Cyprus Banking Crisis: What really happened, the myth, the collapse and now what?

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ABSTRACT

This thesis aims to comparatively analyze the Cyprus Financial Crisis that hit the island in 2012/2013 and led to the shut down of all Banking activities for a period of 12 days. Also it will go over the other 4 financial crisis that have occurred in Cyprus, in less than 15 years, in an attempts to understand why after 4 warnings such huge crisis took the country by shock.

The aim of this study is to write a qualitative thesis that would explain what is known to us as the Cyprus Banking Crisis; which was mainly caused by its exposure to the existence of overleverage real estate companies, the Greek debt crisis, the reluctance of the Cypriot government to restructure its financial sector, its inability to refund state expenses from the international market, and last but not least by its exposure to corruption that unraveled with the fall of Laiki Bank and the implementation of a Memorandum of Understanding by the TROIKA.

On the other hand, the choice of this topic is to try and unravel the truth behind what is said and to analyze the possible and measures that are continuously being implemented in an attempt to make sure another crisis does not hit the financial sector of the country.

Keywords: Cyprus, crisis, sovereign debt, crisis management, TROIKA, bail-in, bail-out

ÖZ

Bu tezin amacı 2012 ve 2013 yılında yaşanan ve bütün banka faaliyetlerinin 12 gün boyunca durmasına sebep olan Kıbrıs finansal krizin karşılaştırmalı analizi amaçlar. Ayrıca 15 yıldan az süren Kıbrısta 4 ayrı finansal krizin ve 4 uyarıdan sonra böyle bir krizin ülkeyi neden büyük bir şoka soktuğunu inceleyecektir.

Bu çalışmanın amacı Kıbrıs banka krizi olarak bilinen krizi açıklayacak nitelikli bir tez yazmaktır. Emlak şirketlerinin eğiliminin fazla olan teşhiri genel sebeptir. Yunan borç krizi Kıbrıs hükümetinin finansal sektörünü yeniden yapılandırmaya gönülsüzlüğü giderlerini uluslararası markette ülke giderleri geri ödemedeki acizliği ve son olarak fakat önemsiz değil, Laiki bankasının çöküşüyle yolsuzluğa maruz kalman,TROİKA tarafından anlayış notasının uygulaması.

Diğer tarafta, bu konuyu seçmekteki amacım söylenenin arkasındakini çözmek ve ülkeyi tekrar finansal krize sokmayacak diğer krizlerden emin olmak için uygulamaya devam edilen imkan ve tedbirleri analiz etmektir.

Anahtar Kelimeler: Kıbrıs, kriz, borç, içinde kefalet, gevezlik patlama

DEDICATION

Dedicated to my late grand father Sheikh Louis Michel Gemayel with love….

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LIST OF ABREVEATION

BoC	Bank of Cyprus
CBC	Central Bank of Cyprus
CDS	Credit Default Swap
CGB	Cyprus Government Bonds
EBA	European banking Authority
ECB	European Central Bank
EC	European Commission
ESM	European Stability Mechanism
EU	European Union
EWS	Early Warning Systems
GDP	Gross Domestic Product
GGB	Greek Government Bonds
IMF	International Monetary fund
MoU	Memorandum of Understanding
OECD	Organization for economic co-operation & development
PIMCO	Pacific Investment Management Company, LLC.
TRNC	Turkish Republic of North Cyprus
TROIKA	Triumvirate representing the financial decision group of the EU. It is formed by the IMF, the EC and the ECB.

Chapter 1

INTRODUCTION

Cyprus is an Island located on the crossroad of three continents (Europe, Asia and Africa) in the heart of the Mediterranean Sea. It is divided into two parts, the north being referred to as the Turkish Republic of Northern Cyprus, and the South being referred to as The Republic of Cyprus.

While most people learned of the financial crisis the Greek part of the Island was facing in March of 2013, the reality is that this crisis was the last draw of a result of 18 years of history of mismanagement of worldwide financial crisis' by the Government and the Central Bank of South Cyprus.

From the rise of the "Dot Com" Market in 1995, to the Bail-In in 2013, passing by the burst of the Housing Bubble in 2007 and the Greek Crisis in 2009; the situation in which Cyprus finds itself today, is in other words a result of consequent decisions of actions and inactions, handlings and mishandlings of worldwide financial crisis' by local politicians and so called economists that ran and continue to run the South part of the Island up to this day.

1.1 Goal of the study

The Goal of this study is to concisely analyze the unspoken-of trends, actions, handlings and decisions that eventually led to what is known to us as the "Cyprus Banking Crisis".

The other goal of the thesis is to stress that austerity alone will not be able to solve the "Cyprus Banking Crisis" issue on one hand, and to derive the need for policy directives that could be implemented by the government of the Republic of Cyprus in response to the crisis on the other hand.

1.2 Research method

Rather than using the traditional quantitative research method, in this paper, I will be using the qualitative method.

A qualitative research is mainly an exploratory research. It is used to gain an understanding of underlying reasons, options and motivations; as well as to provide insights into a given problem, or to help develop ideas or hypothesis for potential quantitative research (Investopedia, 2015).

Indeed, when I started working on this paper in 2013, there were very few to none academic papers that were being written at the time on the subject of the Cyprus Banking Crisis. In the light of this critique, a qualitative research method was decided to be the best way to identify the dimensions and magnitude of the crisis that was taking place. On the other hand, a qualitative research allowed me to analyze multiple policy options that if used by the government, would allow the government of the Republic of Cyprus to deal with the accumulated problems in much better way.

1.3 Framework of the study

The paper has four main sections. In the first, through an academic literature review, I draw a lesson learned from the mistakes undertaken by other nations before a crisis. In the second part, I try to analyze the reasons of the Cyprus Banking Crisis through

a broader historical perspective. In the third part I analyze the crisis itself before finally discussing possible policy directives and implications that would allow the Republic of Cyprus to recover.

Chapter 2

LITERATURE REVIEW

Since the beginning of the 20th century, the world has faced quite a few financial crisis whether it was during the European exchange rate crash (1922) or the Mexican crisis (1994) or even the Asian one in (1997). Consequently, an important amount of studies have been conducted for that matter and researchers such as Reinhart and Rogoff (Reinhart & Rogof, 2009) have significantly tried to develop a system that would trigger pre-crisis warning in an attempts to minimize the effects.

Stephen Haber (Haber, 2005) conducted a research on experiments that were undertaken by the Mexican authorities, which eventually led to their financial crisis in 1997. Indeed he argues that the government undertook 2 separate experiments in which they firstly privatized Banks to eventually be forced to restructure. Haber argues that Mexican financial institutions were in a too weak position to have the strength of a "privately owned Bank" and that weak management by authorities is only bound to trigger a collapse of the Banks and the currency (Haber, 2005).

What about the development of early warning systems? In fact, Gramlich (Gramlich, Miller, & Oet, 2010) argued that EWS are data driven models that will aim to create a relation between observed variables and past crises in order to identify the relevant variables that would eventually lead a country to avoid a financial crisis. In other words he argues that they provide warning signals that should be taken seriously by

relevant authorities. Nevertheless, Gramlich's theory has yet to be developed even more as it concentrates on 2 matters being firstly that the stability of relationships between crisis and crisis-driven factors and secondly, that the crisis-driven factors can be identified ex-ante. Unfortunately, the main problem of Gramlich's theory, was that sometimes these warnings can be a false alarm and sometimes they cannot even be premeditated as natural catastrophe – such as a tsunami – can also throw a country into a huge financial crisis (Panayi, 2014).

Other researchers such as Babecky et al (Babeckly, Havranek, Mateju, Rusnak, Smidkiva, & Vasicek, 2014) have also tried to find early warning signals to a financial crisis. After having used quarterly data's of all OECD countries for a period that included debt crisis, currency crisis and banking crisis; they argued, "The ratio of domestic private credit to GDP represents the most consistent early warning indicator of a banking crisis". Yet again, we can clearly analyze that causes of financial crisis can be very different from one state to another, making it almost impossible to detect on a long-term basis (Rose & Spiegel, 2014).

In Asia, Arestis and Gilckman (Arestis & Glickman, 2002), used Minsky's "Financial Instability Theory" in order to prove that the overly "liberalized economy was what paved the way to the crisis that hit the Asian continent between 97 and 98. They determined that by using Minsky's theory they could derive policy implications and identify the threats of growth and employment that emerge from the financial sector of a given economy. They concluded that Minsky's theory could have been clearly applied to the financial crisis that took place 18 years ago in Asia.

Borio on the other hand (Borio, 2006), argues that it is changes in the monetary and financial organizations that have been taking place in the past +/- 30 years are the reason why countries across the world have been facing challenges such as the ones of a financial crisis. He argues that current economical and financial environment are the very same reason why financial crisis are occurring. He stresses – in his research – the need for long term and firm focus measures as well as greater policy measures when it comes to facing upswings and downswings situations.

Other economists, (Bordo, Redish, & Rockoff, 2011), argued that it is possible for any country including Cyprus to avoid a financial crisis. By using the example of Canada – which they argue was not hit by the crisis in 2008, 1930 and 1907 – they argue that it is the structure of financial systems that lead or avoid a financial collapse. They argue that in order to avoid crisis, – just like Canada – countries should – under utter tight control – absorb the domination of two sectors being the mortgage market and investment banking sector. They say that it is tight regulation of these two sectors that eventually lead to greater control and the avoidance of consequences most of the world had subside in 2007-2008.

Coming to the example of Cyprus, two main economists have analyzed what happened and put forward theories explaining the reasons why the 2012/2013 crises was so big for the island.

Anathtasios Orphanides (Orphanides, 2014), argued that the crisis was politically driven by the socialist government that came into power in 2008. He argues that the "communist" government's mismanagement of the country's finances is what led to the crisis and extreme debt. Orphanides adds that while – during his term as governor

– he tried to warn authorities, politicians increased spending in the public sector and gave “too much freedom to the bank”. This according to him led to Banks holding a volume 8 times bigger than the island’s GDP; which was bound to explode sooner or later (Orphanides, 2014).

Stravos A. Zeinos (A. Zenios, 2013) argues that although economical factors were involved, it is undeniable that Cypriot authorities were widely responsible for the collapse of the island’s economy. By comparing the Cyprus crisis to the ones that occurred in Mexico, the USA or Japan, he puts forward systematic analysis of data he collected in order to define the source of the Cypriot financial crisis (A. Zenios, 2013). Just like Orphanides, Zeinos proves, through his researches that the effects of the crisis could have been strongly minimized as signals to it went back to 2009.

Chapter 3

CYPRUS BANKING CRISIS: 18 YEARS OF BACKGROUND

In this chapter, I will go back to the DotCom bubble burst in order to be able to give a better explanation of all the "pile-ups" that eventually let to the Cyprus economical crisis of 2012/2013. By doing so, I will analyze the subprime mortgage crisis as well as the European sovereign debt most commonly known as the Euro Crisis.

3.1 Worldwide financial crisis: From the DotCom bubble to the Greek Recession

Figure 1: Dot Com Bubble Crash

The Business Dictionary defines the “DotCom Bubble” as a “phenomenon that began in 1995, rose to its peak in 1997 before collapsing in the year of 2001”. This period was manifested by a rise in investments and speculations in what is known to us as the “Internet Firms” (Web Finance Inc, 2015).

Basically, the dot com market was an easy and promising way through which people could be able to multiply their wealth by creating an Internet Firm with a strict minimum of funds involved. In other words, people were creating new companies which were using the internet as the operating base for their operations thus saving money on rent, office material, stationaries, employees, salaries and so on. By saving these costs, the revenue that would be retained would be at its utmost profit and stock prices would increase which encouraged households not only in Cyprus but also across the world to invest in it.

Accordingly, the phenomenon was accentuated by the media and politicians saw Banks being more than happy with lending money to people wanting to create their Internet companies (Lakkotrypis, 2010). But the Bubble was soon to burst paving the path that would lead to the Cypriot economic crisis that would follow almost 18 years later.

The beginning of the end of the Dot Com Bubble began in 1999 when the United States of America’s Federal Reserve increased interest rates by 6 and was followed by the United States vs. Microsoft case (Federal Reserve of the United States of America, 1999).

By 2001, the Dot Com market was collapsing at an incredible speed. Indeed, 50% of the world's Internet firms were forced to shut down thus leaving an incredible number of consumers with debts to financial institutions that they could not repay (Lakkotrypis, 2010).

3.2 The Subprime Mortage Bubble: 2002-2009

What is known to us as the "Housing Bubble" began in the early start of the millennium in the United States of America and was caused by changes in legislation as well as the attractiveness of the rather inexpensive real estate market at the time.

As a result of these factors, investing in the real estate industry seemed more secured and promising than the stock market and people were motivated in doing so. Accordingly, the so-called subprime mortgages were increasingly becoming popular; which meant that people with a lower credit score, were able to borrow from Banks at elevated fees and interest rates (Bianco, 2008).

However, the bubble was soon to burst, and its consequences on the world, Cyprus included, starting with the U.S. would be devastating as it would create a sort of economical domino effect that led one country after the other into a harsh economical crisis.

- In 2002, Freddie Mae and Freddie Mac begun to purchase large amounts of subprime mortgages (Mollenkamp, Craig, Nguyen, & Lucchetti, 2008).

- In 2004, the Security & Exchange Commission lifted leveraging restrictions, which was supposed to make securities more profitable for both the lenders and the issuers. Unfortunately, this caused a large threat of inflation, as there was a lot of liquidity circulating in the economy that originated from borrowers that were looking to invest (Mollenkamp, Craig, Nguyen, & Lucchetti, 2008).

- In 2006, subprime mortgages rates increased, real estate prices started depreciating and households began to not be able to cope with the payments involved in the reimbursement of their housing loans. A vicious circle was then created; borrowers couldn't pay back financial institutions, which had borrowed the funds from Freddie Mae and Freddie Mac and what seemed to be as a promising investment turned out to be a problem with no solution (Mollenkamp, Craig, Nguyen, & Lucchetti, 2008).

- In 2007, IndyMac Bank was forced to hold $10.7 billion worth of loans it could not sell to secondary markets and the housing bubble collapsed when in 2008, depositors with IndyMac Bank withdrew $1.55 billion out of scare that depositors would lose their money (Mollenkamp, Craig, Nguyen, & Lucchetti, 2008).

- In 2008, Lehman Bothers Holdings Inc, The Bear Stearns Companies Inc, Merill Lynch, The Goldman Sachs Group Inc and Morgan Stanely all filed for bankruptcy one after the other. All except Lehman Brothers Holdings Inc received government support (Mollenkamp, Craig, Nguyen, & Lucchetti, 2008).

- Consequently Fannie Mae and Freddie Mac were placed under conservatorship of the government and the crises spread world wide at an astonishing speed; hitting one country after the other like a domino game (Agency, 2008).

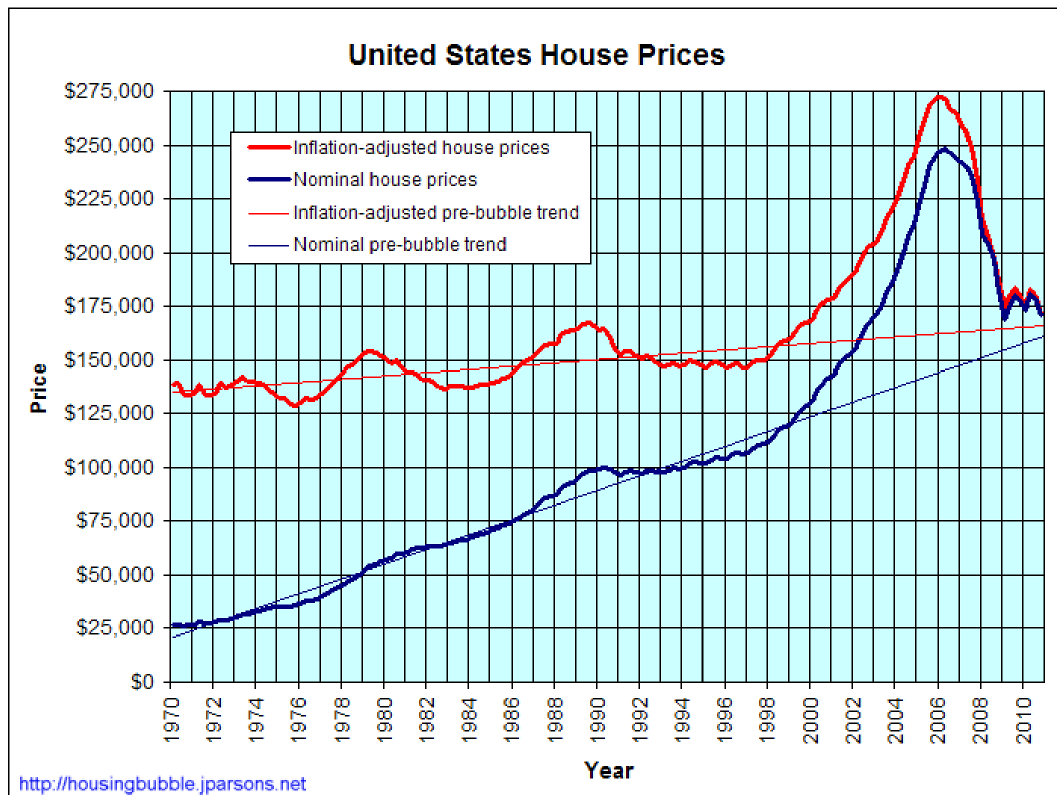

Figure 2: United States House Prices

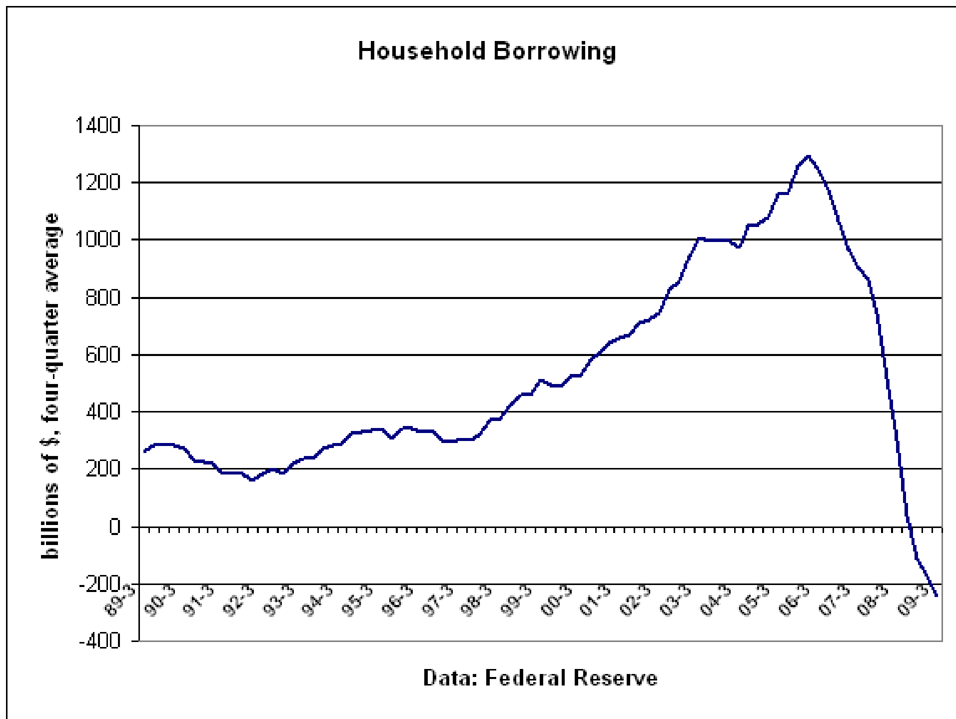

Figure 3: United States Household Borrowing

Figure 2 represents the U.S house prices from 1970n to 2010. It can be seen that during the period from 1970-1999 the inflation adjusted house prices were increasing steady and normal. From 1999-2007 there is an impressive increase in the housing prices which was the result of people's willingness to borrow and invest, and bank's willingness to lend subprime mortgages. It is remarkable that a house was sold for $150000 in 1999 and seven years later for $275000; almost double price, whereas from 1970-1999 the price increased approximately $25000. After analyzing this graph, it can be understood that the households that turned to be highly risked consumers and borrowed from banks subprime mortgages were just following the events happening at the time (Standard & Poor, 2013).

I have inserted Figure 2 in and Figure 3 in order to show the relationship between the increasing housing prices and the increasing borrowing trend, emphasizing the period 2000-2010. It can be seen from the figures that from 1999 to 2006, the price of houses was increasing along with the increasing borrowings. After 2006-2007, the price of houses was declining, and so was the amount of borrowings. This two figures can show that households could borrow relatively easy for the first six years of the 21st century, and relatively harder to borrow in the last four years of the 21st century (Standard & Poor, 2013).

3.3 The Theory of Inter-Temporal Choices in order to explain the 2008 recession

The theory of inter-temporal choice explains the choices of consumption over time. Consumers can decide whether they want to become a borrower or a saver depending on the variables at a given time period. The variable that influenced the consumers in investing in the housing market was interest rates and the willingness of the banks to give subprime mortgages easier than before. In this model we are therefore going to examine what happens in the case of consumers want to become borrowers due to decreased interest rates. In theory, a consumer might be better off if interest rates are low and become a borrower and if interest rates are high, become a saver. In the first scenario, the consumer will be better off today since he will have more money available upon consumption or investment whereas in the second case, the consumer will be better off tomorrow rather than today (Unver, 2009).

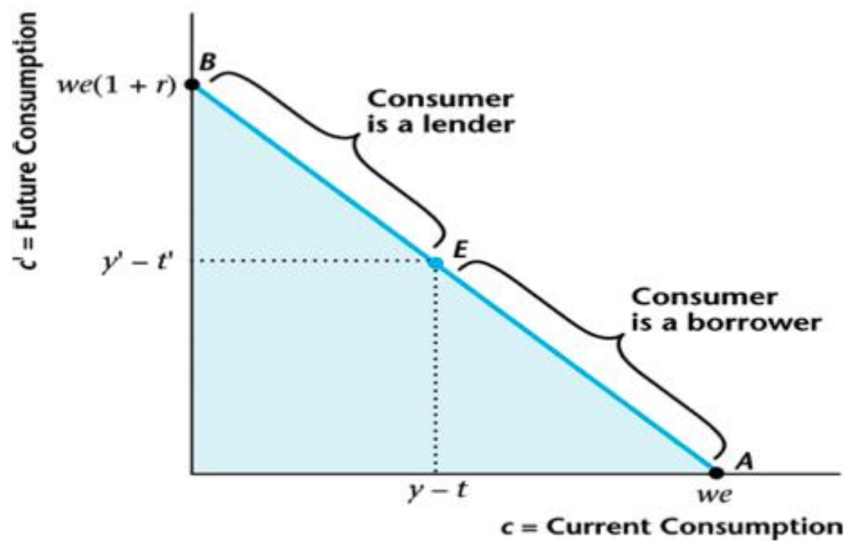

Figure 4: Consumer’s preferences according to the indifferent curve

The above diagram shows consumer’s preferences according to the indifferent curves. If the consumer wants to consume equally in both periods then he would choose point E on the diagram where consumption today and tomorrow are equal therefore he would not wish to substitute his consumption in either periods despite the fact that this would have been beneficial to him. On the other hand if consumer wishes to consume more in the future he would choose any point between E-B and become a lender that is a saver (Unver, 2009).

Such a choice might be influenced by high interest rates. Following this, a consumer who wished to spend more in the current consumption, that is today, he will choose any point between E-A. Again, such choice might be influenced by low interest rates and the consumer will become a borrower.

In order to better understanding and analysis of consumer‟s behaviour, we are going to look at the (Sufe, 2011)and Intertemporal Choice (Unver, 2009). As previously stated there are several factors that can influence a customer in wether becoming a

borrower or a saver and by analyzing Slutsky, we are only focusing on the changes in demand due to an interest rate change.

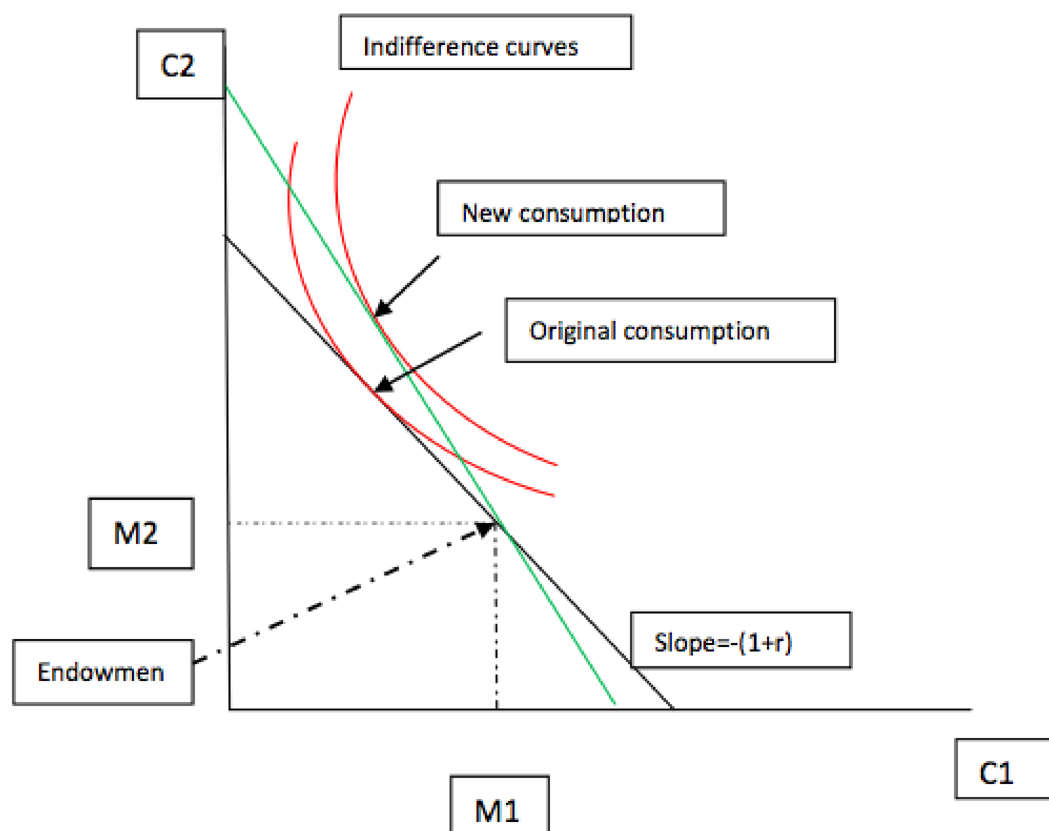

Figure 5: Consumer's decision to remain a saver if interest rates increase

The above figure illustrates a consumer's decision to remain a saver if interest rates increase. This is because as interest rates increase, it will be more beneficial if consumers save their money and spent less today in order to have more money tomorrow. When interest rates increase, the budget line pivots around the endowment to a steeper position resulting to the new consumption line lying on the left of the endowment. The substitution effect happens when interest rates increase and current consumption is more expensive and people shift away from current consumption. The new consumption as shown on the diagram, gives the consumers less opportunities to consume today but they will be better off tomorrow. Banks may

increase real interest rates value in order to persuade people to save their money and decrease borrowing. Such decision might be taken if the economy is threaded by inflation that is a rise in prices foreign investment or currency strength and imports (Sufe, 2011).

At the time that households were borrowing money from the banks in order to invest them mostly in the housing sector, the interest rates on the subprime loans was very small for a given time. After a certain period of time, the interest rates on the loan were increased and this is how banks were aiming in making profits. The problem that rose from this mechanism was that too many households were borrowing and only a small proportion of them could repay the loan after the interest rates increased. This is due to the fact that households were buying houses in order to sell them later on when their prices would increase, make a profit and repay the loans to the banks.

When the price of houses started to depreciate at some point around 2008, borrowers who sold the houses for less than what they bought them for, they were left with a dept at the banks that could not repay. Interest on the subprime mortgages increased and therefore it was impossible for households to handle the mortgage.

At that point, banks could not get their money and the economic problem was created when banks had no liquidity.

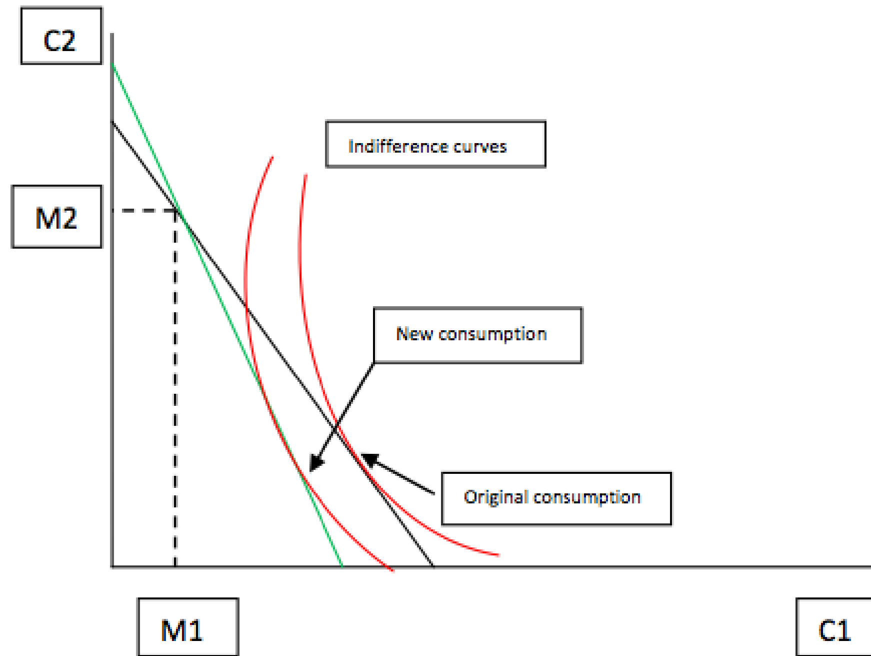

Figure 6: Representation of what will happen to consumers who are borrowers and interest rates increase

The above diagram represents what will happen to consumers who are borrowers and interest rates increase. At the beginning borrowers will be able to spent more today because they have more money since they are on loan and thus less tomorrow when they have to repay the loan (Unver, 2009).

Following the increase in interest rates, the consumer will have to pay more interest tomorrow and therefore might consider decreasing his consumption today and borrowing less in order to be able to repay the loan in the future. This situation describes the situation where household faced when interest rates increased in the subprime mortgages. On the other hand, lenders which in this C1 case they are the banks, are benefited from the rise of interest rates since they would earn more money in the future as the loan plus the increased interest rates would be more than what they would earn if interest rates remained low. In real time though this was not the case because as borrowers did not have the money to repay the loans, banks were not

receiving what they had previously given (Unver, 2009).

3.3 The Sovereign Debt: A Europen Crisis

What is the “European Debt Crisis”? In brief words, the European Debt Crisis is the almost failure of the euro, which links 19 countries in a close but imperfect manner. Over the past 5 years, 5 countries within the Euro Zone (Greece, Ireland, Portugal, Italy and Spain) have doddered on the edge of financial collapse thus threatening to bring down the entire European Union and toss the world into a new recession.

In order to understand the Eurozone crisis, one must look back to history to understand why the almost flawless concept of the Euro came to be in the first place. Indeed, if one looks back, most of Europe’s history is made of wars and disagreements; moreover it had always been a continent with accentuated border tariffs and restrictions on trade with neighboring countries consequently stifling economical growth (Salmon & Sir Nicoll, 1997).

Following WWII, the situation was so calamitous that the fastest way to put the continent back on its feet was to eliminate those barriers. That was when the first steps towards the European Union and eventually the Eurozone began. This happened with the establishment of the European Coal and Steel Community in 1952 (Quermonne, 2005).

So in other words trade barriers were brought down because European countries wanted to create an ideal union that would force all countries that are members not to go at war against each other anymore. This led to the cost of doing business being lowered and in 1992, following the reunification of Germany, the Maastricht Treaty was signed thus creating the European Union. Yet one obstacle resided, the different

currencies and exchange rates, but in 1999 the issue was solved and the Euro was created.

On January the 1st 1999, the Euro was introduced; this meant that the currencies of the countries within the Euro Zone ceased to exist. These countries didn't only give up their currency but they also halted their monetary policies thus passing on the said power to a newly established European Central Bank (ECB). However all members of the Eurozone kept their different fiscal policies which was and still is a key reason to the sovereign debt crisis.

According to the federal reserve, a Monetary Policy involves changes in currencies interest rates and the authority of money supply wherehas Fiscal Policy involves changes in tax rates aand government spendings in order to influence the agregated demand in a country's economy (Federal Reserve of the United States of America, 2015).

Before the Euro, countries like Portugal, Ireland, Greece – just to name a few – not only had to pay high interest rates (18%) to borrow, but they could only borrow so much. Ater the Eurozone was created not only were interest rate lowered (3%), but the amount they started borrowing drastically increased. Lenders were reassured by the fact that if small countries could not repay their debts they would be saved by "bigger ones" such as Germany or France, because they were bound by the same currency (Paulo, 2011).

Consequently countries like Greece were able to adjust their fiscal policies, increase spending and embark on a road of huge deficit scheemes that were previously

unthought of. Greece accumulated skyrotcket debts, had weak and unfased fiscall policies, and kept on repaying debts by borrowing some more. Countries like Spain and Ireland created huge housing bubbles with cheap credit – a bit like what happened in the US.

As a result, credit was flowing, debt was being accumulated and the economies of Europe began to fall in shambles due to the interdependency of these countries that had resulted from the creation of the European Union and the Eurozone. And in 2008, after the subprime crisis emerged, credit was halted and countries with weak fiscal policies such as Greece had economies that could not function no more.

Following the credit crisis that had taken the world by a storm, borrowing was discontinued and the greek government could not pay up its loans anymore. This cause the government not to be able to pay the wages of all the new jobs they had created, or the pensions they had increased. Due to the fact that all Eurozone countries were interlinked, the problem became a continental one rather than local.

But what really underlined the crisis?

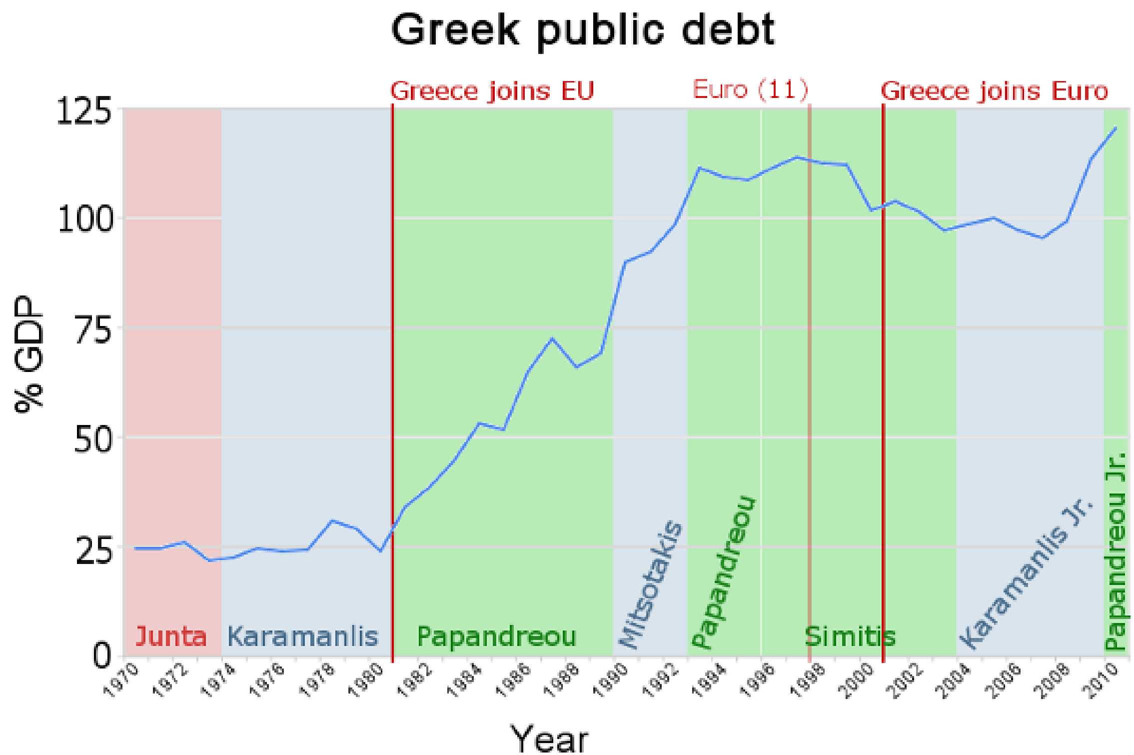

Figure 7: Greek Public Debt (COFACE, 2015)

Since the mid-seventees, the Greek government was running a deficit supported by the issuance of Government Bonds and when the Euro was introduced, all government bonds were consider as equivaling one another. With a deficit that was everlasting increasing, and failing to collect what other governments owed them, the Greek government made arrangement with financial institutions such as Goldman Sachs to obscure the country's true level of borrowing (Martinuzzi , 2010). Having spending kept at high level, the debt to GDP ratio reached a peak of 146% by 2010 (Mrsnik, Gill, & Cullinan, 2010).

In April of 2010, Standard & Poor downgraded Greecs's credit rating to a "junk status" which led to shutting down private lending to the country. By June 2011, Greece's credit rating had dropped to CCC the lowest rating that can be given by a monitoring institution (Linnane, 2010).

Facing the possibility of default, by mid 2011, the country agreed to a bailout set in place by the TROIKA na the first batch was agreed to on May 2d of 2010 and amounted to 110 Billion Euros, in July of 2011 another bach of 109 Billion Euros and in October of 2011 the TROIKA and other Banks came to a final agreement that they would write of 50% of Greece's debt before 2020. In other words, this would reduce the country's debt to 120% of GDP by 2020 (TROIKA, 2011).

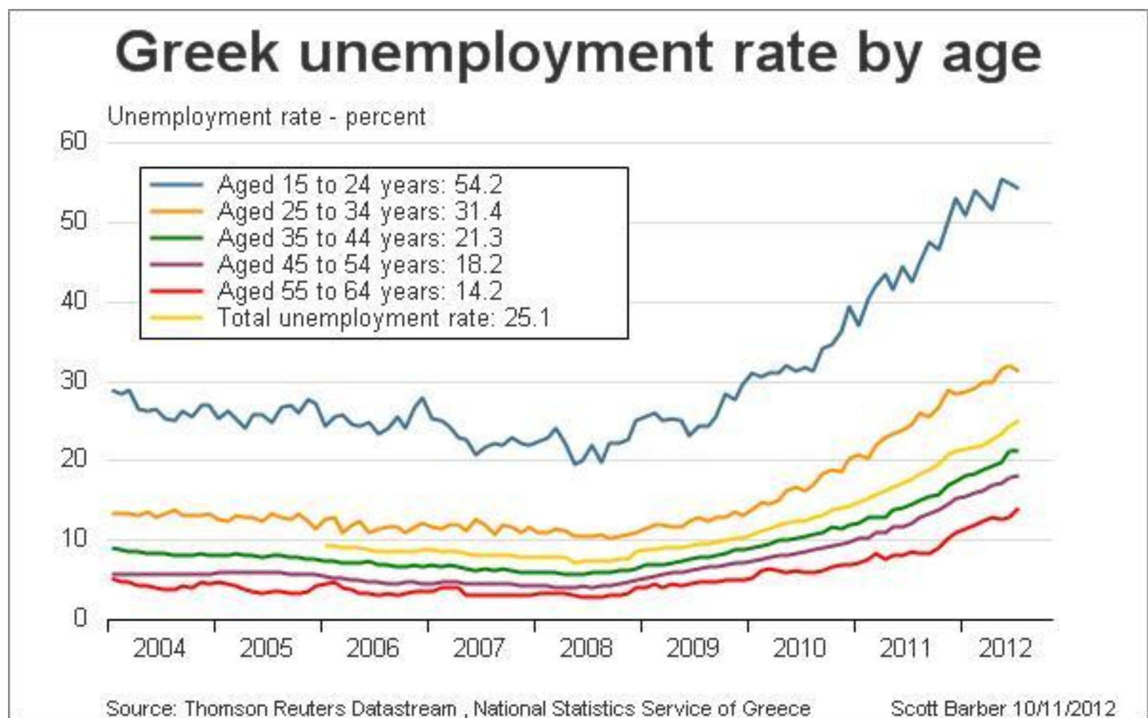

Figure 8: Greek Unemployment Rate by Age

Nonetheless all of these measures came at a price. The Greek government was forced to take great austerity measures in exchange of the loans and help it was receiving from the TROIKA. This included drastic spending cuts, public sector salary and pension cuts as well as the privatization of national industries. Austerity measures were negatively received and violence errupted across the country which actually worsened the Greek recession rather than anything else. The country still pays, today, the price of these austerity meansures. Indeed, as of February 2015, unemployment levels have reached 26% for the general working population – 54.2%

for those under the age of 25 – and at least a third of the population is currently living under the poverty line (TROIKA, 2011).

On February 28 of 2015, Greece was scheduled to receive its last batch of funding, but the newly elected leftist president has enforced his will to halt austerity and demanded a renegotiation of the terms initially agreed on with the TROIKA (IMF, 2015)

Chapter 4

WHAT REALLY HAPPENED IN CYPRUS

In this chapter, I analyzed the studies that were made by Constantinos Stephanou, Stravos Zeinos and former governor of the Central Bank of Cyprus Athanasios Orphanides. This analysis was done to show the mismanagement of the Bank of Cyprus as well as Laiki Bank, which led to a great exposure to Greek Bonds and eventually led to the crisis.

I will also analyze the Credit Default Swap, in order to show that Cyprus reacted too late and that the effects of the crisis could have been considerably minimized had the authorities takes the appropriate measures.

4.1 Cyprus a general overseeing of facts

In July of 1990, Cyprus submitted a request for a full membership to the then European Economic Community. After 14 years, Cyprus became a full member of the EU in May of 2004.

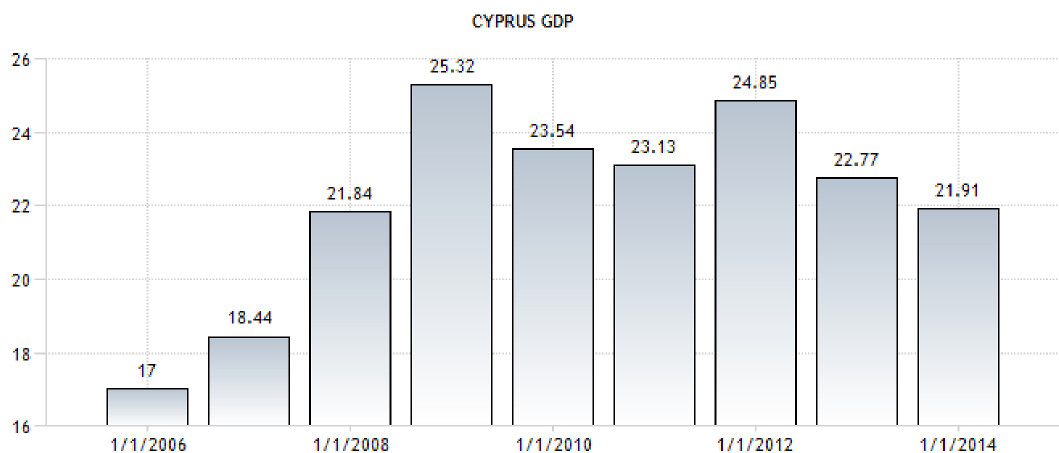

Figure 9: Cyprus Gross Domestic Product

In 2007, Cyprus applied for a full membership to the EU monetary union; in order to join the Euro, Cyprus had to meet the European economic indicators that were prescribed by the Maastricht treaty, and it did. Having then a GDP of 15.8 Billion Euros and a debt of 8.4 Billion Euros, it was clear that Cyprus was well within the 60% threshold set by the treaty signed in 1992 (Orphanides, 2014).

Consequently, on January the 1st of 2008, the streets of Nicosia, Larnaca & Limassol were filled with people chanting, dancing and celebrating the introduction of the Euro currency on the Island. These celebrations were a result of tremendous efforts to bring the South Side of the island closer to "The Heart of Europe". Yet behind all the joy it was crystal clear to the world that the main reason Cyprus had worked so hard to get close to Europe, was no other but political.

Political, one may ask why? An English banker in Cyprus once asked me a question, he said: " Why would Cyprus be attractive for Banking?" I was given half a day to answer yet nothing came up and eventually I went back and asked for the answer. The reason I lay this short story here, is that his answer actually answers the political motive of why Cyprus was so keen on getting closer to Europe. He said to me: "Cyprus is the perfect location, it's a small, independent and isolated island located on the crossroads of three continents, it is a strategic location" (FBME, 2013). Indeed, Cyprus is a small island, and its decision to join the European Union in 2004 and the subsequent adherence to the Euro System in 2008 were mainly made to strengthen the political standing of the island, and get greater support against the republic of Turkey, when it came to the latest's desire to enter the EU, and against The Turkish Republic of Northern Cyprus (TRNC).

As previously stated, in January the 1st of 2008, the Greek side of the island's fiscality was in good condition. 2007 was closed with a debt to-GDP ratio of 53% and predictions were that it would fall bellow 50% by 2008 (European Commission, 2008). The Banking system on the island was renowned and solid, deposits exceeded loans, funding was stable and the government's tax income was 7.1 Billion Euros and it's expenditure, 6.5 Billion Euros, thus producing a profit of 0.5 Billion Euros which is more or less 3.5% of the GDP. One must note that the surplus was higher than most EU countries at that time, Germany included (Orphanides, 2014).

So what really happened? How did a stable country, with already set liquidity regulations and significant macro-prudential measures, ended up going bankrupt in a space of four years only? Why didn't anyone see this coming? Or did they and did nothing about it? Who is responsible? Why didn't the Central Bank try to save the Banking system before all of the economy collapsed?

Allot of questions need to be answered indeed… and a lot more will remain unanswered due to a lack of responsibility from Governmental & Central Bank authorities.

It is undeniable that Greek bonds played a big role in Cyprus's downfall, yet was it enough to reduce the island's once strongest asset to shambles? Well the answer is simple, it's no.

Are there people that should be held responsible? The answer is yes: Dimitris Christofias – former President – and Athanasios Orphanides – former Governor of the Central Bank – just to name a few.

What one should understand is that inexperienced so-called politicians and economists began to rule the country and five years later, the once perfect economy was left in ruins.

By March 2013, euro deposits in the island were unequal to euro deposits elsewhere, restrictions were imposed on the use of funds by depositors, pensions were cut back by nearly 50%, the government lacked access to capital markets and the economy was down for a free fall (A. Zenios, 2013).

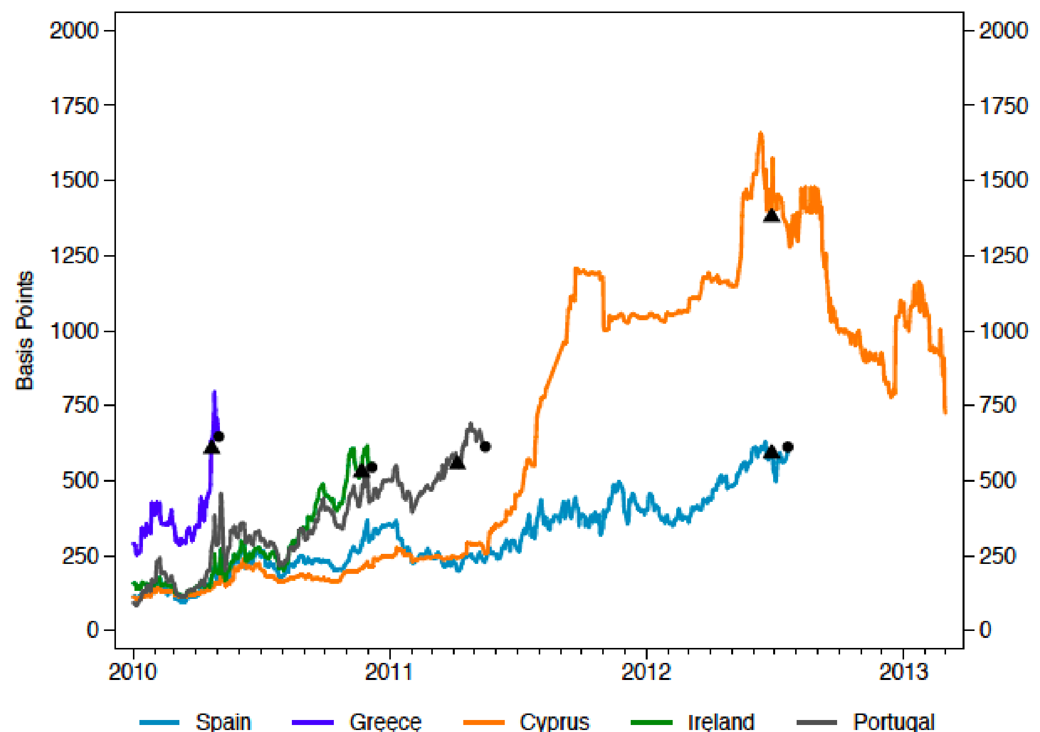

Figure 10: Credit Default Swap for Spain, Greece, Cyprus, Ireland and Portugal

The above figure reflects two main things:

- The credit default swap – also known as CDS – for the Republic of Cyprus and the Republic of Greece on a monthly basis. The figure shows that Cyprus had been in a crisis for quite some time as it demonstrates monthly data that

reflect the amount of pay one should insure against a default on governomental bonds (Sengupta & Noeth, 2012).

- On the other hand, the figure also shows for each of the two countries the date when the troika receiveid a request for assistance (**Δ)** from both Greek and Cypriot governments and the date at wich the MoU was finalized (□).

Let us begin with Greece's case before analysing Cyprus' situation:

- The Figure shows that on Friday the 23d of April of 2010, shown with a triangle, the Greek Government reached out for help just as its CDS spreads slightly began to exceed 625 basis points. 15 days later, on Sunday the 2d of May – shown with a circle –, a Memorandum of Understanding (MoU) was signed, financial help was alocated and the Greek government directly began the emplementation of the MoU in its country (Orphanides, 2014).

- Analysing the trend, we can clearly see the Cypriot Government's deliberal omitment to refuse to act or abide by the rules set to it when it decided to join the EU as well as Euro Zone.

  The Cypriot CDS spread began to exceed 625 basis points around end of July of 2011, yet it only asked for help on Monday the 25th of June 2012 (European Stability Mechanisim, 2013). And not only did the Greek-Cypriot Government wait one year before it asked for help, but it also refused to

finalize a Memorandum of Understanding after it had deliberatly asked for help from the troika. The MoU was finally aproved and signed by Cyprus on Monday the 25th of March of 2013, note that it took 9 month for the MoU to be implemented in Cyprus when averagely, it only took a maximum of 3 weeks with the 4 other countries that had previously asked for the troika's help – being Spain, Greece, Ireland & Portugal – (Sengupta & Noeth, 2012).

Consequently, it is only logical to deduct that the government's subsequent choice of actions & inactions, management & mismanagement during the "Negotiation of the MoU" period had severe consequences on the South side of the island's economy. For the first time since 1974, unemployment had exceeded 10% reaching a ratio of 16.9 % at its peek with over one third of the young generation being hit by unemployment (A. Zenios, 2013).

After extensive research, experience and analysis, this chapter will review what happened in Cyprus, what were the events that led to the collapse of the Southern side of the island's economy and what is being done at the present moment.

4.2 Cyprus: The Illusion

In February of 2008, President Tassos Papadopoulos's term came to an end and a new President was elected – Dimitris Christofias – from the AKEL Party. By becoming President, this meant that Christofias was in for 5 years in power and had full executive control for the fixed time of his term with no added checks and balances. But was Christofias up for the presidential job? Was he the man to chose? The events that followed his election give us a clear answer.

Following the collapse of the world-renowned Investment Bank: Lehman Brothers on September the 15th of 2008 and the subsequent trigger of the Global Financial Crisis. The President and the Minister of Finance, Mr. Charilaos Stavrakis, downplayed the public's fear of being hit by a global crisis and Cyprus continued to showcase a bubble of prosperity. It is important to observe that in 2008, the economy was doing quite well in Cyprus although it was affected by a mild recession, which saw growth decline by 2009 (Central Bank of Cyprus, 2009).

But this Global Crisis was definitely not enough to destroy the country's economical system. So what really happened?

With Christofias in power, overspending quickly became an issue as doubts started rising when it came to the country's fiscal affair's viability. Furthermore, exposure to Greek bonds did not make things any simpler.

Imbalance began in 2008, the government was bankrupt by 2011, and propaganda was at its peek in 2010 when the government presented its budget for the coming year of 2011.

Having no involvement in the US mortgages debt; this gave the government and responsible parties the illusion that the Island would not be hit by the crisis.

Thus, following through with its pre-electoral commitments, the government went on with spending in the form of benefits of payrolls increases for the public sector. It is important to note that all of this was done while income taxes began to drop, housing started slowing down and tourism was dramatically impacted by the global crisis.

Meanwhile the Island became popularly known amongst foreign companies as a safe European alternative to other worldwide tax havens; given a corporate tax rate of only 10%, number of tax treaties, work oriented people, and a highly trustworthy reputation. With a high number of business deposits and transactions going through the Greek Cypriot banking system, the Banks were encouraged to give out more loans and expand aggressively in other countries. Mainly, in Greece (Deloitte, 2011).

A direct consequence of the profusion of loans was the fueling of a housing bubble and a continuously increasing overheating economy. As a result, housing prices increased by nearly 50% and private loans reached the second highest ratio per GDP in Europe.

The bellow figures show inconsistency in real government expenditures in contrast with the country's real GDP evolution:

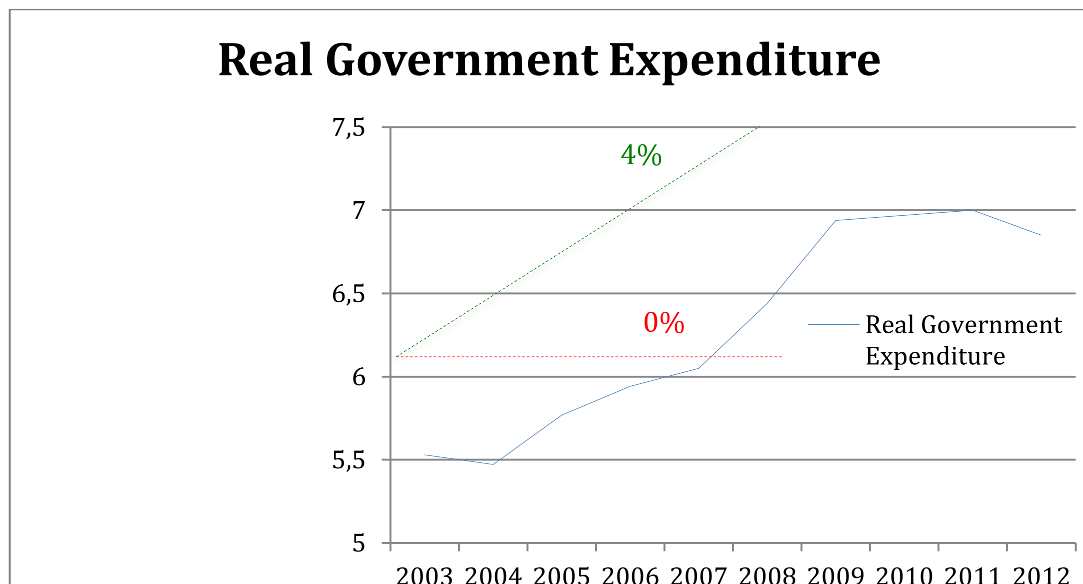

Figure 11Cyprus Real Government Expenditure

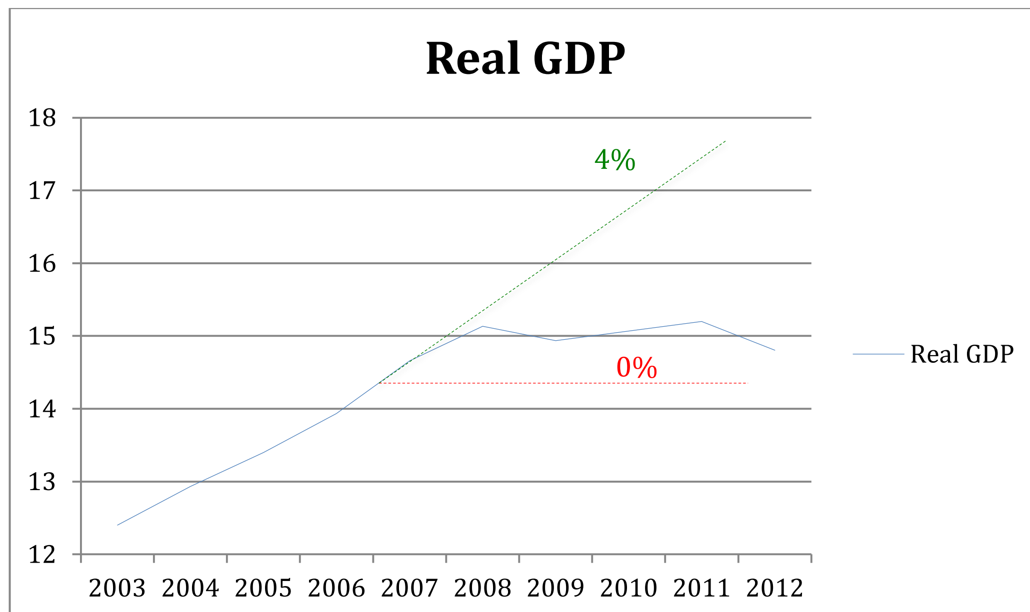

Figure 12: Cyprus Real Gross Domestic Product

As it can be seen, before Christofias came to power, there was a general growth of 4% after 2007, this rate fell bellow 4% still government expenditures were drastically increasing – social spending increased by 42% over a five year timeframe – until 2010/2011; time at which the Greek-Cypriot authorities had gone bankrupt (Michaelides, 2014).

By 2010, ensuring the Greek-Cypriot authorities' integrity became more and more vital, sadly the people in power did not really care, they kept still and did nothing to prevent the foreseeable downfall they were heading for.

Therefore, the country lost access to financial markets by May 2011; and in July of 2011 – following the explosion of the Evangelos Florakis Naval Base – the country's economical and banking systems were thrown into recession.

The government was left with two choices:

1. Restore sustainability, regain credibility and fix the problem

2. Make the problem worse

And of course, the people in power chose to make the problem worse. Regardless of the obvious warnings the Greek Cypriot Government decided the following:

1. Increase in current and future expenditures

2. Increase of wages in the public sector (9% in 3 years)

3. Increase of pensions without any measure being put in place to secure funding

Hence throwing the Republic of Cyprus into the "highest risk" for long-term sustainability in the European Union (European Commission, 2012).

Rather than focusing on the country's economy, Christofias and his government were looking forward to the elections of February 2013. They focused on reducing short-term costs, postponing imminent decisions until after the elections and diverting attention by running a campaign based on "bashing banks". However, that wasn't all; Christofias, the Central Bank and the Greek-Cypriot Government also tried to solve their "issues" by playing a double game – a game they desperately still try to master – little did they know that by 2015 they'd be put in a corner answering for their actions.

However all this is merely an overview of what really happened. For it to be more understandable, it is important to go into depth into the downfall of the economy.

4.3 The collapse of the economy, a loan from Russia and the eventual Bail-In

Following the intensification of the Euro Crisis, a few euro countries were in a bad economical shape, this included countries such as Spain, Greece, Portugal, Ireland and Cyprus.

In 2009, the newly elected socialist Greek government revised the estimate of the Government Budget Deficit for 2009 increasing it from 6.7% to 12.7% of GDP. This caused a heavy weight on the country's debt sustainability triggering a series of downgrades by credit rating institutions and a rapid increase of Greece's credit borrowing on the international market.

In April of 2010, being faced with inability of borrowing from international markets, the Greek government applied for a bailout at the International Monetary Fund (IMF) and the European Union. The Bailout was to try and cover a debt that Banks and individuals had lent the Greek government in the form of Greek Bonds. Nonetheless, this debt was getting riskier by the day (TROIKA, 2013).

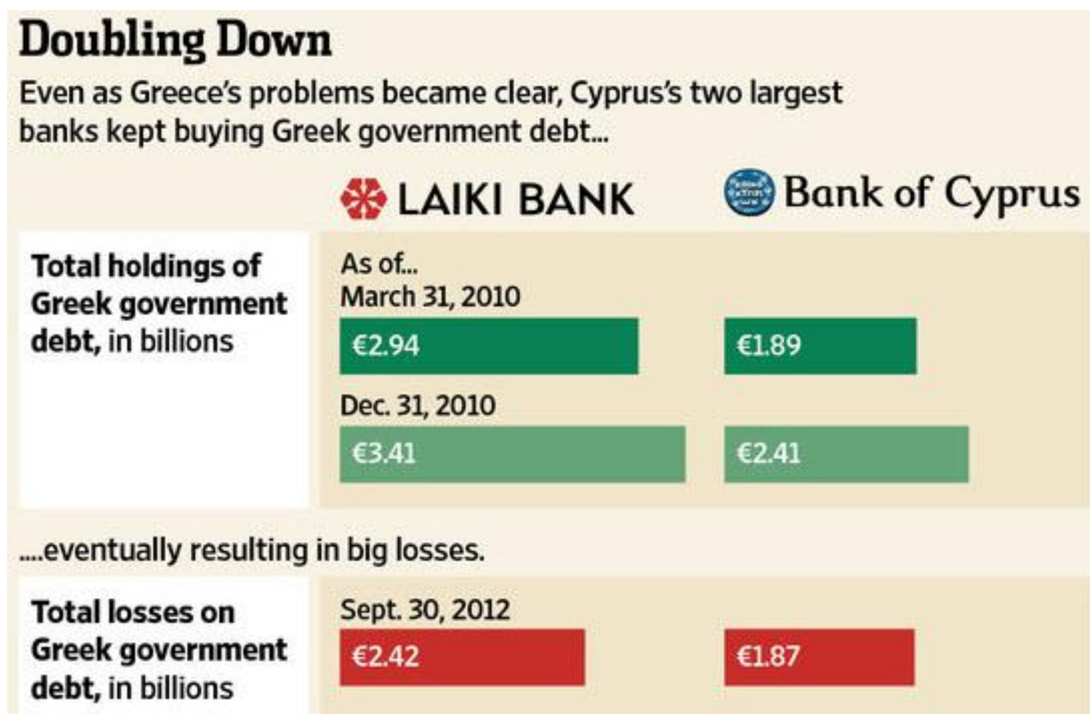

Figure 13: Total Holding of Greek Government Debt

While foreign Banks such as Barklay's halfed their exposures to Greek bonds, in Cyprus, Laiki Bank and Bank of Cyprus – the two biggest Banks on the island – continued an aggressive expansion. By 2010, 30% of Bank of Cyprus's loans and 43% of Laiki Bank's loans where in Greece and both Banks increased their amount of Greek Bond holdings by 30 % thus increasing it to 5.8 Billion Euros. As a direct result of this expansion, the two Banks' total exposure in Greece was 1.5 times higher than the Islands GDP (Kambas, Grey, & Orphanides, 2013).

By the end of 2010, the total Cypriot Banking Sector was 8 times bigger that the Island's GDP making the Banks "too big" for the country to save should anything go wrong. Insured deposits fewer than 100,000 Euros were equal to 32 Billion Euros while the fund of deposit guarantee scheme had enough to cover 150 Million Euros only (Kambas, Grey, & Orphanides, 2013).

With a deficit as high as 5.3% of GDP and a drastic pejorative forecast, the EU put Cyprus under financial supervision. The bad state of public finances and the abnormal exposure of Cypriot Banks to Greece caused a slight downgrade of the island's credit rating making it more difficult for the government to borrow on the international market. By May 2011 the cost of credit on international markets was so high that it had become impossible for the Island's authorities to borrow (Kambas, Grey, & Orphanides, 2013).

In July of 2011, an explosion near the main electricity power plant in Cyprus whipped out 53% of the island's electricity production and resulted in heavy financial losses (2.16 Billion Euros) (Smith, 2011).

Left with no choice, the Cypriot Government turned to its best ally, the Russian Federation. By January of 2012, Russia allocated an emergency loan of 2.5 billion euros – for a period of 4.5 years with an interest rate of 4.5% (Wikipedia, 2015)– to allow the country to refinance maturing debt, cover its midterm needs and postpone the application for an IMF/EU bailout. Yet the loan was not enough to cover recapitalization of the economy and the request for an additional loan was clear and inevitable.

4.4 Cyprus stranded: The Bail-In / Bail-Out Situation

By February of 2012, rumor had it that a Greek haircut materialized by the PSI (Private Sector Involvement) was to take place. The PSI was a part of the Greek bailout package, which was set and agreed by both the Greek government and the TROIKA (IMF/EU/ECB). But what did the PSI really involve?

According to the agreement of the PSI, private lenders to Greece agreed to a voluntary reduction of the loans Greece owed them. Thus causing a more or less loss of 75% on Greek and Cypriot Banks, which held a rather large amount of Greek Bonds. However, unlike the Greek Banks who would be "saved" by the "package" agreed on with the TROIKA, the Cypriot government refused any type of negotiation to "rescue" its own Banks as its participation would cost the Island a quarter of its GDP (Reserve Bank of Australia, 2012).

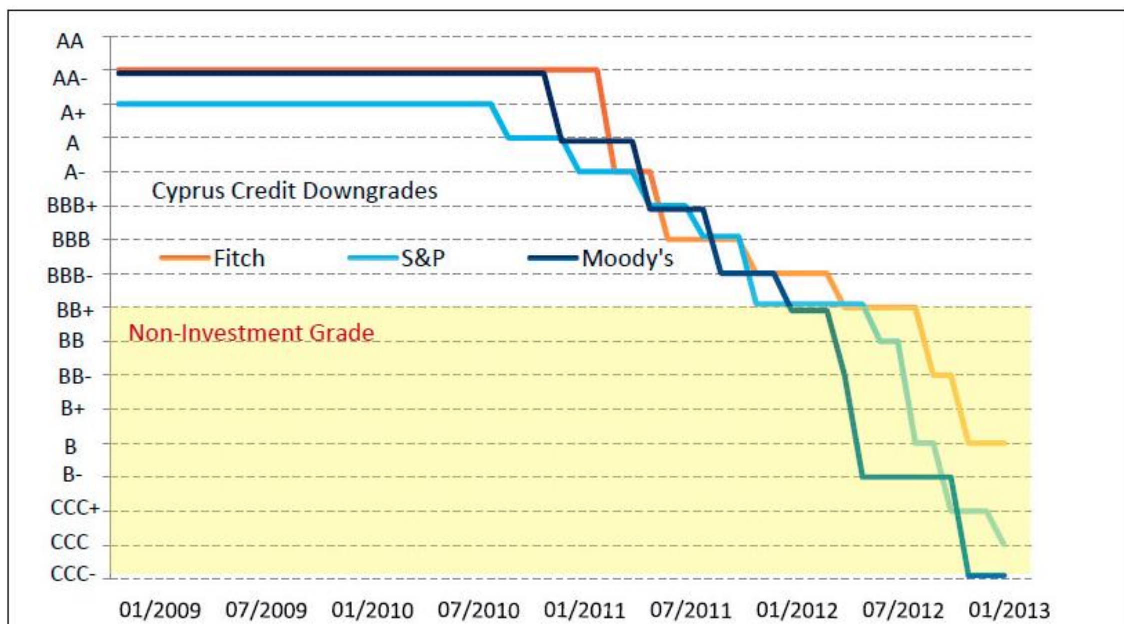

Figure 14: Cyprus Credit Downgrades by Fitch, Standard & Poor and Moody's.

On the 13th of March of 2012, the country's credit rating was downgraded to the status of "Junk" by Moody's and on the 25th of June of 2012, when Fitch slashed the ratings on bonds issued by the country to BB+ the government found it-self stuck and finally turned to the TROIKA for assistance. When the Greek Cypriot government requested a bailout, they cited in their report difficulties in supporting the country's banking sector due to high exposure to Greek debt (Al Jazeera, 2012). Hence the arrival of the TROIKA in July of 2012, yet little did the European

representative know what they were heading for. The first attempt of negotiations was unsuccessful as on 25th of July, a Memorandum of Understanding was submitted to the Greek-Cypriot Government and to the world's astonishment, it was refused.

The second round of negotiations began in September, however, the delay in reaching a bailout plan and agreement with the TROIKA, caused market uncertainty and led to a significant and serious deterioration of the country's market economy and Banking sector.

In November of 2012, and with the unavoidable collapse of one of the country's biggest Banks, LAIKI Bank, Cypriot authorities were forced to agree to a bailout Memorandum of Understanding drafted by the TROIKA and the drafting of 24 laws implementing the agreement. Meanwhile, the "Euro-group" had decided that all its major decisions in regards to the MoU were postponed until after a report by PIMCO (an independent Bank auditor) in regards to the exact amount of funds needed to recapitalize Cypriot Banks was to be released.

In December of 2013, an interim PIMCO report published the "worst case recapitalization scenario" with a figure amounting to 10 Billion Euros (Allianz, 2013).

In a desperate attempt to save the economy, in January and February of 2014, pending the final PIMCO report, the Cypriot government borrowed 235 Million Euros from 3 semi-governmentally owned institutions (Electricity of Cyprus, CYTA & Cyprus Ports Authority) in order to pay public sector wages and pensions.

The Final PIMCO report was handed over in February of 2014 and made public in March of 2014. On the 13th of February, a new president was elected – Nicos Anastasiades –. In March of 2014 after publicly assuring his people that depositors' contribution was out of the question he flew to Europe and negotiated just the opposite. Finally, on the 30th of April of 2014, after exhaustive sessions of negotiation, a plan was finally approved and utterly endorses by the Greek-Cypriot House of Representatives.

Consequently, the government was left with the heavy task of restarting the island's economy. The coming chapter will discuss the aftermath of the "rescue package" that has yet to be fully developed and implemented.

Chapter 5

THE AFTERMATH OF THE BAIL-IN

5.1 Bail-out & Bail-in

As previously stated, following the collapse of its economy, Cyprus was forced into a bail-out turned bail-in cituation however it is quite important to distinguish what happened with Cyprus as it was the first time the TROIKA had taken such measures (TROIKA, 2013).

A bail out situation occures when governments and taxpayer initiatives are used to resolve the troubles of Financial institutions that have collapsed. In other words, it is when a Government steps in financially in order to avoid the drastic damages that would occure should the financial institution be foreclosed (Investopedia, 2015).

On the other hand, a bail in, is a situation whereby just before bankruptcy, negociations take place and authorities agree on imposing losses on bondholders all while protecting other minor creditors. In other words a bail in forces the reduction of depositors holdings in order to reduce risk exposure and keep financial institutions alive (Mac Millan Dictionary, 2013).

5.2 Hair Cut

According to the PIMCO report the island's debt to GDP ratio would have reached approximately 140% should cypriot authorities inject capital into their financial institutions. Moreover it was also discovered that the CBoC had provided last minute

liquidity in order to “maintain” Laiki Bank alive throughout the presidential elections of February 2013 (Allianz, 2013).

As a result of the PIMCO report and the report of the IMF, it was decided that Cypriot Banks should be recapitalised and internal directives should be taken. Consequently, the negociations to a “Hair-cut” began justified by the fact that worldwide economists believed that: “a bail-in of uninsured depositors is probaby the only option that would restore the country’s financial stability” (TROIKA, 2013) For a while, President Dimitris Christofias tried to deny the rumors of a hair cut since he had specifically stated during his presidential campain that he would not allow depositors to be affected. Yet as time passed by, solutions were narrowing down and it had become clear to the Cypriot people and to the world that only 2 concrete solutions would sustain:

- Cyprus would either be allowed to default – this meant new directives that would be creating thus allowing the island to default from the Euro and go back to the Cypriot Pound.

- Or face haircuts on Bank bonds and deposits – this solution meant that most depositors would not get all of their money back.

While the first solution looked more friendly, it was rather clear that it would be out of the question to allow a “euro country” to default. This is mainly due to the fact that if Cyprus did default on the Euro, then its debt would be canceled and it would go back to a national currency thus paving the way for other weak european

economies such as Greece, Portugal, Ireland, Spain, etc…. consequently creating a dominos effect and throwing the world into a new recession.

In February of 2013, the Communist Party lost the elections, and for the first time in months officials publicly acknowledged that a forced contribution from depositors was the only way the country would be able to meet the Bank's "recapitalization needs" and was under discussion and about to be agreed on between Cyprus and the TROIKA (Orphanides, 2014)

5.3 Measures Taken

In the months that followed the agreement of the hair-cut numerous measures directives were taken and implemented (Brown, 2013). These included (Mathews, 2013):

- Revamp of all cooperative Banks which eventually led to the discovery of "written off" loans that were handed out against no securities.

- A haircut of 100,000.00 Euros was reinforced.

- A deposit levy of 47.5% was agreed on for all shareholders, bondholders and depositors with accounts exceeding the amounts of 100,000.00 Euros.

- The country's second biggest bank – Laiki Bank – would close its doors and be absorbed by the Bank of Cyprus.

- The restructuring of the Bank of Cyprus and the Banking system in general would include job reduction, pension cuts and reduction of the country's economy size by at least 18.7% by 2016 (Hazou, 2013).

5.4 Reactions

It is only normal to assume that the citizens of Cyprus – being highly effected by the haircut – reacted in a very negative way. Outburst erupted and protests expolded across the island. This forced the government to order all Banks, publicly and privately owned to shut down for a periode of two weeks in March of 2013 so as to allow the government to pass a batch of laws needed to forcefully emplement the Bail-in.

Following the emplementation of the Hair-cut, investoigations were open, former officials were interrogated and the people who allowed the exacerbation of the banking crisis to continue are still awaiting trial. Nonetheless, the country's economy is still fragile and being shaken by scandals (Agence France Presse, 2014). Indeed, in May of 2015 it was discovered that the new governor of the central bank Mrs. Chrystalla Georghadji had overwrote 29 loans to members of parliament amounting the sum of 24 million euros against no securities. The attorney general had called for new trials to take their course, 3 members of the cBoC's board have resigned and a new restructuring of the CBoC are taking place (Maurice, 2015).

Chapter 6

CONCLUSION

After extensive research, I have found that that there are indeed systems that may allow us to predict a financial crisis. However this is to a certain extent only.

Indeed, financial crisis are not always due to a pile up of economical political and human mistakes, they may be provoked by unexpected events such as a natural disaster, a sudden war or a terrorist act. – Hurricane Katarina (2005) Bali Tsunami (2004) World Trade Center (2011) – are famous examples amongst others.

When it comes to Cyprus, it is clear that the crisis' exorbitant effects were caused by mismanagement and misuse of power on behalf of the Central Bank, the Parliament as well as the Government. Should spending been cut, tighter control measures on Bank's expansion been taken – especially in regards to the purchase of Greek bonds – and early warnings systems taken into consideration; the effects of the crisis on the economy, the authorities and the people wouldn't have reached the level they have nowadays.

Unfortunately a crisis is a pile-up; therefore the crisis would have eventually been unavoidable however the extent of the damage endured could have been considerably minimized. The Cypriot Banking system is still trying to recover.

Nevertheless, daily discoveries of mistakes made by previous and current authorities, the task of recovery is becoming quite difficult.

This is the reason why, now more than ever, it is utterly important to deal with the complexity of the crisis, evaluate the policy directives that need to be implemented, address the problem, restore competitiveness, etc. so as to allow the Republic of Cyprus to recover and eventually restore a prosperous political and economical environment.

6.1 Solutions to create opportunities

After extensive research, I have found that applying austerity measures to any given economy is not always the right solution. In the case of Cyprus, it is undeniable that necessary adjustments need to be made the soonest.

In this conclusion, I will suggest a few policy implications such as austerity measures; structural reforms, financial innovations, denationalization and debt restructuring for which the details will be given bellow. Indeed, I will argue that, instead of focusing solely on one issue, it will be much more effective should we focus on a few points that have a main goal of restoring balance to the overall Greek-Cypriot economy.

Consequently, through these policy implications, I will be able to show that austerity measures, which exhaust the country and the population without really solving the problem, are not always the best solution to save an economy from collapse.

6.2 Austerity measures

Austerity measures are measures taken by authorities that aim at reducing public spending in an attempt to decrease the country's deficit and eventually regain primary surplus.

In the case of the Cyprus, these measures are agreed on in the MoU passed with the TROIKA. However, austerity measures are not always the best solutions as they do not restore competitiveness for instance nor do they solve the debt problem for households. Which is why it is important for Cyprus to have other policy implications as well.

6.3 Structural reforms

A structural reform policy is a way of improving and encouraging competitiveness, however, this would include a decentralization planning made by the government.

In the case of the economy of Cyprus, structural reforms would be highly recommended, as they would allow:

- Improve the efficiency of the civil society
- Improve the efficiency of the active force
- Improve the economical environment in order to improve and encourage transparency and competitiveness.

Nonetheless, it is important to stress that in order to witness significant improvements in the island's economy, drastic changes will have to take place within government, the legislation and the current models in use.

6.4 Financial innovations

There are multiple ways one can define what financial innovation is. In the case of Cyprus, financial innovation should involve the implementation of “new markets”. Indeed, this would allow the economy to create liquidity in an almost illiquid market; which would in return allow the economy to resolve some of its problems.

However, improving risk sharing and eliminating inefficiencies may result in inadvertent consequences if not regulated and controlled properly.

6.5 Denationalization

Denationalization is the process in which ownership of businesses, agencies or public properties is transferred from the public sector to the private sector for a certain sum. In other words, denationalization is part of capitalism and allows a country to create liquidity in a very short time in order to solve a problem, in Cyprus case the crisis, or increase its primary surplus.

However, when privatization occurs, government loses power on big industries that were once in their hand. In Cyprus’s case, the government has refused to do so and is only considering it as a last resort. Consequently, if authorities keep holding a grip on denationalization or at least partial-denationalization, it will become increasingly difficult for fair competitiveness and transparency to occur in the economy.

Nonetheless, should the Greek-Cypriot government decides to go though, in the future, with partial privatization, the country’s economy will have the opportunity to develop and heal much faster than expected.

6.6 Debt restructuring

Debt restructuring is irrefutably one of the most important points we stress in regards to the Cyprus banking crisis. Indeed, debt restructuring is the process in which private companies; financial institutions and sovereign entities will come together and agree to forgive Cyprus of a certain percentage of its debt. This would in fact, relieve Cyprus from a big part of the economical burden it holds nowadays.

Debt Restructuring should of course be done under the control of independent institutions such as the European Stability Mechanism in order to avoid disorderly distribution or use of the process. We would suggest that the later be done under (i) GDP linked bonds or (ii) credit enhancement by natural gas proceeds for instance.

John Fitzgerald Kennedy once said, “our problems are man-made, therefore they can be solved by men” (Kennedy, 1963). The Republic of Cyprus is not the only country whose economy faced a profound recession and will not be the last.

Although no solution is ever pain or sacrifice free, on the long run, if applied properly than the recession shall pass and the economy will be solid again like it once was. However, one must note that this is a slow process as “discoveries” of mishandling by Greek-Cypriot authorities are being unraveled up till today.

Indeed, in order for the recovery and healing processes to take place, transparency is a must in all-business, economical, political private and public matters. After extensive research and study, I believe that Cyprus can make a full recovery, if all the appropriate directives are applied in a space of 15 years. This would include

coming out of this crisis with a strong solid external and internal economical and political systems.

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