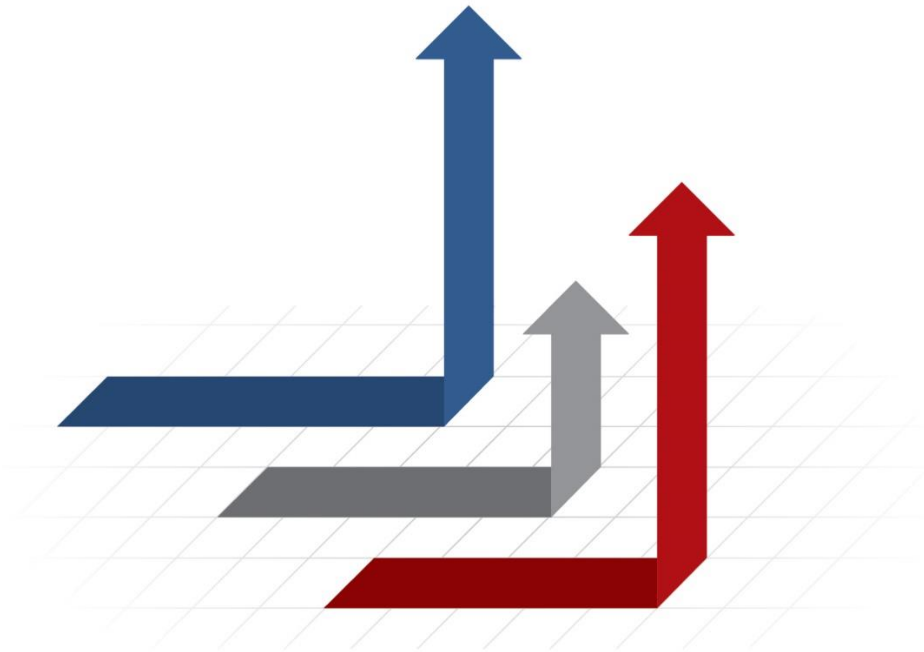
MINISTRY OF FINANCE

STABILITY PROGRAMME UPDATE 2022-2025



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CONTENTS

PREFACE ... 3

CHAPTER 1: OVERALL POLICY FRAMEWORK AND OBJECTIVES ... 4

1.1 Policy Strategy ... 5

1.2 Macroeconomic, budgetary and debt prospects ... 6

CHAPTER 2: ECONOMIC OUTLOOK ... 9

2.1 Macroeconomic Developments 2021 ... 9

2.1.1 Global economy ... 9

2.1.2 Domestic economy ... 10

2.1.3 Financial sector developments ... 15

2.2 Macroeconomic outlook 2022-2025 ... 19

2.2.1 GDP prospects 2022-2025 ... 19

2.2.2 Price developments ... 26

2.2.3 Risks to economic outlook ... 27

CHAPTER 3: GENERAL GOVERNMENT BALANCE AND DEBT ... 28

3.1 Policy Strategy ... 28

3.2 General Government Balance 2021 ... 28

3.3 Budget 2022 ... 30

3.4 Medium-Term Budget Balance 2022-2025 ... 32

3.5 Medium Term Objective ... 33

3.6 General Government Debt ... 34

CHAPTER 4: SENSITIVITY ANALYSIS OF THE GENERAL GOVERNMENT BALANCE AND DEBT ... 39

CHAPTER 5: SUSTAINABILITY OF PUBLIC FINANCES ... 42

APPENDIX: STABILITY TABLES ... 44

PREFACE

In accordance with the provisions of the Stability and Growth Pact (SGP), the Republic of Cyprus submits its Stability Programme (SP) for the period 2022-2025 as approved by the Council of Ministers on 20th April 2022. The SP has been prepared in line with the updated Code of Conduct, which sets out the “Guidelines on the format and content of the Stability and Convergence Programmes”. The SP was submitted to the European Commission on 2nd May 2022 in accordance with the requirements of the European Semester and takes into account the key policy orientations provided in the Annual Sustainable Growth Survey.

The SP shall be considered as the national medium-term fiscal plan in the sense of Regulation 473/2013 and should be read in conjunction with the National Reform Programme (NRP), and sets out a broad range of structural reform measures and national targets within the context of the EU2020 strategy.

In this context, the budgetary developments and targets in the SP are consistent with the structural reforms and policy ambitions set out in the NRP. The same holds for the macroeconomic outlook. Inevitably, this leads to a certain degree of overlap between the two documents. The SP elaborates in much greater detail on the macroeconomic outlook and budgetary plan, while the NRP mostly focuses on the various policy measures and reforms in the framework of the priorities of the EU2020 strategy. Where appropriate, cross references are included in both documents.

The analysis and forecasts contained in this document are based on data available at end- March 2022. The macroeconomic forecasts contained herein have been endorsed by the Fiscal Council.

CHAPTER 1: OVERALL POLICY FRAMEWORK AND OBJECTIVES

The structure and content of this Stability Programme follows the requirements of the Code of Conduct and presents the macroeconomic and budgetary outlook for the forecasting horizon 2022-2025, taking into account the application of the general escape clause of the SGP in 2022 that has been in activation since 20th March 2020.

During 2021, the restriction measures for the containment of Covid-19 were far less strict, allowing the restart of most of the economic sectors of the economy, aided by better international travel conditions, following the guidelines issued by the ECDC country categorization. The government implemented a targeted economic support package of €0.7 billion or 3% of GDP (€0.1 billion of which were allocated for health expenditure), with particular emphasis on the hospitality industry, including hotels and restaurants and other related enterprises, organizers of conferences and trade fairs, event organizers, companies related to the performing arts and their supporting activities, other economic activities affected by remaining restrictions such as gyms and dance schools, theme parks and other activities related to the art and entertainment industry. The support measures consisted of employee furlough schemes and direct financial support to companies aimed at supporting coverage of operating costs.

The end of 2021 proved more challenging with the prevalence of the Omicron variant in the community that lead to a significant surge of Covid-19 cases that were not, however, matched with an analogous increase in hospitalisations, mortality or uncontrollable pressure on the health system. Some limited restrictive measures were introduced in December 2021 but have since been nearly completely abolished. Meanwhile, the vaccination coverage of the population is progressing well with 74.1% of the general population (cumulative uptake of full vaccination) having been vaccinated by mid-April 2022. The support of the economy for Covid-19 related issues continues, with an envisaged support package of €0.2 billion, including health expenditures, interest subsidies and some small-sized measures for targeted economic activities.

The return to growth was indeed strong in 2022, with real GDP growth reaching 5.5% compared to an average of 5.3% in the EU27 and the Euro area. In the last Stability Programme Update 2019-2024, strong growth was expected to continue going forward in 2022. However, economic conditions in 2022 are proving even more challenging with the onset of the Russian invasion in Ukraine at the beginning of the year.

Even before the onset of the Russian – Ukraine war and despite the more favourable prospects, economic conditions were affected by the onset of an increase in inflation in late 2021 and problems in supply chains as an aftermath of the pandemic. The increase in inflation in 2021, attributed mainly to increases in the price of energy, was initially viewed as temporary, albeit more persistent than expected, due to factors such as base effect, supply bottlenecks and supply-demand shifts.

However, the Russian war in Ukraine brought about an increase in long-term inflation expectations. The war has accelerated price increases in raw materials such as energy, metals, and agricultural products for which Russia and Ukraine are important suppliers for the global economy. The inflation developments, along with the effects of the economic and financial sanctions imposed on Russia by Europe and the US, raise concerns of potential stagflation over the course of the year. Overall, uncertainty surrounding short and medium term growth forecasts is indeed quite high and will remain so as long as the military conflict continues.

In Cyprus, the economic effects of the Russian-Ukraine war are expected to be limited on effects in the tourism sector and inflation increases. Other transmission mechanisms, such as through the financial system are weak

and growth prospects remain positive for 2022. In this Stability Programme update, real GDP growth for the Cyprus economy is forecast at 2.7% in 2022 (compared to 3.8% in the last Stability Programme Update and 4% in the Draft Budgetary Plan 2022), 3.8% in 2023, 3.4% in 2024 and 3.0% in 2025.

The macroeconomic and fiscal forecasts underlying this Programme have been submitted to the Fiscal Council for endorsement and the Council concluded that the headline GDP and budget balance figures as forecast by the Ministry of Finance are considered realistic for the programming period under consideration.

1.1 Policy Strategy

The overall objective of the fiscal policy strategy outlined in this Stability Programme is to support economic growth, in line with the Council recommendations of June 2021 while maintaining fiscal sustainability through a sound fiscal position in the medium term and reducing public debt as a percentage of GDP in a sustainable manner. The focus of the government strategy is driven by the implementation of the National Recovery and Resilience Programme (RRP), which encompasses the main national policies for sustainable growth and competitiveness enhancement. The RRP is fully reflected in the Long-Term Growth Strategy for Cyprus, or "Vision 2035", proposed by the Cyprus Economy and Competitiveness Council. The implementation of the RRP is well underway with all structures already in place. The authorities will be submitting the first payment request, consisting of 14 milestones, soon.

The uncertainty introduced by the recent geopolitical events requires to keep a vigilant stance. The full impact of the Russian-Ukraine war cannot be fully estimated at this point, but it is worth noting that the government has already taken measures to alleviate the impact of the increase in energy prices for households and companies, that in Cyprus are driven by the developments in oil prices.

The increase in energy prices at this particular juncture poses a significant challenge for economic policy makers, in relation to the green strategy agenda. The Fit-for-55 package of the European Commission that is currently being discussed at EU level has at its core the vision of Europe to reduce CO2 emissions by 55% by 2030, compared to the 1990 levels, and become the first carbon-neutral continent by 2050. Cyprus is a strong advocate for decarbonisation and the recent events have highlighted the need to disassociate economic growth from fossil fuel consumption. At the same time, a thorough impact analysis is needed, in order to assess the economic repercussions and prepare Member States to weather adverse short and medium term impacts that will affect potential growth and at the same time design effective transition policies that will span over an adequate time-horizon to adequately address the fiscal impact of the transition and the socio-economic and re-distributive impacts.

It is noted that the Ministry of Finance is in the process of developing its own green budgeting methodology, envisaged to be first implemented with 2023 Budget.

Long term strategy

The need to establish a long-term strategy and strengthen the resilience and viability of the Cypriot economy was identified by the Cyprus Economy and Competitiveness Council (Ecompet), which, with the consent of the Minister of Finance, commissioned the preparation of the Long-Term Growth Strategy for Cyprus, or "Vision 2035", with funding provided by the European Commission.

The main goal is to formulate a comprehensive Strategy for revamping the growth model of Cyprus for the next 15 years. The transition to a new, modern economic model aims at the long-term viability, competitiveness and resilience of the economy and at maximizing the well-being of the citizens of Cyprus. Resilience will be achieved through diversification, by widening the economy's productive base so that the top five sectors' combined contribution to the country's GDP growth will not exceed 50%, while the strategy aims to increase the economic potential and improve distortions such as the trade deficit stemming from Cyprus' reliance on imports. In summer 2021, a public consultation was held where the vision and the strategic framework for its achievement were presented. The Strategy is expected to be approved by the Council of Ministers in the next couple of months and will be implemented mainly through the Ministries/Deputy Ministries Strategic Plans.

The Strategy consists of 3 pillars and 13 Strategic Objectives:

(a) A model nation worldwide: (i) With an effective state mechanism, (ii) With an effective judicial system that resolves disputes quickly, (iii) With an open, transparent and fair market for domestic and foreign companies, and (iv) Able to shape its future.

(b) A thriving and resilient economy: (i) With high and rising levels of productivity, (ii) With an innovation dynamic, (iii) Supporting digitization, (iv) a greener economy and (v) sustainable and more resilient

(c) A just and inclusive society: (i) A world-class education system; (ii) An excellent and accessible healthcare system; (iii) which adheres to the rule of law and combats corruption and (iv) promotes liveability, equal access and opportunities for all.

The strategic objectives will be achieved through the implementation of over 300 horizontal and Sectoral (vertical) actions which contribute to the achievement of the "Vision 2035".

Ecompet used a multi-criteria analysis to identify the sub-sectors that can become the growth drivers in Cyprus, namely higher education, renewable energy sources, agri-tech, agrotourism, health and wellness tourism, light manufacturing, professional services and the fields of technology, information and communications.

The Resilience and Recovery Plan's objective are fully aligned with the Long-Term Strategy and will pave the way for its implementation.

1.2 Macroeconomic, budgetary and debt prospects

Output Growth Developments

Real output in 2021 increased by 5.5% in real terms, as opposed to a decrease of 5% in 2020. The positive GDP growth in 2021 from the expenditure side was mainly driven by higher exports and by private and public consumption. Private consumption increased by 3.7% in real terms, government consumption recorded an increase of 8.4%. Gross fixed capital formation was affected by decreases in transport equipment and dwellings and recorded a decrease of 6.3%. Imports in real terms increased at a rate of 9.5% following the increase in private consumption, and exports, in real terms, increased significantly at a rate of 13.4% reflecting the significant increase in tourist arrivals.

The medium-term baseline scenario presented in this Stability Programme projects that the economy will present a slowdown in 2022 due to the Russian-Ukraine conflict, turning to recovery trajectory again from 2023 onwards. Real GDP growth is forecast at 2.7% in 2022, 3.8% in 2023, 3.4% in 2024 and 3.0% in 2025. This year's forecasting profile carries a high degree of uncertainty due to the invasion of Russia in Ukraine and the sanctions imposed on Russia and Belarus by the EU. Growth in 2022 will be supported by domestic demand, private and government consumption and reinforced by the implementation of a significant number of projects included in the National Resilience and Recovery Plan and the European Structural and Investment Funds (2021-2027) which will have an impact on growth in the period 2022-2025.

Budgetary and Debt Developments

From early 2020, the government's attention was on safeguarding?? the economy from the outbreak of the Covid-19 pandemic crisis by alleviating its effects on economic metrics and on society, while reinforcing the ability of the health system to respond to the increased demand. During 2020 the government introduced a series of measures with a direct and indirect impact on the accounts of the general government of about -3.6% of GDP in total. In 2021, the continuation of the pandemic provided the need for the extension of some of these Covid-related measures, which impacted the accounts of the general government by about -3.1% of GDP.

The overall objective of the fiscal policy strategy outlined in this Stability Programme is to support economic growth, in line with the Council Recommendations of June 2021, while maintaining fiscal sustainability through a sound fiscal position in the medium term and reducing public debt as a percentage of GDP in a sustainable manner. The focus of the government strategy is driven by the implementation of the National Reform and Resilience Programme (RRP), which encompasses the main national policies for sustainable growth and competitiveness enhancement.

The uncertainty introduced by the recent geopolitical events requires to keep a vigilant stance. The full impact of the Russian-Ukraine war cannot be fully estimated at this point, especially while the conflict is still ongoing, although the effects through inflation and the economic sanctions are already evident and have been factored into the medium term projections and policies of the government.

The budget balance during 2021 remained in deficit of 2.1% of GDP, recording a substantial improvement compared to a deficit of 5.8% of GDP in 2020. The presence of a deficit in the accounts of the general government, despite the rebound of the economy, which recorded a positive rate of growth of 5.5% in real terms during the year under review surpassing already pre-pandemic levels, was due to the impact of the government's measures of a one-off nature undertaken to tackle the effects of the COVID-19 outbreak, mainly targeting health, businesses and employment positions. In nominal terms, the deficit in the accounts of the general government reached €495 million in 2021 compared to a deficit of €1,244.5 million the year before. Primary deficit decreased to €62.3 million in 2021 (-0.3% of GDP) compared to a primary deficit of €785.9 million (3.6% of GDP) in 2020.

In 2022, the budget balance is expected to record further improvement during 2022 reaching a budget balance, taking into account the withdrawal of the majority of the measures related to the pandemic, which negatively impacted the accounts of the general government by 3.1 percentage points of GDP. The primary balance is forecast to turn positive during 2022, reaching 1.6% of GDP.

Taking into account the baseline macroeconomic scenario, and after three continuous years of budget deficits, it is expected that the budget position will improve further from 2022 onwards reaching a surplus of about 1.3% of GDP by the end of the programming period, allowing debt-to-GDP ratio to continue its downward path over 2022-2025 at a satisfactory pace.

At the end of 2021, the General Government public debt stood at approximately 103.9% compared to 115% the year before. The reduction of the debt to GDP was attributed to increase of the GDP and the utilization of a significant amount of cash reserves to cover a part of gross financing needs in 2021.

By the end of 2022, the general government debt is projected at €23.5 billion or as a percentage of GDP at 93.9%. The expected reduction of general government debt by 10.1 percentage points is attributed to the repayment of a significant amount of debt due within the year which is expected to be covered both through new debt issuances as well as through the utilisation of the cash buffer. During the programming period 2023-2025, debt-to-GDP ratio is projected to continue its downward trend declining to about 88.2%, 81% and 76.7% by year end 2023, 2024 and 2025 respectively.

CHAPTER 2: ECONOMIC OUTLOOK

2.1 Macroeconomic Developments 2021

2.1.1 Global economy

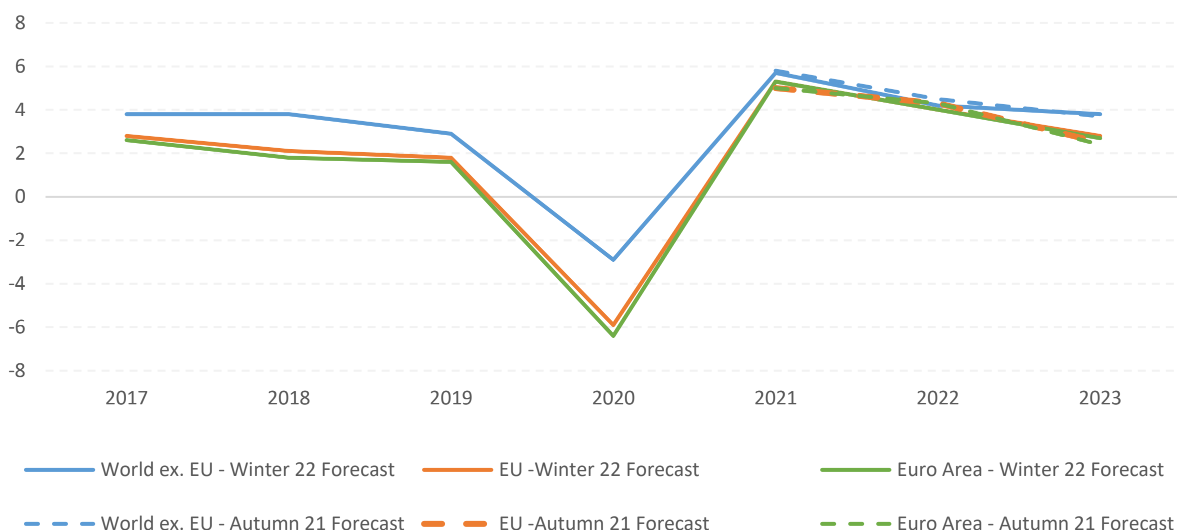
According to the European Commission Winter Forecast 2022, the world economy (excluding the EU) expanded by an estimated 5.7% in 2021, compared to a contraction of 2.9% in 2020.

The expansion was largely due to the rapid recovery of China and the US. The majority of advanced and emerging economies remained below their pre-pandemic output levels. Covid-19 Pandemic continued throughout 2021, with the spread of the Delta variant and the emergence of the more-transmittable Omicron variant in the final quarter of 2021. The vaccination coverage increased with over 55% of global population having received at least one dose, although the distribution is uneven. Restrictive measures differed between countries, with China imposing a zero-tolerance Covid-19 policy and US pursuing a much more moderate stance.

Economic expansion in the EU and the Euro area was strong in 2021, estimated at 5.3%, compared to a contraction in 2020 of 5.9% in the EU and 6.4% in the Euro area. The EU economy regained most of its lost output within the first six months of 2021, however the spread of COVID-19 Omicron variant in the second half of 2021 led to the reinstatement of restrictive measures, absences from work and continued disruptions in supply chains, consequently weighing down on growth.

Within the European Union, the 2021 recovery was more prominent in Ireland - the only EU country that recorded growth in 2020 - (13.5%), Croatia (10.4%), Malta (9.4%), Greece (8.3%), Estonia (8.3%), Slovenia (8.1%), Hungary (7.1%), and France (7.0%). In contrast, in Germany, Slovakia, Czech Republic and Finland, the recovery was contained at 2.9%, 3.0%, 3.3% and 3.5% in real terms.

Figure 1: Real GDP growth, World (excl. EU), EU and the Euro area, 2017-2023 (European Commission Winter Forecast 2022 and Autumn Forecast 2021)



According to the European Commission Winter Forecast 2022, inflation has been increasing sharply since the start of 2021, particularly in advanced economies. In emerging markets, inflation has also picked up but with the increase being less pronounced. In China, the producer price index (PPI) increased sharply during 2021, due to rising prices of energy and metals, but inflation remains contained since the pass-through to consumer prices is low. Regarding other emerging market economies, the rising prices in food and energy (for example Russia, Mexico, Brazil and India) have contributed to higher inflation. In some of these countries, most notably in Turkey, these developments have been accompanied by the Turkish Lira depreciation.

Inflation in the EU, as measured by the Harmonised Index of Consumer Prices, increased to 2.9% in 2021 and in the Euro area rose to 2.6%, compared to 0.7% and 0.3% in 2020, respectively. The supply bottlenecks persisted throughout the year and the energy prices rose significantly towards the end of 2021. Inflation accelerated rapidly in the third quarter of 2021, mainly driven by high energy prices (Euro area energy inflation in December was 26%). The highest inflation rates were recorded in Poland (5.2%), Hungary (5.2%), Lithuania (4.6%), Estonia (4.5%) and Romania (4.1%). The European Central Bank maintained its base rate at -0.5% throughout 2021, on the background of temporary inflation pressures.

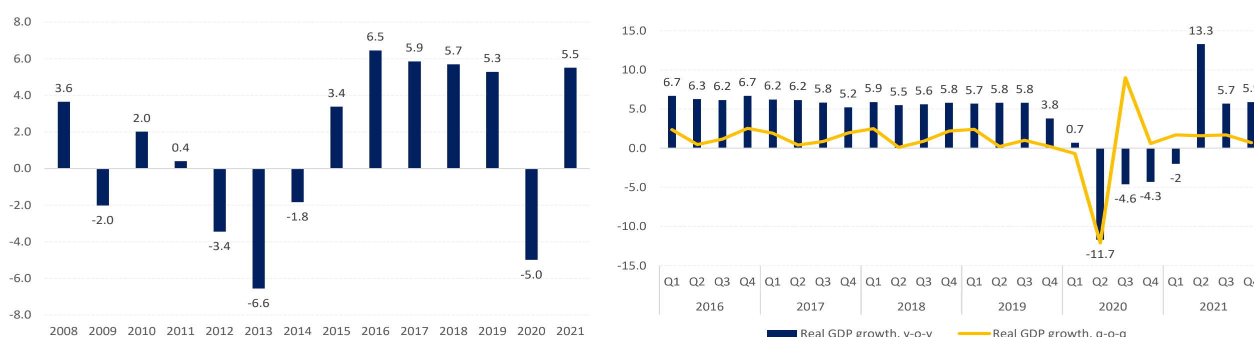
2.1.2 Domestic economy

Following the COVID-19 crisis in 2020, when the Cyprus economy recorded a contraction, in 2021 the economy recovered and returned to its pre-crisis levels. The GDP in 2021 increased by 5.5% in real terms, as opposed to a contraction of 5% in 2020 in real terms.

The positive GDP growth in 2021 from the expenditure side was mainly driven by higher exports and by private and public consumption. Private consumption increased by 3.7% in real terms, government consumption recorded an increase of 8.4%. Gross fixed capital formation was influenced by decreases in transport equipment and dwellings and recorded a decrease of 6.3%. Imports in real terms increased at a rate of 9.5% following the increase in private consumption, and exports, in real terms, increased significantly at a rate of 13.4% reflecting the significant increase in tourist arrivals.

On a quarterly basis, real output decreased by 2.0% in the first quarter of 2021, compared to the first quarter of 2020, reflecting the COVID restriction measures that were still on track, and recovering as of the second quarter. In the second quarter real GDP increased by 13.3% and in the third and fourth quarter by 5.7% and 5.9% respectively compared with the same quarters in the year before.

Figure 2: Real GDP growth, 2008-2021, annual % change

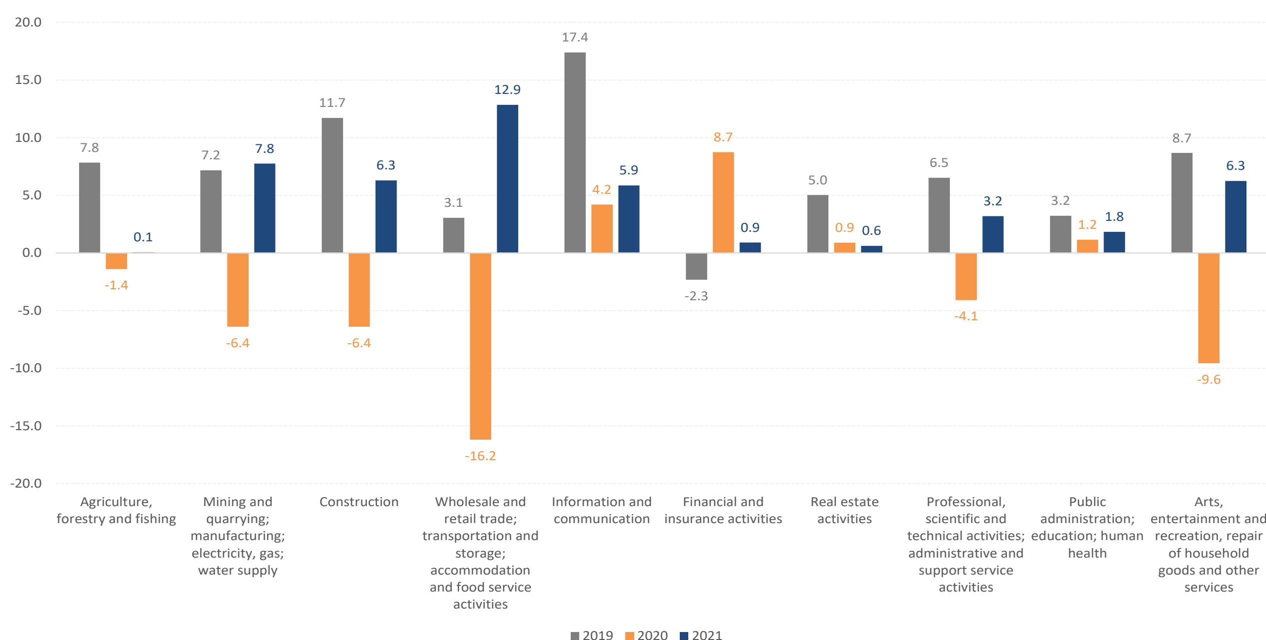


Source: CYSTAT

In 2020, the COVID crisis caused a massive external shock to the economy and its impact spread over several sectors of production. In 2021, following the gradual abolition of most restrictions (including travel restrictions), all sectors and in particular those that were affected by the crisis recovered significantly.

As seen in Figure 3, the improvement in value added was more pronounced in "Wholesale and retail trade; transportation and storage; accommodation and food service activities (12.9%), Mining and quarrying; manufacturing; electricity, gas; water supply (7.8%), Information and communication (5.9%), and Construction (6.3%) while on the remaining sectors was less pronounced. On sectors such as Financial and insurance activities (0.9%), Real estate activities (0.6%) and Agriculture, forestry and fishing (0.1%) the improvement was marginal.

Figure 3: GDP growth, production approach, 2019-2021, annual % change

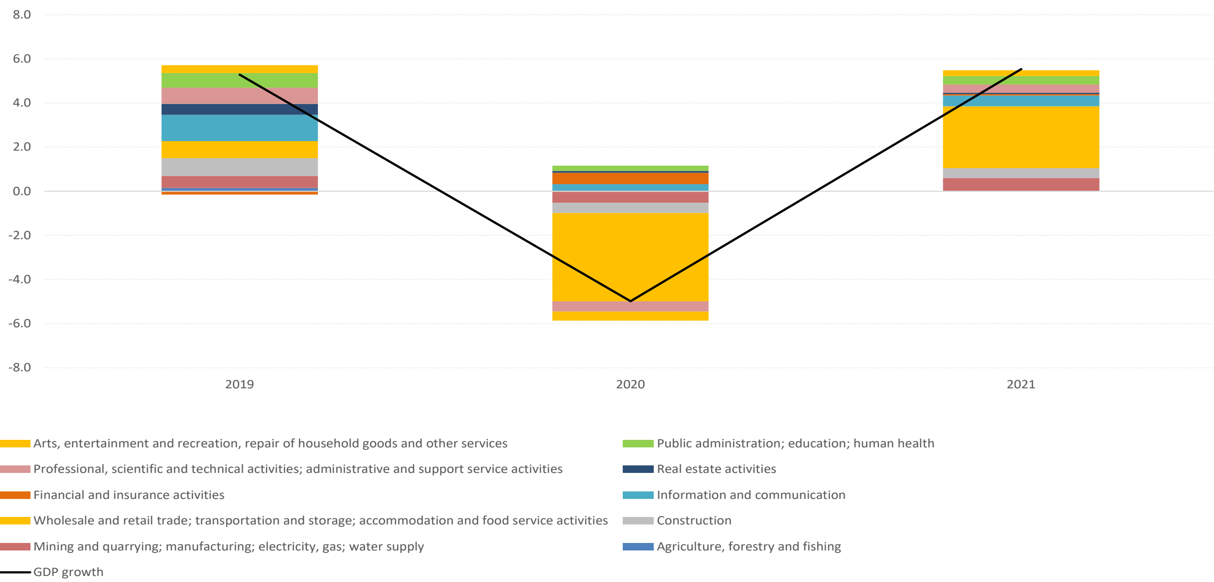


Source: CYSTAT

Value added increased in all sectors but it was most pronounced in the following six sectors: Accommodation and food service activities (37.9%) as a result of an increase of 286.1% in revenues from tourism, Wholesale and retail trade; repair of motor vehicles and motorcycles (6.3%), Transportation and storage (11.1%), Information and communication (5.9%), Construction (6.3%) and Manufacturing (6.8%).

The labour market in 2021 improved, following the negative effects of the pandemic in 2020 when employment in persons reduced marginally by 0.5% and more significantly by 6.4% in hours worked. These reductions were due to the support schemes put forward by the Ministry of Labour, Welfare and Social Insurance (MLWSI) which included the prohibition of lay-offs in the eligibility criteria to receive support, indicating that employers selected to avoid massive laying offs and kept the employees even though they had not been working as seen in the reduction of hours worked. This situation was reversed in 2021.

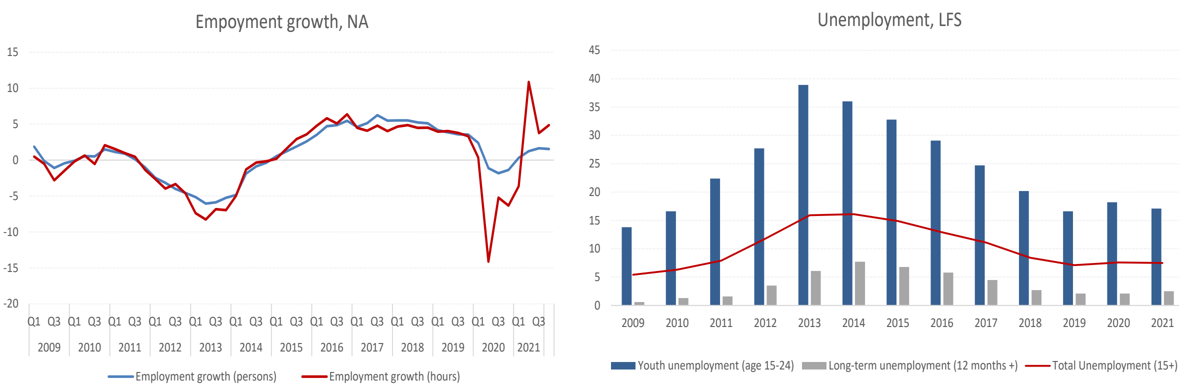
Figure 4: Sectoral contribution to growth 2019-2021, percentage points



Source: CYSTAT

Employment in 2021 increased by 1.2% in persons (5.292 persons) and by 3.8% in hours in comparison to 2020. Employment increase in terms of persons employed was significantly more prominent in the sector of Accommodation and Food service activities (3.3% or 1.595 persons) following by Education (2.7% or 847 persons), Construction (2.1% or 819 persons) and Information and Communication (4.3% or 627 persons). Smaller increases were recorded in the sectors Professional, scientific and technical activities (1.3% or 401 persons), Manufacturing (0.9% or 325 persons), Human health and social work activities (1.4% or 284 persons) and Public administration and Defence; compulsory social security (0.7% or 244 persons). In contrast, the sector Financial and Insurance activities recorded a decrease in persons employed by 1.5% (or 287 persons).

Figure 5: Labour market



Source: CYSTAT

The **unemployment rate** in 2021, as measured by the Labour Force Survey, averaged at 7.5%, recording a marginal decrease of 0.1 percentage points compared to the average of 2020. Youth unemployment averaged

at 17.1%, compared to 18.2% in 2020, while long-term unemployment averaged at 2.5%, compared to 2.1% in 2020.

The composition of unemployment indicates that youth and long-term unemployment still remain the major challenges of the labour market, but recording significant de-escalation since. Youth unemployment peaked in the 2nd quarter of 2013 reaching a rate of 40.3% of the labour force and pursued a downward path since then. Likewise, long-term unemployment peaked at 7.7% in 2014 and has been on a declining path since.

Compensation per employee increased in 2021 by 4.7%, compared to the preceding year, following a decrease of 3.2% in 2020. The increase in this ratio in 2021 reflects the significant reduction in 2020 due to wages subsidization schemes put forward by the MLWSI.

Labour productivity per person employed in 2021 increased by 4.3% due to the fact that employment in persons increased by 1.2% compared with the 5.5% increase in GDP. As a consequence, nominal unit labour costs increased in 2021 by 0.4%, following an increase of 1.4% in 2020, while real unit labour cost in 2021 decreased by 2.1% following an increase of 2.0% in 2020.

Table I: Selected economic indicators, 2019-2021, y-o-y %

	2019	2020	2021
GDP (constant prices)	5.3	-5.0	5.5
Public consumption	12.7	15.0	8.4
Private consumption	3.0	-5.0	3.7
Gross Fixed Capital Formation	2.9	0.0	-6.3
Exports	7.5	-5.1	13.4
Imports	8.3	-2.5	9.5
Tourist arrivals (000's)	3,976.8	631.6	1,936.9
Tourist arrivals growth	1.0	-84.1	206.7
HICP	0.5	-1.1	2.3
Labour productivity growth (persons)	1.4	-4.5	4.3
Employment growth	3.8	-0.5	1.2
Compensation per employee	4.4	-3.2	4.7

Source: CYSTAT

Inflation, as measured by the Harmonized Index of Consumer Prices (HICP), turned positive again and averaged at 2.3% in 2021 from a negative rate of 1.1% in 2020. Inflation is driven by developments in international oil prices, with a significant impact on domestic prices of energy products. For the period January-December 2021, compared to the corresponding period of the previous year, the largest change was noted in Transport (8.6%). The HICP, excluding energy and unprocessed food, in 2021 was 1%.

According to the preliminary Balance of Payments data for 2021, the current account balance of Cyprus recorded an improvement, with the deficit decreasing from €2,177.2 million (-10.1% of GDP) in 2020, to €1,695.8 million (-7.3% of GDP), in 2021. The reduction in the current account deficit resulted from the improved surplus in services (from €3,605.5 million to €4,542.7 million) and the lower deficit of the secondary income (from -€350.2 million to -€213.0 million). The aforementioned developments were partly offset by increased deficits in goods (from -€4,151.2 million to -€4,292.5 million) and primary income (from -€1,281.3

million to -€1,733.0 million). It is worth mentioning that the developments in the period under review continue to be affected by the COVID-19 pandemic.

Imports of goods remained consistently higher than exports. The trade deficit in 2021 increased, as the increase in imports (driven by general merchandise) outweighed the positive developments in exports (associated with an increase in exports of general merchandise, exports of movable equipment as well as merchandising).

In services, the increase in the surplus of services resulted almost entirely from the substantial increase in travel and, to a lesser extent, financial services. These developments were partially offset by the decrease in transport, telecommunications, computer and information services as well as other business services.

The widening in the deficit of primary income was mainly associated with the negative developments in direct investment income, which is linked with the improvement in the services surplus.

The shrinkage of the deficit of secondary income was mainly associated with an increase in the receipts of other sectors and an increase in funds received by the government from the EU. These were mitigated by an increase in the respective payments of other sectors and government.

Table II: Balance of Payments, 2008-2021

in % of GDP	**Goods Balance**	**Services Balance**	**Trade Balance**	**Income Balance**	**Current Account Balance**	**Current Account Balance (adj. for SPEs)**
2008	-30.1	17.4	-12.8	-2.0	-14.7	…
2009	-21.6	16.3	-5.3	-1.3	-6.7	…
2010	-24.1	15.7	-8.3	-2.4	-10.7	…
2011	-21.5	17.7	-3.8	1.5	-2.3	…
2012	-19.4	17.5	-1.9	-2.0	-3.9	…
2013	-17.7	19.3	1.6	-3.1	-1.5	…
2014	-18.8	19.8	0.9	-5.0	-4.1	-4.4
2015	-18.1	20.7	2.6	-3.1	-0.4	-1.0
2016	-22.0	23.7	1.7	-5.9	-4.2	-0.6
2017	-24.5	24.0	-0.5	-4.6	-5.1	-1.4
2018	-21.0	22.3	1.3	-5.3	-4.0	-3.1
2019	-20.1	20.3	0.2	-5.9	-5.7	-5.8
2020	-19.2	16.7	-2.5	-7.5	-10.1	-9.7
2021	-18.4	19.5	1.1	-8.3	-7.3	-8.6

Source: Central Bank of Cyprus

With the introduction of the ESA2010 and BMP6 statistical methods, total imports and exports of Cyprus include, among others, the economic transfer of mobile transport equipment and activities of Special Purpose Entities (SPEs). These transactions are not affected by domestic developments and, hence, do not have a real footprint on the economy. In order to present external statistics in a more objective manner, the main figures are also adjusted for the impact of SPEs, i.e., by classifying the said entities as non-residents.

The resulting deficit adjusted for the impact of SPEs, that is, classifying them as non-residents, stood at €2,014.3 million (-8.6% of GDP) in 2021, compared with a deficit of €2,092.4 million (-9.7% of GDP) in 2020.

The international investment position (IIP) recorded an improvement in 2021, presenting a net liability position of €28,786.8 million (123.3% of GDP), compared with a net liability position of €29,447.0 million (-136.2% of GDP) in 2020. This small improvement was due to the increase of all IIP categories (mainly portfolio investment and other investment), apart from direct investment which decreased and thus, restricted the above increases. In parallel, the slight improvement in the net international investment position in 2021 was driven by positive net exchange rate revaluations, net price changes and net other volume changes, which were partially offset by negative net transactions.

With the corresponding data being adjusted for the impact of SPEs, IIP recorded a net liability position of €10,150.0 million (43.5% of GDP) in 2021, compared with a net liability position of €10,839.5 million (50.1% of GDP), in 2020.

The gross external debt increased to €192,714.8 million in 2021 from €190,427.0 million in 2020. The external assets in debt instruments increased to €133,889.4 million, up from €124,963.0 million in 2020. Consequently, net external debt decreased by €6,638.6 million to €58,825.4 million, in 2021. The increase in the gross external debt resulted from a debt increase in all categories, with the most prominent increases recorded in Deposit-Taking Corporations (except the Central Bank), apart from intercompany lending which decreased and thus, restricted the above increases. The increase of external assets in debt instruments resulted from an increase in all categories, mainly by the Central Bank, Other Sectors and Intercompany Lending.

Adjusted for the impact of SPEs, gross external debt reached €68,271.0 million in 2021, compared to €61,395.8 million, in 2020. The corresponding net external debt indicator increased to -€3,730.1 million in 2021, compared with -€946.2 million in 2020.

2.1.3 Financial sector developments

Banks have to date fared the pandemic impact on the economy fairly well. While the comfortable capital and liquidity positions provide some comfort, banks continue to face challenges as regards their profitability and cost rigidity. The asset quality has improved further reaching a new record low level.

Banking sector overview

The banking sector increased by €7 billion in terms of assets over 2021 owing to Eurosystem market operations undertaken by the largest Cypriot banks. As a proportion to GDP the sector size increased from 273% to 287% over 2021. As the asset growth is attributed to cash this development is considered as carrying low risks. In terms of breakdown, banks have been generally following a shift towards less risky assets, namely cash and government bonds, which together make up about half of their balance sheet. Loans remain naturally the largest asset category at 42% of total assets, albeit being lower than the respective European average.

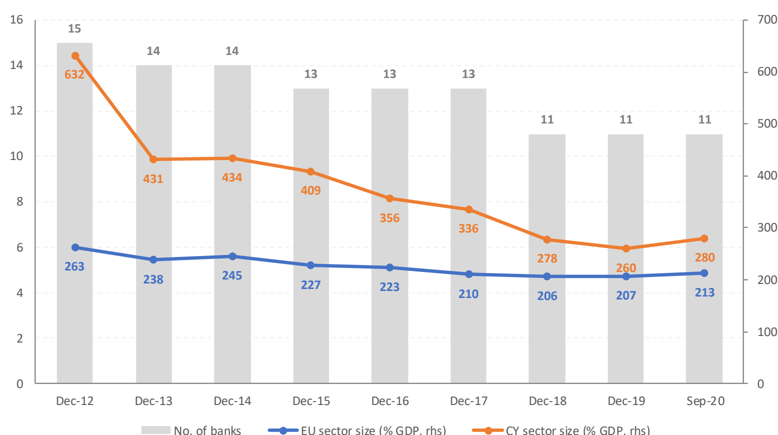
In March 2022 RCB Bank, the third largest bank in terms of asset size, announced the intention to give up its banking license, repay all deposits and convert to an asset management company as a result of geopolitical developments which had affected its business model and prospects. This development will consolidate further the banking sector in terms of both asset size and number of institutions. Moreover, given RCB Bank's non-resident loan stock, the Cypriot banking sector will be almost entirely domestically focused.

The banking sector remains well capitalised. The CET1 ratio reached 17.5% at end 2021 recording a small decrease compared to 17.7 % at end 2020, due to the phasing in of IFRS9. The solvency ratio increased slightly from 20.4% to 20.5%. following the issuance of a Tier II bond by Bank of Cyprus. While profitability improved

over 2021, due to lower loss provisioning, profitability remains a challenge, amidst a low-interest environment and cost rigidities.

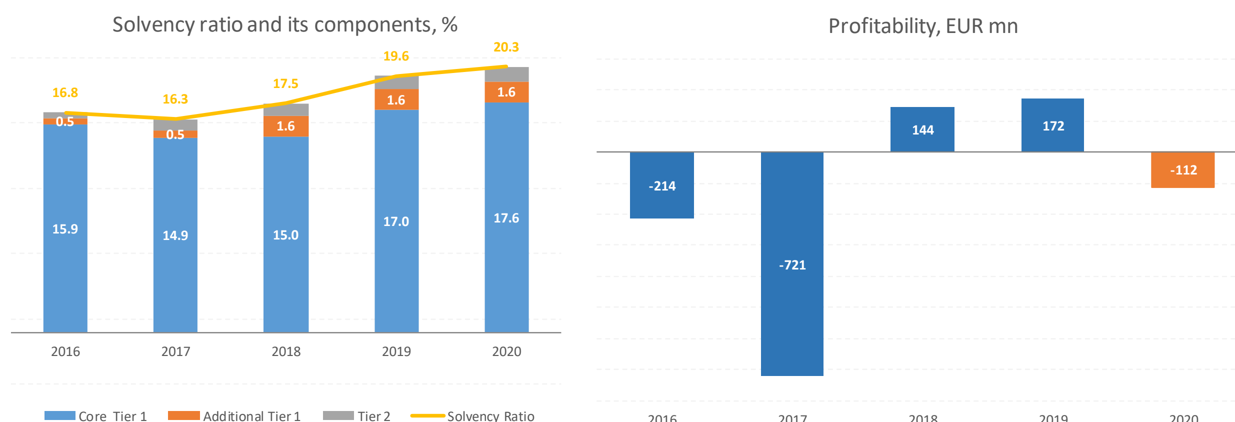
In terms of liquidity, Cypriot banks continue to maintain relative high buffers, with both Liquidity Coverage Ratio and Net Stable Funding Ratio considerably exceeding the regulatory minimum requirement. Liquidity is deposit-funded in Cyprus, with the share of other instruments, such as bonds, quite low. Household and corporate domestic deposits increased over 2021 as a result of both the growth in economic activity and precautionary buildup of savings. Non-resident deposits, despite recording small increases over 2021, maintained a share of 18% to total deposits, similar to end 2020 and lower over the previous years. Non-resident deposits are comprised of both Euro area and third country deposits. Total Euro area and third country household and corporate deposits at end 2021 were €2.8 billion and €6.4 billion respectively. Total deposits in the system of Russian households and corporates were €0.6 billion out of a total of €51.5 billion at end 2021.

Figure 6: Banking sector size



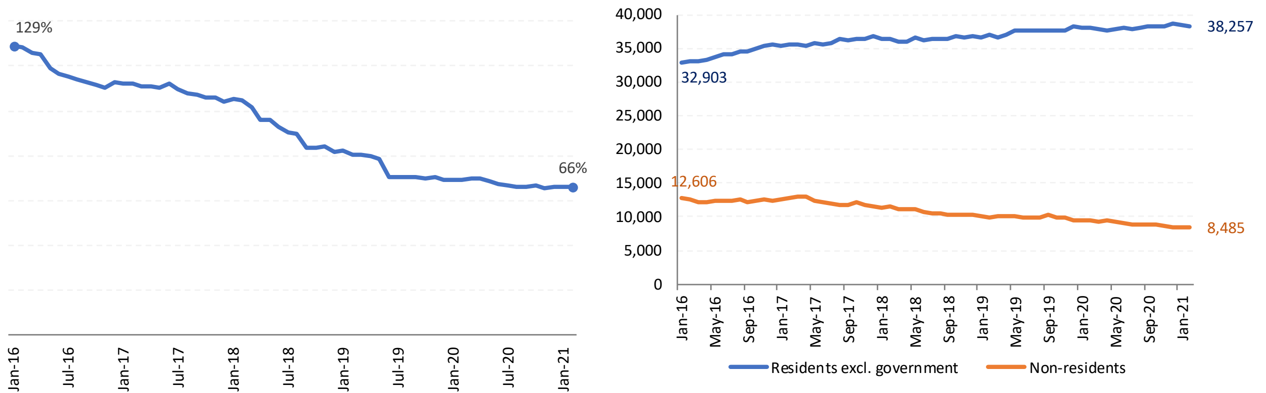
Source: Central Bank of Cyprus, ECB

Figure 7: Solvency and Profitability



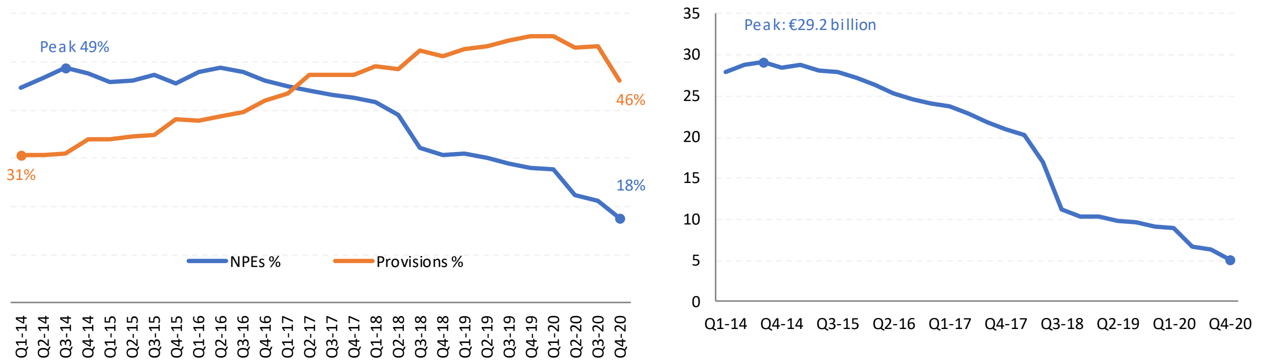
Source: Central Bank of Cyprus, ECB

Figure 8: Deposits



Source: Central Bank of Cyprus

Figure 9: Non performing loans



Source: Central Bank of Cyprus

Management of Non-Performing Loans

Non-performing loans (NPLs) declined from €5,3 billion to €3,0 billion between December 2020 and December 2021 as a result mainly of sales and write-offs. The NPL ratio declined from 18% to 11% respectively. Excluding the NPLs of third-country branches, for which risk lies with the parent entity, NPLs for locally authorised and subsidiary banks at end December 2021 were €2,6 billion or 9,8% of gross loans.

NPLs are now a small fraction of the peak of €29 billion portfolio in 2014, reaching the single-digit threshold for the first time since then. The continuous and steady progress on asset quality has been the result of collective efforts by all stakeholders and was achieved through the utilisation of various NPL management and resolution tools, regulatory reforms and supervisory actions.

As regards the potential for new NPLs, the pandemic has to date not caused significant new inflows of NPLs. Moreover, the fact that post loan installment moratorium, repayments have resumed with very low arrears and default rates is encouraging but further monitoring and pre-emptive restructurings by banks are essential.

Indeed, the Stage 2 loan population has increased by 34% from €2.9 to €3.8 billion between the two-year period of December 2019 and December 2021. Moreover, due to the ongoing geopolitical developments, which may impact certain sectors of the economy, new inflows of NPLs in the near future are a possible scenario.

The Ministry is examining the introduction of one more element in the current framework for the resolution of remaining NPLs which will address the socially sensitive segment of NPLs collateralised by the primary residence and SME primary business premise. The proposed government policy, namely a Mortgage to Rent Scheme, will be undertaken by the state-owned Kedipes, which currenltly manages the bad assets of the former Cyprus Cooperative Bank and is the largest asset manager in Cyprus. Under the Mortgage to Rent scheme, Kedipes will acquire on market terms primary residences or primary business premises which secure NPLs and rent these properties to debtors. Therefore the debtors would maintain occupancy of the property but not its ownership. In exchange, the outstanding debt would be written off.

The Ministry is currently working on addressing existing commitments for KEDIPES under the European Commission’s State Aid decision no. 34335 of 2018 before the potential launch of the Scheme.

Moreover, the Ministry has proposed further enhancement of the legal framework for NPL resolution with non-bank entities. The current proposal in the legislative framework concerns the access to the credit registry and land registry by credit servicers and credit acquirers. This would stregthen their resolution capabilitites, and address inefficiencies in the secondary loan market. The relevant bills have been the subject of parliamentary discussion since March 2021.

The legislative framework regarding NPL management has been enhanced throughout the years and includes a broad range of tools and reforms. The framework includes tools which directly reduce NPLs in banks’ balance sheets, mainly the possibility of loan sale to non-bank entities and the enforcement of collateral through foreclosures. Both of these tools have been widely utilized and have actively contributed to the positive evolution of NPLs to date. Other reforms have indirectly assisted in the NPL resolution such as the swift issuance of title deeds for legacy cases, and the introduction of an insolvency framework with debtor-friendly elements.

Non-bank financial sector

Since 2018 specialised **credit acquiring companies** have been established in Cyprus. There are 7 active credit acquiring companies managing bad loans of around €19 billion in contractual value in the economy. The largest credit acquirers are KEDIPES and Gordian Holdings, managing assets acquired from the former Cyprus Cooperative Bank and Bank of Cyprus respectively.

The **insurance sector** comprises 34 entities with total assets in Q3-2021 of €4.5 billion exhibiting an increase by 0,4 billion compared to end 2020. The majority of assets under management is invested in corporate bonds and collective investment schemes. The Solvency Ratio in Q3-2021 reached 292% similar to end 2020. Total underwritten insurance premia reached €832 million in the first nine months of 2021, of which about 62% in the non-life segment and 38% in the life segment.

Regarding **capital markets**, at the end of 2020 there were 788 supervised entities by Cyprus Securities and Exchange Committee exhibiting an increase compared to 746 supervised entities at the end of 2019, mostly in the fund management segment. The supervised entities were: 242 Cyprus Investment Firms (CIFs); 146

Administrative Service Providers (ASPs); 266 Fund Managers; 132 listed companies and 2 trading venues. Total employees with CIFs, ASPs and Fund Managers during 2020 were nearly 7300 persons or about one third of the total financial sector employees. The majority in the capital markets sub-sector, at about 74%, is employed at Cyprus Investment Firms.

- *Cyprus Investment Firms*

As per 2020 data there are 242 CIFs, remaining stable compared to the year before. The sector's asset size, as per 2020 data, is at €7,3 billion. The financial products offered are mostly forex, binary options and traditional products.

- *Fund management*

The total number of authorised management companies and undertakings in collective investments reached 266 at the end of 2020, from 210 at the end of 2019.

Assets under management reached €11.5 billion at the end of 2021 exhibiting an increase of nearly €3 billion compared to the end of the previous year. Of this, the largest share is managed under Alternative Investment Funds. In terms of investment location, about €2.6 billion of assets or 22% of the total are invested in Cyprus, mostly in private equity.

2.2 Macroeconomic outlook 2022-2025

2.2.1 GDP prospects 2022-2025

The medium-term baseline scenario presented in this Stability Programme projects that the economy will present a slowdown in 2022 due to the Russian-Ukraine conflict, following a rate of 5.5% in 2021, turning to recovery trajectory again from 2023 onwards. Real GDP growth is forecast at 2.7% in 2022, 3.8% in 2023, 3.4% in 2024 and 3.0% in 2025.

A high degree of uncertainty though is surrounding this year's forecasting profile due to the invasion of Russia in Ukraine and the sanctions imposed on Russia and Belarus. For Cyprus, Russia is a relatively significant trading partner in the export of services sector, especially tourism and the provision of business services. The current situation has also caused energy and commodities prices to increase to unusually high levels, which in in turn creates inflationary pressures as Cyprus is an oil dependent economy. Although not an importer of Russian oil, Cyprus is affected though by the increase in the international energy prices. The exact magnitude of the impact of the sanctions on the Cyprus economy will largely depend on their duration and extension, but also on new, stricter sanctions imposed by the US and the EU and countersanctions by Russia.

COVID presents a less significant threat at this point in time. Although the new variant Omicron spreads faster, it generally causes less severe disease than infection with prior variants. Furthermore, the vaccination rollout programmes continue and the daily infections in Cyprus have more or less stabilized.

Cyprus starts from a strong position in 2022 and growth will be supported by domestic demand, private and government consumption and reinforced by the implementation of a significant number of projects included in the Cyprus RRP which will have an impact on growth in the period 2022-2025. The growth forecast for 2022 has been revised downwards, compared to the projected 4% for 2022 in the DBP October 2021, due to the invasion of Russia in Ukraine with the related uncertainty of its duration and its economic

impact. This will mainly cause a slowdown in exports, which have picked up significantly in 2021 due to a better-than-expected performance in tourism. Imports are expected to increase in value due to higher oil and gas prices, but in real terms the increase will be moderate thus creating a small positive net exports component. A modest slowdown, in real terms, has been embedded in the forecast for private consumption, due to the resilience that this GDP component has exhibited in the past in relation to lower growth and imports in real terms.

For 2022 it is expected that tourist arrivals will remain at the levels reached in 2021, based on the assumption for replacing part of the lost Russian market from new tourist markets via new air connectivity routes and also from enhancing existing routes, due to the efforts exerted by the Deputy Ministry of Tourism. Furthermore, tourist arrivals are expected to be supported by higher per capita expenditure.

In the medium-term period 2023-2025, growth is forecast to gain pace and be robust. The macroeconomic environment is expected to gradually recover by the last quarter of 2022. Investment and domestic demand are expected to be the main drivers of growth, supported also by external demand. Consumption will continue to have a positive contribution to growth and remain strong after picking up in 2023 and afterwards increase at a lower pace, due to continue improving employment developments and better access to finance. Inflation is expected to return to lower levels thus improving households' disposable income and, thus, purchasing power.

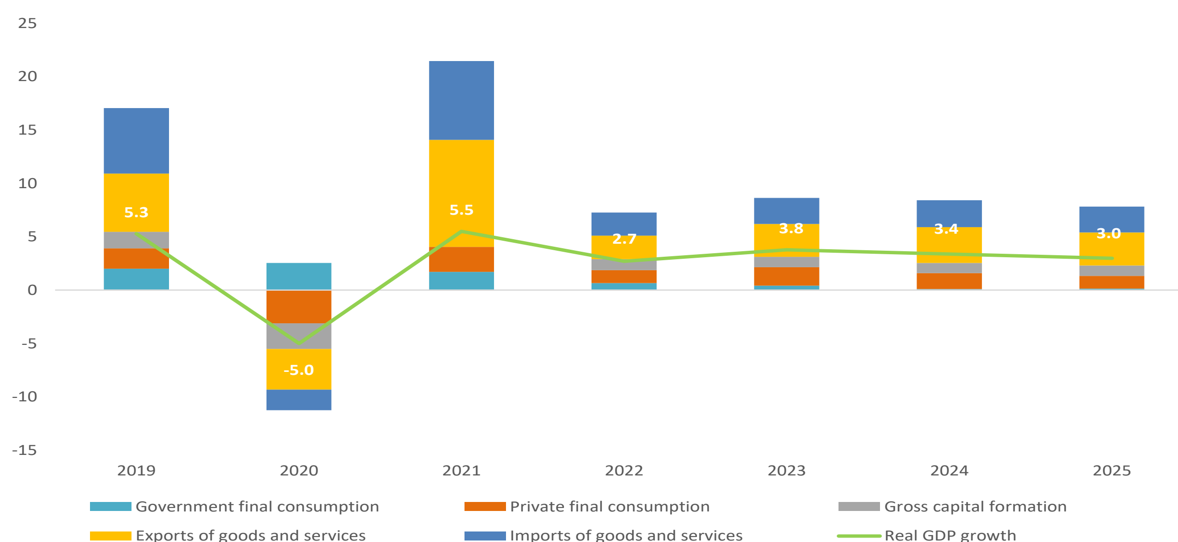
External demand from 2023 onwards will contribute more strongly to growth as tourism is forecast to gradually recover from the projected loss in 2022. Imports are expected to grow in line with consumption and investment. All of the above, combined with the improved confidence and expectations, especially regarding investment opportunities in the energy, education, ICT, innovation and health sectors, including the implementation of investments and reforms under the RRP[1], create a promising outlook for the prospects of the Cyprus economy. Real GDP growth is forecast to accelerate to about 3.8% in 2023. Thereafter, growth will decelerate to 3.4% in 2024 and 3.0% in 2025, years in which the tourism sector is envisaged to return to its 2019 levels. From a sectoral perspective, growth is expected to be broad based but will concentrated in the sectors of retail trade, shipping, construction, manufacturing, other business services sectors and, gradually, tourism.

Growth prospects in the construction sector are expected to be positive, despite the effects of the termination of the Cyprus Investment Programme (CIP) since October 2020, given that investments in real estate through the CIP were about 60% of total programme investments. However, the impact on GDP growth was estimated at around 0.4 p.p. on average during the period 2021-2023 (cumulative around 1.3 p.p.) but this is expected to fade out after 2023. The RRP related projects will compensate along the increased demand from the domestic sector and cover the gap, created by the termination of CIP, in 2022-2023.

Inflation, as measured by the CPI, is estimated to increase significantly in 2022 due to the high oil and gas prices exhibiting an increase of 4.5% and then projected to decelerate at 1.5% in 2023 and then hover around 2.0% in 2024-2025.

[1] According to CypERC (UCY) study on the impact of RRP to GDP, the RRP can increase the GDP of Cyprus by about 3% in the short-term and by around 7% in the medium-term, compared to the baseline development of the economy without the RRP.

Figure 10: Contribution to GDP growth 2019-2025, percentage point change



Source: CYSTAT, MOF

Table III: Medium Term Framework, 2021-2025

change in percent	**2021**	**2022**	**2023**	**2024**	**2025**
Real GDP	5.5	2.7	3.8	3.4	3.0
Government Consumption	8.4	3.1	2.0	0.5	0.7
Private Consumption	3.7	2.0	2.8	2.5	2.0
GFCF	-6.3	5.8	5.4	5.2	5.2
Exports	13.4	2.8	3.8	4.2	3.8
Imports	9.5	2.7	3.0	3.2	3.0
Deflator	2.4	4.5	1.5	2.0	2.0
Nominal GDP	8.0	7.4	5.3	5.5	5.0
HICP	2.3	4.1	1.5	2.0	2.0
CPI	2.5	4.5	1.5	2.0	2.0

Source: CYSTAT, MOF

The **current account (CA)** deficit has improved significantly in recent years, mostly due to a cyclical correction of the goods balance. In 2020 though, due to the COVID crisis, the deficit increased significantly to 10.1% of GDP. In 2021, following the improvement of the economy, the deficit decreased to 7.3% of GDP due to the improved surplus in services. **Over the medium-term, deficit is expected to decrease** but remain relatively high, along with the improvement in the trade balance and in particular export of services (tourism). Trade balance contributed positively in 2021 and is expected to continue to contribute positively during the whole forecasting period, to a lesser extent in 2022-2023 and a higher in 2024-2025 following the improvement in the tourism sector. The income account was relatively high in 2019-2021, especially in 2021 where it recorded almost €2 billion deficit and contributed negatively to the CA deficit. This trend is expected to continue but with a deceleration. The income account projection relies on the assumptions that the primary and secondary

income account balances will hover around last year's average levels, in absolute terms, with a small improvement in time, while ship registration/deregistration will remain at 2021 levels.

Box 1: Economic effects of the Russian invasion of Ukraine

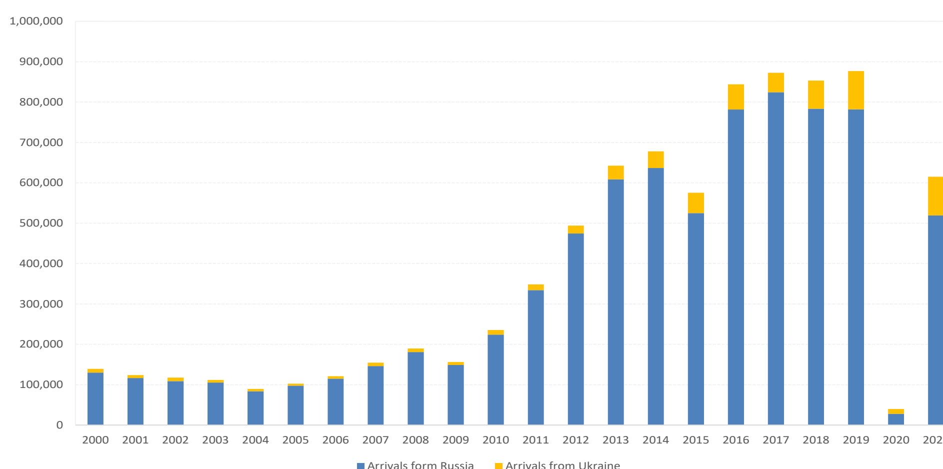
The onset of the war coincided with a period of increased energy prices that the EU has been experiencing as a result of the market disruptions due to the Covid-19 restrictions aftermath. Following the invasion of Russia in Ukraine, the EU responded with economic sanctions towards Russia that target specific economic sectors.

The impact of the war on commodity prices (oil, natural gas and other important materials), along with the impact of the economic sanctions, will differ across EU Member States and Cyprus' real economy may potentially be affected from this invasion via the following channels:

- Export of services including tourism and other services (transport, financial and other business services) in which Russia has a significant share.
- Imports of oil due to the high international oil prices (Cyprus' is highly oil dependant).
- Inflation in all commodities, including essential goods which affects consumption
- Supply chain disturbances and delays in shipments of raw and intermediate materials.
- Possible increase of interest rates and therefore borrowing cost (affecting investments and possible creation of new NPLs)
- Indirect effects via other EU countries (purchasing power of EU citizens, affects tourism from other destinations as well).
- Consumer and market confidence (Russia-phobia / Anti-Russian sentiment).
- Second round effects (i.e., price-wage spiral)

Of all possible channels mentioned above the major channels are two, tourism and inflation. On tourism, Russia has a significant share in total arrivals especially in recent years. From 2010 onwards, Russian tourist arrivals have been increasing and constitute now the 2nd largest tourist destination. On average, in the years 2015-2019 the share of Russian tourist arrivals to the total amounted to 21.3% and Ukrainian tourist arrivals to 1.9%. For 2022, around 1.6 million passengers were expected from Russia and Ukraine (1.3 and 0.3 million equivalently) which translates to 800.000 arrivals.

Figure B1: Tourist arrivals from Russia and Ukraine



Despite the fact that Russia is the second biggest market in arrivals, Russian citizens come not individually but mainly by organized tour operators and their per capita expenditure is not that high compared to visitors from other EU countries. Notably, their average daily expenditure (in total 69.8 euros and for packages 76.6 euros in 2019) is below the average daily (in total 75 euros and for packages around 92 euros in 2019). Countries like Switzerland and Israel for instance have their daily per capita expenditure close to 110 euros. This is the main reason why the actual impact of the lost Russian tourists on GDP becomes less as seen from the revenue side.

According to an estimate by the Statistical Service of Cyprus, the impact on the economy if there are zero arrivals from Russia and Ukraine in 2022, taking into accounts all related sectors, is only 0.6% in growth although in arrivals or revenues loss the effect appears much higher. And this is all else equal, i.e. does not include substitution from other markets or enhancement of the existing ones.

Out of the 800.000 arrivals lost, a part of them of around 200.000 - 300.000 can be replaced by other countries (Belgium, Switzerland, Scandinavia etc.) according to the efforts made by the Deputy Ministry of Tourism. In 2022 arrivals are expected to increase, with the worst case scenario being the same as in 2021. In 2021 arrivals from the UK were much lower than usual, but they are expected to pick up this year and with the addition of new destination markets and air connectivity, with higher per day expenditure, total revenues from tourism are expected to be higher than 2021.

Regarding other exports of services, there will be an impact. A small part will be compensated by its import counterpart. Legal and accounting services will be possibly affected but as uncertainty prevails it is difficult to make and estimation.

Cyprus has relatively tight economic relations to Russia and this can be seen by the high number of Russians living in Cyprus and companies of Russian origin and interests. These ties are attributed to the familiar and trusted legal system that Cyprus offers based on common law, its reputational international financial center which provides a high quality of professional business, financial and consulting services, and even ties related to the same religion. These companies have no special treatment now, and after signing the amended double tax agreement with the Russian Federation (which applies as of January 2021), they have the same obligations. It is expected though that due to sanctions these companies will not be allowed to perform transactions in Russia with Russian banks and therefore their liquidity and profits might be reduced causing lower revenues for the Government in terms of taxes received.

Trade in goods with Russia and Ukraine is very small and is not expected to have an impact on the economy. Specifically, Cyprus is on average a net exporter to Russia in goods.

On **Foreign Direct Investment (FDI)**, and the relatively big amount of FDI flow and stock with Russia, it is noted that on average, between 2018-2020, Cyprus recorded net FDI outflow to Russia. Additionally, SPEs have a large contribution in Cypriot FDI, and these entities have similar inward and outward income due to the structure of their financial assets and liabilities. This makes the effect on the real economy small. Russians invest in all sectors of activity; therefore no specific sector will be affected.

Nevertheless, the final impact on the exports of services and the FDI will depend as previously mentioned on the duration of the war, the sanctions imposed and retaliatory moves by Russia.

The property market and shipping are two sectors not expected to be affected. Russian citizens used to have a significant share in the past in the foreign demand for properties in Cyprus, partly due to the Cyprus Investment Programe (CIP). Following its termination in 2020, demand reduced significantly but has been replaced by local demand.

Shipping in Cyprus is German dominated, so there will be no impact on this sector from the sanctions on Russian ships.

Cyprus mainly imports oil from other countries (like Greece, Italy, the Netherlands) and not Russia, and thus has no dependence from Russia's natural gas directly. Nevertheless it is indirectly affected by the international oil price increase channel. Cyprus will be affected by the increase in international prices since its oil dependent and imports of oil present a significant share in imports of goods. In volume terms, the impact will be lower after the effect of the prices is removed. Higher energy and commodity prices (like wheat and metals) will be channeled in other sectors of the production line and on the final product cost (depending how much of the increase will be absorbed by the producer/seller) affecting private consumption and construction (construction materials). Higher energy prices will affect total final consumption directly via electricity (which is around 2.4% of total final consumption) and fuels (which are around 5% of total final consumption).

On **interest rates,** already the Federal Reserve (FED) and the Bank of England (BoE) have increased the main interest rates. ECB is holding a no changed position. The interest rates increase will cause an increase in the borrowing cost for both consumers and business thus affecting investments and create possible new NPLs.

Labour market

Developments in the labour market for 2022 are surrounded by uncertainty, as was the case for 2021, due to different reasons. The invasion of Russia to Ukraine, with unknown duration and the consequent effects from the imposed sanctions on Russia and Belarus, have created uncertainty in all sectors of the economy, thus affecting also the labour market.

The baseline macroeconomic scenario projects a continuation of the 2021 trend, with the employment rate in 2022 denoting an increase, at a rate of about 1.0% in terms of persons employed. The improvement in the labour market conditions is expected to be slower, following the developments of the war in Ukraine. Developments will depend largely on the tourism sector and its gradual recovery from the effects of the war and the sizable abolition of tourists from Russia and Ukraine. From 2023 onwards, employment is projected to grow at a rate of 1.5-2% on average. In the period 2023-2025, employment growth is foreseen to continue improving, as long as the economy performs in a similar path.

At the same time, the average annual unemployment rate is envisaged to pursue a downward path, pursuing a similar pace as economic growth, but with a delay, adhering to the norm that unemployment usually follows economic activity with a time lag. The declining path of unemployment is projected to maintain pace during 2022-2025, falling to 7.1% in 2022, to 6.4% in 2023, 6.0% in 2024 and to 5.5% in 2025. The reduction of the unemployment rate is triggered by improved economic activity, significant capital investment, resilient private consumption and the gradual return of tourism back to the 2019 levels in 2024, all leading to a sustained job creation.

Table IV: Labour market developments

	2019	2020	2021	2022f	2023f	2024f	2025f
Employment (persons) growth	3.8	-0.5	1.2	1.0	1.5	1.5	2.0
Unemployment rate	7.1	7.6	7.5	7.1	6.4	6.0	5.5
Compensation per employee, growth	4.4	-3.2	4.7	2.5	3.2	2.8	2.5
Nominal unit labour cost, growth	2.9	1.4	0.4	0.7	0.9	1.0	1.5
Real unit labour cost, growth	2.7	2.0	-2.1	-3.8	-0.6	-1.0	-0.5
Productivity (persons)	1.4	-4.5	4.3	1.7	2.2	1.9	1.0

Source: CYSTAT, MOF

Wages

Wage growth, as reflected in the compensation per employee, following the increase by 4.7% in 2021 is expected to continue increasing at a slower pace. It is forecast to increase by 2.5% in 2022, as the economy slows down and employment decelerates compared to 2021. In 2023 it is expected to increase by 3.2% due to the improvement in the economic situation, the higher employment and following the high inflation rate in 2022 which is expected to pass through to wages in 2023 via COLA (cost of living allowance). Afterwards, in 2024-2025 it will continue to grow at a moderate pace of 2.8% and 2.5% equivalently. Wage developments are projected to reflect the improved labour market performance.

Productivity and ULC

Based on the aforementioned forecasts in the labour market, productivity increased significantly in 2021 by 4.3% following a negative rate of 4.5% in 2020, reflecting the recovery of the economy and the small increase/decrease in employment compared to the GDP change. The GDP improvement of 5.5% in 2021 was reflected in the improvement in hours worked by 3.8%. In 2022, productivity is projected to follow the slowdown in the economy and then normalize by increasing by 1.7%. In 2023 it is expected to increase to 2.2% mainly by the recovery of the economy and employment in persons which will be aligned by fluctuations in hours worked. In 2024 and 2025 productivity is expected to slow down to 1.9% and reach 1.0% respectively, signaling a moderate improvement and returning to more steady levels.

Nominal Unit Labour Cost (NULC) is forecast to follow a similar path to compensation per employee. In 2021, which was a transition year for the economy in returning to its pre-crisis levels, NULC is estimated to have increased by 0.4% following an increase of 1.4% in 2020. NULC is forecast to exhibit an increase of 0.7% in 2022 and 0.9% and 1.0% in 2023 and 2024 respectively, and then increase by 1.5% in 2025. The projections in NULC underpin that cost competitiveness shall be sustained at a relatively moderate level.

Real Unit Labour Cost (RULC) growth in 2021 was negative by 2.1%. Over the forecasting horizon 2022-2025, following the decrease of 3.8% in 2022 due to the high inflation rate, it is envisaged that RULC will pursue a steady pace, whereby price inflation is expected to offset any significant productivity fluctuation.

2.2.2 Price developments

Inflation, as measured by the Harmonized Index of Consumer Prices (HICP) recorded an increase of 2.3% compared to the year before, mainly due to the sharp increase in the prices of categories Housing, Water, Electricity, Gas and Other Fuels, as well as of Transport, which recorded an annual rate of growth of 13.9% and 10.7%, respectively. The increase in these price indices was the outcome of the significant rise in international oil prices during 2021 of about 69.3% (from a monthly average of $41.76 in 2020 to $70.68 in 2021).

In 2021 the Consumer Price Index (CPI) recorded an increase 2.4% compared to the year before.

Table V: CPI by Economic Activity

	2016	2017	2018	2019	2020	2021	Jan-22	Feb-22
GENERAL INDEX	**-1.4**	**0.5**	**1.4**	**0.3**	**-0.6**	**2.4**	**5.4**	**6.6**
LOCAL GOODS	-2.7	1.4	2.0	1.9	-0.6	1.7	6.6	9.5
Local Agricultural	0.4	-0.7	2.4	3.3	1.9	-0.8	7.5	18.7
Local Industrial	-0.6	-0.7	-0.2	-0.4	0.9	0.3	1.7	2.4
Electricity and Water	-13.8	12.1	9.3	7.5	-9.3	11.4	21.8	18.4
IMPORTED GOODS	-0.4	-1.0	-1.1	-1.1	-0.7	1.2	3.0	3.6
Imported Agricultural	-0.6	2.4	-5.2	-3.7	0.0	-2.3	4.6	5.0
Imported Industrial (Excl. petr.)	-0.4	-1.1	-1.0	-1.1	-0.7	1.3	3.0	3.5
PETROLEUM PRODUCTS	-7.6	7.1	6.0	-6.6	-9.1	15.0	25.3	28.4
SERVICES	-0.8	0.5	1.8	1.7	1.1	1.3	2.4	2.4
Rents	-0.5	0.8	2.5	3.4	2.5	1.9	3.2	3.2
Repairs &maintenance of dwellings	1.1	1.8	4.5	3.1	2.3	7.0	13.7	13.7
Transport	-14.1	0.5	6.6	4.3	1.0	5.1	2.0	0.3
Communication	-0.3	-1.0	-1.4	-1.6	0.7	-1.4	2.4	2.4
Insurance	0.2	-2.5	0.8	0.4	0.7	1.7	1.7	1.7
Government services	-2.4	0.6	3.5	0.8	0.2	-1.4	-2.2	-0.8
Education	0.4	0.7	2.6	1.8	1.0	0.3	0.6	0.6
Medical care	1.6	1.1	0.8	0.7	0.7	0.5	0.5	0.5
Restaurants & Coffee shops	0.3	0.7	1.7	1.6	0.9	1.2	3.7	4.1
Personal & Household services	-0.1	0.8	2.0	2.5	1.4	1.3	1.2	1.1

Source: CYSTAT

Analysis of CPI under economic activity classification shows that all categories recorded an increase during 2021, with the prices of Petroleum Products, as well as of Local Goods contributing the most on inflation. More specifically, Petroleum Products price index increased by 15%, thus contributing to the growth of CPI by 0.8 percentage points, reflecting the sharp increase in international oil prices during the year under review. For the same reason, Local Goods exhibited an increase of 1.7% in 2021 due to the significant increase of Electricity and Water price index, which recorded an increase of 11.4%, contributing to the growth of CPI by 0.4 percentage points.

CPI category Services also recorded an increase of 1.3%, with almost all its sub-indices increasing during 2021. Finally, Imported Goods increased by 1.2% due to increases in imported industrial products (excluding petroleum).

Core inflation averaged at 1% during 2021, deviating by 1.4 percentage points compared to the headline inflation, mainly reflecting the increases, which were recorded in energy prices in the year under review.

2.2.3 Risks to economic outlook

The risks associated with the forecasts presented in this update of the Stability Programme are tilted mostly to the downside, given negative global economic developments.

More specifically, the most significant downside risk stems from the recent Russian invasion in Ukraine and the ongoing conflict that does not show signs of de-escalation at the time this Stability Programme is drafted. The strict sanctions imposed to Russia by the E.U., U.S.A. and U.K, are causing, a direct and indirect negative impact on the European economy, including Cyprus.

The major channels that the Cyprus economy is expected be affected relate to the export of services including tourism, in which Russia has a significant share, the heightened inflation levels in all commodities, especially on energy products and wheat and supply chain disturbances and delays in imports for raw and intermediate materials. The ban on the use of EU airspace by Russia and vice versa, as well as the devaluation of the Ruble, are expected to have a significant impact on tourism inflows from Russia in Cyprus. In any case, the magnitude of the impact will depend on the duration and the extent of the war and the sanctions imposed. Moreover, the increase in energy prices will in turn affect the cost of electricity production in Cyprus, given that Cyprus is highly oil dependent country. This additional cost or part of it, could be transmitted to the final products' price, thus affecting consumption and pushing temporarily inflation upwards.

Professional legal, accounting, consulting and other services to companies/businesses of Russian origin/interests, may be also significantly affected, through the reduction of their turnover and profits, with subsequent impact on government revenues.

Another possible downside risk stems from the uncertainty surrounding the continuation of the pandemic, although Covid-19 poses a less significant economic risk at this juncture.

Banking sector developments are still regarded as a source of downside risk mainly due to the still high, despite the progress, percentage of non-performing loans (NPLs). Given the crisis in Ukraine, the sanctions imposed and the ramifications on the real economy, a new wave of non-performing loans cannot be excluded. On the other hand, significant steps towards effectively reducing the level of NPLs are constantly being made, while the banking system is supported by a resilient capital position and a surplus liquidity.

On the upside, the output growth forecasts presented in the Stability Programme are based on a partial inclusion of the impact of investments expected to be implemented under the RRP.

In parallel to the RRP, additional new investments that are expected over the projected horizon, but are not fully factored in the baseline scenario, constitute an upside risk to forecasts. These investments are linked to the energy sector, health, education but their potential impact cannot be fully captured.

CHAPTER 3: GENERAL GOVERNMENT BALANCE AND DEBT

3.1 Policy Strategy

From early 2020, the government's attention was on the protection the economy from the outbreak of the Covid-19 pandemic crisis by alleviating its effects on economic metrics and on society, while reinforcing the ability of the health system to respond to the current demand. During 2020 the government introduced a series of measures with a direct and an indirect impact on the accounts of the general government of about -3.6% of GDP in total. In 2021, the continuation of the pandemic provided the need for the extension of some of these Covid-related measures, which impacted the accounts of the general government by about -3.1% of GDP.

The overall objective of the fiscal policy strategy outlined in this Stability Programme is to support economic growth, in line with the Council recommendations of June 2021 while maintaining fiscal sustainability through a sound fiscal position in the medium term and reducing public debt as a percentage of GDP in a sustainable manner. The focus of the government strategy is driven by the implementation of the National Reform and Resilience Programme (RRP), which encompasses the main national policies for sustainable growth and competitiveness enhancement.

The uncertainty introduced by the recent geopolitical events requires to keep a vigilant stance. The full impact of the Russian-Ukraine war cannot be fully estimated at this point, especially while the conflict is still ongoing, although the effects through inflation and the economic sanctions are already evident and have been factored into the medium term projections and policies of the government. It is worth noting that the government has already taken measures to alleviate the impact of the increase in energy prices for households and companies, that in Cyprus are driven by the developments in oil prices.

3.2 General Government Balance 2021

The budget balance during 2021 remained in deficit of 2.1% of GDP, recording a substantial improvement compared to a deficit of 5.8% of GDP in 2020. The presence of a deficit in the accounts of the general government, despite the rebound of the economy, which recorded a positive rate of growth of 5.5% in real terms during the year under review surpassing already pre-pandemic levels, was due to the impact of the government's measures of a one-off nature undertaken to tackle the effects of the COVID-19 outbreak, mainly targeting health, businesses and employment positions. In nominal terms, the deficit in the accounts of the general government reached €495 million in 2021 compared to a deficit of €1,244.5 million the year before. Primary deficit decreased to €62.3 million in 2021 (-0.3% of GDP) compared to a primary deficit of €785.9 million (3.6% of GDP) in 2020.

Revenue

In 2021, total revenue as a percentage of GDP reached 42.1% from 39.3% the year before, recording a significant increase of 2.8 percentage points of GDP. In value terms, total revenue increased by 15.6% compared to 2020, with almost all revenue categories recording a positive rate of growth during the year under review.

Tax revenue increased by 16% during 2021, reaching 24.8% of GDP from 23.1% of GDP during 2020. Receipts from taxes on production and imports had the highest contribution to the growth of tax revenue, of about 8.4 percentage points, recording an increase of 14.6% in value terms, mostly due to increased VAT receipts compared to the year before in line with the restrictive COVID-19 measures in 2020 and consequently the sharp drop in consumption.

Revenue from taxes on income and wealth increased by 18%, in line with the improved labour market conditions and the increased activity of businesses. As a percentage of GDP, current taxes on income and wealth increased by 0.9 percentage points, from 9.7% of GDP in 2020 to 10.6% of GDP in 2021. It is worth mentioning that the continuation of the targeted support measures of the government for the provision of wage subsidisation as well as direct support to businesses, restrained possible losses from this revenue category.

Revenue from social security contributions increased by 13% during 2021. The positive growth in social security contributions was partly the outcome of increased contributions in the context of the NHS, which contributed by 5.2 percentage points to this year-on-year increase, as the increased NHS contribution rates was in effect from the beginning of 2021, compared to 7 out of 12 months the year before[2]. The improved labour market conditions as well the reduced loss from wage subsidisations, which are not subject to any contributions, also contributed positively to the increase of this revenue category. As a percent of GDP, revenue from social security contributions increased from 11.2% in 2020 to 11.7% in 2021.

Property income in nominal terms remained almost at the same levels as in the year before, as well as a percent of GDP of 0.5%.

Finally, category ‘other revenue’ recorded a substantial increase of 21.7% in nominal terms, reaching 5.1% of GDP compared to 4.6% of GDP in 2020, reflecting the continued pick-up in the rate of absorption from the EU’s Structural and Cohesion Funds.

Expenditure

Total expenditure in 2021 as a percent of GDP, exhibited a decrease of 0.9 percentage points, from 45.1% of GDP in 2020 to 44.2% of GDP in 2021. In value terms, public expenditure increased by 5.9%, of which 2.8 percentage points attributed to higher expenses in the context of the NHS, as the second Phase of the System took effect as of 1st June 2021.

Compensation of employees exhibited an increase of 3.6%, mainly attributed to the gradual phasing out of wage cuts (contribution 1.8 percentage points), increments (contribution 1 percentage point), increased contribution of the government as an employer in the context of the NHS (contribution 0.3 percentage points), as well as due to increased wages and salaries of the State Health Service Organization (SHSO). As a percentage to GDP, compensation of employees recorded a decrease of 0.5 percentage points, from 13.4% in 2020 to 12.9% of GDP in 2021.

Intermediate consumption recorded a positive rate of growth of 15.1% compared to the year before, mainly due to increased health expenditure in the context of the pandemic, as well as due to increased expenses for

[2] The increased NHS contributions was in effect from 1st March 2020. In the context of the measures to compact the consequences of the pandemic, the suspension of the increased contributions was decided for a 3-month period.

water desalination. As a percent of GDP, intermediate consumption increased by 0.3 percentage points, reaching 4.5% in 2021from 4.2% the year before.

Social payments increased at a rate of 7.7% and had the highest contribution to the growth of public expenditure during 2021 by 2.8 percentage points. This substantial increase was mainly due to increased compensations of Health Insurance Organisation (HIO) to private health providers for their services in the context of the NHS (contribution to the increase of social payments, 5.9 p.p.), as the second Phase of the NHS took effect 1st June 2021. On the contrary, decreased COVID-19 related expenses for wage subsidisation for employees that needed to be absent from work and for special unemployment allowances contributed negatively to the growth of this expenditure category by 1.1 p.p. As a percent of GDP, social payments decreased marginally from 16.6% in 2020 to 16.5% during 2021.

Expenditure category subsidies recorded an increase of 1.2% in 2021, due to marginally increased COVID-19 related expenditure for the subsidisation of wages of employees of companies that experienced full or partial suspension of their operations, as well as for the one-off payments to companies to cover part of their operating costs. As a percent of GDP, subsidies decreased by 0.2 percentage points, from 2.7% of GDP the year before to 2.5% of GDP in 2021.

Interest expenditure recorded a decrease of 5.7% in 2021 compared to the year before. As a percent of GDP, interest expenditure declined from 2.7% in 2020 to 2.5% of GDP in 2021.

Finally, category other expenditure recorded an increase of about 8.5% during 2021, remaining as a percent of GDP to 3.3 percent as in the year before.

3.3 Budget 2022

The budget balance is expected to record further improvement during 2022 reaching a budget balance, taking into account the withdrawal of the majority of the measures related to the pandemic, which negatively impacted the accounts of the general government by 3.1% of GDP. The primary balance is forecast to turn positive during 2022, reaching 1.6% of GDP.

Revenue

In accordance with the baseline macroeconomic scenario, total revenue in 2022 is anticipated to record a positive rate of growth of the order of 5.9% compared to 2021, estimated to decrease as a percentage to GDP by 0.6 percentage points, from 42.1% the year before to about 41.5% of GDP.

Tax revenue in 2022 is expected to exhibit a rate of growth of about 6% compared to the year before, yet decline as a percentage of GDP by 0.3 percentage points, from 24.8% in 2021 to 24.5%. The increase of tax revenue in value terms, is mainly attributed to the expected growth in revenues from taxes on production and imports, which are forecast to exhibit an increase of 6.4% compared to 2021, in line with the anticipated increase in private consumption. As a percent of GDP, taxes on production and imports are expected to reach 14% from 14.2% the year before. Taxes on income and wealth are also expected to record an increase of about 5.5% compared to the year before, and marginally decline as a percentage of GDP, from 10.6% in 2021 to 10.4% in 2022.

Social security contributions are forecast to exhibit an increase of about 6% in 2022, as nominal earnings are forecast to increase further during the year under review, taking also into account last year's loss from the wage subsidisations, in the context of the covid-19 related measures to support employment and businesses, which were not subject to any contributions. As a percent of GDP, revenue from social security contributions is expected to drop by 0.2 percentage points in 2022, reaching 11.5% from 11.7% of GDP in 2021.

Revenue from property income in value terms is expected to remain at the same level as in the year before. As a percent of GDP, this revenue category is also expected remain at 0.5% in 2022 as in 2021.

Finally, category "other revenue" is also expected to record an increase of about 5.9% stemming mainly from the expected increase of grants to be received in the context of the RRF, contributing with 6.2 percentage points to the growth of this revenue category. As a percent of GDP, this revenue category is expected to remain at 5.1% as in the year before.

Expenditure

Total expenditure is estimated to exhibit a marginal increase of 0.8%, despite the withdrawal of the majority of the covid-19 related measures, falling as a percentage of GDP compared to 41.5% from 44.2% in 2021.

In more detail, compensation of employees is forecast to exhibit an increase of 5.7% in 2022 compared to the year before, brought mainly from the gradual abolition of wage cuts with contribution on the growth of this expenditure category of about 1.7 percentage points. Increases of wages and salaries in the context of the NHS are also expected to contribute positively to the growth of this category with 1.2 percentage points, as well as the provision of Cost-of-Living Allowance (COLA) and annual increments with an estimated total of 1.2 percentage points. As a percent of GDP, compensation of employees is forecast to fall at 12.7 percent of GDP from 12.9 percent of GDP the year before.

Intermediate consumption is forecast to record an increase of 7% during 2022, brought mainly from the expected increases of goods and services prices during the year under review, as well as from the expected increased expenses under the RRP. As a percent of GDP, intermediate consumption is estimated to marginally drop to 4.4% in 2022 from 4.5% of GDP the year before.

Social transfers, are expected to increase substantially by 5.5% in 2022, contributing the highest to the growth of public expenditure, by 2.1 percentage point. This increase is mainly attributed to increased payments of the HIO to public health providers, estimated to contribute to the growth of this expenditure category by 2.7 percentage points. On the contrary, the withdrawal of the special schemes of the government in the context of the pandemic, are expected to negatively impact the growth of social transfers by 0.6 percentage points. As a percent of GDP, this expenditure category is expected to decrease by 0.2 percentage points, from 16.5% the year before to 16.3% in 2022.

Interest expenditure is forecast to record a decrease of 7.8% in 2022, and decline as a percentage of GDP from 1.9% in 2021 to 1.6% in 2022.

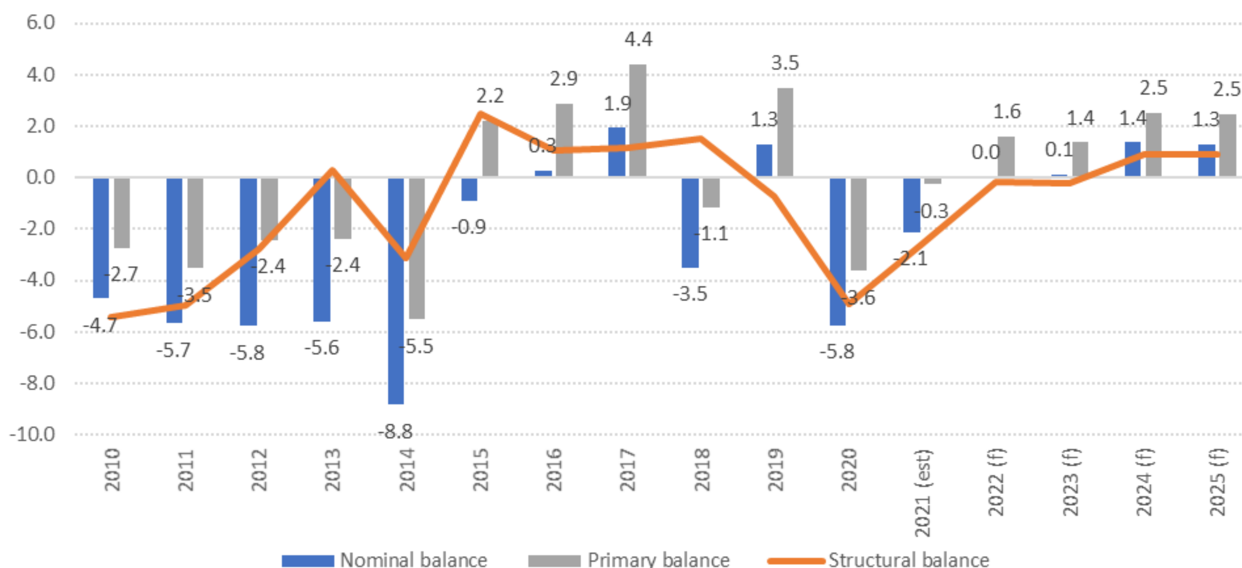
Gross fixed capital formation as a percent of GDP is forecast to exhibit an increase of 0.4 percentage points, reaching to 3.1% from 2.7% of GDP in 2021. The y-o-y increase of 21.5% of this expenditure category, in value terms, is mainly attributed to the impact of the RRF.

Finally, category 'other expenditure' is estimated to drop to 3.1% of GPD during 2022 from 3.3% of GDP the year before and increase in value terms by 1.4%

3.4 Medium-Term Budget Balance 2022-2025

Taking into account the baseline macroeconomic scenario, and after three continuous years of budget deficits, it is expected that the budget position will improve further from 2022 onwards reaching a surplus of about 1.3% of GDP by the end of the programming period, allowing debt-to-GDP ratio to continue its downward path over 2022-2025 at a satisfactory pace.

Figure 11: Nominal, Primary and Structural Balance (% GDP)



Source: CYSTAT, MOF

Total revenue in nominal terms is projected to record a y-o-y growth of 4.2% in 2023 and it is expected to increase further by about 5.7% in 2024, as a result of the increase in social security contributions as from 1st January 2024, according to the relevant Law, and record a 3.1% increase in 2025. As a percent of GDP, total revenue is forecast to reach 41.1% in 2023 and in 2024 compared to 42.1% in 2022, and drop at 40.4% of GDP in 2025.

On the expenditure side, it is projected that public spending will increase by 4% in 2023 compared to the year before, and then exhibit y-o-y increases of 2.5% and 3.2% in 2024 and 2025, respectively. As a percent of GDP, total expenditure is forecast to drop to 40.9% in 2023 from 41.5% in 2022, then decrease further to 39.8% of GDP in 2024, mainly as a result of the impact from the termination of the gradual wage cuts, and fall further to 39.1% of GDP in 2025.

Allocation of expenditure

In line with the objective of the government to direct public expenditure to growth-enhancing categories, the structure of expenditures over time, exhibits a continued reallocation towards high priority functions such as Environmental Protection and Health. At the same time, there is a reduction in government expenditure on functions such as General Public Services, Defence, Public Order and Safety, Education and Economic Affairs.

Table VI: Functional classification of expenditure

% of expenditure	2014	2015	2016	2017	2018	2019	2020	2025 (f)
General public services	18.5	22.4	21.0	20.1	16.4	18.8	19.5	17.8
Defence	3.2	3.6	4.1	5.6	4.3	4.5	4.6	4.1
Public order and safety	3.6	4.2	4.4	4.5	3.9	4.3	4.4	4.2
Economic affairs	23.1	8.7	7.0	6.7	22.8	11.3	8.4	6.3
Environmental protection	0.5	0.9	0.7	0.8	0.6	0.7	0.7	2.2
Housing and community amenities	4.5	4.4	3.9	4.2	3.5	3.9	4.1	3.9
Health	5.4	6.3	6.7	6.8	6.2	9.2	9.6	15.6
Recreation, culture and religion	1.8	2.2	2.3	2.4	1.9	2.4	2.4	2.5
Education	11.3	13.9	14.6	14.4	11.8	13.5	14.0	12.0
Social protection	28.1	33.4	35.4	34.6	28.6	31.3	32.4	31.3
Total expenditure	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: CYSTAT, MOF

Finally, public debt is estimated to decrease further by 5.7 percentage points of GDP, declining to 88.2% of GDP at end-2023 compared to 93.9% of GDP at the end of the year before, and continue its downward trend during 2024 and 2025, falling to 81% and 76.7% of GDP, respectively.

3.5 Medium Term Objective

The medium-term fiscal strategy of the government is consistent with the fiscal rules embedded in our Public Financial Management Framework through inter alia the enactment of the Fiscal Responsibility and Budget Systems Law. According to the law, the overall budgetary position rule establishes that the general government structural fiscal balance is balanced or in surplus in the medium term. By the termination of the activation of the escape clause, the MTO remains at a balanced fiscal position (0.0% of GDP) in structural terms.

Potential output estimates used for the calculation of the cyclical position of the fiscal policy are obtained from the commonly agreed methodology of the European Commission. Potential GDP is estimated to continue to grow by 3.2% in 2022, from a growth of 2.9% in 2021, and further by 3.2% in 2024 and 2025, respectively.

As a result of the real and potential GDP estimated evolution, the output gap turned positive in 2021, from a negative 1.6% of GDP in 2020, to 0.9% of GDP. From 2022 onwards, the output gap is expected to remain positive reaching 0.8% of GDP in 2025.

Cyclically adjusted balance (CAB) in 2021 is estimated at about -2.6% of GDP, due to public expenditure during the year targeting the consequences of the pandemic crisis as well as from revenue losses stemming from the measures undertaken. In 2022 CAB is expected to record a marginal deficit of about 0.2% of GDP and improve by 0.2 p.p. in 2023 reaching a balance. By the end of the programming period 2024-2025 the CAB is forecast to turn positive reaching 1% and 1.3% of GDP, respectively. In the absence of any one-off and other temporary measures during the programming period, the structural balance path coincides with the cyclically-adjusted balance path.

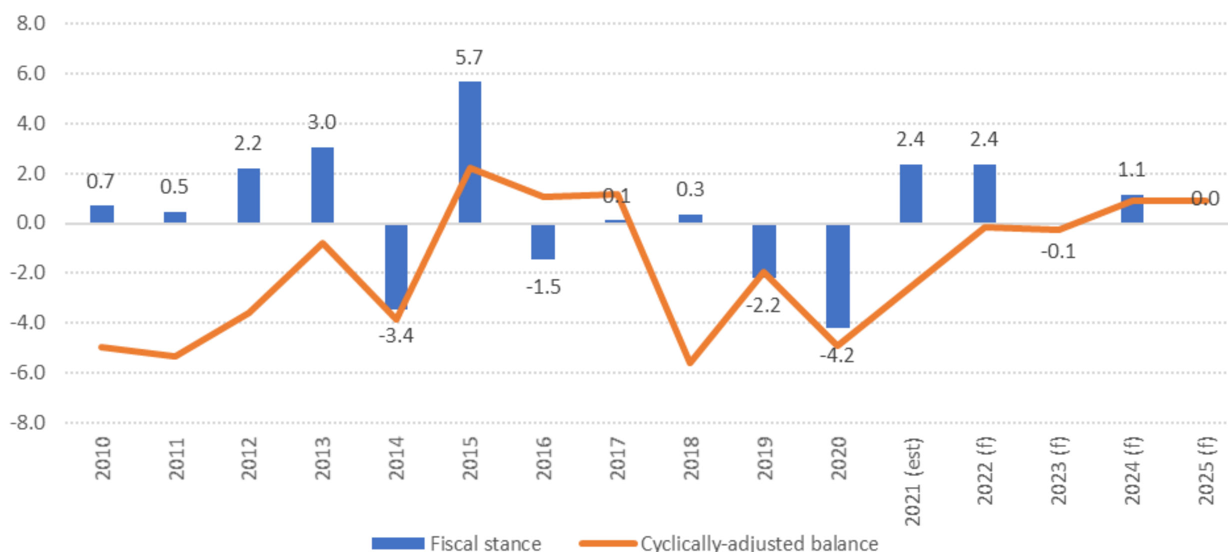
Table VII: Cyclical developments

in percentage of GDP	2021	2022	2023	2024	2025
Real GDP growth (%)	5.5	2.7	3.8	3.4	3.0
Net lending of general government	-2.1	0.0	0.4	1.5	1.7
Interest expenditure	1.9	1.6	1.2	1.1	1.2
One-off and other temporary measures	0.0	0.0	0.0	0.0	0.0
Potential GDP growth (%)	2.9	3.2	3.4	3.2	3.2
Output gap	0.9	0.4	0.7	1.0	0.8
Cyclical budgetary component	0.4	0.2	0.4	0.5	0.4
Cyclically-adjusted balance	-2.6	-0.2	0.0	1.0	1.3
Cyclically-adjusted primary balance	-0.7	1.4	1.2	2.2	2.5
Structural balance	-2.6	-0.2	0.0	1.0	1.3

Source: Statistical Service and Ministry of Finance

Taking into account the output gap estimations adopted in this Stability Programme, which are derived from the commonly agreed methodology, and the fiscal forecasts for a medium-term horizon, where, at the time of their compilation uncertainty remains substantial, the structural balance for the period 2024-25 achieves the medium-term budgetary objective, averaging at 1.2% of GDP.

Figure 12: Cyclically-adjusted balance and fiscal stance (% of GDP)



Source: Ministry of Finance

3.6 General Government Debt

The Medium-Term Public Debt Management Strategy (MTDS) 2022-2024 which was approved by the Council of Ministers in 2021 is focused on the following guidelines:

- Smoothening of debt maturity profile and maintaining the maturity of marketable debt at a satisfactory level compared to the EU average;
- Risk mitigation through increased cash reserves to cover the financing needs of the next 6-9 months and management of interest rate risks;
- Development of the government securities markets;
- Minimisation of marketable debt borrowing costs through the improvement of investor relations and expansion of the investor base.

Each guideline is disaggregated into qualitative and quantitative targets and actions.

Financing actions in 2021

The total borrowed amount of the Republic of Cyprus in 2021 reached €1.8 billion of which the main source of funding came mainly through the issuance of European Medium-Term Note (EMTN) totalling €1.0 billion. The remaining funding was mainly done through bilateral loans granted by European Commission under SURE instrument and European Investment Bank for ongoing infrastructure projects. A detailed statement of the annual financing in 2021 per source is presented in the table below.

Table VIII: Net annual financing per source, 2021

	€ million
Treasury Bills	300 [1]
Funding from EC (RRF, SURE)	379
Retail bonds	43
Euro Medium Term Notes	1000
EIB loans	75
Total net annual financing	**1797**

1= An amount of €300 million concerns repaid roll-over amount on a quarterly basis.

Financing in 2022

The Annual Funding Plan 2022 was approved by the Minister of Finance and is presented in table VIII below. The funding needs of 2022 are estimated at €2.4 billion of which an amount of €2.2 billion concerns debt redemptions and €0.2 billion fiscal needs. It is noted that the above estimations do not take into consideration the impact of Russian – Ukraine crisis on the Cypriot economy.

The main funding of the Annual Funding Plan 2022 has already been completed through a single-tranche euro denominated issuance of the order of €1.0 billion in January 2022. The transaction closed successfully with a bid cover ratio larger than 7 times of the requested amount, with diversified offers from worldwide investors and a coupon rate of 0.95% at a re-offer yield 0.994%. In April 2022 €100-110 million are expected to be received from EIB and CDB as disbursements for ongoing projects. An amount of €170 million is expected to be disbursed from EC under the Recovery and Resilience Plan. Based on the current available data on cash reserves, Government is able to cover the financing needs for this year and a significant amount of financing needs of the next year.

Table IX: Net annual financing per source, 2022

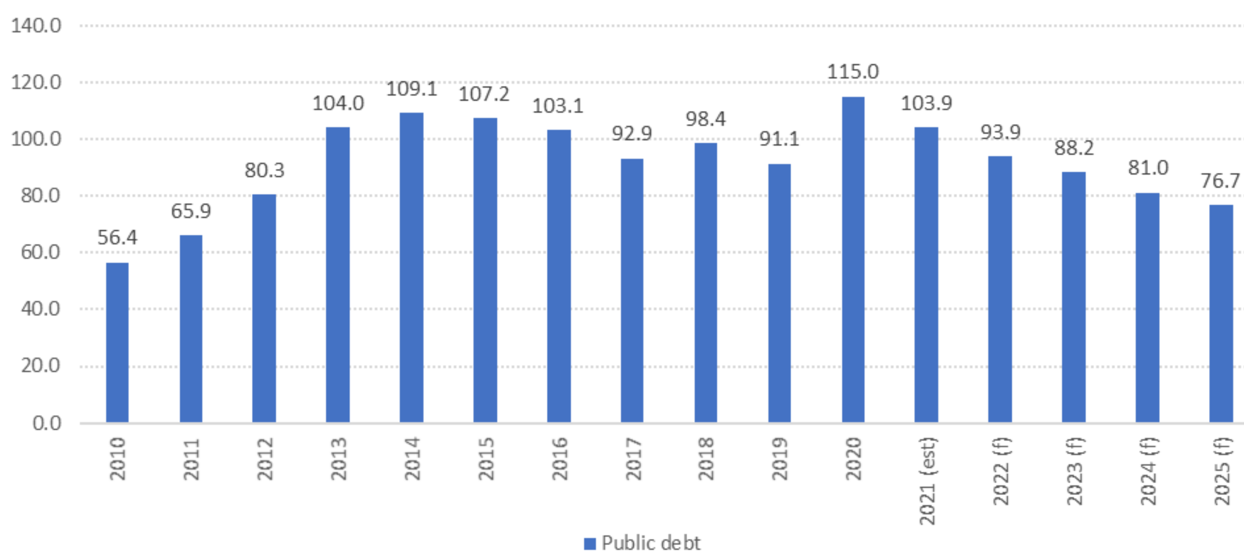
Financing source	AFP 2022 up to € million
Treasury Bills	300
Retail bonds	40
Euro Medium Term Notes (EMTN)	1500
EIB-CEB loans	124
Use of cash reserves	497
Total net annual financing[1]	2461

1=The total net annual financing of the annual funding plan refers to the maximum amount of funding. It is noted that pursuant to Public Debt Management Law the Annual Funding Plan is updated at least twice a year.

2=An amount of €170 mn is expected to be disbursed as a grant during the year 2022 under RRF.

As presented in Figure 13 below, the general government debt to GDP ratio in 2021 decreased to 103.9% compared to 115% the year before. The reduction of the debt to GDP was attributed to increase of the GDP and the utilization of a significant amount of cash reserves to cover a part of gross financing needs in 2021. Based on the Ministry of Finance projections, the downgrade path of debt ratio is expected to continue in the following years reaching around 77% by the end of 2025.

Figure 13: Debt ratio



Source: Ministry of Finance

Debt developments

The general government debt is projected at €23.5 billion or as a percentage of GDP at 93.9% at the end of 2022, as presented in Table XI below. The expected reduction of general government debt by 10.1 percentage points is attributed to the repayment of a significant amount of debt due within the year which is expected to be covered both through new debt issuances as well as through the utilisation of the cash buffer. During the programming period 2023-2025, debt-to-GDP ratio is projected to continue its downward trend declining to about 88.2%, 81% and 76.7% by year end 2023, 2024 and 2025 respectively. The debt-to-

GDP ratio is projected to exhibit a reduction of 5.6 percentage points in 2023 compared to 2022, 7.2 percentage points in 2024 compared to 2023 and 4.4 percentage points in 2025 compared to 2024.

Table X: General government debt 2021-2025

in percentage of GDP	2021	2022	2023	2024	2025
Gross debt ratio	103.9	93.9	88.2	81.0	76.7
Change in debt ratio	-11.0	-10.1	-5.6	-7.2	-4.4
Primary balance	-0.3	1.6	1.6	2.6	2.9
Interest expenditure	1.9	1.6	1.2	1.1	1.2
Stock-flow adjustment	-13.2	-10.0	-5.3	-5.7	-2.6

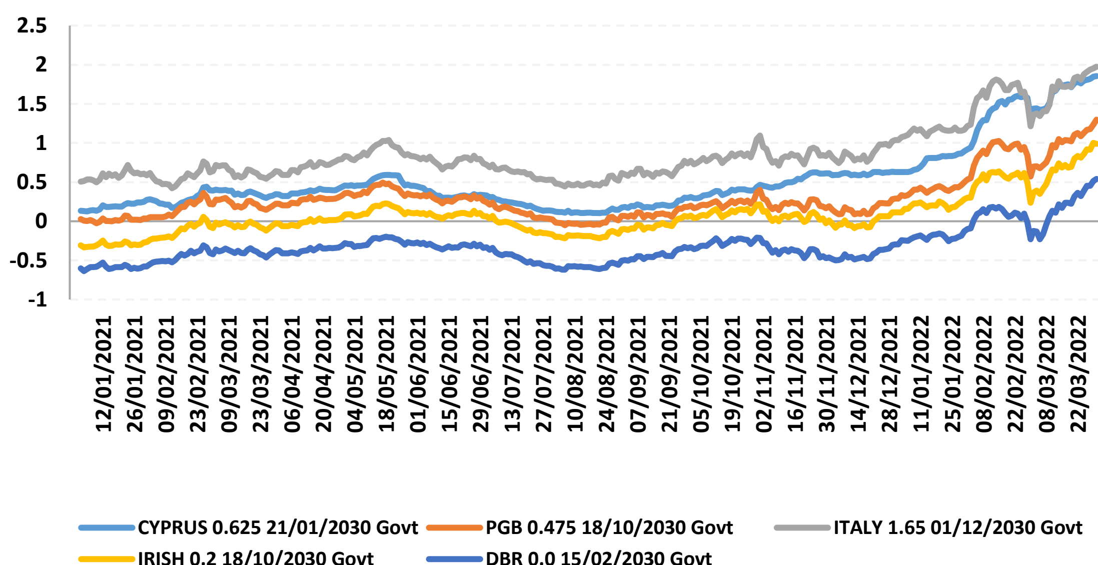
Source: Ministry of Finance

The Stock-Flow Adjustment (SFA) analyses the factors contributing to changes in government debt, other than government deficits/surpluses. The main items include the accumulation or running down of financial assets and the so called "snow ball" effect. The substantial negative stock flow adjustment in 2021, equivalent to -13.2% of GDP, reflects the significant reduction of the cash buffer accumulated the year before. In 2022 onwards, the stock flow adjustment remains negative owing to further decreases in financial assets used for the repayment of debt.

Spreads – secondary market yields (from 1/1/2021 to 30/3/2022)

As presented in Figure 14 below, the 2030 Cyprus sovereign market bond yield curve recorded a good performance for the whole year and moved aligned and fairly smooth with all the other bond yield curves presenting a stable movement closely to zero yield and almost always under 0.5% with the exception of the late end of 2021. The 2030 Cyprus bond performed very well and had tightened further during the summer months, starting from June, recording a significant down drop and shift of the yield curve underpinned by the robust economic performance.

Figure 14: Secondary market yields levels of Cyprus and selected Eurozone States (10-year government bonds)



Source: Bloomberg

These figures also resulted by the number of confirmations about the Cyprus' sovereign ratings with the upgrade by one notch by Moody's and by upgrading the outlook positive from stable from other two Credit Rating Agencies (CRA) during the year. It is noted that the 10-year Cypriot yield curve, from June to beginning of October, converges significantly on the respective yield curves of Portugal and Ireland while on the same time gains space spread from the Italian. Since November, the 2030 Cyprus sovereign market bond yield has exhibited an upward trend mainly because of the increase of interest rates mainly due to inflation increase. Most recently and since February 2022, when the war started in Ukraine an obvious upset occurred and observed a sharp increase in yield curves with Cypriot curve climbing to the levels of the Italian curve and deviating significantly from the Portuguese and Irish curve.

CHAPTER 4: SENSITIVITY ANALYSIS OF THE GENERAL GOVERNMENT BALANCE AND DEBT

This chapter presents the sensitivity analysis for the projected general government balance and debt, in respect to risks that could impact macroeconomic and fiscal performance over the medium-term.

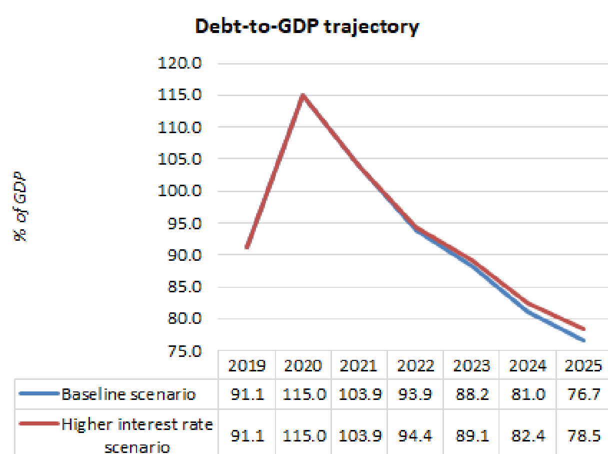
Sensitivity analysis

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 distinct scenarios. In line with the approach taken in the rest of this Programme, all simulations assume unchanged policies.

Scenario 1: Higher interest rate by 50 basis points annually

The first scenario assumes higher interest rates than the baseline scenario for each year over the programming period. In particular, the real interest rate increases 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 78.5% by 2025, compared to 76.7% under the baseline scenario.

Figure 15: Debt to GDP trajectory under the higher interest rate sensitivity scenario



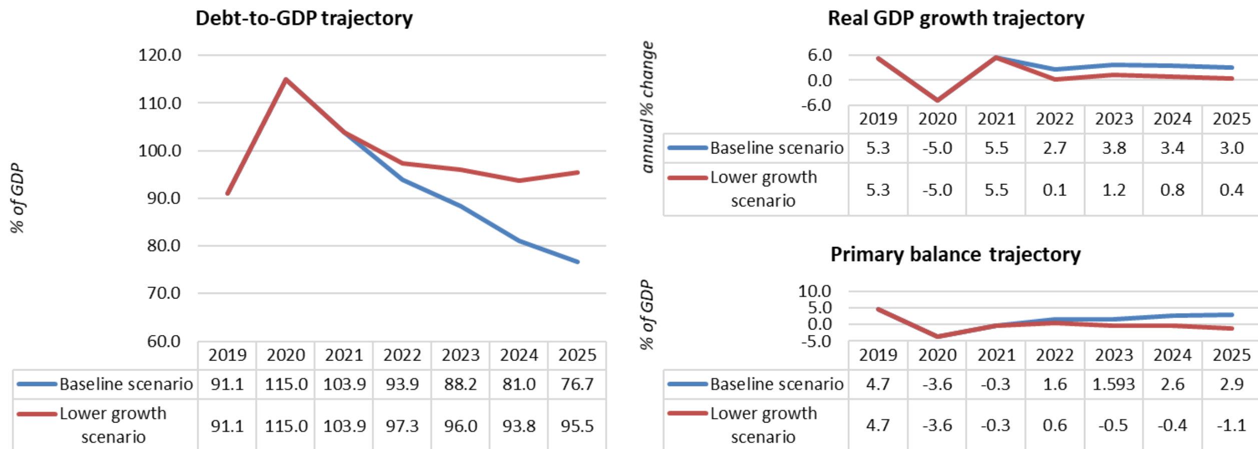
	2019	2020	2021	2022	2023	2024	2025
Baseline scenario	91.1	115.0	103.9	93.9	88.2	81.0	76.7
Higher interest rate scenario	91.1	115.0	103.9	94.4	89.1	82.4	78.5

Source: Ministry of Finance

Scenario 2: Lower real GDP growth by half of the 10-year historical standard deviation

Under this scenario, real growth in GDP is assumed to be lower by half of the 10-year standard deviation, for each year over the programming period, compared with the baseline scenario. Along with the real growth trajectory, Figure 16 below presents the trajectories for debt-to-GDP ratio and primary balance as percentage of GDP for the period 2019-2025. The debt ratio projects an unsustainable path over the medium term, reaching 95.5% by 2025 from 93.7% the year before, exhibiting a deviation of about 18.8 percentage points of GDP compared to the projected outcome under the baseline scenario, due to the negative growth rates during 2012-2014 and in 2020. It is noted that, excluding these negative growth rates, the path of the debt ratio under the growth scenario is sustainable following a downward trend, reaching 80.3% by 2025.

Figure 16: Debt to GDP, real GDP growth and primary balance as % of GDP trajectories under the lower real growth rate sensitivity scenario

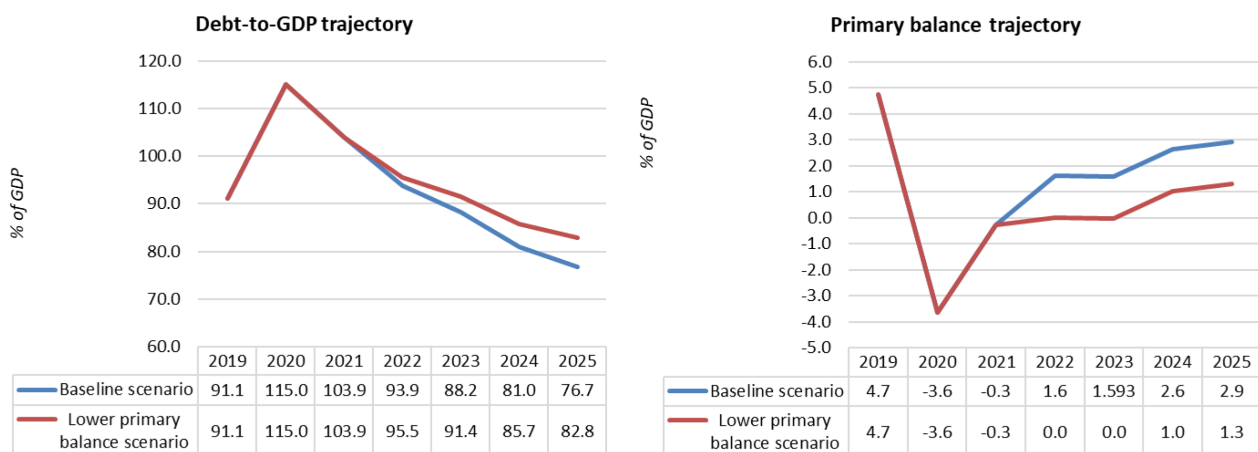


Source: Ministry of Finance

Scenario 3: Lower primary balance by half of the 10-year historical standard deviation

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 2025 is expected to be higher than the baseline, there is still a downward trend, where debt ratio declines to 82.8% by 2025.

Figure 17: General government debt and primary balance trajectories under the lower primary balance sensitivity scenario (% of GDP)

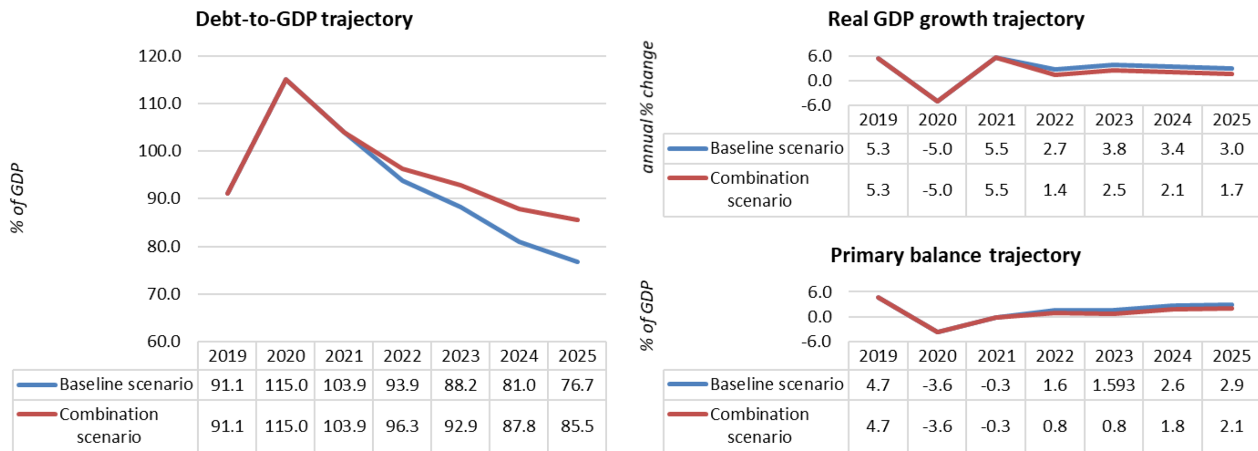


Source: Ministry of Finance

Scenario 4: 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 in 2025 is expected to be higher than the baseline, there is still a downward trend, declining to 85.5% by 2025.

Figure 18: Debt to GDP, real GDP growth and primary balance as % of GDP trajectories under the combination sensitivity scenario



Debt-to-GDP trajectory (% of GDP)

	2019	2020	2021	2022	2023	2024	2025
Baseline scenario	91.1	115.0	103.9	93.9	88.2	81.0	76.7
Combination scenario	91.1	115.0	103.9	96.3	92.9	87.8	85.5

Real GDP growth trajectory (annual % change)

	2019	2020	2021	2022	2023	2024	2025
Baseline scenario	5.3	-5.0	5.5	2.7	3.8	3.4	3.0
Combination scenario	5.3	-5.0	5.5	1.4	2.5	2.1	1.7

Primary balance trajectory (% of GDP)

	2019	2020	2021	2022	2023	2024	2025
Baseline scenario	4.7	-3.6	-0.3	1.6	1.593	2.6	2.9
Combination scenario	4.7	-3.6	-0.3	0.8	0.8	1.8	2.1

Source: Ministry of Finance

CHAPTER 5: SUSTAINABILITY OF PUBLIC FINANCES

Chapter 5 illustrates the overall situation as regards the sustainability of public finances. In this chapter a more detailed analysis is performed on the projected development of the General Social Insurance Scheme (GSIS) and other public age-related expenditures, as well as the future evolution of the general government expenditures and revenues. For the purposes of this analysis, it is assumed that the budgetary situation evolves in line with the Stability Programme (SP) targets of 2022-2025. Thereafter, the projected changes in age-related expenditure and revenue are cumulated to the 2025 general government expenditure and revenue ratios to obtain the projected long-term paths for the general government balance.

It is noted that that public pension projections as included in this SP cover the pension expenditure of the General Social Insurance Scheme (GSIS), Government Employees Pension Scheme (GEPS) and Social Pension Scheme (SPS), which essentially represent the total public pension expenditure as defined by Eurostat (ESSPROS).

Table 7 in the Appendix includes an analysis of the long-term fiscal sustainability which takes into account the impact of age-related changes in expenditure over the period 2020-2060. The main elements of the analysis are the long-term projections on public pensions, health care, long-term care and education expenditures. The projections undertaken for the purposes of the present SP are based on the latest available commonly agreed assumptions of the EPC-Ageing Working Group (AWG) formulated in 2020 with 2019 as a base year. For the purpose of this SP, actual data for 2020 were used, except in cases where data were not available and AWG projections were used instead.

Table XI below, presents the key demographic and labour market assumptions used in the 2021 Ageing Report, Underlying Assumptions and Projection Methodologies (published in November 2020).

Table XI: Basic Demographic and Labour Market assumptions 2020-2060

	2020[1]	**2030**	**2040**	**2050**	**2060**
Total Fertility Rate	1.34	1.38	1.42	1.46	1.49
Life Expectancy at birth					
Males	80.3	82.1	83.3	84.5	85.6
Females	84.3	86.1	87.2	88.3	89.3
Participation Rates (15-64)	**75.8**	**77.9**	**78.4**	**78.7**	**79.4**
Males (15-64)	82.3	81.6	81.8	82.1	82.8
Females (15-64)	69.7	74.5	75.3	75.6	76.2
Net migration (thousand)	**4.5**	**3.4**	**3.0**	**2.7**	**2.4**

[1]Data for 2020, except TFR, are historical.

The population of Cyprus is projected to increase from its current level of 0.9 million in 2020 to 1.1 million in 2060. Fertility rates, which have decreased between 2000 and 2014, are now projected to increase over the projection period from 1.34 in 2020 to 1.49 in 2060. Life expectancy also increases significantly. Gains in life expectancy over this period 2020-2060 are 5.3 years for males and 5.0 years for females.

On the labour market, the total participation rate is expected to increase by 3.6 p.p. between 2020-2060, mainly due to the increase in the female participation rates (0.5 p.p. for males and 6.5 p.p. for females). Unemployment rate (15+) is expected to decline and stabilize at a rate of 6.7%.

Table XII presents the aggregate results of the projections for the public pension expenditure and the contributions over the period 2020-2060.

Table XII: Projected public pension expenditure and contributions, 2020-2060

in per cent of GDP	2020[3]	2030	2040	2050	2060
Total Expenditure[1]	8.9	9.7	10.1	10.1	10.7
Total Amount of Contributions[2]	8.0	9.2	10.1	10.1	10.0

[1] *Expenditure represents pension spending under GSIS, GEPS and SPS.*
[2] *Contributions arising from GSIS legislated schedule of contribution rates and GEPS employee contribution rate.*
[3] *Data for 2020 are historical*

Results in Table 7 presented in the Appendix indicate that over the period 2020-2060, the public pension spending, as percentage of GDP, is expected to increase to 10.7% in 2060 mainly due to the significant deterioration of the old-age dependency ratio. Partially offsetting the above negative contribution from demographics, is a positive contribution primarily resulting from a decrease in the benefit ratio, primarily due to the termination of GEPS to new members effective as from 2011, as well as the price indexation on GEPS pension benefits in the longer-term.

Over the same period, the pension contributions are expected to increase to 10.0% of GDP in 2060, primarily due to the legislated future increases in the GSIS contribution rate over the period until 2039.

The accumulated reserves of the GSIS are expected to increase from 37.3% of GDP in 2020 to 44.4% of GDP in 2050 and then decline to 39.5% in 2060.

In total, all age-related expenditure including spending on healthcare and education – which are based on the projection methodologies and assumptions of the EPC-AWG as adopted in 2020 for the purposes of the 2021 Ageing Report - are projected to decrease from 21.9% in 2020 to 19.6% of GDP in 2060.

Health care expenditure is projected to decrease during 2020-2060, from 5.9% of GDP in 2020 to about 3.2% in 2060. Long-term care expenditure is also projected to increase by 0.2 p.p. during 2020-2060, increasing from 0.4% of GDP in 2020 to about 0.6% in 2060.

Additionally, education expenditure is projected to decrease by 1.3 p.p. from 5.8% in 2020 to about 4.5% of GDP by 2060. This decrease is also due to demographic factors and the change in the age structure of the population.

Other age-related expenditures are expected to decline and then remain stable at 0.7% of GDP across the projection period.

On the revenue side, property income is expected increase and then remain stable at 0.4% of GDP across the projection period. In addition, pension contributions are expected to increase to 10% of GDP in 2060.

As a result of the above, total general government expenditure will decrease from 45.1% of GDP in 2020 to 38.9% in 2025. This is due to the higher expenditure and the GDP contraction in 2020 as well as to the COVID-19 pandemic that increased the ratio of government expenditure to GDP. Following the termination of all COVID-19 support measures and the improvement of the economy the ratio decreases until 2025. Afterwards, it is expected to increase to 40% of GDP by 2060 mainly due to the increase in the pension expenditure. General government revenue is projected to increase from 39.3% of GDP in 2020 to around 41.8% of GDP in 2060 due to the increase in contributions.

APPENDIX: STABILITY TABLES

Table 1a. Macroeconomic prospects

		2021	2021	2022	2023	2024	2025
		€ million	rate of change	rate of change	rate of change	rate of change	rate of change
1. Real GDP	B1*g	22,433.5	5.5	2.7	3.8	3.4	3.0
2. Nominal GDP	B1*g	23,352.8	8.0	7.4	5.3	5.5	5.0
3. Private consumption expenditure	P.3	13,874.0	3.7	2.0	2.8	2.5	2.0
4. Government consumption expenditure	P.3	4,730.5	8.4	3.1	2.0	0.5	0.7
5. Gross fixed capital formation	P.51	3,942.7	-6.3	5.8	5.4	5.2	5.2
6. Changes in inventories and net acquisition of valuables (% of GDP)	P.52 + P.53	-96.0	0.0	0.0	0.0	0.0	0.0
7. Exports of goods and services	P.6	17,985.3	13.4	2.8	3.8	4.2	3.8
8. Imports of goods and services	P.7	18,053.5	9.5	2.7	3.0	3.2	3.0
Contributions to real GDP growth							
9. Final domestic demand		22,547.3	2.8	2.9	3.1	2.6	2.3
10. Changes in inventories and net acquisition of valuables	P.52 + P.53	-96.0	0.0	0.0	0.0	0.0	0.0
11. External balance of goods and services	B.11	-68.3	2.7	0.0	0.6	0.8	0.7

Notes

(1) The chain-linking method, is not applicable to the variable "changes in inventories (incl. valuables)", since negative values are observed for certain years. This method is followed by all Member States and Eurostat. For completeness purposes of this table, the difference between Total Investment and Gross Fixed Capital Formation is used.

(2) The volume measures (reference year 2010) is the result of the chain-linking method, as well as the application of the non-additivity approach, as required by Eurostat so the total GDP is not the same as the sum of its components. This applies for 2021 while for the forecasted years, total GDP is the sum of its components. So for 2022, the sum of the component's contribution to growth is not the same as total GDP growth due to the non-additivity in 2021.

Table 1b. Price developments

	ESA Code	2021 Level	2021 rate of change	2022 rate of change	2023 rate of change	2024 rate of change	2025 rate of change
1. GDP deflator		104.1	2.4	4.5	1.5	2.0	2.0
2. Private consumption deflator		104.8	2.1	4.2	1.5	2.0	2.0
3. HICP[1] [2015=100]		101.9	2.3	4.1	1.5	2.0	2.0
4. Public consumption deflator		99.9	1.3	4.1	3.7	3.0	2.5
5. Investment deflator (GFCF)		106.0	3.6	5.6	2.1	2.6	2.5
6. Export price deflator (goods and services)		105.1	1.7	3.7	1.0	1.7	2.0
7. Import price deflator (goods and services)		104.0	1.3	3.9	1.7	2.1	2.3

Table 1c. Labour market developments

	ESA Code	**2021** Level	**2021** rate of change	**2022** rate of change	**2023** rate of change	**2024** rate of change	**2025** rate of change
1. Employment. persons (thousands)[1]		448.1	1.2	1.0	1.5	1.5	2.0
2. Employment. hours worked[2] (thousands)		782,084.6	3.8	1.0	1.5	1.5	2.0
3. Unemployment rate (%)[3]		34.8	7.5	7.1	6.4	6.0	5.5
4. Labour productivity. persons[4]		50,063.2	4.3	1.7	2.2	1.9	1.0
5. Labour productivity. hours worked[5]		28.7	1.6	1.7	2.2	1.9	1.0
6. Compensation of employees (€ million)	D.1	10,474.6	6.0	3.5	4.7	4.4	4.5
7. Compensation per employee (in €)		26,264.3	4.7	2.5	3.2	2.8	2.5

[1]Persons with occupation. domestic concept. national accounts definition.
[2]National accounts definition.
[3]Harmonised definition. Eurostat; levels.
[4]Real GDP per person employed.
[5]Real GDP per hour worked.

Table 1d. Sectoral balances

% of GDP	ESA Code	**2021**	**2022**	**2023**	**2024**	**2025**
1. Net lending/borrowing vis-à-vis the rest of the world	B.9	-7.3	-6.0	-5.4	-4.4	-3.6
of which:						
- Balance on goods and services		1.1	0.4	0.4	0.9	1.3
- Balance of primary incomes and transfers		-8.3	-6.4	-5.9	-5.4	-5.0
2. Net lending/borrowing of the private sector	B.9	-2.2	-6.0	-5.8	-5.9	-5.4
3. Net lending/borrowing of general government	EDP B.9	-2.1	0.0	0.4	1.5	1.7
4. Statistical discrepancy		0.0	0.0	0.0	0.0	0.0

Table 2a: General government budgetary prospects

% of GDP	ESA Code	2021	2021	2022	2023	2024	2025
Net lending (EDP B.9) by sub-sector		**€mn**					
1. General government	S.13	-495.0	-2.1	0.0	0.4	1.5	1.7
2. Central government	S.1311	-823.3	-3.5	-1.2	-0.8	0.4	0.7
3. State government	S.1312	M	M	M	M	M	M
4. Local government	S.1313	4.7	0.0	0.0	0.0	0.0	0.0
5. Social security funds	S.1314	323.6	1.4	1.2	1.1	1.1	1.0
General government (S13)							
6. Total revenue	TR	9,824.5	42.1	41.7	41.3	41.3	40.6
7. Total expenditure	TE[1]	10,319.5	44.2	41.7	40.9	39.9	38.9
8. Net lending/borrowing	EDP B.9	-495.0	-2.1	0.0	0.4	1.5	1.7
9. Interest expenditure	EDP D.41	432.5	1.9	1.6	1.2	1.1	1.2
10. Primary balance[2]		-62.5	-0.3	1.6	1.6	2.6	2.9
11. One-off and other temporary measures[3]		0.0	0.0	0.0	0.0	0.0	0.0
Selected components of revenue							
12. Total taxes (12=12a+12b+12c)		5,784.3	24.8	24.7	24.5	24.3	24.1
12a. Taxes on production and imports	D.2	3,305.8	14.2	14.2	14.1	14.0	13.9
12b. Current taxes on income. wealth. etc	D.5	2,477.9	10.6	10.4	10.4	10.3	10.2
12c. Capital taxes	D.91	0.6	0.0	0.0	0.0	0.0	0.0
13. Social contributions	D.61	2,724.3	11.7	11.5	11.4	11.7	11.4
14. Property income	D.4	115.7	0.5	0.5	0.4	0.4	0.4
15. Other[4]		1,200.2	5.1	5.1	4.9	5.0	4.7
16=6. Total revenue	TR	9,824.5	42.1	41.7	41.3	41.3	40.6
p.m.: **Tax burden** (D.2+D.5+D.61+D.91-D.995)[5]		8,508.6	36.4	36.2	35.9	36.0	35.5
Selected components of expenditure							
17. Compensation of employees + intermediate consumption	D.1+P.2	4,043.4	17.3	17.0	17.1	16.7	16.3
17a. Compensation of employees	D.1	3,003.0	12.9	12.7	12.8	12.6	12.4
17b. Intermediate consumption	P.2	1,040.4	4.5	4.3	4.2	4.0	3.9
18. Social payments (18=18a+18b)		3,862.2	16.5	16.3	16.1	15.8	15.6
of which Unemployment benefits[6]		53.2	0.2	0.3	0.4	0.5	0.6
18a. Social transfers in kind supplied via market producers	D.6311. D.63121. D.63131	799.3	3.4	3.6	3.6	3.4	3.3
18b. Social transfers other than in kind	D.62	3,062.9	13.1	12.7	12.5	12.4	12.3
19=9. Interest expenditure	EDP D.41	432.5	1.9	1.6	1.2	1.1	1.2
20. Subsidies	D.3	585.2	2.5	0.4	0.4	0.4	0.3
21. Gross fixed capital formation	P.51	632.3	2.7	3.1	3.0	2.7	2.6
22. Other[6]		763.9	3.3	3.3	3.1	3.1	3.0
23=7. Total expenditure	TE[1]	10,319.5	44.2	41.7	40.9	39.9	38.9
p.m.: Government consumption (nominal)	P.3	4,724.9	20.2	20.2	20.2	19.7	19.2

1. TR-TE=B.9.
2. The primary balance is calculated as B.9 (item 4) plus D.41 (item 5).
3. A plus sign means deficit-reducing one-off measures.
4. P.11+P.12+P.131+D.39rec+D.7rec+D.9rec (other than D.91).
5. Including those collected by the EU and including an adjustment for uncollected taxes and social contributions (D.995). if appropriate.
6. Includes social benefits other than social transfers in kind (D.62) and social transfers in kind via market producers (D.632) related to unemployment benefits.
7. D.29pay+D4pay (other than D.41pay) + D.5pay+D.7pay+P.52+P.53+NP+D.8.

Table 2b. No policy-change projections

	2021 Level (€mn)	2021 % of GDP	2022 % of GDP	2023 % of GDP	2024 % of GDP	2025 % of GDP
1. Total revenue at unchanged policies	9,619.0	41.2	40.4	39.7	39.3	38.6
2. Total expenditure at unchanged policies	10,065.0	43.1	42.0	41.3	40.2	39.3

Table 2c. Amounts to be excluded from benchmark

	2021 Level (€ mn)	2021 % of GDP	2022 % of GDP	2023 % of GDP	2024 % of GDP	2025 % of GDP
1. Expenditure on EU programmes fully matched by EU funds revenue	192.7	0.8	0.6	0.5	0.6	0.5
2. Cyclical unemployment benefit expenditure	0.2	0.0	0.0	0.0	0.0	0.0
3. Effect of discretionary revenue measures	205.5	0.9	1.3	1.5	2.0	2.1
4. Revenue increases mandated by law	-	-	-	-	-	-

Table 3. General Government expenditure by function

% of GDP	**COFOG Code**	**2020**	**2025**
1. General public services	1	7.6	6.9
2. Defence	2	1.9	1.6
3. Public order and safety	3	1.9	1.6
4. Economic affairs	4	5.6	2.5
5. Environmental protection	5	0.3	0.9
6. Housing and community amenities	6	1.5	1.5
7. Health	7	5.9	6.1
8. Recreation, culture and religion	8	0.9	1.0
9. Education	9	5.8	4.7
10. Social protection	10	13.6	12.2
11. Total expenditure (=item 3=22 in Table 2a)	TE	45.0	38.9

Table 4. General government debt developments

% of GDP	ESA Code	2021	2022	2023	2024	2025
1. Gross debt		103.9	93.9	88.2	81.0	76.7
2. Change in gross debt ratio		-11.0	-10.1	-5.6	-7.2	-4.4
Contributions to changes in gross debt						
3. Primary balance	B.9+D.41	-0.3	1.6	1.6	2.6	2.9
4. Interest expenditure	D.41	1.9	1.6	1.2	1.1	1.2
5. Stock-flow adjustment		-13.2	-10.0	-5.3	-5.7	-2.6
of which:						
- Differences between cash and accruals		-0.3	-0.1	-0.1	0.3	0.2
- Net accumulation of financial assets		-4.3	-2.8	-0.4	-1.4	1.1
p.m.: Implicit interest rate on debt						
6. Liquid financial assets[8]		30.2	25.3	23.6	21.0	21.1
7. Net financial debt (7=1-6)		73.7	68.5	64.6	60.0	55.6

Table 5. Cyclical Developments

% of GDP	ESA Code	2021	2022	2023	2024	2025
1. Real GDP growth (%)		5.5	2.7	3.8	3.4	3.0
2. Net lending of general government	B.9	-2.1	0.0	0.4	1.5	1.7
3. Interest expenditure	D.41	1.9	1.6	1.2	1.1	1.2
4. One-off and other temporary measures[1]		0.0	0.0	0.0	0.0	0.0
5. Potential GDP growth (%)		2.9	3.2	3.4	3.2	3.2
contributions:						
- labour		0.9	0.9	1.0	0.7	0.6
- capital		0.7	0.8	0.9	1.0	1.0
- total factor productivity		1.2	1.4	1.5	1.5	1.5
6. Output gap		0.9	0.4	0.7	1.0	0.8
7. Cyclical budgetary component		0.4	0.2	0.4	0.5	0.4
8. Cyclically-adjusted balance (2 - 7)		-2.6	-0.2	0.0	1.0	1.3
9. Cyclically-adjusted primary balance (8 + 3)		-0.7	1.4	1.2	2.2	2.5
10. Structural balance (8 - 4)		-2.6	-0.2	0.0	1.0	1.3

[1]A plus sign means deficit-reducing one-off measures

Table 6. Divergence from previous update

	ESA Code	2021	2022	2023	2024	2025
Real GDP growth (%)						
Previous update		3.6	3.8	3.2	2.8	n.a.
Current update		5.5	2.7	3.8	3.4	3.0
Difference		1.9	-1.1	0.6	0.6	n.a.
General government net lending (% of GDP)	B.9					
Previous update		-4.7	-0.9	0.1	1.6	n.a.
Current update		-2.1	0.0	0.4	1.5	1.7
Difference		2.6	0.9	0.3	-0.1	n.a.
General government gross debt (% of GDP)						
Previous update		111.9	103.9	99.5	92.9	n.a.
Current update		103.9	93.9	88.2	81.0	76.7
Difference		-8.0	-10.0	-11.3	-11.9	n.a.

Table 7. Long-term sustainability of public finances

% of GDP	2007	2010	2020	2030	2040	2050	2060
Total expenditure	37.6	41.8	45.1	38.9	39.4	39.3	40.0
Of which: **age-related expenditures**	15.1	17.8	21.9	18.6	19.1	18.9	19.6
Pension expenditure	6.0	6.8	8.9	9.7	10.1	10.1	10.7
Social security pension	4.0	4.7	6.7	8.2	8.9	9.5	10.5
Old-age and early pensions	2.9	3.6	5.5	6.7	7.2	7.8	8.8
Other pensions (disability, survivors)	1.1	1.2	1.3	1.5	1.7	1.7	1.7
Occupational pensions (if in general government)[1]	2.0	2.1	2.2	1.5	1.2	0.5	0.2
Health care	2.6	3.0	5.9	3.0	3.1	3.1	3.2
Long-term care	0.2	0.2	0.4	0.4	0.5	0.5	0.6
Education expenditure[2]	5.6	6.5	5.8	4.7	4.7	4.5	4.5
Other age-related expenditures	0.8	1.3	0.9	0.7	0.7	0.7	0.7
Interest expenditure[3]	…	…	…	…	…	…	…
Total revenue	40.8	37.1	39.3	41.0	41.8	41.8	41.8
Of which: property income	0.6	1.4	0.5	0.4	0.4	0.4	0.4
Of which: from pensions contributions (or social contributions if appropriate)	5.8	6.8	8.0	9.2	10.1	10.1	10.0
Pension reserve fund assets	32.7	36.0	37.3	37.4	41.9	44.4	39.5
Of which: consolidated public pension fund assets (assets other than government liabilities)	…	…	…	…	…	…	…
Systemic pension reforms	…	…	…	…	…	…	…
Social contributions diverted to mandatory private scheme	…	…	….	…	…	…	…
Pension expenditure paid by mandatory private scheme	…	…	…	…	…	…	…
Assumptions							
Labour productivity growth	-0.9	1.5	1.6	0.8	1.9	1.8	1.7
Real GDP growth	5.1	2.0	-5.0	1.7	2.4	2.1	1.6
Participation rate males (aged 20-64)	82.9	80.4	82.3	81.6	81.8	82.1	82.8
Participation rates females (aged 20-64)	65.4	67.4	69.7	74.5	75.3	75.6	76.2
Total participation rates (aged 20-64)	73.9	73.6	75.8	77.9	78.4	78.7	79.4
Unemployment rate (15+)	3.9	6.3	7.5	8.4	7.6	6.8	6.7
Population aged 65+ over total population	12.4	12.7	16.4	19.6	20.9	22.4	25.1

[1] Occupational Pension expenditure projection results are extracted from an expert actuarial study and also take into account the lump-sum.
[2] National estimates based on EPC-AWG projection methodology and assumptions.
[3] Possible interest rate effects were not taken into account.

Table 7a. Contingent liabilities

% of GDP	2021	2022
Public guarantees	14.1	13.1
Of which: linked to the financial sector	6.2	5.8

Table 8. Basic assumptions

	2021	2022	2023	2024	2025
EA: Short-term interest rate (3-months money markets)	-0.55	-0.21	0.86	…	…
EA: Long-term interest rate (10-year government bonds, Germany)	-0.37	0.50	0.72	…	…
USD/€ exchange rate (annual average)	1.18	1.11	1.10	1.10	1.10
Nominal effective exchange rate of the EU (% change)	1.64	-1.07	-0.09	…	…
World growth excluding EU (in PPP terms)	5.8	3.4	3.9	…	…
EU 28 GDP growth	5.3	4.0	2.8	1.9	1.7
Growth of relevant foreign markets [UK]	7.4	4.7	2.3	1.6	1.5
World import volumes. excluding EU	10.3	4.7	4.5	…	…
Oil prices (Brent. USD/barrel)	70.7	104.6	90.8	85.0	75.0

Table 9a. RRF impact on programme's projections - GRANTS

% of GDP	2021	2022	2023	2024	2025
Revenue from RRF grants					
1. RRF GRANTS as included in the revenue projections	0.3	0.6	0.7	1.0	0.8
2. Cash disbursements of RRF GRANTS from EU	0.6	0.7	0.8	0.7	0.6
Expenditure financed by RRF grants					
3.TOTAL CURRENT EXPENDITURE	0.0	0.2	0.2	0.3	0.2
4. TOTAL CAPITAL EXPENDITURE	0.2	0.4	0.5	0.7	0.7
of which:					
- Gross fixed capital formation	0.1	0.3	0.4	0.5	0.4
- Capital transfers	0.0	0.1	0.1	0.3	0.3
Other costs financed by RRF grants					
5. Reduction in tax revenue	0.0	0.0	0.0	0.0	0.0
6. Other costs with impact on revenue	0.0	0.0	0.0	0.0	0.0
7. Financial transactions	0.0	0.0	0.0	0.0	0.0

Table 9b. RRF impact on programme's projections - LOANS

% of GDP	2021	2022	2023	2024	2025
Cash flow from RRF loans projected in the programme					
1. Disbursements of RRF LOANS from EU	0.6	0.7	0.8	0.7	0.6
2. Repayments of RRF LOANS to EU	0.0	0.0	0.0	0.0	0.0
Expenditure financed by RRF loans					
3. TOTAL CURRENT EXPENDITURE	0.0	0.1	0.1	0.1	0.1
4. TOTAL CAPITAL EXPENDITURE	0.0	0.1	0.1	0.1	0.1
of which:					
- Gross fixed capital formation	0.0	0.1	0.1	0.1	0.1
- Capital transfers	0.0	0.0	0.0	0.0	0.0
Other costs financed by RRF grants					
5. Reduction in tax revenue	0.0	0.0	0.0	0.0	0.0
6. Other costs with impact on revenue	0.0	0.0	0.0	0.0	0.0
7. Financial transactions	0.0	0.0	0.0	0.0	0.0

Table 10. Table on the stock of guarantees adopted/announced according to the Programme

% of GDP	Date of adoption	Maximum amount of contingent liabilities[1] (% of GDP)	Estimated take-up (% of GDP)
In response to COVID-19			
- **Support to the tourism sector in the form of government guarantees related to credit notes issued for the cancellation of contracts due to the pandemic of COVID-19, in case of insolvency of the issuers**	2020	-	-
- **Government guarantee scheme towards credit institutions for the granting of loan to businesses and self-employed individuals**	2021	0.03	0.03
SUBTOTAL		0.03	0.03
Others			
- **Stock of Government Guarantees (excluding related to Covid-19 and linked to the financial sector)**		7.3	
- **APS exposure (linked to the financial sector)**		5.8	
SUBTOTAL		13.1	
TOTAL		13.1	

1/ Any possible budgetary impact related to the call of those guarantees should be provided in the table on the discretionary measures in the SCP.