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Fitch Ratings
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Fitch Ratings-London-25 June 2012: Fitch Ratings has downgraded the Republic of Cyprus's Long-term foreign and local currency Issuer Default Ratings (IDRs) to 'BB+' from 'BBB-' and its Short-term IDR to 'B' from 'F3'. The Outlook is Negative.

Cyprus’s Long-term foreign and local currency IDRs are now rated one notch below the Republic of Cyprus’s Country Ceiling of 'BBB'. The agency has downgraded Cyprus’s IDRs to reflect the material increase in the budget deficit projected for 2012, ongoing fiscal consolidation challenges and the high probability of further rating actions in the event of a renewed deterioration in public finances.

The near to medium-term economic outlook for Cyprus is weak. Fitch expects the economy to stagnate this year and next and thereafter to recover only slowly as macroeconomic imbalances unwind and the headwinds from the ongoing eurozone economic and political weaknesses abate. The budget has underperformed government expectations in the first half of 2012. The shortfall in the underlying primary budget for the first six months of the year was EUR1.3bn (4.8% of GDP), driven by weakness in tax revenues, delays in the introduction of additional taxes and a fall in the contribution of remittances. The sharp rise in public finances was offset by a large EUR1.5bn cash injection from the eurozone Eurogroup in January 2012. This is principally due to Greek corporate and households' continuing liquidation of their foreign currency deposits in Cyprus in response to the ongoing sovereign debt crisis in Greece.

However, the agency also expects that Cyprus will have to secure a loan from the International Monetary Fund (IMF) and the European Union (EU) in the second half of 2012. Fitch expects that these complements will be of modest size, potentially as high as EUR6bn, general government debt is likely to exceed 100% of GDP, which will have to be provided by the government. With the fiscal cost of bank support continuing to increase and a potential further weakening in the terms of trade, with the current account deficit remaining high, general government debt as a share of GDP is expected to rise over the medium term, potentially reaching 125%. The government will be required to implement fiscal consolidation programmes and to increase its structural saving in order to avoid a further deterioration in its fiscal situation.

The government's creditworthiness is very weak and the country will need to secure a rescue package from the EU and the IMF to cover its fiscal deficits. Fitch's opinion, Cypriot banks will require substantial injections of capital in order to retain their creditworthiness and market access to affordable term finance underscores the constrained financing environment. Fitch's opinion, Cypriot banks will require substantial injections of capital in order to retain their creditworthiness and market access to affordable term finance underscores the constrained financing environment. The budget has underperformed government expectations in the first half of 2012.

The downgrade of Cyprus's sovereign ratings reflects a material increase in the budget deficit projected for 2012, ongoing fiscal consolidation challenges and the high probability of further rating actions in the event of a renewed deterioration in public finances.

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