institutions and individuals is clearly visible.

As clients become more and more accustomed to the digital experience offered by companies such as Google, Apple, Facebook and Amazon, they expect the same level of customer experience from their financial services providers. State-of-the-art customer experience, speed and convenience will further accelerate the adoption of FinTech, offering solutions that can better address customer needs by offering enhanced accessibility, convenience and tailored products. Over the next decade, the average financial services client profile will change dramatically as the leadership in global economy moves from older generations (Baby boomers) to newer and more technologically adept ones (Generation X and Millennials).

The investment industry is another area that has the potential to be affected dramatically by vast technological developments. The emergence of data analytics in the investment sector has enabled firms to focus on investors and design and deliver tailored products and solutions. Investors of the new generation will most likely prefer to conduct personal research and thus retain more control over financial decisions. This trend will result in asset management firms moving towards a more holistic, goal-based advice. This could in turn enable the emergence of robo-advisors that will accommodate these needs and assist firms to attract and serve clients more efficiently and at a lower cost for the clients. Robo-advisors can provide automated, algorithm-based portfolio management advice to the client. Recent developments also enable robo-advisors to offer tools and methodologies that generate real-time trade and investment recommendations tailored to individual investors' history and preferences.

The Blockchain technology, the technology underpinning cryptocurrencies like Bitcoin, is also attracting a lot of interest within the financial industry. This resides in the potential to create a secure, pseudo-anonymous, traceable and decentralised transaction system using a distributed ledger network to allow for peer-to-peer (P2P) transactions without the need for any third party. These idiosyncrasies offer novel approaches to data management and sharing, offering the opportunity to improve efficiency in a number of applications such as faster interbank clearing and settlement, lower transaction costs, reduced counterparty risk and increased transparency. The fund industry can greatly benefit from the adoption of this technology by facilitating disintermediation through greater transparency and tracking of transactions and assets records, which will certainly be the basis for further innovation and transformation.

Throughout the past decade, increased compliance and regulation has put financial institutions under immense pressure. This has facilitated the emergence of Regulatory Technology (RegTech) that deals with regulatory monitoring, reporting, risk management and compliance. In terms of regulatory reporting, RegTech can enable automated data distribution and regulatory reporting through big data analytics and real time reporting. With regards to risk management, it can detect compliance and regulatory risks, assess risk exposure and anticipate future threats. RegTech can also provide enhanced identity management and control by facilitating counterparty due diligence and Know Your Customer (KYC) procedures as well as Anti Money Laundering (AML) and anti-fraud screening and detection. It can also provide real time monitoring and tracking of current state of compliance and upcoming regulations and provide solutions for real time transaction monitoring and auditing, especially with the utilisation of the Blockchain technology.

Over the next years, the impact of FinTech will become more noticeable as new technological solutions start to flourish. The emergence of FinTech should be looked at as a once-in-a-generation opportunity to reimagine and modernise the funds industry.

Dr Antonis Houry is the Strategy and Business Development Manager at Eurobank Cyprus Wealth Management. He joined Eurobank Cyprus in 2011, having previously worked at Citigroup and Commerzbank in London. He has extensive experience in financial services and investment funds. Antonis holds a PhD in Quantitative Finance from Imperial College Business School, an MSc in Communications and Signal Processing and a BSc in Electrical and Electronic Engineering both from Imperial College London. He is the Chairman of the FinTech Committee of CIFA.

For information, please contact:

Mr. Marios Tannousis
Member of the Board, Secretary
E-mail: mtannousis@investcyprus.org.cy

Severis Bldg. 9 Makarios III Ave., 4th Floor
Lefkosia 1065, Cyprus
PO Box 27032, Lefkosia 1641, Cyprus
Tel: +357 22 44 11 33
Fax: +357 22 44 11 34
E-mail: info@cifacyprus.org