Cyprus Economy:
Past - Present and Prospects
The road for stabilization and growth

Cyprus Economic Society Discussion Forum

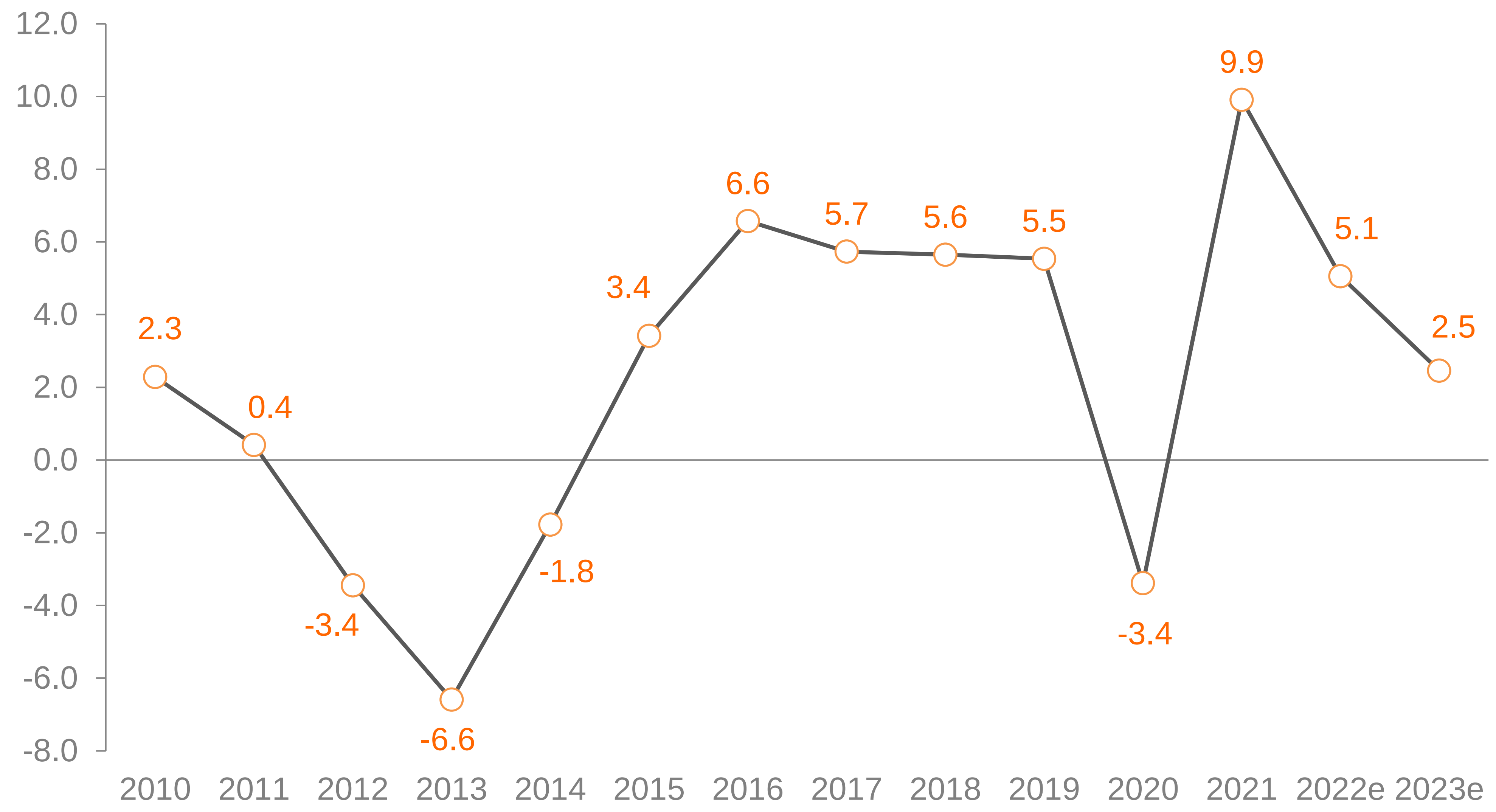
April 4, 2024

Ministry of Finance

OVERVIEW OF MAIN MACRO VARIABLES

- *Economic activity in 2021-2022 recovered strongly following the COVID-19 pandemic (GDP returned end 2021Q1) by 9.9% and 5.1% respectively. Growth in 2023 by 2.5% point to a continued resilience and flexibility, amid the war/sanctions. Growth is among the highest among member states and significantly higher than the EA/EU average (CY 2.5% in 2023 vs. EA/EU around 0.4% y-o-y %).*
- *Labour market developments showed resilience and flexibility. Unemployment rate in 2023 decreased significantly (6.1%) with still high level of vacancies. Limited impact from ongoing war. But, the market is less tight now given the employment growth deceleration. Wage demand is still moderate and productivity levels are rising.*
- *Inflation is decelerating following to the gradual correction in oil prices, the normalization of food prices and the monetary policy tightening.*
- *The current account deficit worsened in 2023/9m compared to 2022/9m mainly due to increases in mobile transport equipment and elevated imports for home consumption and to a lesser extend by lower increase in services surplus (impact of sanctions).*

annual % change	2019	2020	2021	2022	2023
GDP growth (constant prices)	5.5	-3.4	9.9	5.1	2.5
Government consumption	12.4	10.6	7.9	2.7	1.6
Private consumption	*3.9*	*-6.8*	5.6	8.5	4.2
Gross fixed capital formation	*6.9*	*4.7*	-0.1	7.8	19.5
Exports	*8.7*	*2.2*	21.6	13.6	-1.5
Imports	*9.5*	*3.1*	15.4	18.3	5.1
HICP (%)	0.5	-1.1	2.3	8.1	3.9
Productivity growth	1.7	-2.3	6.6	2.0	1.0
Employment growth (persons, %)	3.8	-1.2	3.2	3.0	1.5
Compensation per employee (%)	4.4	-0.5	4.3	1.1	5.6
Unemployment rate (Labour Force Survey)	7.1	7.6	7.5	6.8	6.1
Current Account Balance (% of GDP)	-5.6	-10.0	-6.1	-7.9	...



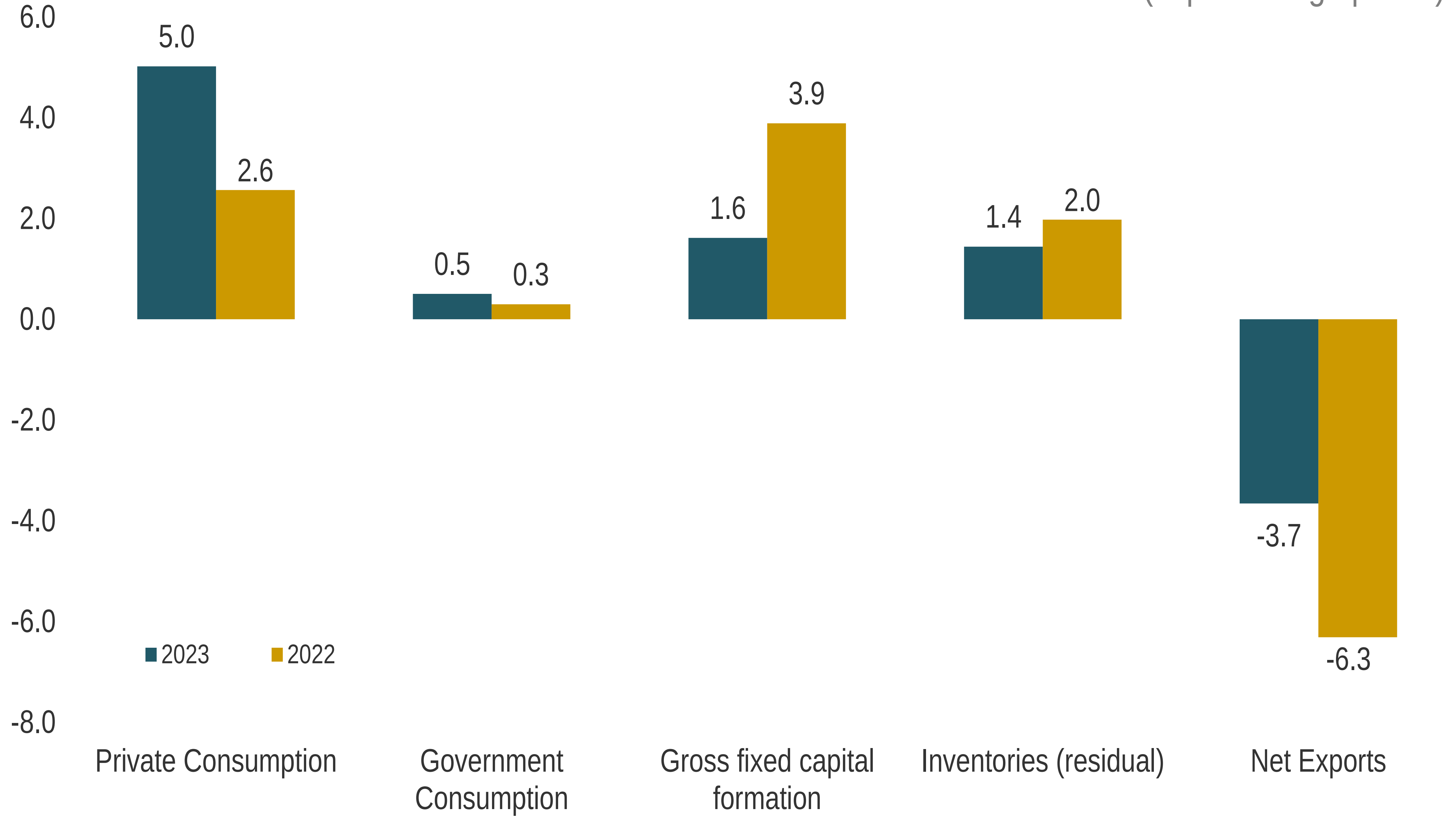
MINISTRY OF FINANCE

2023 EXPENDITURE SIDE

- *In terms of **domestic demand**, compared with 2022, public consumption increased by 1.6% and private consumption increased by 4.2%. Gross fixed capital formation increased by 19.5% over the same period. In terms of **external demand**, exports decreased by 1.5% while imports increased by 5.1% compared with 2022.*

- ***Growth** was mainly driven by investment and private consumption. Net exports contributed negatively (due to lower non-tourist services exports and growth in imports due to robust domestic demand).*

Contribution to growth in 2023 vs 2022
(in percentage points)



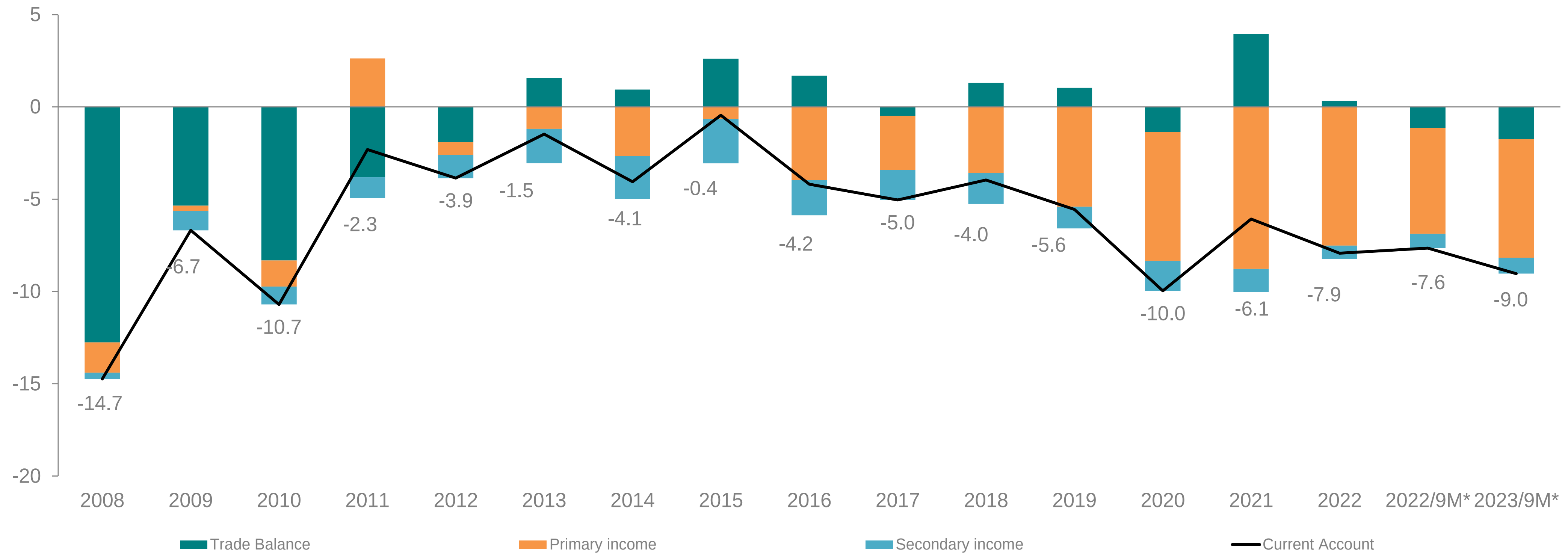
2023 PRODUCTION SIDE

- *From a **sectoral point** of view, growth in 2023 is positive and widespread with negative contribution only from the sectors “Financial and insurance activities” and “Professional, scientific and technical activities”.*

- *The positive growth rate is mainly attributed to the sectors: "Hotels and Restaurants", “Construction”, “Wholesale and retail trade; repair of motor vehicles and motorcycles”, "Administrative and support service activities", “Information and communication” and “Transportation and storage".*

CURRENT ACCOUNT

- *The current account (CA) balance of Cyprus recorded a worsening, with the deficit increasing to €2,688.3 mn (-9.0% of GDP) in 2023/9M, from €2,124.2 mn (-7.6% of GDP) in 2022/9M.*
- *This was mainly due to the trade deficit in goods (due to a significant size transaction of mobile transport equipment and increased imports for home consumption in 2023Q1) and to a lesser extent to a lower increase in the services surplus (financial services were impacted by sanctions implementation).*
- *The deterioration in primary income account in recent years is related to the expansion of service exports (especially ICT-related exports) due to the foreign companies that have settled on the island profits of which are accounted for as outflows.*



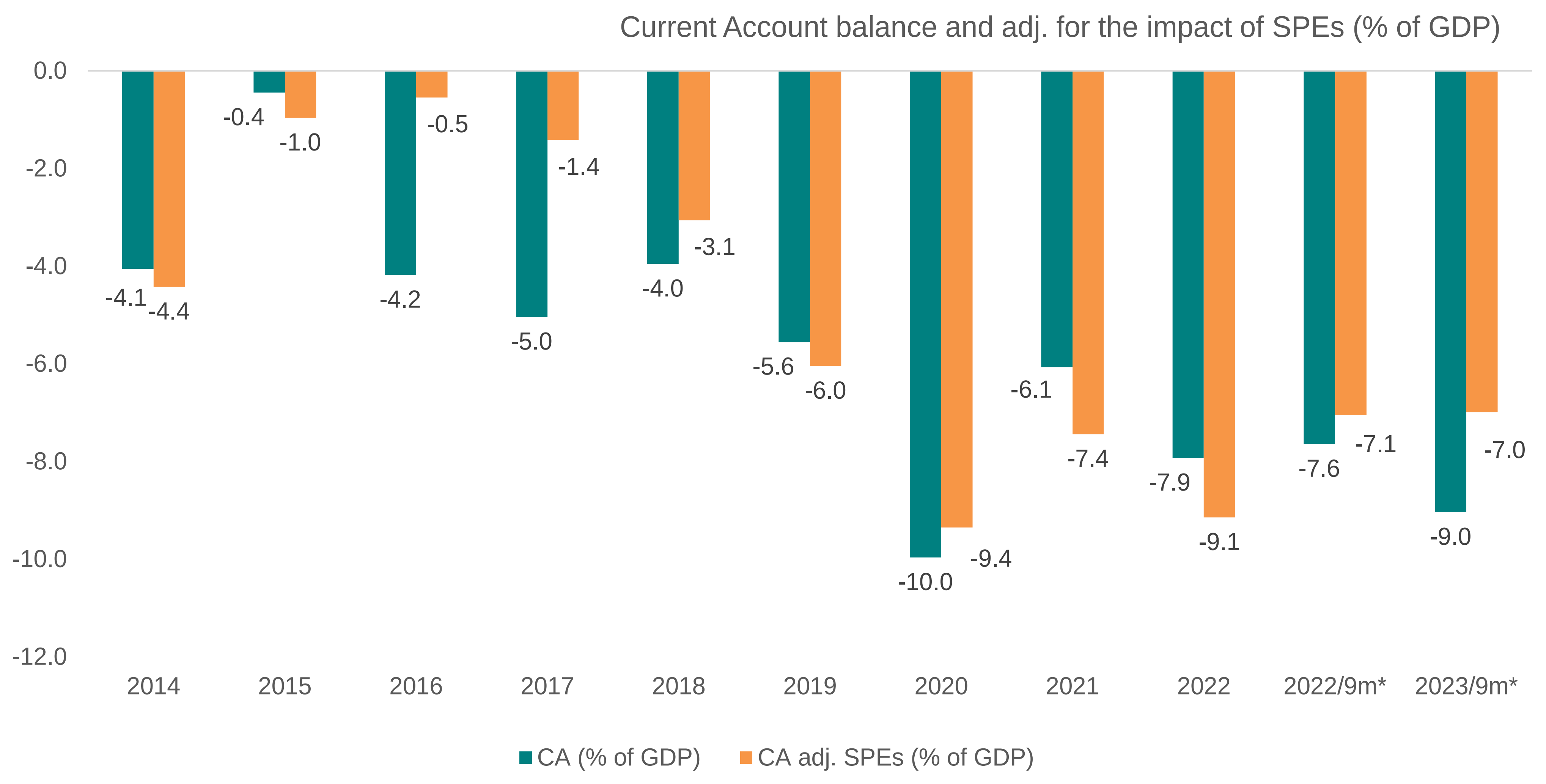
EUR mil	2019	2020	2021	2022	2022-9M	2023-9M
Current account balance	**-1,287.8**	**-2,201.6**	**-1,513.5**	**-2,202.7**	**-2,124.2**	**-2,688.3**
as a % of annual GDP	*-5.6%*	*-10.0%*	*-6.1%*	*-7.9%*	*-7.6%*	*-9.0%*
Balance on goods and services	239.0	-301.8	986.8	88.3	-315.8	-520.7
as a % of annual GDP					*-1.1%*	*-1.7%*
Primary income	**-1,253.5**	**-1,539.1**	**-2,187.2**	**-2,087.7**	**-1593.7**	**-1909.5**
Secondary income	**-273.4**	**-360.7**	**-313.1**	**-203.4**	**-214.8**	**-258.1**
as a % of annual GDP					-6.5%	-7.3%

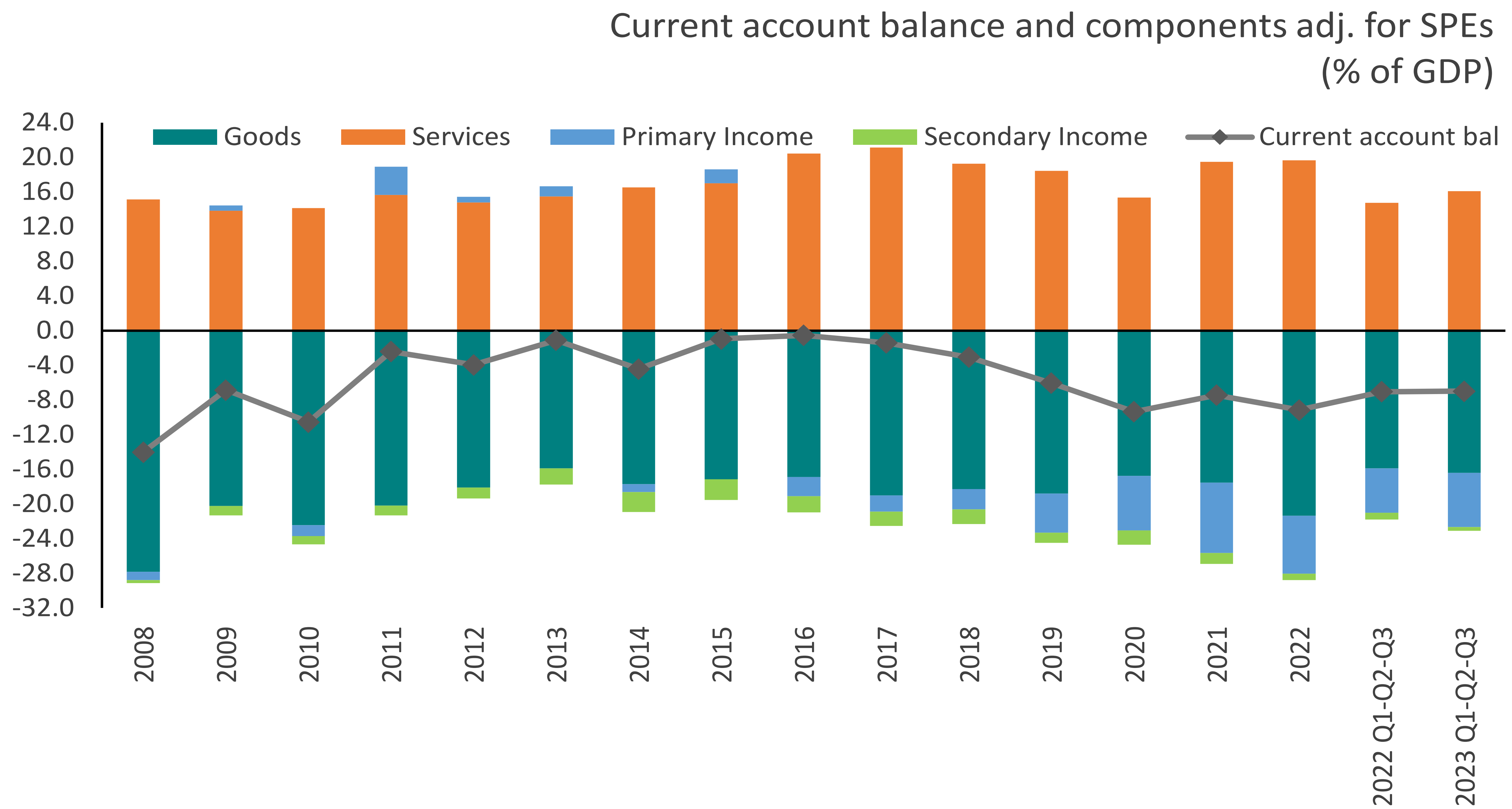
EUR mil	2019	2020	2021	2022	2022-9M	2023-9M
Balance on goods and services	**239.0**	**-301.8**	**986.8**	**88.3**	**-315.8**	**-520.7**
Goods balance	**-4,631.5**	**-4,211.3**	**-4,398.4**	**-5,973.1**	**-4869.5**	**-5663.2**
Exports of Goods	*3,079.7*	*2,969.0*	*3,693.3*	*4,581.5*	*3015.1*	*3044.7*
Imports of Goods	*7,711.2*	*7,180.3*	*8,091.7*	*10,554.6*	*7884.5*	*8707.9*
Services balance	**4,870.4**	**3,909.5**	**5,385.2**	**6,061.5**	**4553.7**	**5142.5**
Exports of Services	*14,648.5*	*14,851.0*	*18,594.3*	*21,817.2*	*16238.7*	*16646.4*
Imports of Services	*9,778.0*	*10,941.4*	*13,209.1*	*15,755.7*	*11685.0*	*11503.9*

Source: CBC

CURRENT ACCOUNT

- *Current Account deficit is significantly affected by the net transactions of mobile equipment (ships).*
- *The resulting deficit adjusted for the impact of Special Purpose Entities (SPEs) stood at 7.0% of GDP in 2023/9m, compared with a deficit of 7.1% of GDP in 2022/9m.*





*For the 9m period, the annual GDP figures are used to derive the % to GDP ratio.

Source: CBC

THE ROLE OF FDI ON CAB

- *The structural change in the primary income deficit from 2016 onwards is, among other things, a result of the attraction of FDI to Cyprus.*
- *The impact of these companies operating in Cyprus on the Current Account (CA) depends mainly on the nature of their operations, i.e. whether they deal with Cypriot residents or export/import goods and services to/from non-Cypriot residents.*
- *Their influence on the CA has increased in recent years, which partly contributes to the widening of the CA deficit.*
- *The questions that arise are whether the expansion of the CA deficit and the possibility of its financing should be of concern.*
  - *In relation to the 1st question, it is noted that the expansion in question is partly due to factors that can be considered transitory or will not exist in the medium term.*
  - *In relation to the 2nd question, the funding of the CA deficit appears to be sustainable.*
- *Inward foreign direct investments - FDI are considered the preferred method of financing, since they reflect the long-term interest of investors and their confidence in future growth in the country. These FDIs are an important source of funding for the CA in Cyprus.*

Source: CBC's Economic Bulletin (Box 1, pages 31-36)

CURRENT ACCOUNT

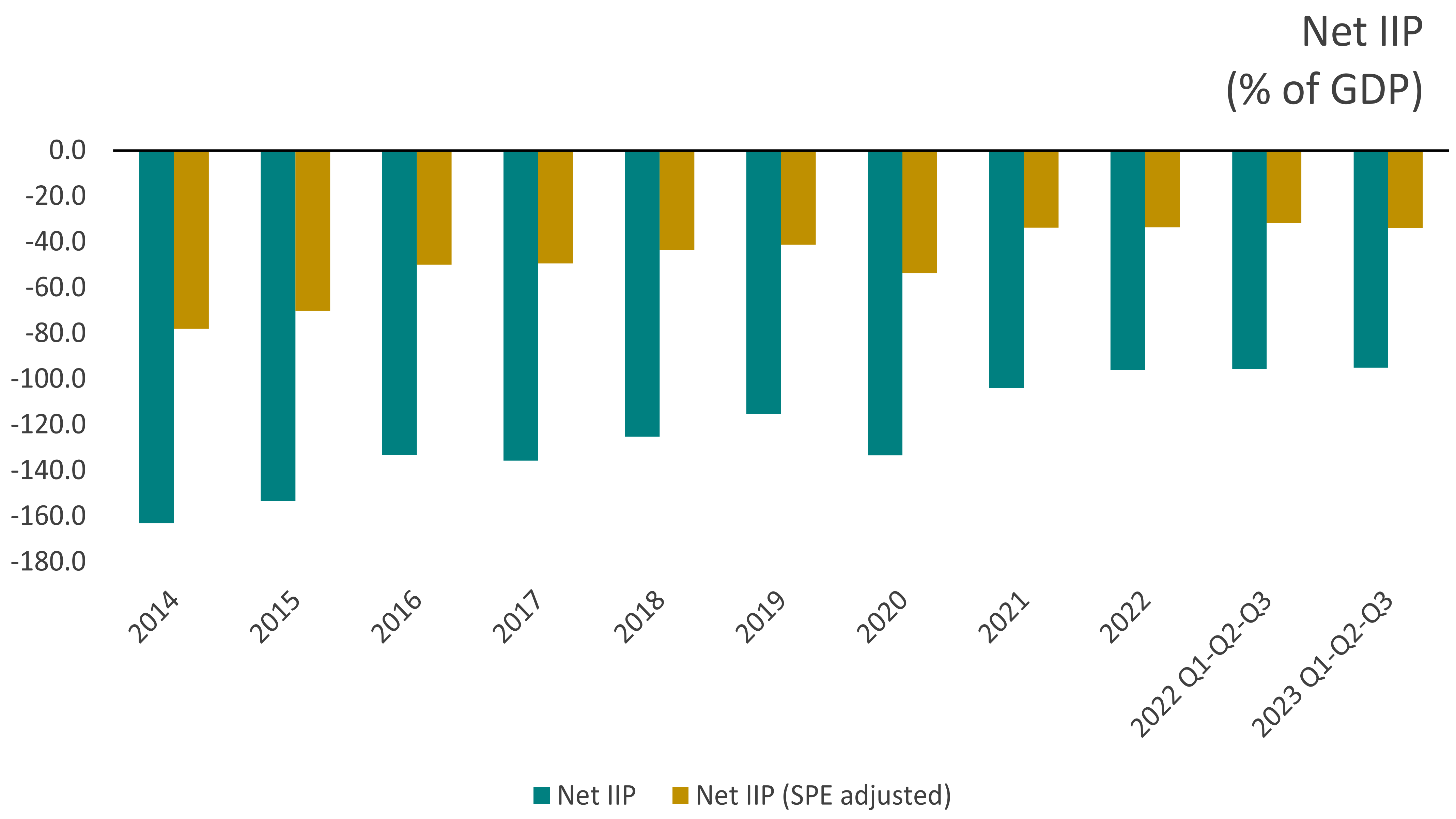
Concluding remarks:

- *The recent increase in the CA deficit is partly due to circumstantial reasons, which are expected to reverse in the medium-term or to decline significantly, but also to the change in the structure of the balance of services which leads to an increase in the deficit, but at the same time it is accompanied by FDI which is the best possible form of financing that supports the sustainability of CAs.*
- *The further growth prospects of the sectors of ICT, tourism, financial services and transport will continue to improve the services balance in the medium-term, while in the long-term the exploitation of hydrocarbons and renewable energy sources are expected to significantly improve the goods balance. Additionally, attracting high value-added investment from inward FDI ensures the financing of the CA deficit and lays the foundation for the sustainable growth of the economy.*
- *The importance of the CA in a small and open economy, cannot be underestimated, especially due to the significant international and geopolitical upheavals of recent years. The best protection for the economy from such shocks are provided by maintaining competitiveness and ensuring sound economic fundamentals of the country.*
- *In the coming years, we do not expect significant improvement in the income account but a normalization over time. Thus, the Government's efforts are focused on improving the trade balance via policies i.e.*
  - *increasing tourist capacity, expanding tourist season and adding new destinations*
  - *weaning off conventional fuels consistent with green transition policies*
  - *emphasis on companies of Cypriot interests that will be able to contribute to the increase of exports of products and services as well as in the Primary and Secondary (light industry) sectors.*

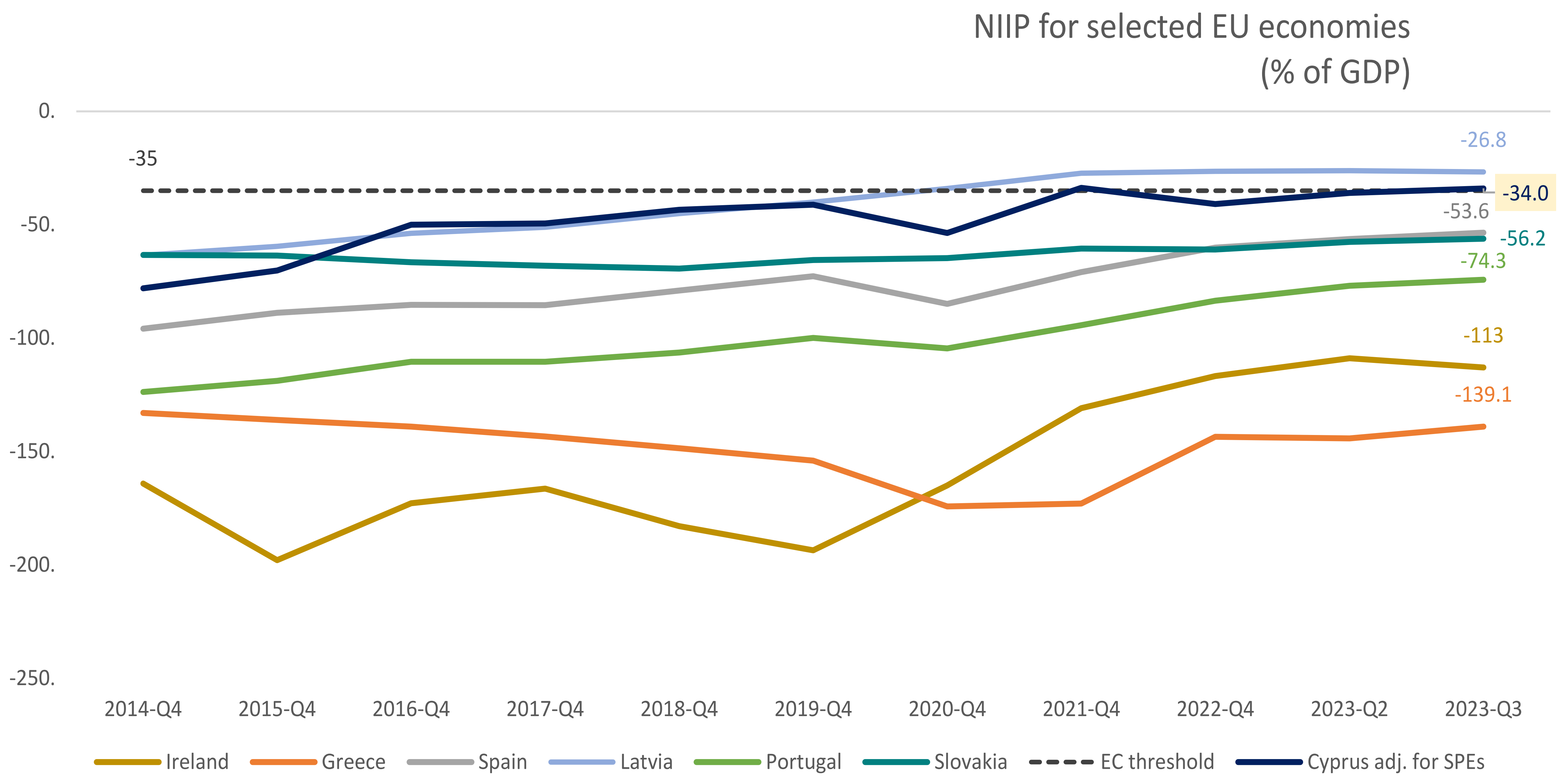
Source: CBC's Economic Bulletin (Box 1, pages 31-36)

INTERNATIONAL INVESTMENT POSITION

- *The IIP in 2023Q3 presented a net liability position of 95.0% of GDP. With the corresponding data being adjusted for the impact of SPEs, IIP recorded a net liability position of 34.0% of GDP. The negative net IIP is thus driven mainly by SPEs.*
- *Adjusted for the impact of SPEs is below to the scoreboard's threshold of 35%, which though is ad hoc and atheoretical. Also, adjusted for SPEs compares favourably with other EA countries.*



Source: CBC



Source: Eurostat

"Draft Budgetary Plan 2024 (October 2023)"

PROSPECTS 2023-2026

- *Going forward, according to the baseline macroeconomic scenario as presented in the DBP 2024, growth in the medium term is expected to continue on a positive path, albeit at a decelerated pace. The deceleration is attributed to the expected deterioration of the external economic environment and to the impact of the continued rise of energy prices, coupled with high interest rates, that will put a pressure on both domestic and external demand.*

- *Over the period 2024-2026, growth is expected to stabilize, with real GDP growth projected at 2.9%, 3.1% and 3.2% respectively.*

MEDIUM-TERM FRAMEWORK

	2019	2020	2021	2022[e]	2023[e]	2024[f]	2025[f]	2026[f]
Real GDP (%)	5.5	-4.4	6.6	5.6	2.5	2.9	3.1	3.2
Unemployment rate	7.1	7.6	7.5	6.8	6.1	5.8	5.3	5.0
Inflation rate (HICP)	0.5	-1.1	2.3	8.1	3.9	2.5	2.0	2.0

f = MoF (DBP 2024)

CLIMATE CHANGE AND EFFECTS ON THE CYPRIOT ECONOMY (1/2)

- *The MoF has signed this year a Research Cooperation Agreement with the Center for Economic Research (CyERC) of the University of Cyprus titled "Climate Change and Effects on the Cypriot Economy".*

- *The purpose of this research paper is to assess the possible effects of climate change on GDP and the potential growth rate, in critical sectors of the economy (tourism, agriculture, shipping), public finances and more generally in the prospects and the development model of Cyprus.*

- *Due to the importance of the topic of climate change and its effects, the MoF in its basic forecasts should also take into account possible external shocks and risks, from the uncertainty caused by climate change with a long-term horizon.*

- *The duration of the Agreement is three years (2023-2025), it will be completed in three stages and the final study will be delivered in December 2025.*

CLIMATE CHANGE AND EFFECTS ON THE CYPRIOT ECONOMY (2/2)

ECONOMIC IMPACTS OF CLIMATE CHANGE: A REVIEW

- *To assess the economic and fiscal impact of climate change, the channels through which climate affects the economy and public finances should be explored. To explore this relationship climate risks are classified in two types: physical risks and transition risks. Physical risks involve damage from extreme weather events and gradual global warming, while transition risks stem from policies to address climate change, like transitioning to a low-carbon economy.*
- *The impact of physical and transition climate risks on the economy involves various mechanisms affecting both supply and demand. On the supply side, extreme weather events can damage land and physical capital and reduce labour productivity particularly in outdoor sectors like construction due to high temperatures. Further, the transition to a low-carbon economy poses a challenge, balancing the need to mitigate future climate damages with immediate costs, which can divert resources from productive investments, affecting economic growth. On the demand side, private consumption and investment may decline due to reduced household wealth, weakened firm balance sheets, and increased uncertainty. Transitioning to a low-carbon economy can disrupt high-carbon industries, leading to significant investment decreases, and government investments in low-carbon technologies may inadvertently displace private investments ('crowding-out' of private investments).*

SUMMARY: POTENTIAL IMPLICATIONS OF "FIT-FOR-55" FOR THE CYPRUS ECONOMY (1/2)

- *New ETS for heating & transport fuels could increase cost of living modestly (1.4% in low-income to 0.6% in high-income households) assuming ETS prices of the Commission's Impact Assessment*

- *Gradual decline in air transport activity by 15% by 2030 due to ETS, Energy Tax Directive, ReFuel EU Aviation*
  1.7% decline in GDP; 2.6% decrease in employment (10,000 jobs) in hotels, restaurants, retail trade assuming full effect of all three legislative changes; using input-output and tourist expenditure data

- *4% increase in consumer prices due to environmental policies in shipping (ETS, Fuel EUMaritime, Energy Tax Directive)*

MINISTRY OF FINANCE

SUMMARY: POTENTIAL IMPLICATIONS OF “FIT-FOR-55” FOR THE CYPRUS ECONOMY (2/2)

- *No serious distributional issues in heating/transport fuels from Energy Tax Directive – but serious fiscal implications.*
  Findings are in line with Commission’s Impact Assessment

- *Electrification of transport affects ~12,000 jobs in NACE sectors 45 & 47.3 – vehicle and fuel sales and maintenance*
  Some of these jobs may be at risk

- *Cost increases in energy-intensive industries affect 17,000 direct + 18,000 indirect jobs (NACE sectors 10,11,12,20,21,22)*
  Small risk for most of these jobs, but re-skilling will be needed

Public finances,
– outcome during January-December 2023

DEVELOPMENTS, JANUARY-DECEMBER 2023

General government budget balance was in surplus during 2023 of about €876 mn (2.9% of GDP) compared to a surplus of €676 mn (2.4% of GDP) in 2022, recording an improvement of ½ percentage point of GDP, attributed to the significant increases recorded in most of revenue categories.

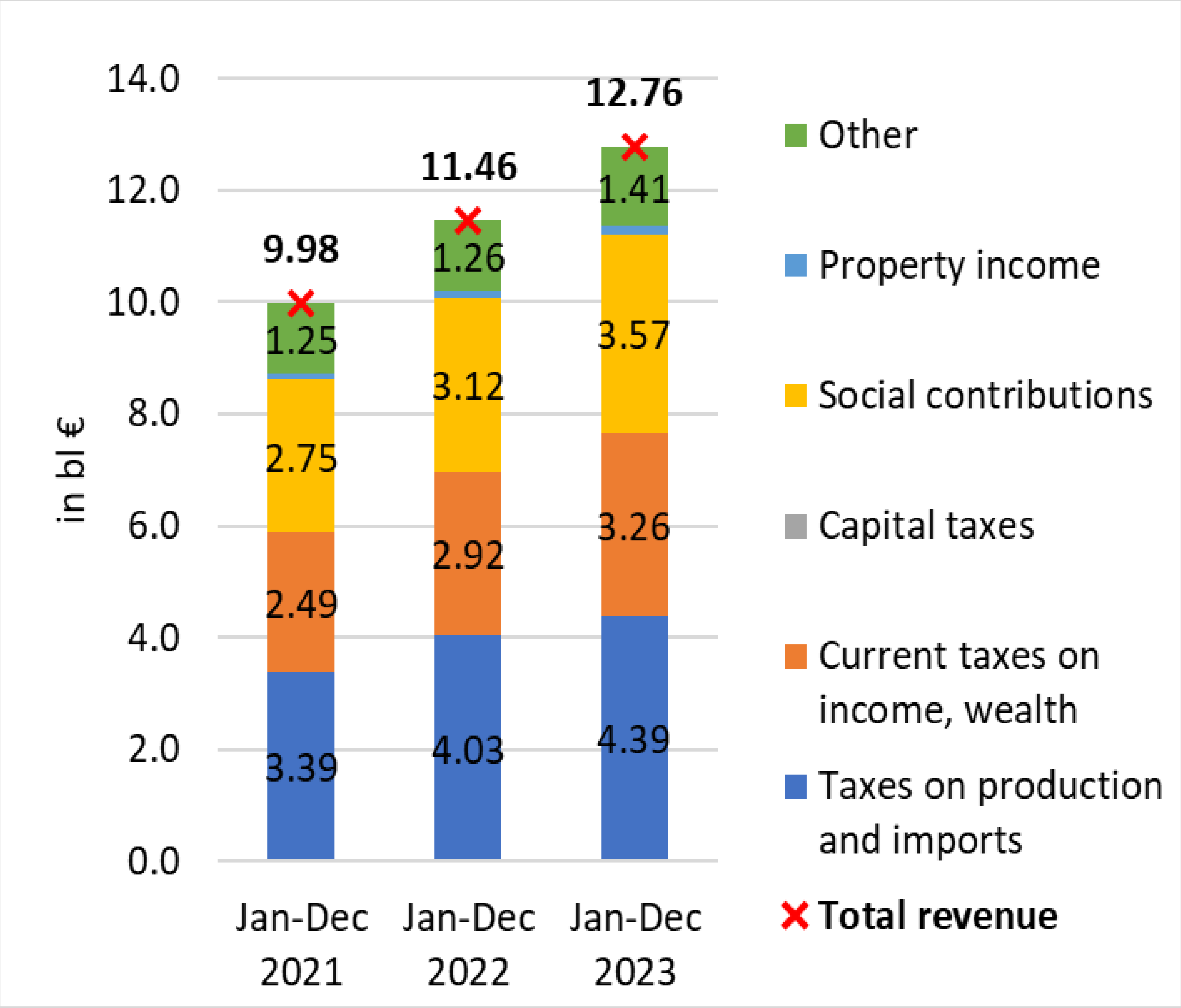
Primary balance was in surplus of about €1,136 mn (4.4% of GDP), compared to a primary balance of €1,086 mn (3.9% of GDP) in 2022.

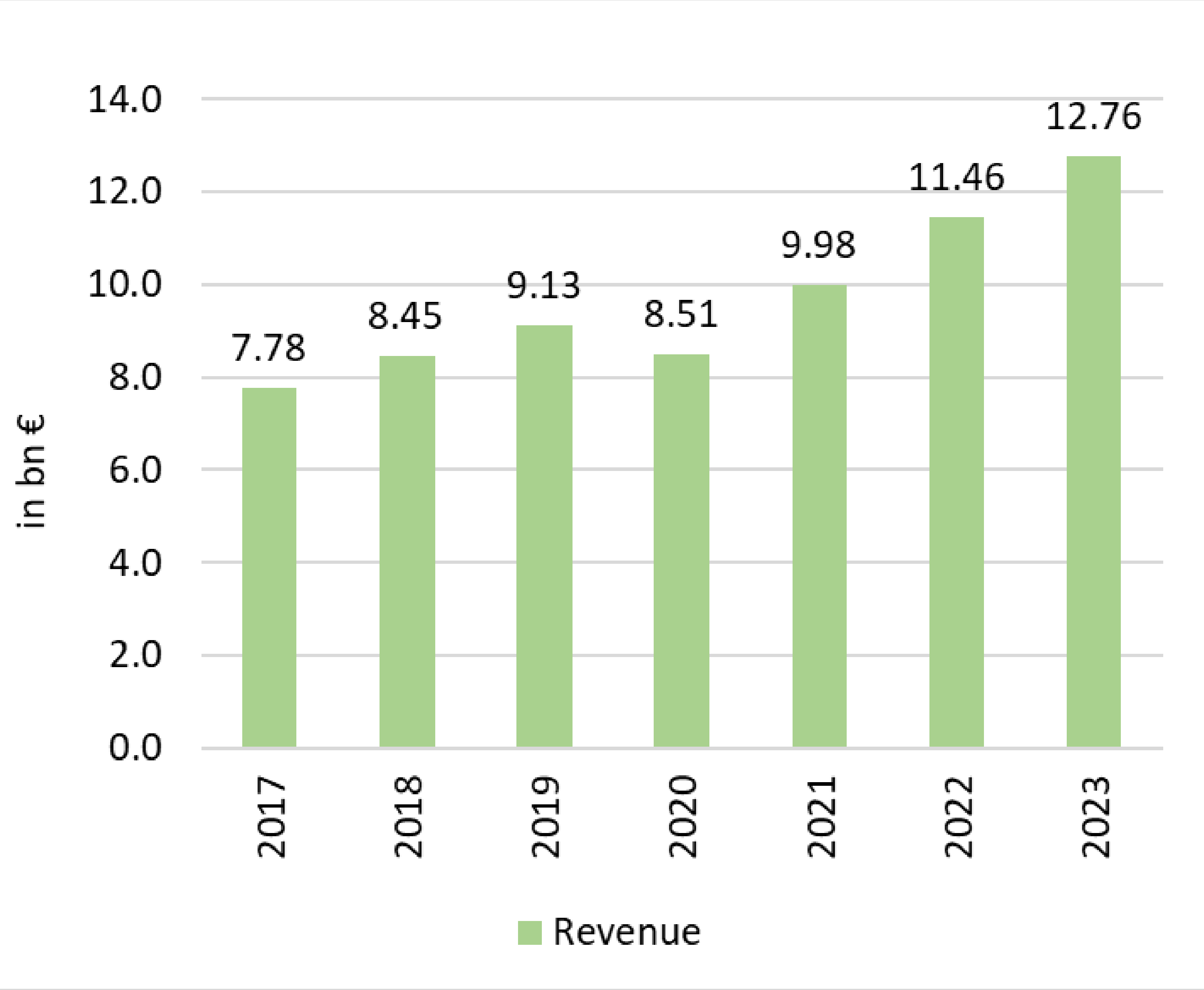
	ESA Code	2021	2022	2023
	% of GDP			
General government	S.13	-1.9	2.4	2.9
Central government	S.1311	-3.0	0.4	-0.8
State government	S.1312	M	M	M
Local government	S.1313	0.0	0.1	-0.1
Social security funds	S.1314	1.1	2.0	3.8
Total revenue	TR	40.0	41.2	42.9
Total expenditure	TE	41.9	38.8	39.9
Net lending/borrowing	EDP B.9	-1.9	2.4	2.9
Interest expenditure	EDP D.41	1.7	1.5	1.5
Primary balance		-0.1	3.9	4.4
Public Debt		99.3	85.6	77.4

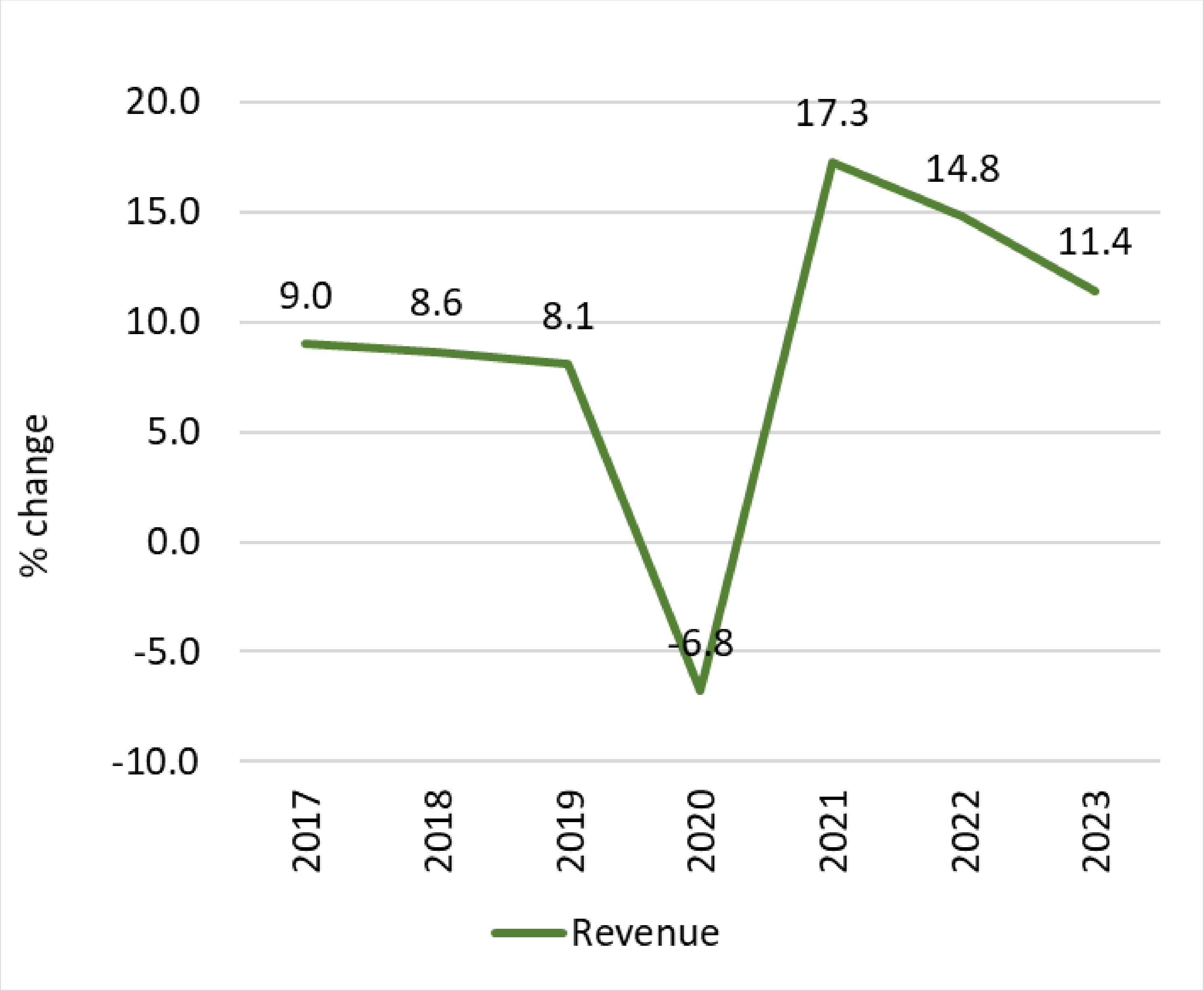
DEVELOPMENTS, JANUARY-DECEMBER 2023

- PUBLIC REVENUE

Total revenue recorded a significant increase of 11.4% during 2023, reaching €12,763 mn from €11,456 mn during 2022. This was mainly attributed to increases, which were recorded in the revenue from social contributions (contribution 3.9 pp.) and to revenues from in taxes on production and imports (contribution 3.1 pp.) of about 14.5% and 8.8%, respectively.





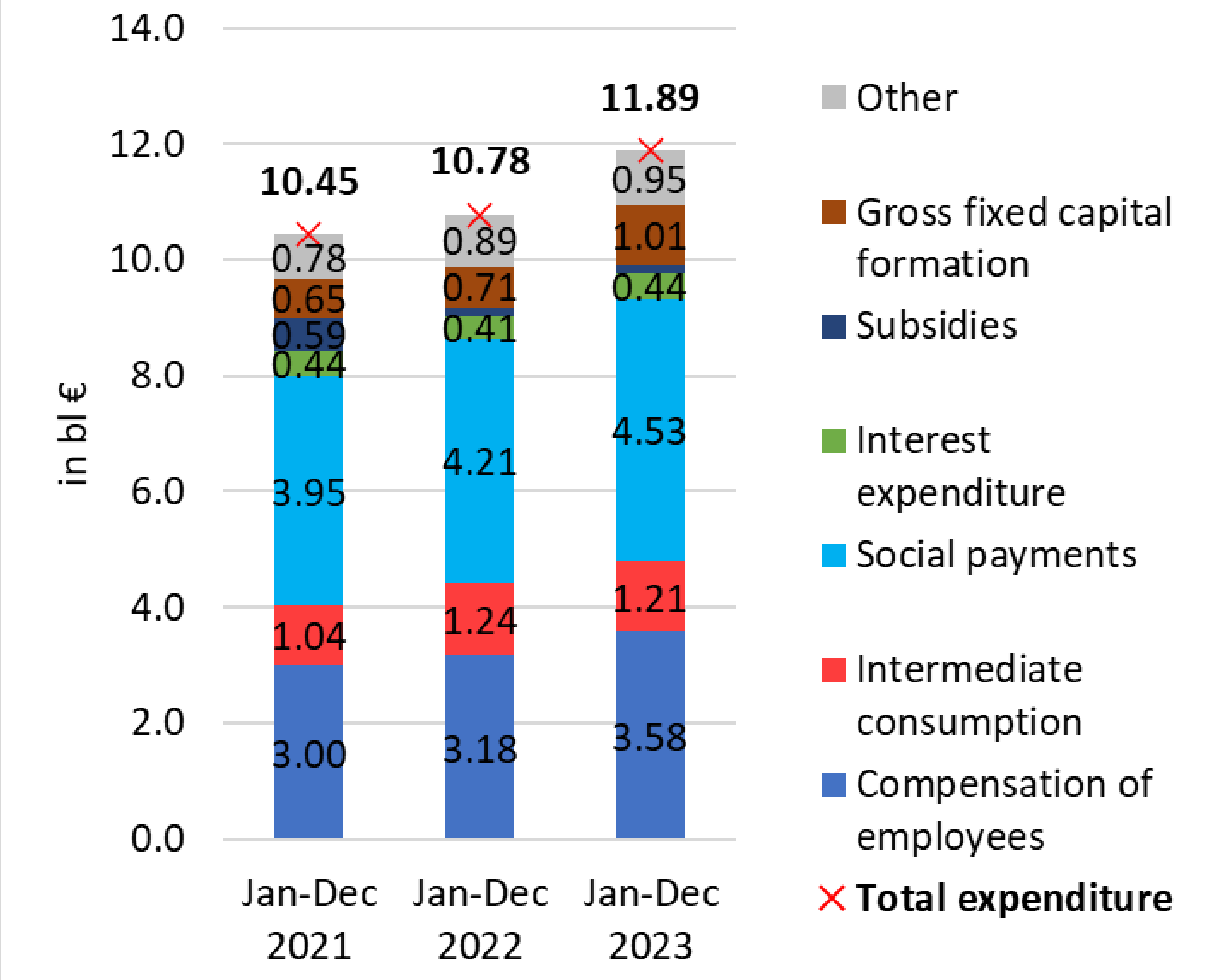


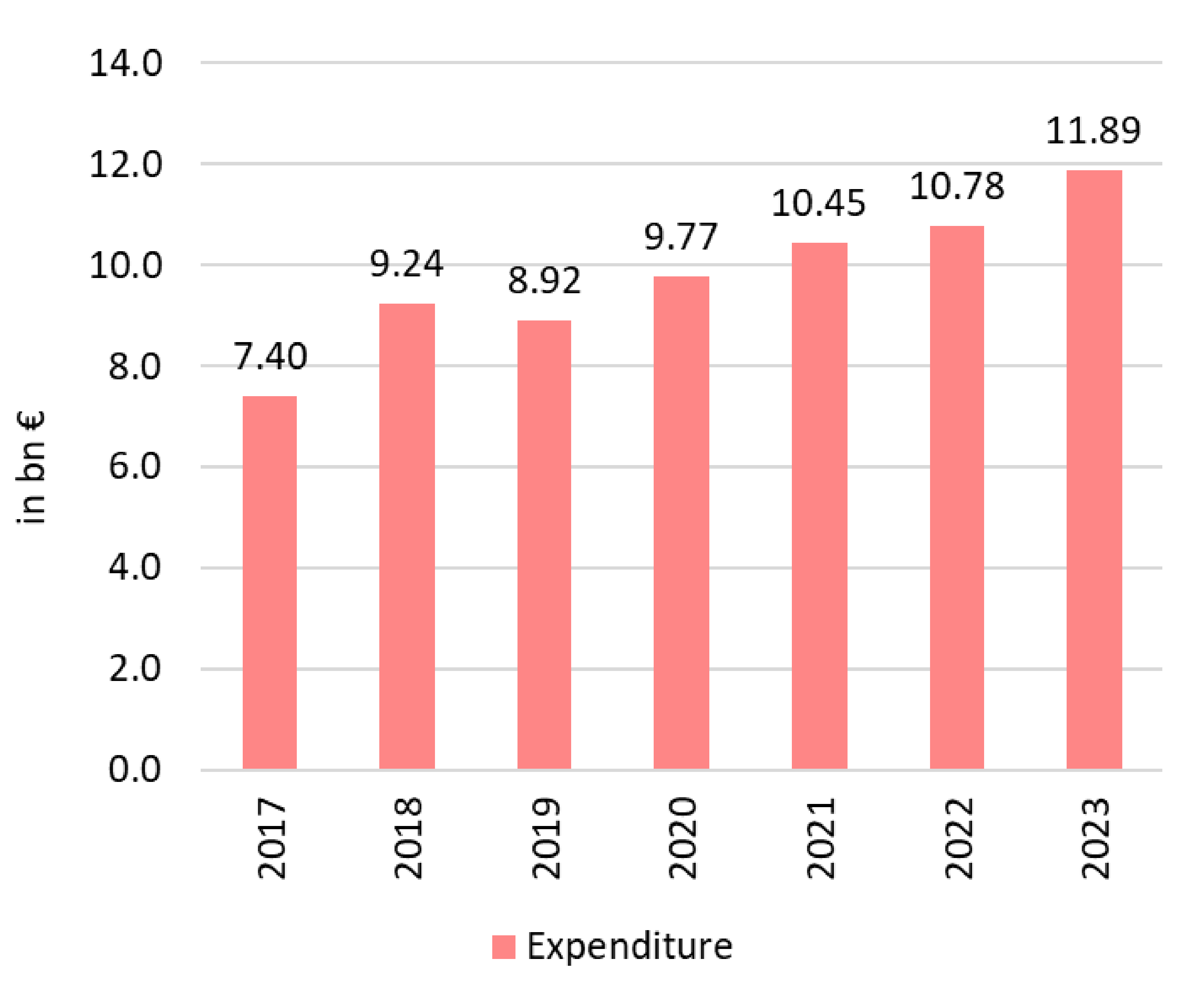
MINISTRY OF FINANCE

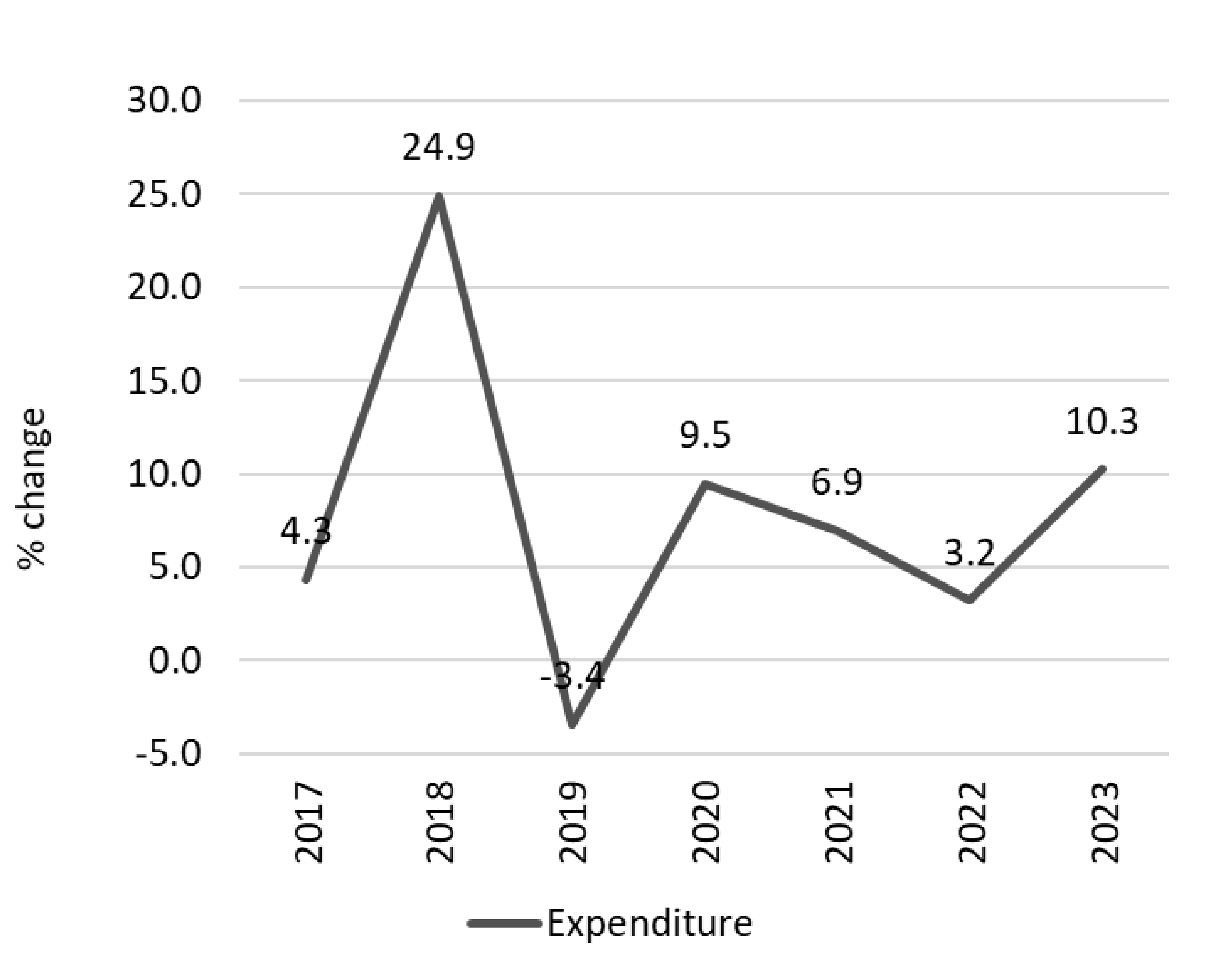
DEVELOPMENTS, JANUARY-DECEMBER 2023

- PUBLIC EXPENDITURE

Public expenditure recorded an increase of 10.3% during 2023, reaching €11,887 mn from €10,781 mn in 2022, with categories ‘compensation of employees’ and ‘social payments’ contributing the most to this increase by 3.8 pp. and 3 pp., respectively.







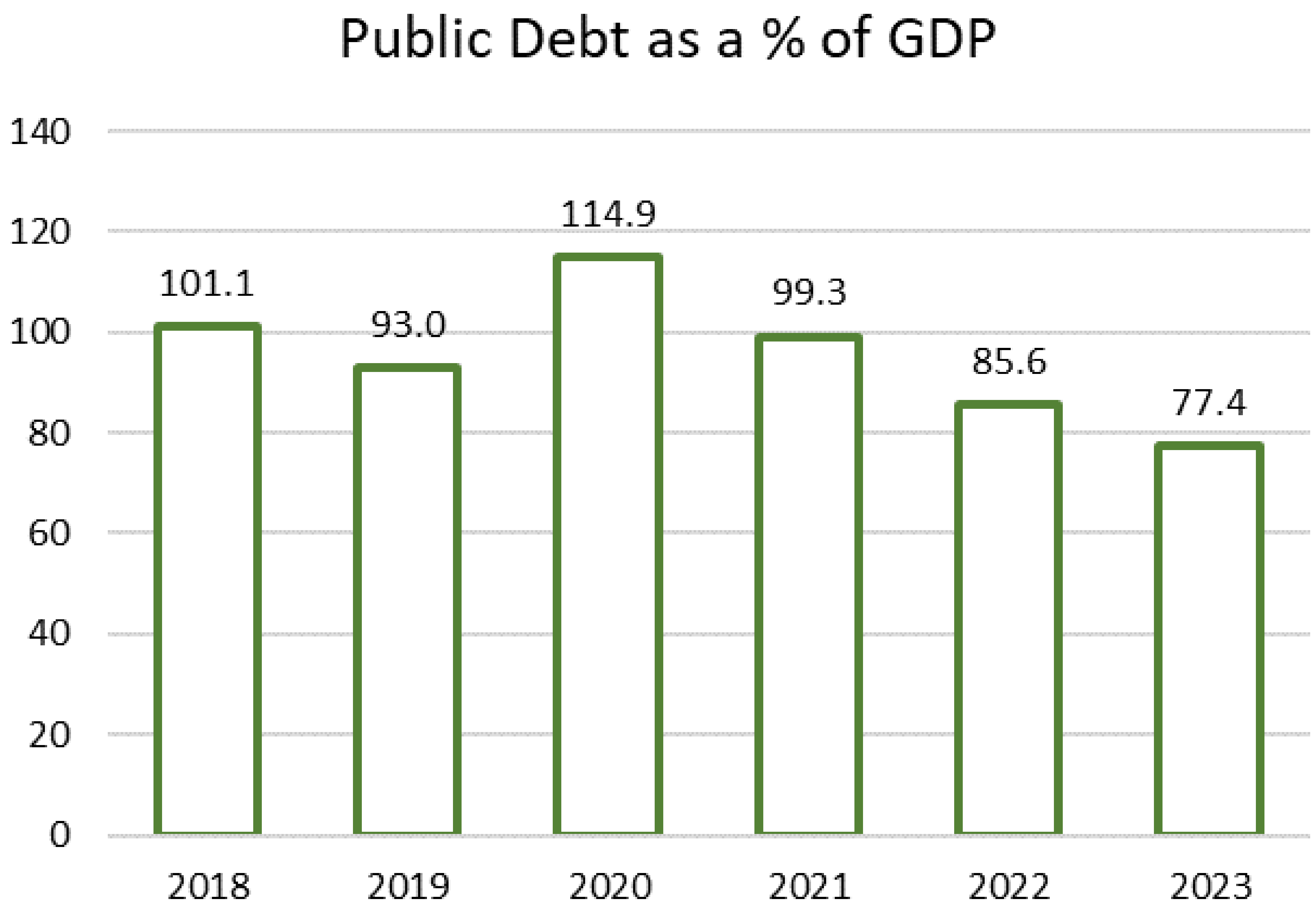
MINISTRY OF FINANCE

Debt developments

DEBT DEVELOPMENTS

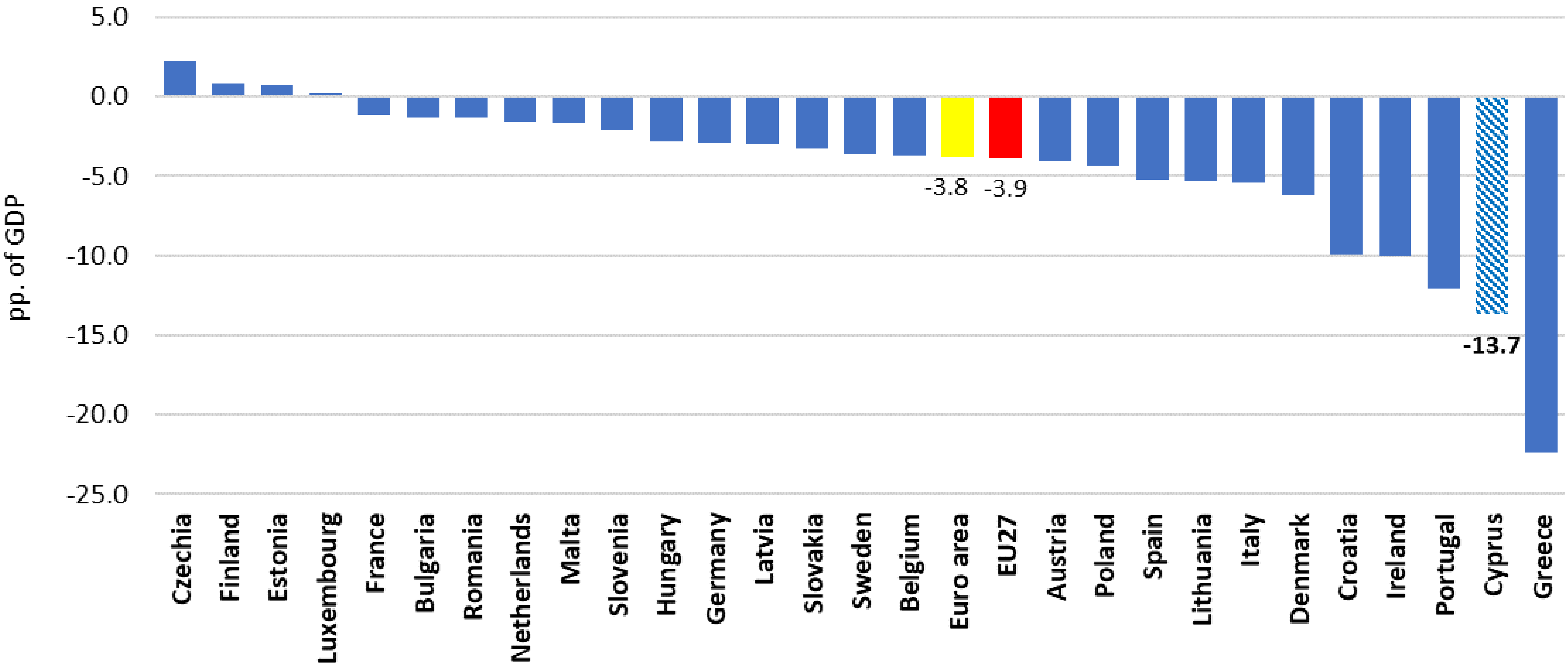
At the end of 2023, the debt-to-GDP ratio stood at approximately 77.4% of GDP, recording a cumulative decline of more than 37.5 percentage points since 2020.

This **significant reduction** was both attributed to the utilization of a significant amount of cash reserves to cover a part of gross financing needs and to the increase of the nominal GDP.



DEBT DEVELOPMENTS

- CHANGES IN DEBT TO GDP RATIO, 2022 COMPARED TO 2021



Source: Eurostat

MINISTRY OF FINANCE

Public finances,
– fiscal outcome during January 2024

DEVELOPMENTS, JANUARY 2024

General government budget balance was in surplus during January 2024 of about €456 mn (1.5% of GDP) compared to a surplus of €369 mn (1.3% of GDP) in January 2023, recording an improvement of 0.2 percentage point of GDP, attributed to the significant increases recorded in most revenue categories.

Primary balance was in surplus of about €491 mn (1.7% of GDP), compared to a primary balance of €410 mn (1.5% of GDP) during the same month in 2022.

		% of GDP		
(in mn €)	**ESA Code**	**Jan-22**	**Jan-23**	**Jan-24**
Net lending (EDP B.9) by sub-sector				
1. General government	S.13	0.9	1.3	1.5
2. Central government	S.1311	0.6	1.0	1.2
3. State government	S.1312	M	M	M
4. Local government		-0.1	0.0	0.0
5. Social security funds	S.1314	0.3	0.4	0.3
6. Total revenue	TR	3.8	4.2	4.4
7. Total expenditure	TE[1]	2.9	2.9	2.9
8. Net lending/borrowing	EDP B.9	0.9	1.3	1.5
9. Interest expenditure	EDP D.41	0.2	0.2	0.1
10. Primary balance[2]		1.1	1.5	1.7

DEVELOPMENTS, JANUARY 2024

- PUBLIC REVENUE

Public revenue recorded a positive annual growth rate of 13.2% during January 2024 reaching €1,316 mn from €1,163 mn during January 2023 to, with revenue from current taxes on income and wealth contributing the most to this y-o-y percentage change (+8.5 pp.):

- **Current taxes on income and wealth** reached €541 mn from €442 mn during January 2023, recording an increase of 22.4%, reflecting the continued performance of businesses as well as the improvements in labour market conditions.
- Revenue from **taxes on production and imports**, remained at around €351 mn, broadly at the same levels as in January 2023.
- **Social contributions** recorded an increase of 14.1%, reaching €343 mn compared to €301 mn during the same month of 2023, attributed to the increase in the contribution rates in the SSF as from January 2024 (+5.3 pp.), as well as the improved labour market conditions.
- **Property income** increased, from €7.1 mn during to €10.7 mn.
- Finally, category '**other revenue**' reached €71.3 mn in January 2024 from €62.8 mn during the same month in 2023 (+13.5%).

DEVELOPMENTS, JANUARY 2024

- PUBLIC EXPENDITURE

Total expenditure recorded an increase of 8.3% during January 2024, reaching €860 mn from €794 mn during January 2023:

- **Compensation of employees** recorded an increase of 16.2%, reaching €297 mn from €256 mn. This was mainly the outcome of the higher contribution as an employer in the context of the SSF and of the NHS (+5.4 pp., in total), taking also into account the increased contribution rates in the context of the SSF as of 1st January 2024 as well as the contribution under the new pension scheme, COLA adjustments (+3.9 pp.), the need for extra assistance under the Ministry of Education (+1.4 pp.) and increments (+1 pp.).
- Expenditure under category **social payments** contributed positively to the growth of total expenditure with 4.8 pp., reaching €366 mn from €328 mn in January 2023, recording an annual growth of 11.6%, mainly due to the increased contribution in the context of SSF (+6.1 pp.), as well as to the increased compensations of HIO to private health provides for their services in the context of NHS (contribution +2 pp.) and to the increased payments for old-age pensions (contribution +2.7 pp.).
- Category **subsidies** contributed the most to the containment of public expenditure with -0.9 pp., falling to €4.3 mn from €11.1 mn during January 2023.

Medium-term projections

(Draft Budgetary Plan 2024, October 2023)

Medium-Term Projections

According to the latest projections of the Ministry of Finance, presented in the context of the Draft Budgetary Plan 2024 (October 2023), **the budget balance of the general government was projected at 2.5% of GDP for 2023 and debt-to-GDP ratio to fall to about 79.4%. Recently available data for 2023 suggest a better than expected outcome for the budget balance of 0.4 pp. of GDP and of about 2 p.p. of GDP regarding debt-to-GDP ratio.**

Taking into account the most recently available public finance data, as well as any new information available, the Ministry will revise the fiscal projections accordingly, which will be presented in the context of the Stability Programme 2024-2027 by the end of April 2024.

	ESA Code	2021	2022	2023	2024	2025	2026
		% of GDP					
General government	S.13	-1.9	2.4	2.5	2.8	2.7	2.5
Central government	S.1311	-3.0	0.4	-0.3	-1.1	-1.0	-1.2
State government	S.1312	M	M	M	M	M	M
Local government	S.1313	0.0	0.1	0.1	0.1	0.1	0.0
Social security funds	S.1314	1.1	2.0	2.7	3.9	3.7	3.6
Total revenue	TR	40.0	41.2	43.5	44.1	43.7	42.7
Total expenditure	TE	41.9	38.8	41.1	41.3	41.0	40.2
Net lending/borrowing	EDP B.9	-1.9	2.4	2.5	2.8	2.7	2.5
Interest expenditure	EDP D.41	1.7	1.5	1.3	1.4	1.5	1.5
Primary balance		-0.1	3.9	3.8	4.2	4.2	3.9
Public Debt		99.3	85.6	79.4	72.5	67.4	61.1

Debt Sustainability Analysis (DSA)

projections October 2023

DEBT SUSTAINABILITY ANALYSIS

In order to address the sensitivity of the projected general government balance and debt ratios, alternative assumptions for real GDP growth rates, interest rates and primary balances have been incorporated in three different scenarios.

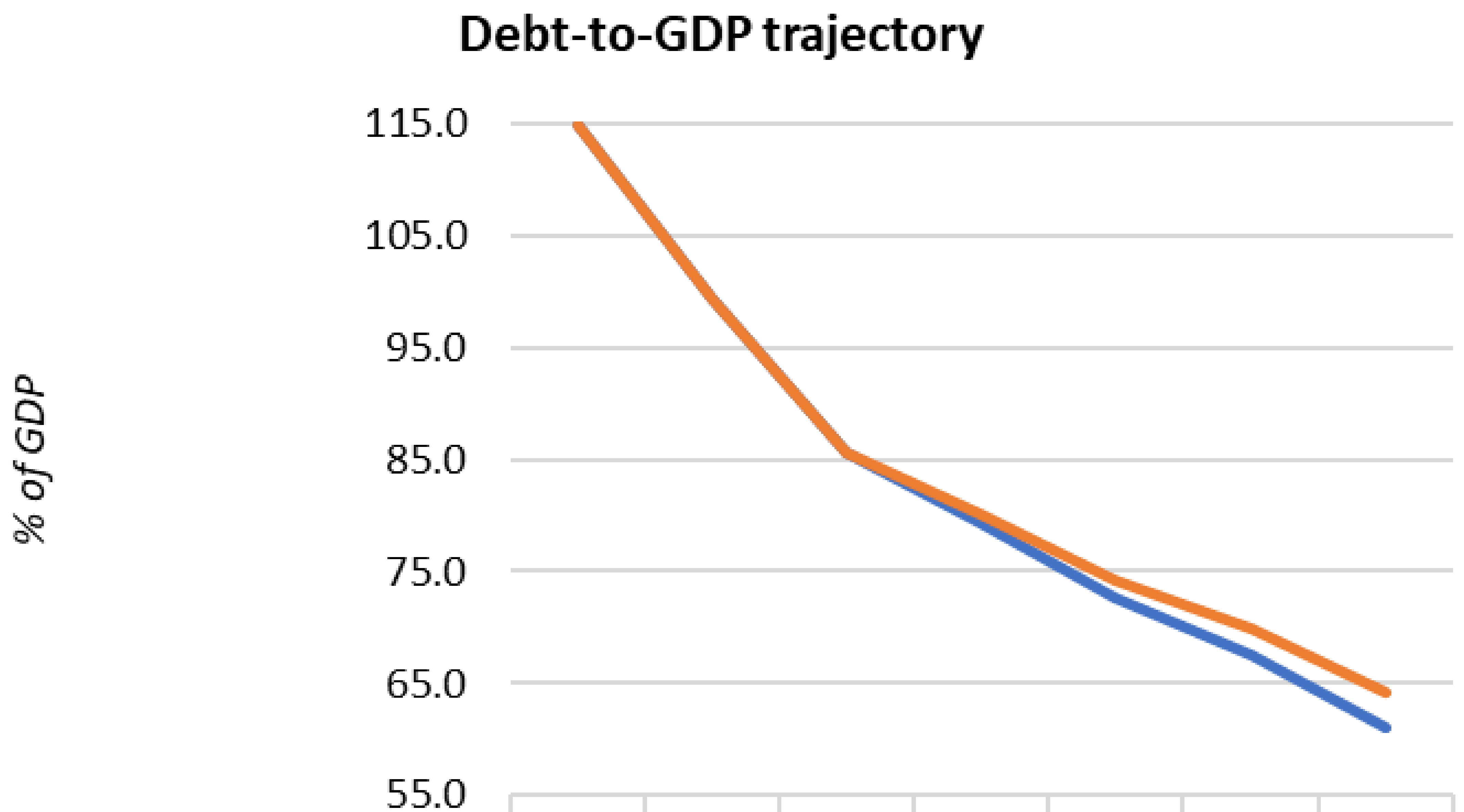
*It is noted that according to the Debt Sustainability Monitor 2022 (ISSN 2443-8014 (online), April 2023), "medium-term fiscal sustainability risks" are found to be **medium** in Cyprus (the stochastic projections point to large uncertainty surrounding the baseline projections), where "long-term fiscal sustainability risks" are **low** (in terms of structural primary balance).*

% of GDP	2020	2021	2022	2023	2024	2025	2026
Baseline scenario							
GDP	-3.4	9.9	5.1	2.4	2.9	3.1	3.2
Primary Government Balance	-3.6	-0.1	3.9	3.8	4.2	4.2	3.9
General Government Debt	114.9	99.3	85.6	79.4	72.5	67.4	61.1
Higher interest rate scenario							
GDP	-3.4	9.9	5.1	2.4	2.9	3.1	3.2
Primary Government Balance	-3.6	-0.1	3.9	3.8	4.2	4.2	3.9
General Government Debt	114.9	99.3	85.6	80.2	74.2	69.9	64.3
Lower growth scenario							
GDP	-3.4	9.9	5.1	-0.2	0.3	0.5	0.6
Primary Government Balance	-3.6	-0.1	3.9	2.7	2.1	1.0	-0.2
General Government Debt	114.9	99.3	85.6	82.5	79.7	79.6	78.9
Lower primary balance scenario							
GDP	-3.4	9.9	5.1	2.4	2.9	3.1	3.2
Primary Government Balance	-3.6	-0.1	3.9	1.8	2.2	2.2	2.0
General Government Debt	114.9	99.3	85.6	81.3	76.2	72.9	68.3
Combination scenario							
GDP	-3.4	9.9	5.1	1.1	1.6	1.8	1.9
Primary Government Balance	-3.6	-0.1	3.9	2.8	3.2	3.2	2.9
General Government Debt	114.9	99.3	85.6	81.9	77.5	74.7	70.5

DEBT SUSTAINABILITY ANALYSIS

- HIGHER INTEREST RATE SCENARIO

The first scenario assumes higher interest rates than the baseline scenario for each year over the programming period, with the real interest rate increasing by half of the 10-year historical standard deviation. Under this scenario, only the trajectory of general government public debt is affected which, however, continues to present a downward trend, declining to around 64.3% by 2026, compared to 61.1% under the baseline scenario.



	2020	2021	2022	2023	2024	2025	2026
Baseline scenario	114.9	99.3	85.6	79.4	72.5	67.4	61.1
Higher interest rate scenario	114.9	99.3	85.6	80.2	74.2	69.9	64.3

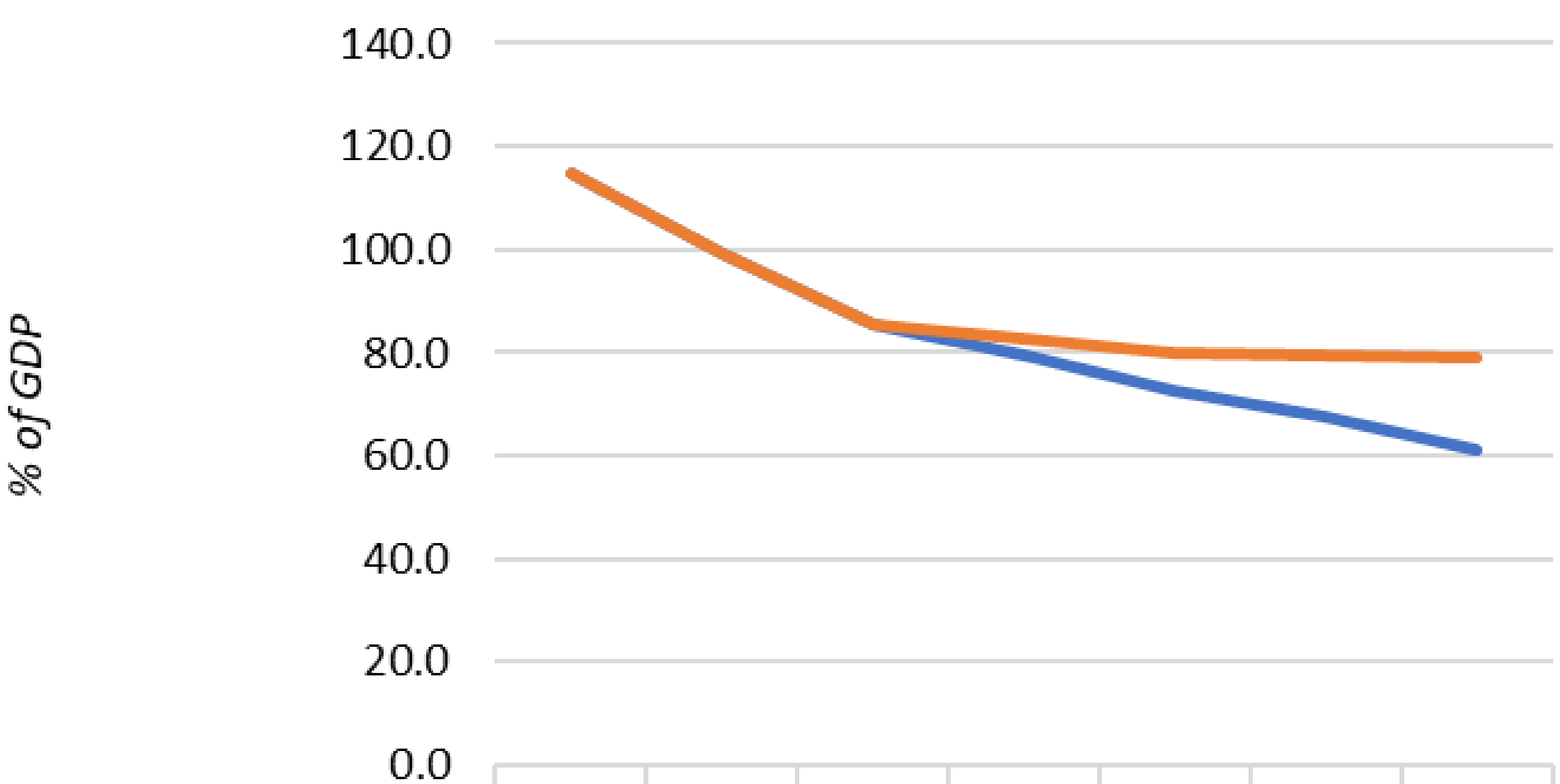
MINISTRY OF FINANCE

DEBT SUSTAINABILITY ANALYSIS

- LOWER GROWTH SCENARIO

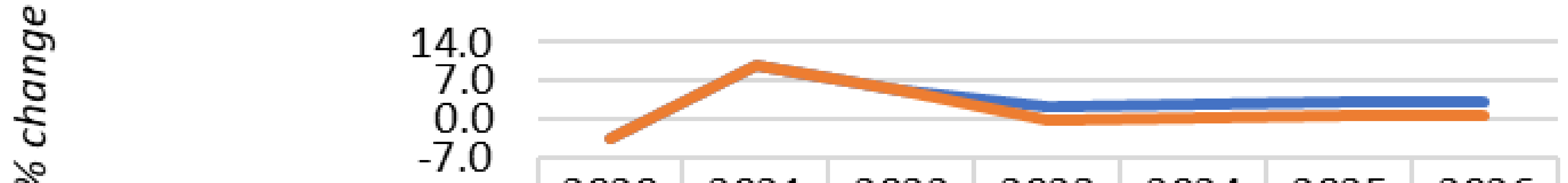
Under the lower growth scenario the debt ratio projects a sustainable path over the medium term, reaching 78.9% by 2026, exhibiting a deviation of about 17.8 percentage points of GDP compared to the projected outcome under the baseline scenario, as a result of the negative growth rates which were recorded during 2013-2014 and in 2020.

Debt-to-GDP trajectory



	2020	2021	2022	2023	2024	2025	2026
Baseline scenario	114.9	99.3	85.6	79.4	72.5	67.4	61.1
Lower growth scenario	114.9	99.3	85.6	82.5	79.7	79.6	78.9

Real GDP growth trajectory



	2020	2021	2022	2023	2024	2025	2026
Baseline scenario	-3.4	9.9	5.1	2.4	2.9	3.1	3.2
Lower growth scenario	-3.4	9.9	5.1	-0.2	0.3	0.5	0.6

Primary balance trajectory

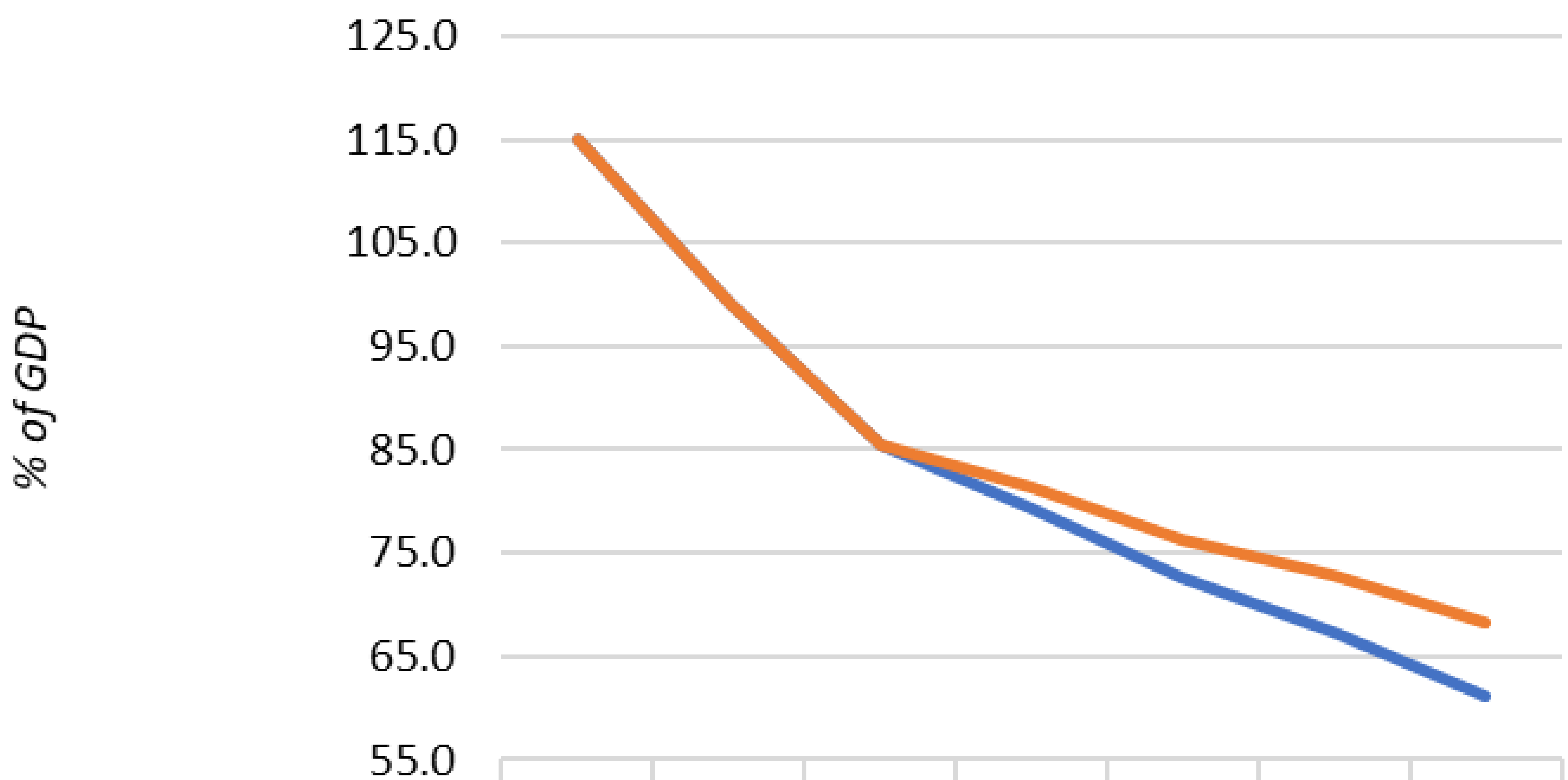
	2020	2021	2022	2023	2024	2025	2026
Baseline scenario	-3.6	-0.1	3.9	3.8	4.2	4.2	3.9
Lower growth scenario	-3.6	-0.1	3.9	2.7	2.1	1.0	-0.2

DEBT SUSTAINABILITY ANALYSIS

- LOWER PRIMARY BALANCE SCENARIO

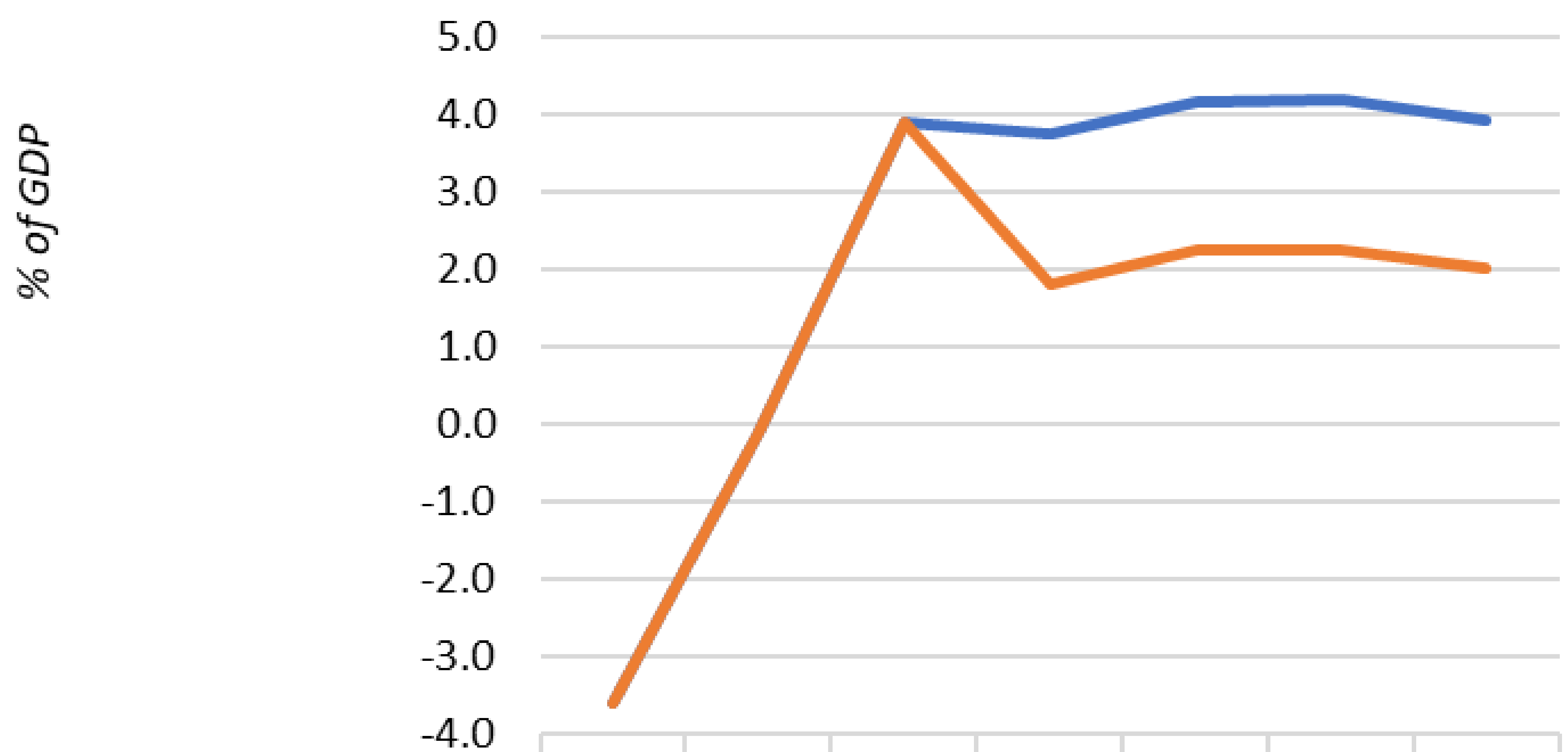
In the third scenario, primary balance as a percentage of GDP is reduced by half of the 10-year historical standard deviation for each year over the programming period. Under this scenario, even though the debt to GDP in 2026 is expected to be higher than in the baseline, there is still a downward trend, where debt ratio declines to 68.3% by 2026.

Debt-to-GDP trajectory



	2020	2021	2022	2023	2024	2025	2026
Baseline scenario	114.9	99.3	85.6	79.4	72.5	67.4	61.1
Lower primary balance scenario	114.9	99.3	85.6	81.3	76.2	72.9	68.3

Primary balance trajectory



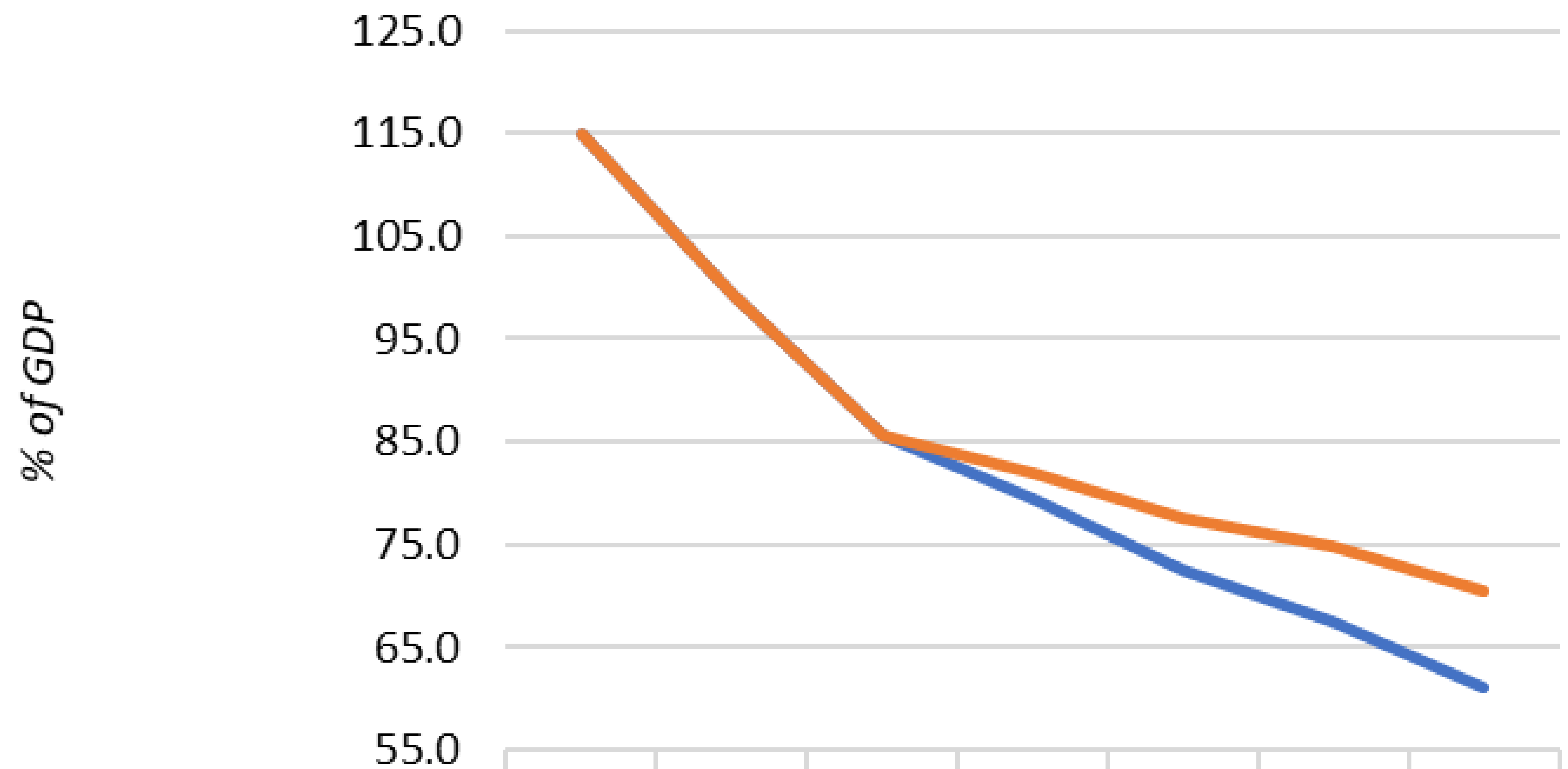
	2020	2021	2022	2023	2024	2025	2026
Baseline scenario	-3.6	-0.1	3.9	3.8	4.2	4.2	3.9
Lower primary balance scenario	-3.6	-0.1	3.9	1.8	2.2	2.2	2.0

DEBT SUSTAINABILITY ANALYSIS

- COMBINATION SCENARIO

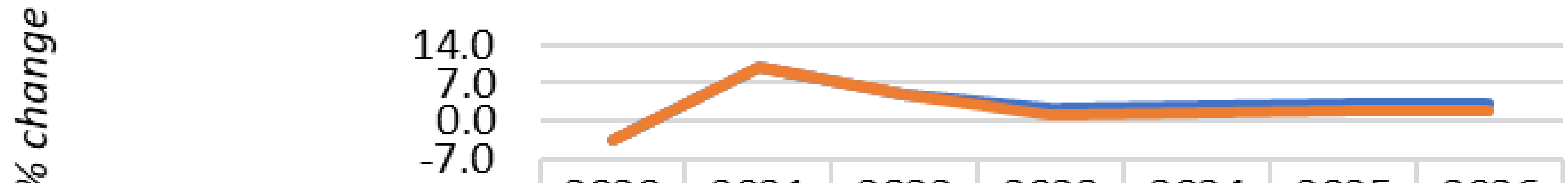
Under the combination scenario, it is assumed that shocks occur simultaneously on real interest rates, real growth and in primary balance, of the order of ¼ of their 10-year historical standard deviation. Under this scenario, even though the debt to GDP ratio in 2026 is expected to be higher than the baseline, there is still a downward trend, declining to 70.5% by 2026.

Debt-to-GDP trajectory



	2020	2021	2022	2023	2024	2025	2026
Baseline scenario	114.9	99.3	85.6	79.4	72.5	67.4	61.1
Combination scenario	114.9	99.3	85.6	81.9	77.5	74.7	70.5

Real GDP growth trajectory



	2020	2021	2022	2023	2024	2025	2026
Baseline scenario	-3.4	9.9	5.1	2.4	2.9	3.1	3.2
Combination scenario	-3.4	9.9	5.1	1.1	1.6	1.8	1.9

Primary balance trajectory

	2020	2021	2022	2023	2024	2025	2026
Baseline scenario	-3.6	-0.1	3.9	3.8	4.2	4.2	3.9
Combination scenario	-3.6	-0.1	3.9	2.8	3.2	3.2	2.9

Other Issues

- Energy Measures

- Resilience and Recovery Plan

-Tax Issues

- Risks to the Outlook

ENERGY MEASURES

A series of targeted and horizontal measures were taken from end-2021, to cushion the impact of the rising prices, with a negative impact of 0.6% of GDP on the accounts of the general government, in 2022 and in 2023, respectively (about €257 mn and €220 mn) .

The extension of part of these measures until end-June 2024, is estimated to impact the budget balance by -0.2% of GDP (-€88 mn) in 2024.

in % of GDP	**2021**	**2022**	**2023**	**2024**
Revenue Measures				
Reduction of excise duties on gasoline and diesel of 8.3 cents per litter for transport fuel and 6.4 cents per litter for heating fuel.	-	- 0.22	- 0.17	- 0.06
Reduction of the VAT rate (from 19% to 5% for the vulnerable consumers and to 9% for the rest of the households) on electricity consumption (terminated August 2022)	- 0.02	- 0.10	-	-
From early-May 2023 until end-April 2024 (initially decided until end-October 2023), a zero VAT rate is applied on basic goods, and more specifically on bread, milk, eggs, baby foods, baby and adult diapers, as well as female hygiene products. Sugar and coffee were added to the list as of November 2023	-	-	- 0.06	- 0.08
Expenditure Measures				
Support in crop production to cover part of employees' expenses, and support to livestock and agriculture sectors to cover part of price increases. The support covers partial refund of energy expenses.	-	0.06	-	-
The subsidisation will be covered in stages from 50% to 85% of the expected new increase in electricity tariffs, with the coverage reaching 100% for the vulnerable	-	0.17	0.27	0.08
Subsidisation of the electricity bills of consumers	-	0.02	-	-
Increase in subsidy of vulnerable beneficiaries for the plan for the installation of photovoltaic systems and roof thermal insulation.	-	0.01	0.03	-
The eligible vulnerable energy consumers are entitled to a higher grant for the schemes of the Ministry of Energy. Approximately 19,500 family units with annual gross income of up to €19,500 will be added to the list.	-	0.01	0.03	-
TOTAL impact on the accounts of the GG	**- 0.02**	**- 0.60**	**- 0.57**	**- 0.22**

RESILIENCE AND RECOVERY PLAN

Following the unprecedented crisis caused by the COVID-19 pandemic, Cyprus' Recovery and Resilience Plan (RRP) has responded to the urgent need to foster a strong recovery, while making Cyprus' economy and society more resilient and future ready.

The total budget of the CY RRP amounts to €1.22 bn, which will be financed through grants of €1.02 bn and additional funding of about €0.20 bn in the form of loan.

The pre-financing payment and the 1st payment have been disbursed in September 2021 and in December 2022, and amounted to €157 mn and €85 mn, respectively. In December 2023, Cyprus submitted its second payment request, which covers the second and third tranche of payments worth €152 mn in grants.

The next payment request is worth €89 mn and is expected to be submitted in July 2024.

TAX REFORM

In September 2023, the Ministry of Finance initiated an ambitious endeavor in holistically reforming the tax system in Cyprus; it is noted that the last tax reform took place almost two decades ago. The main axes of the tax reform are the broadening of the tax base, the increase of employment and competitiveness of the Cyprus economy, the promotion of innovation and the green transition as well as the fairer distribution of the tax burden, maintaining the sustainability of public finances, through a simplified tax system that reduces the administrative burden and the burden on taxpayers. The project is implemented in co-operation with the University of Cyprus and it is expected to be completed within 2025.

Broad public consultation took place at the enactment of the project, and further consultation will take place within the first quarter of 2024. All stakeholders may submit their view and suggestions throughout the project by sending their views to the dedicated website of the University of Cyprus.

Furthermore, the University team is currently working on best practices of other EU member and mapping of macroeconomic trends.

The aim of the tax reform is to be neutral in the context that it does not aim at raising additional revenue. The tax reform will contribute to the attractiveness of the Cyprus economy, expand the economic activity and redistribute the benefits to all households and the workforce through improved working conditions and renumerations.

CLIMATE - GREEN TAXATION

In the contest of the RRP commitments, Cyprus needs to implement a green tax reform in order to address serious climate changes and reduce carbon emissions. The RRP provides that the relevant legislation in order to implement the green tax reform (carbon tax, water levy and landfill tax) according to RRP it should have been in place by 1st quarter of 2024. It is planned to be implemented by 3rd quarter of 2024.

The relevant draft legal instruments have been sent for consultation to the competent departments/ministries and some of them have already been forwarded for legal drafting.

The fiscally neutral Green Tax Reform will mainly affect low-income and vulnerable households and compensatory measures are being designed to alleviate this burden.

RISKS TO THE OUTLOOK

Fiscal side

- The continuation of inflationary pressures, mainly due to the increase in fuel and energy prices, may increase the expenditure of intermediate consumption and investment though construction projects (due to the increase in the cost of raw materials).
- Excessive costs that may arise from the increased flow of immigrants.
- Continuation or imposition of new sanctions on Russia and Belarus, with direct and indirect effects on the European economy, including the Cypriot economy and primarily the service sector.
- Burden on public finances by the National Health Service mainly through the need to finance the deficits of the National Health Service for a longer period of time than the period that has been determined by the relevant legislation.

Macro side

- Russia’s war on Ukraine and sanctions
- Israel-Hamas war
- Banking sector (sector consolidation, NPL portfolio sales) +/-
- Adverse developments in the external environment
- Confidence effects +/-
- Oil and gas developments constitute an upside risk
- Geopolitical development an upside risk

Thank you

MINISTRY OF FINANCE