PANEL REPORT

Regional financial centres: pathways for Greece and Cyprus

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Introduction

On 25 November, we organised an online panel discussion, as part of a series of events which focus on important strategic issues for the Hellenic Observatory. Four distinguished experts participated in a debate on options available derived from the experience of regional financial centres and business model guidelines for a new phase of financial systems internationalisation in Greece and Cyprus.

The panel included **Nikolaos Karamouzis** (Executive Chairman of SMERemediumCap, Chairman of Grant Thornton, Greece and BoD Member of Eurobank Private Bank Luxembourg S.A.), **Charlotte Ruhe** (EBRD's Managing Director for Central and South Eastern Europe), **Michael Sarris** (Chairman of the Board of Directors of AstroBank, Former Minister of Finance of the Republic of Cyprus), and **Apostolos Thomadakis** (Head of Research at the European Capital Markets Institute and Research Fellow in the Financial Markets and Institutions Unit at the Centre for European Policy Studies).

The moderator and chair of the discussion were **Professor Anthony Bartzokas** (UoA, LSE and UNU-MERIT) and **Professor Vassilis Monastiriotis** (LSE) respectively.

Background

Any discussion about the future of financial systems in Greece and Cyprus should start with a core question: what has happened in the banking sector since the crisis? We suggest that there have been three phases: i) restructuring the asset side; ii) improving the profile of liabilities; and iii) addressing growth challenges on the asset side. In this process, we considered two endogenous constraints, the structure of liabilities (dependence on deposits and liquid assets), and limited opportunities for revenue-creating assets.

Past experience suggests that when the financial systems in Greece and Cyprus sought to increase market shares abroad, they did so in two ways; first acquiring assets and second following corporates expanding abroad. Interestingly, while Europe's financial systems have expanded over the years, success has been largely confined to Luxembourg, Ireland, and the Netherlands. This underscores the growth potential of regional financial centres.

We propose a broader perspective that goes beyond the banking system due to new exogenous challenges, such as new market segments that need to be grasped, increased prominence of non-banking activities and a different regulatory framework.

Hence, we propose five pathways for financial systems internationalisation:

1. Expanding the role of investment funds
2. Regional integration potential
3. Fintech and digitalisation
4. Capital markets deepening
5. Green finance offerings

Greece & Cyprus: From recovery to sustainable growth and regional expansion

Nikolaos Karamouzis highlighted Greece's impressive recovery since its deep financial crisis; yet noted unresolved structural issues. Greece faces two main challenges: a) A global environment full of uncertainties and risks, and b) Eurozone and Europe in structural stagnation.

Greece's growth rate has outperformed the Eurozone average, with improving business sentiment and declining unemployment. Fiscal stability and credibility have been restored, and the cost of international borrowing has improved significantly—for example, Greece now borrows on better terms than Italy.

However, Greece remains a consumption-driven economy (private consumption to GDP is 69%, the highest in the Eurozone), systematically underinvesting, under saving, and overconsuming. Sustainable growth requires a significant leap in investment. The ratio of gross capital formation to GDP stood at 15.2% in 2023, compared to the Eurozone average of 22%, creating a notable investment gap. Greece needs equity investment in Green Energy Transition, Digitalisation, and replenishing the capital stock. Consolidation is key to creating competitive players in the SME sector. A positive development has been the establishment of a local private equity market with help from the Hellenic Development Bank, the European Bank for Reconstruction and Development (EBRD), and the European Investment Fund (EIF). Investment opportunities exist in the agricultural sector, renewable energy, pharma, waste management, hospitality services, and infrastructure.

Michalis Sarris focused on the current European context and the path Cyprus can follow. He noted some progress in European financial market integration, but significant hurdles remain before financial institutions can engage in substantial cross-border operations and risk-sharing. The idea of a Banking Union was proposed to foster healthy financial integration; however, a financial backstop for the Single Resolution Fund and common deposit insurance are yet to be implemented. Similarly, a Capital Markets Union is not yet in place, and the recent Draghi report could serve as a wake-up call. The result has been a bias for EU banks, limiting their scale and profitability compared to US banks and depriving the EU of greater risk-sharing and welfare.

Compared to 2013, Cypriot banks are in a much better shape in all categories (capital, profitability, liquidity, NPLs) and are robustly supervised. There is strong competition from non-banking institutions, particularly in payment systems, alongside growth in deposits and modest demand for loans. Mr. Sarris emphasised the interest of foreign banks (mostly Greek) in systemic Cypriot banks. Possible growth in financial services in Cyprus will be supported by EU membership, a robust (albeit slow) legal system, an attractive tax regime, and a highly qualified pool of professionals. Pension funds from the region, including the Middle East, could be attracted, though long-awaited changes in the legal and regulatory framework are necessary. Overall, a cautious and disciplined approach is needed to optimise a response to vulnerabilities in foreign expansion.

Charlotte Ruhe noted the remarkable economic turnaround in Greece and Cyprus, and the EBRD's pride in contributing to their recovery by investing equity in the Bank of Cyprus and all four Greek systemic banks. Improving corporate governance in the banks, through the nomination of experienced independent directors, was a key priority for the EBRD. The Bank also invested in non-performing loan platforms to help Greek systemic banks return to a solid financial position. By the 10th anniversary of the EBRD's presence in Greece in 2025, the Bank will have invested over 8 billion euros, making a significant contribution to the country's recovery. From 2014 to 2020, the EBRD invested 600 million euros in Cyprus.

Since 2017, Greek firms have become increasingly outward-looking, targeting regional expansion. Supporting Greek companies and banks in their international expansion will remain an important priority for the EBRD. Additionally, competition in the financial sector is needed, which could come from traditional bricks-and-mortar banks or fintech. The idea of regional integration of stock exchanges was also endorsed.

The European Capital Markets

Apostolos Thomadakis highlighted the structural characteristics of European capital markets, emphasising their lack of homogeneity. The goal has been to create deep, liquid, and efficient financial markets where all participants face the same set of rules and have equal access to financial products and services. However, at the European level, there is a noticeable lack of ambition, scale, and strength. Among other issues, the heterogeneous and multi-level legislation impacts the competitiveness and attractiveness of European markets.

When examining the structure of capital markets across European regions, it becomes evident that Europe relies heavily on debt markets, with the notable exception of the Nordic market, where public equity markets account for more than debt securities markets. A closer look at market capitalisation across European regions reveals different levels of development. Greece and Cyprus have seen some development in recent years, outpacing other countries, but remaining below the EU average. Regarding financial knowledge across EU member states, both countries rank at the bottom of the list, with only about 20% of citizens achieving a high score in financial literacy.

The development of capital markets should precede their integration. Nearly half of the member states' capital markets have seen little development in the last decade, making the integration of these heterogeneous markets challenging. Local stock markets play an important role in providing access to capital for local companies, fostering integration, and encouraging domestic investment. Positively, recent months have shown increased interest in developing capital markets, with proposals on how to achieve market integration, although some catalysts seem to be missing.

The Debate and the Way Forward

The debate revolved around four key issues:

- Lack of access to finance for SMEs
- Limited supply of risk capital
- Increasing presence of non-banking activities
- Potential role of proposed pathways (green finance and capital markets deepening)

Regarding SMEs, the quality of their published numbers sometimes hinders their ability to secure funding from the banking system. In Greece, family businesses, once considered a blessing, are increasingly seen as problematic due to second-generation leadership issues and uncertainties about the way forward. Converting family businesses to institutional management and private equity is a major challenge. Market failures for SMEs reflect structural issues in the economy and institutional inertia. In addition, limited availability of risk capital is seen as an adjustment problem to new market trends. Nonetheless, it was supported that increasing competition in the banking sector and more cross-border consolidation could open new opportunities in both Greece and Cyprus.

Regarding the importance of financial innovation, the acceleration of digital transformation during the Covid-19 pandemic proved that there is room for improvement. Both countries have made significant strides in digitalisation, which has helped them adapt to the challenges posed by the pandemic and set the stage for future growth. Hence, Greece and Cyprus are both leveraging fintech to drive economic growth, improve financial inclusion, and enhance the overall efficiency of their financial systems.

The question on trade-offs of risk capital vs bank lending activity proved more difficult to answer. In recovering economies, like these of Greece and Cyprus, risk capital can drive innovation and job creation, while bank lending supports the stability and growth of established businesses. Both financing options play crucial roles, supporting different types of businesses and contributing to overall economic growth.

Overall, the need to revisit the impact of policy instruments and how to balance domestic asset creation and expansion abroad are issues to consider going forward.

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