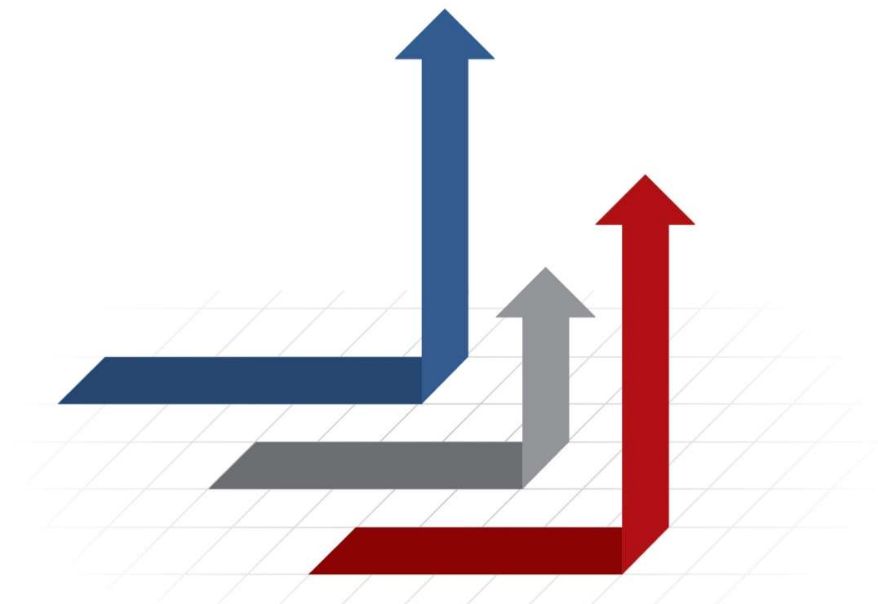
MINISTRY OF FINANCE

STABILITY PROGRAMME UPDATE 2023-2026



APRIL 2023

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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 2023-2026 as approved by the Council of Ministers on 26th April 2023. 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 2023 in accordance with the requirements of the European Semester and takes into account the key policy orientations provided in the Annual Sustainable Growth Survey.

This SP shall, at the same time, 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).

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. 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 2023. 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 2023-2026, taking into account the deactivation of the general escape clause of the Stability and Growth Pact (SGP) will be deactivated at the end of 2023.

Despite the unprecedented events that marked 2022 with the onset of the ongoing Russian invasion in Ukraine, the Cypriot economy exhibited significant resilience and grew by 5.6% in real terms. This was due to the larger than expected activity in the tourism industry and the good performance in other services sectors, particularly ICT. At the same time, growth was supported by increased lending compared to the year before, also reaching higher than the pre-covid levels of 2018 and 2019, reflecting the underlying strong economic activity.

The primary focus of the government policy in 2022 was to support growth and employment in the economy, exercising targeted support to households and businesses to alleviate the effects of increased energy prices and high inflation. On the basis of the strong financial fundamentals of the Cypriot economy, fiscal sustainability was safeguarded with a prevailing budget surplus in 2022 of the order of 2.1% of GDP compared to a deficit of 2.0% on 2021.

The macroeconomic and fiscal forecasts underlying this Stability Programme update 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

Going forward in 2023 and for the medium term horizon 2024-2026, 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 2022, 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 fiscal strategy of the government takes into account the deactivation of the general escape clause at the end of 2023 and is in line with the fiscal adjustment criteria set out in the Commission orientations to ensure medium-term fiscal sustainability.

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. Meanwhile, work is underway to formulate the first Long Term Economic Strategy (LTES) of the Cypriot economy, based on the work undertaken by the Cyprus Economy and Competitiveness Council (Ecompet). The RRP's objectives are fully aligned with the Long-Term Strategy and will pave the way for its implementation.

The increase in energy prices at this particular juncture poses a significant challenge for economic policy makers. It is noted that a series of targeted and horizontal measures were taken from end-2021, to cushion the impact of the rising prices. The measures include the reduction of excise duties on fuels, the reduction of the VAT rates on electricity consumption, support to the husbandry units (farmers), support to the low pensioners and the subsidisation of the electricity bills. The government will continue to take measures to alleviate the impact of the increase in energy prices for households and companies, that in Cyprus are driven mainly by the developments in oil prices.

The efforts to decarbonize our economies through the green strategy agenda of the EU, including the Fit-for-55 package, encompass the longer term energy policy agenda and this will be reflected in the updated Energy and Climate Plan that is underway. While combating the repercussions of climate change is at the forefront of the government's agenda, policy formulation should take into account the fiscal impact of the green transition and the socio-economic and re-distributive impacts. In view of this, the Ministry of Finance has collaborated with the Economic Research Centre at the University of Cyprus in order to undertake a comprehensive study of the impact of climate change on the Cyprus economy.

The impact of climate change on the Cyprus Economy[1]

Climate change is expected to have significant impacts on economies and financial systems globally. These impacts can manifest in the form of "physical risks", i.e. the consequences of the environmental impact, such as damage from extreme weather events, as well as "transitional risks", i.e. the consequences of policies aimed at mitigating climate change, such as the financial impacts of transitioning to a low-carbon economy (Batten, 2018).

According to the UN Environment Program, the Mediterranean region is warming 20% faster than the global average. In the not-so-distant future, Cyprus would face higher temperatures and less precipitation which will intensify the desertification and negatively affect food and water availability. Heat waves, drought and sea-level rise combined with the urbanization of the coastlines and pollution from emissions of carbon dioxide and other greenhouse gases would affect the ecosystem and the economy. Important economic sectors in Cyprus such as tourism, construction, agriculture and energy are climate sensitive and therefore would be particularly affected if mitigation measures are not implemented.

Numerous studies have also highlighted the potential risks of climate change on fiscal accounts. For example, climate change is expected to affect the Mediterranean region's vital tourism and agriculture industries with adverse effects on economic growth and fiscal debt. Moreover, the health effects associated with climate change (such as respiratory and cardiovascular diseases and premature deaths) impose additional public health policies and costs. Another significant risk is the cost of adapting to the impacts of climate change, such as building seawalls, relocating communities, and providing relief after natural disasters. All of these costs can quickly add up, placing a significant burden on government budgets and potentially increasing public debt. In addition, climate change can impact economic growth, reducing tax revenues and increasing social welfare costs.

[1] *References:*
Batten, Sandra, Climate Change and the Macro-Economy: A Critical Review. Bank of England Working Paper No. 706, January 12, 2018. Available at SSRN: https://ssrn.com/abstract=3104554 or http://dx.doi.org/10.2139/ssrn.3104554
International Monetary Fund, Fiscal Policies for Paris Climate Strategies—from Principle to Practice; IMF Policy Paper, February 15, 2019.
World Bank Group, Climate Change Action Plan 2021–2025: Supporting Green, Resilient, and Inclusive Development, World Bank, Washington, DC, 2021.
https://openknowledge.worldbank.org/entities/publication/ee8a5cd7-ed72-542d-918b-d72e07f96c79

Other studies have examined the long-term economic impacts of climate change with International Organizations such as the World Bank and the International Monetary Fund (IMF) contributing to this research. The World Bank has identified that climate change could lead to substantial economic losses especially in low- and middle-income countries. Similarly, the IMF has highlighted the potential of climate change having a significant impact on GDP, with the size of income effects varying across different modeling assumptions and policy scenarios as well as across countries and variability of climate conditions. Such findings underscore the importance of integrating climate change considerations into fiscal planning and budgeting processes to effectively manage climate risks and promote sustainable economic growth.

In view of the above, the Economic Research Centre at the University of Cyprus has undertaken a comprehensive study of the impact of climate change on the Cyprus economy. The first stage of this study analyzes the effects of climate change and the expected economic impact estimated for other countries with regards to the: (i) Impact of climate change on major economic variables such as GDP, fiscal revenue and expenditure, debt etc. (ii) The policies of countries that have integrated climate change into their planning and budgeting frameworks and the effect of these policies. (iii) The tools and methods employed by International Organizations, such as European Commission, IMF, and other countries to quantify climate impact. (iv) The evaluation of the measures and policies proposed and adopted to mitigate climate change. In the second stage a detailed identification and assessment of the climate risks facing the countries in the region and particularly Cyprus. In the third stage, the appropriate tools and models will be developed following the international practice of major research centers in Europe and the US (developing e.g. DSGE models with the energy sector, Input-output tables etc.). These models will be used to assess the impact of proposed climate adaptation measures and mitigation policies in Cyprus. As the project progresses, the identification of Green and Brown public expenditures, climate scenario analysis and proposed climate targets and indicators could be utilized and incorporated into the existing budget framework and process.

1.2 Macroeconomic, budgetary and debt prospects

Output Growth Developments

The GDP in 2022 increased by 5.6% in real terms, following an expansion of 6.6% in 2021 in real terms. The positive GDP growth in 2022 from the expenditure side was mainly driven by higher private consumption and gross fixed capital formation. Private consumption increased by 7.7% in real terms, government consumption an increase of 3.5% and gross fixed capital formation an increase of 6.6%. Imports in real terms increased at a rate of 19.5% following the increase in private consumption, and exports, in real terms, increased significantly at a rate of 14.3% reflecting the significant increase in tourist arrivals (65.3%).

The medium-term baseline scenario presented in this Stability Programme projects that the economy will present a slowdown in 2023 due to the adverse external environment, following a rate of 5.6% in 2022, turning to recovery trajectory again from 2024 onwards. Real GDP growth is forecast at 2.8% in 2023, 3.0% in 2024, 3.1% in 2025 and 3.2% in 2026. A high degree of uncertainty is surrounding this year's forecasting profile again due to the ongoing war between Russia and Ukraine with no signs of de-escalation. There are economic consequences due to sanctions imposed on economic activity, mostly indirect via energy prices and they are expected to be have a bigger magnitude in the first half of the year and this relates more general to the developments of the external environment.

Budgetary and Debt Developments

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 2022, 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.

Despite the continuation of part of the COVID-19 related measures in 2021, the fiscal position recorded a substantial improvement, due to prudent fiscal policy, of 3.8 percentage points of GDP, with the budget deficit falling to 2% of GDP from a deficit of 5.8% in 2020.

In 2022 the fiscal position improved further, with the budget balance turning into a surplus of 2.1% of GDP after two continuous years of fiscal deficits, taking into account to the strong economic activity during the year, the prudent fiscal policy and the withdrawal of the majority of the COVID-19 related support measures, corresponding to further substantial improvement on the fiscal position of 4.1 percentage points of GDP. In nominal terms, the surplus in the accounts of the general government reached €570 mn in 2022 compared to a deficit of €482 mn the year before. Primary balance reached a surplus of €973 mn in 2022 (3.6% of GDP) compared to a primary deficit of €43 mn (-0.2% of GDP) in 2021.

The increase in energy prices at this particular juncture poses a significant challenge for economic policy makers. It is noted that a series of targeted and horizontal measures were taken from end-2021, to cushion the impact of the rising prices. The measures include the reduction of excise duties on fuels, the reduction of the VAT rates on electricity consumption, support to the husbandry units (farmers), support to the low pensioners and the subsidisation of the electricity bills. The government will continue to take measures to alleviate the impact of the increase in energy prices for households and companies, that in Cyprus are driven mainly by the developments in oil prices.

In 2023, the budget balance is expected to remain in surplus driven mainly by the expected economic performance during the year, albeit decline marginally as a percent of GDP. More specifically, general government budget balance is forecast of reach 2% of GDP compared to 2.1% of GDP the year before, where primary balance is forecast to reach 3.2 as a percent of GDP compared to 3.6 in the year before.

Taking into account the baseline macroeconomic scenario, it is expected that the budget position will improve further from 2023 onwards reaching a surplus of about 2.3% of GDP on average over 2023-2026, allowing debt-to-GDP ratio to continue its downward path at a satisfactory pace.

At the end of 2022, the General Government public debt stood at approximately 86.5% compared to 111.2% the year before. The reduction of the debt to GDP was attributed to the utilization of a significant amount of cash reserves to cover a part of gross financing needs in 2022, as well as to the increase of the nominal GDP.

By the end of 2023, the general government debt is projected at €23.4 bn or as a percentage of GDP at 81.1%. The expected reduction of general government debt by 5.4 percentage points is attributed to the expected increase of nominal GDP, as public debt in nominal terms, and in line with the Annual Funding Plan 2023, is forecast to remain broadly at the same levels as in the year before. During the programming period 2024-2026, debt-to-GDP ratio is projected to continue its downward trend declining to about 72.9%, 67.3% and 60.1% by year end 2024, 2025 and 2026 respectively.

CHAPTER 2: ECONOMIC OUTLOOK

2.1 Macroeconomic Developments 2022

2.1.1 Global economy

According to the European Commission Winter Forecast 2023, the world economy (excluding the EU) is expected to expand by an estimated 3.1% in 2022, 3.0% in 2023 and 3.3% in 2024. Those small improvements are mainly attributed to developments in China (expansion 3.9% q-o-q in 2022-Q3 after a contraction of 2.9% q-o-q in in 2022-Q2) and the US (expansion 0.8% q-o-q in 2022-Q3 after a contraction of 0.1% q-o-q in in 2022-Q2). Moreover, India, South Africa, and Argentina also saw some improvement in the third quarter of 2022.

Recent high frequency indicators for U.S indicate a contraction in manufacturing, slower growth in services, and a sharp slowdown in housing starts, sales and prices, while U.S economy is characterized by a tight labour market and persistent inflation. Growth in advanced economies (excluding EU) is expected to fall from an estimated 2.5% in 2022 to 1.3% in 2023, and then recover to 1.7% in 2024.

The relaxation of containment measures in China as from December is expected to boost private consumption, construction activity is also expected to recover gradually, while consumer price inflation fell below 2% in 2022-Q4, from around 2.5% in the previous quarter. Hence, the forecast for Chinese growth in 2023 has been revised upwards to around 5%, compared to the Autumn Forecast, and is unchanged for 2024 at 4.7%. Growth in emerging markets other than China is projected to slow down in 2023 and improve slightly in 2023.

Economic expansion both in the EU and the euro area is estimated at 3.5%, a somewhat milder slowdown than previously estimated in the Autumn Forecast, despite the effects of the energy shock and high inflation. This is due to a number of positive developments (the fall of the European gas benchmark price below its pre-war level, the sharp fall in gas consumption and continued diversification of supply sources, the strong performance of the labour markets and the continuous falling of the inflation rates)**.** Growth is mainly attributed to private consumption (0.6% q-o-q increase) and investment (3.2% q-o-q increase in EU, mainly driven by a boost of investment in Ireland). Employment gains, a further decrease in the saving rate and fiscal support were the factors that supported private consumption by offsetting the decrease in purchasing power (due to high consumer prices and the contraction of real compensation of employees). Excluding Ireland, the EU have contracted marginally. Six out of twelve Member States (for which the preliminary flash estimate is available) recorded a contraction in economic activity (e.g., Germany (-0.2%), Italy (-0.1%)) and some of them even entered (Estonia, Czechia and Hungary) a technical recession. The other six reporting Member States saw continued economic growth (e.g., Spain (0.2%), France (0.1%)).

According to the European Commission Winter Forecast 2023, in annual terms, the Harmonized Index of Consumer Prices (HICP) inflation in euro area decreased to 9.2% in December from 10.6% in October (in EU decreased from 11.5% in October to 10.4% in December) and continued to fall at the beginning of 2023 (flash estimate 8.5%). The fall of the inflation is attributed to the lower-than-expected energy inflation which started declining in November. However, core inflation continued to increase to 6.9% in December. The highest inflation rates (2022) were recorded in Estonia (19.4%), Lithuania (18.9%) and Latvia (17.2%) while the lowest in France (5.9%), Malta (6.1%) and Finland (7.2%).

Regarding inflation outside EU, despite the high reached levels and the inflationary pressures that remain in the major advanced economies with tight labour markets and high core inflation (e.g. US, UK, Canada, and South Korea), inflation seems to have reached its peak. Headline and core inflation in both advanced and emerging economies are expected to ease further in 2023 as a result of declining global commodity prices, easing logistical constraints and the slowdown in global goods demand.

Recent developments do not permit a substantial upward revision to the growth profile projected in autumn for 2023 and 2024 (Figure 1). Specifically, GDP in EU is projected to expand by 0.8% in 2023 and 1.6% in 2024 (0.9% and 1.5% in the euro area, respectively). However, risks to growth are rather balanced (domestic demand might be higher if the reductions in wholesale gas prices[2] pass through to consumer prices more strongly and China's re-opening might strengthen external demand[3]).

Figure 1: Real GDP growth, World (excl. EU), EU and the euro area, 2017-2024 (European Commission Winter Forecast 2023 and Autumn Forecast 2022)

Inflation is projected to ease substantially (fall in energy commodity prices, a stronger euro and tighter financing conditions) ending 2024 a bit higher above the target. Headline inflation in EU is projected to decelerate from 9.2% in 2022 to 6.4% in 2023 and to 2.8% in 2024 (fall from 8.4% in 2022 to 5.6% in 2023 and to 2.5% in 2024 in euro area). Risks to inflation are linked to energy prices and wage pressures due to the tight labour market. On February 2, ECB announced another hike of 50 bps., which main refinancing operations, marginal lending facility and the deposit facility were increased to 3.00%, 3.25% and 2.50% respectively, as from 8 February 2023.

2.1.2 Domestic economy

Following the strong recovery of the economy in 2021 due to the COVID-19 crisis, in 2022 the economic activity remained strong, despite the adverse external environment. The GDP in 2022 increased by 5.6% in real terms, following an expansion of 6.6% in 2021 in real terms.

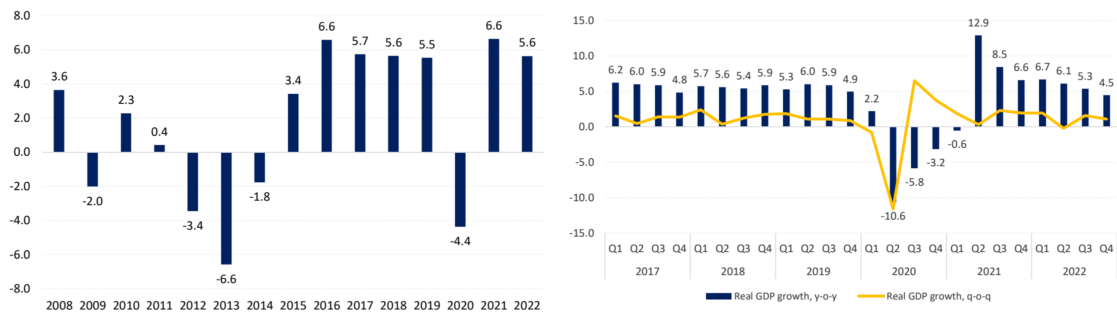
The positive GDP growth in 2022 from the expenditure side was mainly driven by higher private consumption and gross fixed capital formation. Private consumption increased by 7.7% in real terms, government

[2] A reduction that could easily reversed due to Russia's war against Ukraine and other geopolitical tensions.
[3] However, this could boost global inflation.

consumption an increase of 3.5% and gross fixed capital formation an increase of 6.6%. Imports in real terms increased at a rate of 19.5% following the increase in private consumption, and exports, in real terms, increased significantly at a rate of 14.3% reflecting the significant increase in tourist arrivals (65.3%).

On a quarterly basis, real output increased by 6.7% in the first quarter of 2022, compared to the first quarter of 2021, reflecting the COVID restriction measures that were still on track. In the second quarter real GDP increased by 6.1% while in the third and fourth quarter by relatively lower rates of 5.3% and 4.5% respectively compared with the same quarters of the previous year.

Figure 2: Real GDP growth, 2008-2022, annual % change

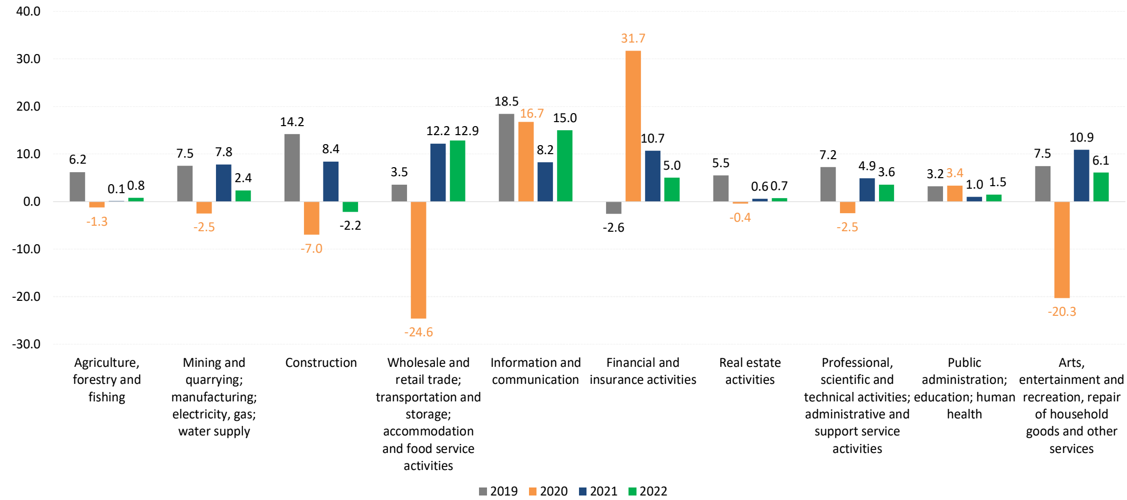


Source: CYSTAT

Economic activity in 2021 recovered following the COVID-19 pandemic, with the GDP increasing by 6.6%. In 2022, economic activity remained strong, despite the adverse external environment. Overall, for 2022 as a whole, the economy grew by 5.6% in real terms. This positive outturn is largely due to the better-than-expected developments in the tourism sector and the continued expansion of exports in other services. The extraordinary increase in private consumption was mainly due to the fast reactivation of the economy following the lockdowns, and was also supported by the savings that were accumulated during 2020-2021 and as well from savings created in 2022.

Value added increased in almost all sectors but it was most pronounced in the following four sectors: Information and communication (15.0%), Accommodation and food service activities (44.4%) following an increase of 61.2% in revenues from tourism, Wholesale and retail trade; repair of motor vehicles and motorcycles (6.4%) and Transportation and storage (10.8%). The only sector that recorded a negative growth was Construction (2.2%).

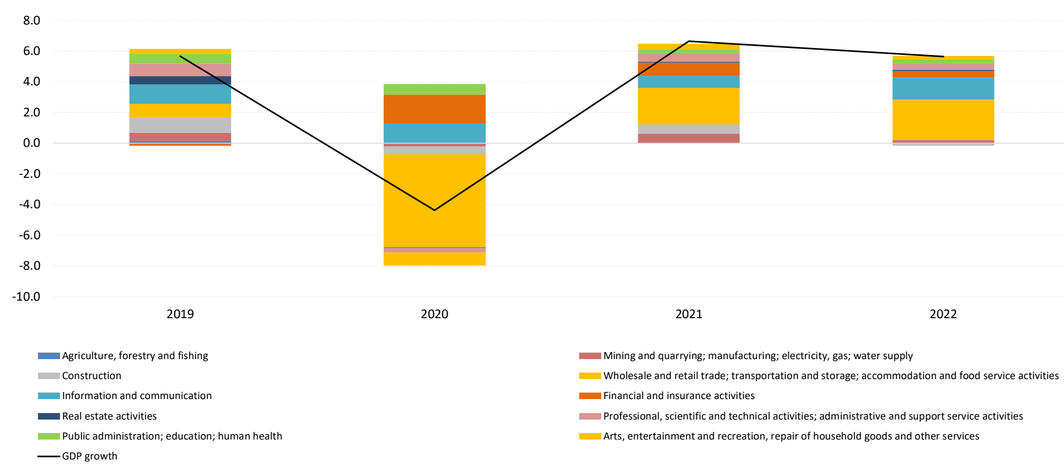
Figure 3: GDP growth, production approach, 2019-2022, annual % change



Source: CYSTAT

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%), Information and communication (15.0%), Financial and insurance activities (5.0%), Professional, scientific and technical activities; administrative and support service activities (3.6%) and Public administration; education; human health (1.5%) while in the sectors Arts, entertainment and recreation, repair of household goods and other services (6.1%), Mining and quarrying; manufacturing; electricity, gas; water supply (2.4%), Real estate activities (0.7%) and Agriculture, forestry and fishing (0.8%), the improvement was marginal. The sector of Construction (-2.2%) was the only sector where the value added decreased. This was mainly due to the significant increase in construction cost due to the ongoing war among Russia and Ukraine which has caused an increase in energy prices and disruptions in the supply chain.

Figure 4: Sectoral contribution to growth 2019-2022, percentage points

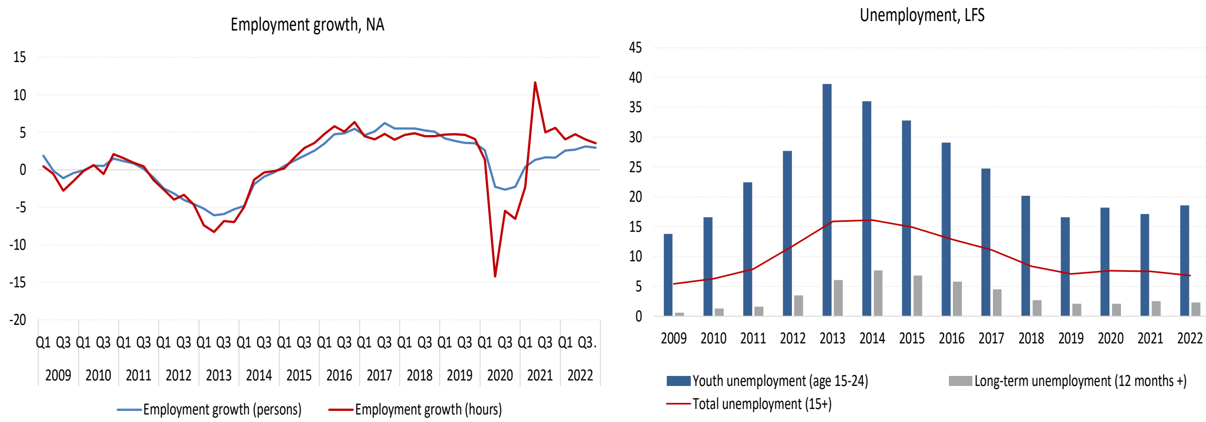


Source: CYSTAT

The labour market in 2022 improved, following the significant increase in the economic activity. In 2021 employment in persons increased by 1.2% and more significantly by 4.8% in hours worked.

Employment in 2022 increased by 2.9% in persons (12.720 persons) and by 4.1% in hours in comparison to 2021. Employment increase in terms of persons employed was widespread but was significantly more prominent in the sector of Accommodation and Food service activities (5.8% or 2.753 persons) following by Wholesale and retail trade; repair of motor vehicles and motorcycles (3.4% or 2.390 persons), Professional, scientific and technical activities (3.7% or 1.195 persons), Manufacturing (3.0% or 1.073 persons), Construction (2.5% or 999 persons), Information and communication (6% or 922 persons) and Education (2.5% or 823 persons). Smaller increases were recorded in the sectors Human health and social work activities (2.4% or 538 persons), Administrative and support service activities (3.4% or 497 persons) and Transportation and storage (2.9% or 479 persons).

Figure 5: Labour market



Source: CYSTAT

The **unemployment rate** in 2022, as measured by the Labour Force Survey, averaged at 6.8%, recording a decrease of 0.7 percentage points compared to the average of 2021. Youth unemployment averaged at 18.6%, compared to 17.1% in 2022, while long-term unemployment averaged at 2.3%, compared to 2.5% in 2021.

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.

Table I: Selected economic indicators, 2019-2022, y-o-y %

	2019	2020	2021	2022
GDP (constant prices)	5.5	-4.4	6.6	5.6
Public consumption	11.9	11.6	6.6	3.5
Private consumption	3.9	-6.8	4.5	7.7
Gross Fixed Capital Formation	6.9	4.5	-4.2	6.6
Exports	8.7	2.2	13.6	14.3
Imports	9.5	3.2	9.0	19.5
Tourist arrivals (000's)	3,976.8	631.6	1,936.9	3,201.1
Tourist arrivals growth	1.0	-84.1	206.7	65.3
HICP	0.5	-1.1	2.3	8.1
Labour productivity growth (persons)	1.7	-3.3	5.4	2.7
Employment growth	3.8	-1.1	1.2	2.9
Compensation per employee	4.4	-0.5	3.8	3.8

Source: CYSTAT

Compensation per employee increased in 2022 by 3.8%, compared to the preceding year, following an equivalent increase in 2021.

Productivity in persons in 2022 increased by 2.7% due to the fact that employment in persons increased by 2.9% compared with the 5.6% increase in GDP. As a consequence, nominal unit labour costs increased in 2022 by 1.0%, following a decrease of 1.5% in 2021, while real unit labour cost in 2022 decreased by 7.3% following a decrease of 3.9% in 2021.

Inflation, as measured by the Harmonized Index of Consumer Prices (HICP), increased significantly and averaged at 8.1% in 2022 from a rate of 2.3% in 2021. Inflation is driven by developments in international oil prices, with a significant impact on domestic prices of energy products. For the period January-December 2022, compared to the corresponding period of the previous year, the largest changes were noted in Housing, Water, Electricity, Gas and Other Fuels (21.5%) and Transport (14.2%). The HICP, excluding energy and unprocessed food, in 2022 was 5.3%.

According to the preliminary **Balance of Payments** data for 2022, the Current Account deficit increased further to €2,463.3 mn in 2022 or 9.1% of GDP, compared with a deficit of €1,638.2 mn in 2021, or 6.8% of GDP. The increase in the deficit resulted from the deterioration of the deficit in goods and the increase in the deficit of primary income. These developments were partly offset by the improved surplus in services, and the reduced deficit of secondary income.

Regarding **goods**, imports remained consistently higher than exports. The trade deficit in 2022 increased, as the increase in imports outweighed the positive developments in exports. The increase in imports was mainly attributed to the developments in general merchandise driven, at least to a certain extent, by the soaring energy prices in 2022. Imports in movable equipment (i.e., vessels, yachts and airplanes) expanded as well, albeit to a lesser extent. The increase in the exports side mainly resulted from the increase in general merchandise and to a lesser extent from increases in movable equipment. In parallel, net exports of goods under merchanting registered a remarkable increase.

On **services**, the increase in the services surplus resulted mainly from the positive developments in telecommunications, computer and information services (associated with the influx of ICT companies in the context of the incentives for international/regional headquartering) and, to a lesser extent from travel. The aid increases were partially offset mainly by decreases in other business services, financial services and transport. The latter is positively correlated with the expansion of imports of goods as well as the increases in the number of Cypriots travelling abroad.

Table II: Balance of Payments, 2008-2022

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	-24.0	15.7	-8.3	-2.4	-10.7	…
2011	-21.4	17.6	-3.8	1.5	-2.3	…
2012	-19.4	17.5	-1.9	-1.9	-3.9	…
2013	-17.7	19.3	1.6	-3.0	-1.5	…
2014	-18.8	19.7	0.9	-5.0	-4.1	-4.4
2015	-18.1	20.7	2.6	-3.1	-0.4	-1.0
2016	-21.9	23.6	1.7	-5.9	-4.2	-0.5
2017	-24.4	23.9	-0.5	-4.6	-5.0	-1.4
2018	-20.9	22.2	1.3	-5.3	-4.0	-3.1
2019	-20.0	21.0	1.0	-6.6	-5.6	-6.0
2020	-19.2	17.9	-1.4	-8.7	-10.1	-9.4
2021	-18.0	20.9	2.9	-9.7	-6.8	-8.1
2022	-21.8	21.4	-0.4	-8.7	-9.1	-10.4

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 Special Purpose Entities** (SPEs), stood at €2,819.9 mn (-10.4% of GDP) in 2022, compared with a deficit of €1,946.5 mn (-8.1% of GDP) in 2021.

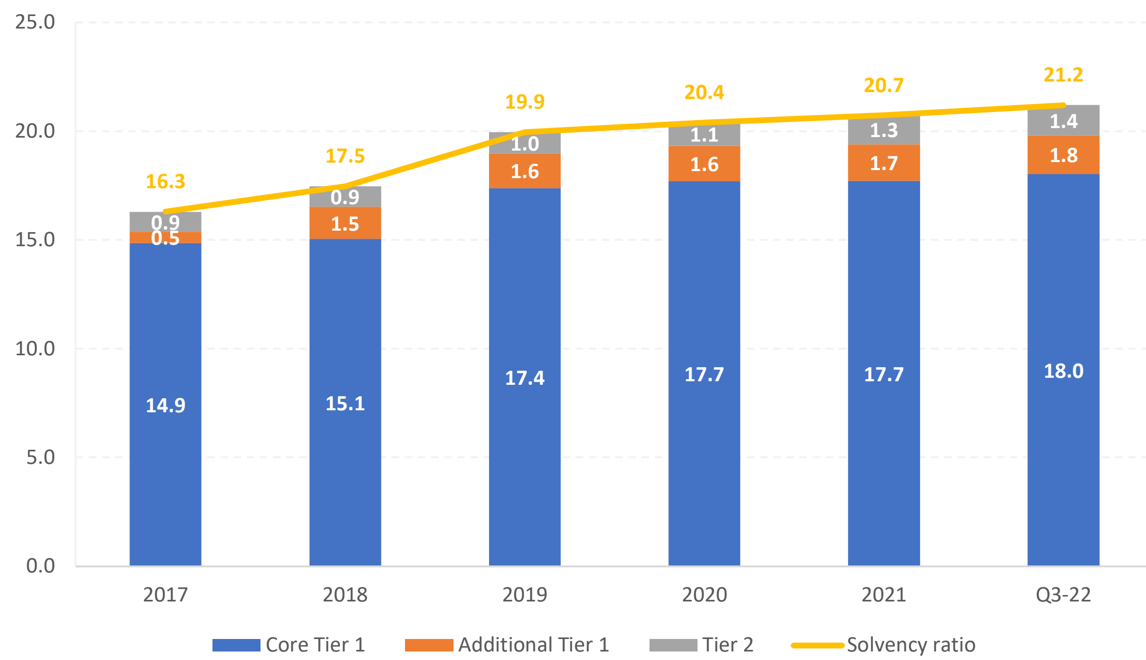
The **international investment position (IIP)** recorded a small deterioration in 2022, presenting a net liability position of €28,439.5 mn (105.3% of GDP), compared with a net liability position of €28,282.4 mn in 2021 (117.8% of GDP). With the corresponding data being adjusted for the impact of SPEs, IIP recorded a net liability position of €11,037.3 mn (40.9% of GDP) in 2022, compared with a net liability position of €10,759.2 mn (44.8% of GDP), in 2021.

The gross external debt decreased to €167,649,7 mn in 2022 from €168,002,7 mn in 2021. The external assets in debt instruments increased to €152,293.4 mn, up from €130,872.1 mn in 2021. Consequently, the net external debt decreased by €21,774.3 mn to €15,356.3 mn, in 2022. Adjusted for the impact of SPEs, gross external debt reached €61,856.7 mn in 2022, compared to €69,108.3 mn, in 2021. The corresponding net external debt indicator decreased further to -€10,311.2 mn in 2022, compared with -€3,111.3 mn in 2021.

2.1.3 Financial sector developments

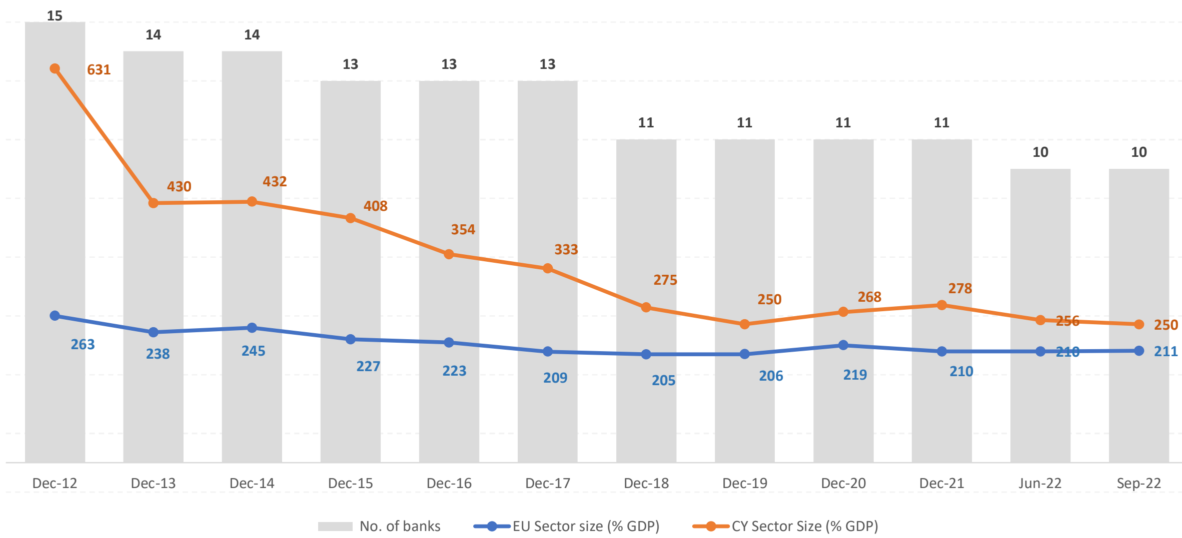
The Capital position and capital buffers remain resilient stemming both from profitability and reduction in RWAs. The CET1 ratio of the banking sector has remained stable in 2022 at 17.7% and the total solvency remained resilient within 2022, with total capital ratio at 21.2% at year end. The two main systemic banks have successfully placed their inaugural MREL-eligible bond issuances over 2021 and 2022.

Figure 6: Capital ratios



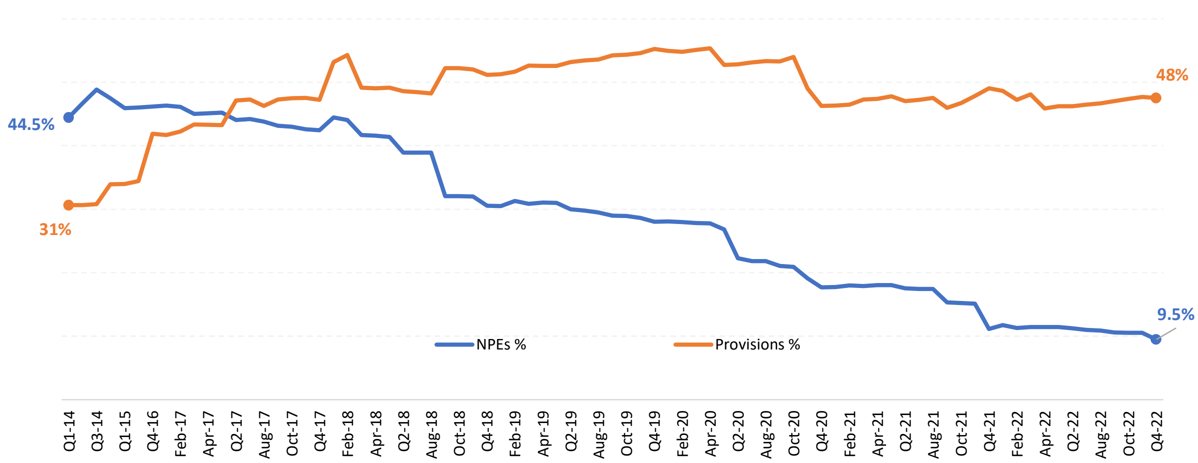
Structurally, the banking sector has consolidated further over 2022. Following the exit of RCB bank from the sector and its voluntary conversion into a credit acquiring company the stand-alone institutions have reduced to ten. The total asset size remains partly elevated due to the liquid low-risk assets held by banking institutions. At year end 2022 total assets of the sector reached €66 bn or about 250% of GDP. Excluding subsidiaries and third country branches, the domestic sector size in terms of GDP is about 210%. The two largest banks exceed cumulatively 70% of the sector's total assets.

Figure 7: Sector size



The NPL ratio reduced by year end 2022 to 9.5%. The level of NPL exposures at €2.3 bn is the lowest level recorded in the past decade. Even though to date there has been no visible impact neither on asset quality nor on Stage 2 loan stock, NPL management and restructurings remain among the banks' priorities given the higher borrowing rates faced by debtors amidst the current interest rate environment.

Figure 8: Non-performing loans



The excess liquidity of the sector has weighed negatively on profitability over the past years, due to the negative basic deposit rates. The rapid upward shift of main interest rates has boosted profitability in 2022 and is expected to contribute significantly to profitability over 2023 as well.

The profitability has been improved within 2022 with the sector – excluding branches- recording profits of €229 mn against a profit of €16 mn a year before. The profit was mainly driven by decreased provisions assumed by the sector within the quarter, increased net interest income and increased non-interest income.

The sector has overall proceeded to branch rationalisation and staff reduction through voluntary exit schemes. Efficiency weaknesses are still present although structural progress in digital transformation is helping towards cost-cutting efforts.

Domestic deposits continue to grow driven mostly by households and to a lesser extent by non-financial corporations. Non-resident deposits have declined further to €8.1 bn, or about 16% of total deposits. The ample deposit base of the Cyprus banking system contributes to a comfortable liquidity standing as measured by LCR and NSFR, which are considerably higher than the minimum requirements of 100% (310% and 177% respectively).

In 2022 total new lending increased compared to the year before, also reaching higher than the pre-covid levels of 2018 and 2019, reflecting the underlying strong economic activity. About 45% of new loans over 2022 has been diverted towards households mostly for housing purposes. Within non-financial corporates, credits were granted to wholesale and retail trade with a share of 17% in total new lending over 2022.

Overall, the banking sector lies on stronger fundaments than in the past and has managed to withstand repercussions from the pandemic and the 2022 Ukraine war so far. In the coming years the banking sector will likely continue its cost-cutting efforts while working to expand on new lending activities.

2.2 Macroeconomic outlook 2023-2026

2.2.1 GDP prospects 2023-2026

The medium-term baseline scenario presented in this Stability Programme projects that the economy will present a slowdown in 2023 due to the highly uncertain external economic environment, following a rate of 5.6% in 2022, turning to recovery trajectory again from 2024 onwards. Real GDP growth is forecast at 2.8% in 2023, 3.0% in 2024, 3.1% in 2025 and 3.2% in 2026.

A high degree of uncertainty is surrounding this year's forecasting profile again due to the ongoing war between Russia and Ukraine with no signs of de-escalation. There are economic consequences due to sanctions imposed on economic activity, mostly indirect via energy prices and they are expected to be have a bigger magnitude in the first half of the year and this relates more general to the developments of the external environment. For Cyprus, Russia was a relatively significant trading partner in the export of services sector, especially in tourism and business services. Although, in 2022 the loss of exports to Russia, including tourism, has been offset by a diversification of services exports to other markets. The current situation keeps energy and commodities prices at still high levels, although a decrease was recorded, which in in turn creates inflationary pressures as Cyprus is an oil dependent economy. Despite the fact that Cyprus is not an importer of Russian oil, it is affected via the increase in the international energy prices. COVID-19 does not present a threat at this point in time for the economy.

Cyprus starts 2023 from a strong position and growth will be supported mainly by domestic demand, and to a lesser extent by external demand. Investment will be 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 2023-2026, and mainly in 2024-2025.

The growth forecast for 2023 has been revised slightly downwards, compared to the projected 3.0% for 2023 in the DBP October 2022, due to the highly uncertain external economic environment, as a result of the of the ongoing war between Russia and Ukraine, the interest rates increases and lastly the still high inflation expectations which are expected to moderate at a slower pace than anticipated.

Interest rates and high prices will cause a significant slowdown in private consumption, which presented an extraordinary performance in 2022, and in gross fixed capital formation as well due to the construction cost. Private consumption, will slow down mainly due to a base effect as it increased significant in 2022 due to the faster reopening of the economy following the lockdowns, and given the observed increase in the savings rate, well above the pre covid period, households are saving and cutting down consumption in order to be able to cover their loan payments.

Gross fixed capital formation is also projected to have a slowdown, due to the significant deceleration in private investment and in specific residential investment. This is driven by the lower demand, due to the high construction cost and the impact of the rises in the interest rates that took place in 2022 and up to March 2023 but will have an effect on new loans cost and loan payments in 2023. Besides residential investment, a slowdown is also projected for the other non-residential which are affected by the high in construction cost in 2022 and also the impact on business sentiment created by the war.

Exports will present an increase as there is still room for growth for the sector due to tourism and ICT related exports. The tourism sector is expected to continue to grow in 2023 with revenues reaching their pre-pandemic levels. The influx of new companies in Cyprus, mainly in the ICT sector due to the Government's attraction schemes, will also help exports of services. Imports are expected to increase, but to a lesser extent, due to the relatively lower oil and gas prices. Net exports thus are expected to contribute positively to growth and the trade surplus will help reducing the Current Account.

For 2023 it is expected that tourist arrivals will increase and approach the pre-crisis levels but not reach them yet. The gap that was created by the Russian/Ukrainian markets, of about 800,000 tourists, is difficult to be covered in number of tourists this soon. But, 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, will help close the gap. Furthermore, tourist arrivals are expected to be supported by higher per capita expenditure and thus in 2023 revenues will return to the pre-crisis levels and thus closing the gap created.

In the medium-term period 2024-2026, growth is forecast to gain pace again and be robust. The expected improvement in the pace is mainly based on the recovery coming from the domestic demand and to the external demand, but to a lesser extent. The continued influx of foreign companies, which are mainly exports oriented in the ICT sector as well as the recovery of tourism receipts and arrivals to pre-pandemic levels will help exports to continue to expand.

Consumption in reals terms will present a smaller increase in 2024 and gain pace again from 2025. A strong growth in the nominal disposable income, due to wages, will drive the consumption growth but inflation and the increase in the saving ratio for loan payments will offset part of the growth. Disposable income in real terms, is projected to return to an increasing path during the forecasted period. Private consumption was supported by the use of accumulated savings during 2020-2021, in 2022 savings were accumulated to smooth consumption while from 2023 onwards the savings ratio will increase to repay the loans.

Gross fixed capital formation will present a significant increase from 2024 onwards and will be supported by the significant and ongoing investment projects that are in the pipeline which are widespread among districts and sectors like health, education, tourism, shipping and energy. Also, the RRP projects will contribute significantly to the investment outlook.

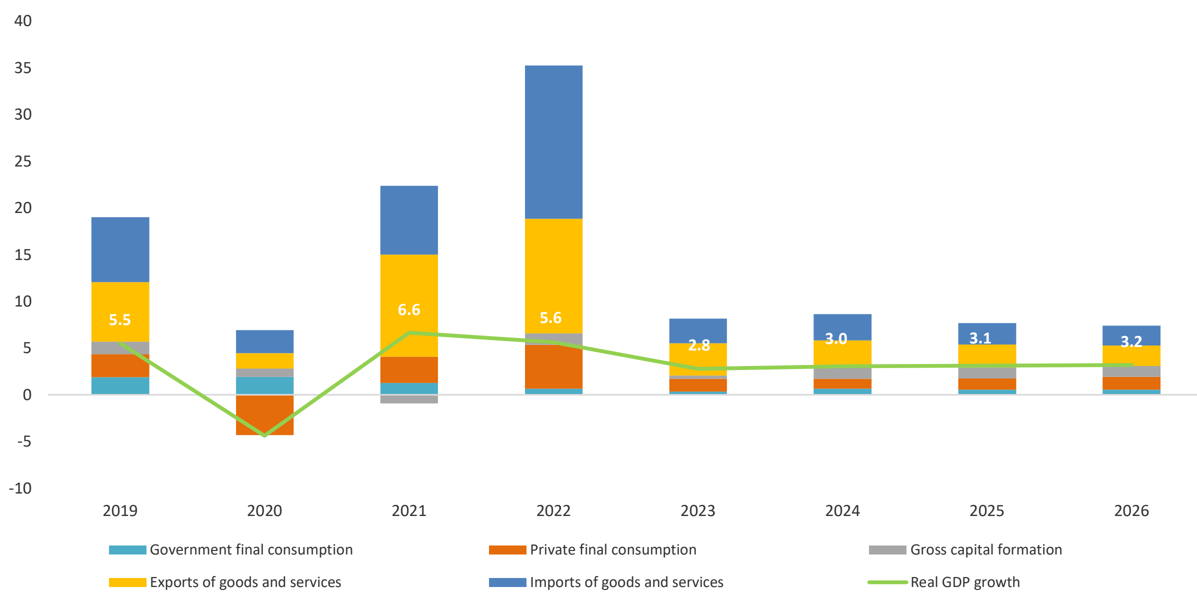
External demand from 2023 onwards will contribute positively but only to a smaller extent to growth as tourism is forecast to gradually recover in 2023 in revenues and in 2024 in arrivals. Imports are expected to grow in line with consumption and investment.

All of the above, combined with improved confidence and expectations, especially as regards the investment opportunities in the energy, education, ICT, innovation and health sectors, including the implementation of investments and reforms under the RRP , create a promising outlook for the prospects of the Cyprus economy.

Real GDP growth is forecast to accelerate to about 3.0% in 2024. Thereafter, growth will accelerate to 3.1% in 2025 and 3.2% in 2026. From a sectoral perspective, growth is expected to be broad based, with the only exception the sector of construction, and will be attributed mainly in the sectors of retail trade, ICT, tourism, shipping, manufacturing and other business services sectors.

Inflation, as measured by the CPI, is estimated to decrease significantly in 2023 due to the lower oil and gas prices and then projected to decelerate at 2.5% in 2024 and then hover around 2.0% in 2025-2026.

Figure 9: Contribution to GDP growth 2019-2026, percentage point change



Source: CYSTAT, MOF

Table III: Medium Term Framework, 2022-2026

change in percent	2022	2023	2024	2025	2026
Real GDP	5.6	2.8	3.0	3.1	3.2
Government Consumption	3.5	1.9	3.4	3.0	3.0
Private Consumption	7.7	2.2	1.8	2.0	2.3
GFCF	6.6	1.7	6.3	6.0	5.8
Exports	14.3	3.7	3.1	2.6	2.4
Imports	19.5	2.7	2.9	2.4	2.2
Deflator	6.5	3.8	2.4	2.1	2.1
Nominal GDP	12.5	6.7	5.6	5.3	5.4
HICP	8.1	3.2	2.5	2.0	2.0
CPI	8.4	3.2	2.5	2.0	2.0

Source: CYSTAT, MOF

The **current account (CA)** deficit has remained high in recent years, mostly due to the income account. In 2020, due to the COVID crisis, the deficit increased significantly to 10.1% of GDP falling again in 2021 to 6.8% of GDP, following the recovery of the economy. In 2022 it increased again at 9.1% due to the deterioration of the deficit in goods, due to oil prices as an impact of the war, and the increase in the deficit of primary income. **Over the medium-term, deficit is expected to gradually improve** as the goods and services balances are expected to improve, and thus the trade balance which is expected to contribute positively. The return of inflation back to lower levels will help having more tourism and thus higher revenues from tourism.

Regarding the terms of trade, following the small increase a deceleration is expected over the forecasting horizon due to prices return back to more normal levels. The income account was relatively high in 2019-2022, especially in 2022 where it recorded around €2.1 bn deficit and contributed negatively to the CA deficit. This trend is expected to continue. The income account projection relies on the assumptions that the primary and secondary income account balances to deteriorate in time, but due to the improvement in the trade balance, overall, the current account will decrease over time but will still remain well above the threshold of -4/+6 of the European Commission.

Labour market

In 2022, the labour market has not been significantly affected by the war as can be seen by the strong job creation which increased by 2.9% and the falling unemployment rate reducing to 6.8% compared with 7.5% of the labour force in 2021. Employment in persons increased by 2.9% and in hours worked by 4.1%.

The baseline macroeconomic scenario projects that the labour market will continue to be resilient and record further improvements in the medium-term. Job creation, employment and thus unemployment are set to continue to improve further over 2023-2026.

From 2023 onwards, employment is projected to grow at a rate of around 1.5% on average. At the same time, the average annual unemployment rate is envisaged to pursue a downward path. The declining path of unemployment is projected to maintain pace during 2023-2026, falling to 6.5% in 2023, to 5.8% in 2024, 5.3% in 2025 and to 5.0% in 2026 where it is estimated to near its natural rate of unemployment ensuring macroeconomic stability. The reduction of the unemployment rate is triggered by improved economic activity and the significant capital investment.

Table IV: Labour market developments

	2020	2021	2022	2023f	2024f	2025f	2026f
Employment (persons) growth	-1.1	1.2	2.9	1.0	1.4	1.6	1.8
Unemployment rate	7.6	7.5	6.8	6.5	5.8	5.3	5.0
Compensation per employee, growth	-0.5	3.8	3.8	8.0	5.2	4.8	4.5
Nominal unit labour cost, growth	2.9	-1.5	1.0	6.1	3.5	3.2	3.1
Real unit labour cost, growth	3.5	-3.9	-7.3	2.9	1.0	1.2	1.1
Productivity (persons)	-3.3	5.4	2.7	1.8	1.6	1.5	1.4

Source: CYSTAT, MOF

Wages

Wage growth, as reflected in the compensation per employee, following the increase by 3.8% in 2022 is expected to increase significantly in 2023 by 8.0% in nominal terms. This increase is due to the COLA paid in January 2023, in order to supporting nominal wages, based on 2022 inflation, towards the public sector and segments of the private sector that also benefit from COLA i.e., the hotel and financial sector and due to lower inflation in 2023. Note that the projected growth in 2023 is also driven by the restitution of public sector wages to the pre-crisis-era wage by returning the last wage cut in January 2023. Going forward, as the price pressures reduce further then wages growth will decelerate.

Productivity and ULC

Labour productivity increased significantly in 2021 by 5.4% due to the impact of the pandemic, the lockdowns and the government measures to secure the labour force, productivity decelerated to 2.7% in 2022. The GDP growth rate of 5.6% in 2022 was reflected in the improvement in hours worked by 4.1%. In 2023, productivity is projected to continue to decelerate and then normalize by increasing by 1.8%. In 2024 it is expected to increase by 1.6% mainly by the recovery of the economy and employment in persons which will be aligned by fluctuations in hours worked. In 2025 and 2026 productivity is expected to slow down to 1.5% and reach 1.4% respectively, signalling 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 2022 NULC increased by 1.0% following a decrease of 1.5% in 2021. NULC is forecast to exhibit a significant increase in 2023 due to wages growth of 6.1% in 2023 and then decelerate to 3.5%, 3.2% and 3.1% in 2024-2026 respectively.

Real Unit Labour Cost (RULC) growth in 2022 was negative by 7.3%. Over the forecasting horizon 2024-2026, following the significant increase of 2022 due to the high inflation rate and the increase of 2.9% in 2023 due to the high wages, it is envisaged that RULC will pursue a steady pace of around 1.1%, 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 8.1% 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 21.5% and 14.2%, respectively. The increase in these price indices was the outcome of the significant rise in international oil prices during 2022 of about 42.6% (from a monthly average of $70.68 in 2020 to $100.78 in 2022).

In 2022 the Consumer Price Index (CPI) recorded an increase 8.4% compared to the year before.

Table V: CPI by Economic Activity

	2017	2018	2019	2020	2021	2022	Jan-23	Feb-23
GENERAL INDEX	**0.5**	**1.4**	**0.3**	**-0.6**	**2.4**	**8.4**	**7.1**	**6.9**
LOCAL GOODS	1.4	2.0	1.9	-0.6	1.7	12.7	13.1	13.0
Local Agricultural	-0.7	2.4	3.3	1.9	-0.8	8.9	3.7	3.2
Local Industrial	-0.7	-0.2	-0.4	0.9	0.3	7.5	11.8	11.3
Electricity and Water	12.1	9.3	7.5	-9.3	11.4	35.1	31.0	33.7
IMPORTED GOODS	-1.0	-1.1	-1.1	-0.7	1.2	4.6	6.5	6.6
Imported Agricultural	2.4	-5.2	-3.7	0.0	-2.3	12.6	13.3	13.3
Imported Industrial (Excl. petr.)	-1.1	-1.0	-1.1	-0.7	1.3	4.4	6.3	6.4
PETROLEUM PRODUCTS	7.1	6.0	-6.6	-9.1	15.0	28.2	6.7	3.9
SERVICES	0.5	1.8	1.7	1.1	1.3	3.9	3.9	3.9
Rents	0.8	2.5	3.4	2.5	1.9	3.1	3.1	3.1
Repairs &maintenance of dwellings	1.8	4.5	3.1	2.3	7.0	17.5	15.2	15.2
Transport	0.5	6.6	4.3	1.0	5.1	4.9	-2.2	-1.0
Communication	-1.0	-1.4	-1.6	0.7	-1.4	-0.4	-3.2	-3.2
Insurance	-2.5	0.8	0.4	0.7	1.7	1.1	0.9	0.9
Government services	0.6	3.5	0.8	0.2	-1.4	-0.8	0.0	0.0
Education	0.7	2.6	1.8	1.0	0.3	1.0	1.8	1.8
Medical care	1.1	0.8	0.7	0.7	0.5	0.4	0.7	0.7
Restaurants & Coffee shops	0.7	1.7	1.6	0.9	1.2	7.5	8.6	8.4
Personal & Household services	0.8	2.0	2.5	1.4	1.3	3.6	5.7	5.7

Source: CYSTAT

Analysis of CPI under economic activity classification shows that all main categories recorded an increase during 2022, 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 28.2%, thus contributing to the growth of CPI by 2.5 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 12.7% in 2022 due to the significant increase of Electricity and Water price index, which recorded an increase of 35.1%, contributing to the growth of CPI by 1.4 percentage points.

CPI category Services also recorded an increase of 3.9%, with almost all its sub-indices increasing during 2022. Finally, Imported Goods increased by 4.6% due to increases in imported industrial products (excluding petroleum).

Core inflation averaged at 4.9% during 2022, deviating by 3.5 percentage points compared to the headline inflation, mainly reflecting the increases which were recorded in other categories apart from energy prices and unprocessed food, 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 the highly uncertain external economic environment.

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

The major channels that the Cyprus economy is affected are related with the export of services, including tourism, in which Russia has a significant share and the heightened inflation levels, especially on energy products and wheat. Regarding the energy products, a possible exchange rate appreciation constitutes an additional risk since it can lead further price increases.

Moreover, the still high energy prices continue to affect the cost of electricity production in Cyprus, given that Cyprus is a highly oil dependent country. This additional cost or part of it, is transmitted to the final products' price, thus affecting consumption and disposable incomes.

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

The recent negative banking developments in U.S.A. and Switzerland have increased tensions in the international financial markets, which can have potentially a negative impact on the economic outlook even though the exposure of Cyprus is limited.

Lastly, the baseline scenario does not incorporate yet any climate-related risks into assessments of financial stability, debt sustainability and the economy.

On the upside, the output growth forecasts presented in the Stability Programme as well, 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 are in the pipeline 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 and also tourism and real estate as well, but their impact on growth cannot be fully measured in order to be captured in the baseline.

Upside risks also include a higher-than-expected performance in services exports, mainly in the ICT sector due to the continued significant influx of foreign companies in Cyprus.

CHAPTER 3: GENERAL GOVERNMENT BALANCE AND DEBT

3.1 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 2022, 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.

Despite the continuation of part of the COVID-19 related measures in 2021, the fiscal position recorded a substantial improvement, due to prudent fiscal policy, of 3.8 percentage points of GDP, with the budget deficit falling to 2% of GDP from a deficit of 5.8% in 2020. In 2022 the fiscal position improved further, despite the impact of the Energy-related measures of about -0.6% of GDP on the accounts of the general government, with the budget balance turning into a surplus of 2.1% of GDP, corresponding to further substantial improvement on the fiscal position of 4.1 percentage points of GDP. At the same time, the debt-to-GDP ratio declined further in 2022 by 14.7 percentage points of GDP, falling to 86.5% from 101.2% in 2021, almost reaching the pre-Adjustment Programme levels.

The increase in energy prices at this particular juncture poses a significant challenge for economic policy makers. It is noted that a series of targeted and horizontal measures were taken from end-2021, to cushion the impact of the rising prices. The measures include the reduction of excise duties on fuels, the reduction of the VAT rates on electricity consumption, support to the husbandry units (farmers), support to the low pensioners and the subsidisation of the electricity bills. The government will continue to take measures to alleviate the impact of the increase in energy prices for households and companies, that in Cyprus are driven mainly by the developments in oil prices.

3.2 General Government Balance 2022

The budget balance during 2022 turned into a surplus after two continuous years of fiscal deficits, taking into account to the strong economic activity during the year, the prudent fiscal policy and the withdrawal of the majority of the COVID-19 related support measures. In 2022 the fiscal position improved significantly by 4.1 percentage points of GDP, with the budget balance reaching 2.1% of GDP from a deficit of 2% of GDP in 2021. In nominal terms, the surplus in the accounts of the general government reached €570 mn in 2022 compared to a deficit of €482 mn the year before. Primary balance reached a surplus of €973 mn in 2022 (3.6% of GDP) compared to a primary deficit of €43 mn (-0.2% of GDP) in 2021, recording an improvement of 3.8 percentage points of GDP.

Revenue

In 2022, total revenue as a percentage of GDP reached 41.9% from 41.5% the year before, recording an increase of 0.4 percentage points of GDP. In value terms, total revenue increased by 13.7% compared to 2021, with almost all revenue categories recording a positive rate of growth during the year under review.

Tax revenue increased by 16.3% during 2022, reaching 25.3% of GDP from 24.5% of GDP during 2021. Receipts from taxes on production and imports had the highest contribution to the growth of tax revenue, of about 5.7 percentage points, recording an increase of 16.9% in value terms, despite the impact from the Energy-related measures undertaken during 2022, mostly due to increased VAT receipts compared to the year before, in line with the increased consumption recorded during the year under review. It should be noted that from the beginning of 2022 until end-August 2022, the VAT rate on electricity consumption was reduced to 5% from 19% for the vulnerable households and to 9% for the rest of the consumers. Also, the reduction of the excise duties on petroleum products was decided, as from March 2022, by 8.3 cents per litter for transport fuel and 6.4 cents per litter for heating fuel. The total revenue loss from these two measures during 2022 is estimated at around 0.3% of GDP.

Revenue from taxes on income and wealth increased by 15.5%, in line with the further improvements in the labour market conditions and the increased activity of businesses. As a percentage of GDP, current taxes on income and wealth increased by 0.2 percentage points, from 10.4% of GDP in 2021 to 10.6% of GDP in 2022.

Revenue from social security contributions increased by 13.4% during 2022. The positive growth in this revenue category was partly the outcome of increased contributions in the context of the NHS, which contributed with 2.9 percentage points to this year-on-year increase, as well as of the improved labour market conditions. As a percent of GDP, revenue from social security contributions increased marginally from 11.4% in 2021 to 11.5% in 2022.

Property income in nominal terms remained almost at the same levels as in the year before, falling as a percent of GDP from 0.5% in 2021 to 0.4% in 2022.

Finally, category ‘other revenue’ recorded an increase of 2.9% in nominal terms, albeit falling at 4.7% of GDP compared to 5.1% of GDP in 2021.

Expenditure

Total expenditure in 2022 as a percent of GDP, exhibited a substantial decrease of 3.7 percentage points, from 43.5% of GDP in 2021 to 39.8% of GDP in 2022. In value terms, public expenditure increased by 3%, a much lower growth rate compared to the revenue side, with category subsidies contributing the most to the containment of public expenditure during the year under review with -4.6 percentage points on this y-o-y rate of growth.

More specifically, expenditure category subsidies recorded a decrease of 82.2% in 2022, due to the withdrawal of 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, which took place in the year before. As a percent of GDP, subsidies decreased by 2 percentage points, from 2.4% of GDP the year before to 0.4% of GDP in 2022.

Compensation of employees exhibited an increase of 5.1%, mainly attributed to the gradual phasing out of wage cuts (contribution 2.1 percentage points), increments (contribution 1 percentage point), Cost-of-Living Adjustment [COLA] (contribution 1.3 percentage points), as well as to the increased wages and salaries of the State Health Service Organization [SHSO] (contribution 0.5 percentage points). As a percentage to GDP, compensation of employees recorded a significant decrease of 0.8 percentage points, from 12.5% in 2021 to 11.7% of GDP in 2022.

Intermediate consumption recorded a positive rate of growth of 18.1% compared to the year before, mainly due to increased expenditure for pharmaceuticals (contribution 3.7 p.p.), increased expenses for the purchase of animal foodstuffs (contribution 1.6 p.p.), as well as due to increased expenses for water supply (contribution 3.4 p.p.) and for lighting/ heating/ fuel (contribution 1.4 p.p.). In addition, expenses of about €14.3 mn for the temporary accommodation of Ukrainian nationals under temporary protection status, in hotels on a full board basis, contributed positively to the growth of expenditure for intermediate consumption with 1.4 p.p. As a percent of GDP, intermediate consumption increased by 0.3 percentage points, reaching 4.6% in 2022 from 4.3% the year before.

Social payments increased by 7.4% and had the highest contribution to the growth of public expenditure during 2022 of about 2.8 percentage points. This increase was mainly the outcome of the subsidisation of part of the electricity bills of households in the context of the energy crisis, increased expenditure of the Health Insurance Organisation (HIO) to private health providers for their services in the context of the NHS, as well as increased expenditures for old-age pensions. Also, the lump sum emergency financial assistance provided to Ukrainian single persons and families that apply for temporary protection, with an estimated cost of around €2.8 mn in 2022, contributed marginally with 0.1 p.p. to the increase of social payments. As a percent of GDP, social payments decreased from 16.4% in 2021 to 15.7% during 2022.

Interest expenditure recorded a decrease of 8.3% in 2022 compared to the year before. As a percent of GDP, interest expenditure declined further from 1.8% in 2021 to 1.5% of GDP in 2022.

Gross capital formation Increased at a rate of growth of 8.2% in 2022, falling marginally as a percent of GDP at 2.6% from 2.7% in 2021. Finally, category other expenditure recorded an increase of about 18.1% during 2022, increasing as a percent of GDP to 3.5 percent compared to 3.3 in the year before.

3.3 Budget 2023

The budget balance is expected to remain in surplus during 2023, driven mainly by the expected economic performance during the year, albeit decline marginally as a percent of GDP compared to 2022. More specifically, general government budget balance is forecast of reach 2% of GDP compared to 2.1% of GDP the year before, where primary balance is forecast to reach 3.2 as a percent of GDP compared to 3.6 in the year before.

Revenue

In accordance with the baseline macroeconomic scenario, total revenue in 2023 is anticipated to record a positive rate of growth of the order of 7.4% compared to 2022, estimated to increase as a percentage to GDP by 0.3 percentage points, from 41.9% the year before to about 42.2% of GDP.

Tax revenue in 2023 is expected to exhibit a rate of growth of about 7.1% compared to the year before, and to marginally increase as a percentage of GDP by 0.1 percentage points, from 25.3% in 2022 to 25.4%. The increase of tax revenue in value terms, is mainly attributed to the expected growth in revenue from taxes on production and imports, which is forecast to exhibit an increase of 7.1% compared to 2022, in line with the anticipated increase in private consumption. It should also be noted that part of the increase in this revenue category is also attributed to the much lower cost form the energy related measures, namely the decreased VAT rate on electricity consumption and the decreased excise duty on petroleum, which in total is estimated to contribute by 1.5 percentage points to the growth of revenue from taxes on production and imports. As a percent of GDP, taxes on production and imports are expected to remain at 14.7% as in the year before. Revenue from taxes on income and wealth are also expected to record an increase of about 7.1% compared to the year before, and to marginally increase as a percentage of GDP, from 10.6% in 2022 to 10.7% in 2023.

Social security contributions are forecast to exhibit an increase of about 8.5% in 2023, as nominal earnings are forecast to increase further during the year under review. As a percent of GDP, revenue from social security contributions is expected to increase by 0.2 percentage points in 2023, reaching 11.7% from 11.5% of GDP in 2022.

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 0.4% in 2023 as in 2022.

Finally, category "other revenue" is expected to record an increase of about 7.2% stemming mainly from the expected increase of grants to be received in the context of the RRF. As a percent of GDP, category "other revenue" is expected remain at 4.7% as in the year before.

Expenditure

Total expenditure is estimated to exhibit an increase of 7.9%, taking into account the continuation of the energy related measures. More specifically, the subsidisation of consumers' electricity bills was decided to be extended until June 2023, with the total cost of the measure during 2023 estimated to contribute to the growth of public expenditure with 0.7 percentage points. As a percent of GDP public expenditure is expected to reach 40.2% from 39.8% in 2022.

In more detail, compensation of employees is forecast to exhibit a substantial increase of 8.8% in 2023 compared to the year before, contributing to the growth of public revenue by 2.6 percentage points. This y-o-y increase is expected to be brought mainly by the provision of Cost-of-Living Adjustment, as the inflation rate for COLA calculation purposes reached 8.71% in 2022, the termination of wage cuts , as well as annual increments. As a percent of GDP, compensation of employees is forecast to increase at 11.9 percent of GDP from 11.7 percent of GDP the year before.

Intermediate consumption is forecast to record an increase of 8.8% during 2023, brought mainly from the expected increases in goods and services prices during the year under review, as well as from the expected increased expenditure under the RRP. As a percent of GDP, intermediate consumption is estimated to remain at 4.6% of GDP as in the year before.

Social transfers, are expected to increase by 7.9% in 2023, contributing the highest to the growth of public expenditure, by 3.1 percentage point. This increase is mainly attributed to the expected increased payments for old-age pensions, higher expenditure of the HIO to public health providers, as well as increased expenditure for the subsidisation of the electricity bills, in the context of the energy related measures. As a percent of GDP, this expenditure category is expected to increase marginally by 0.1 percentage points, from 15.7% the year before to 15.8% in 2023.

Interest expenditure is forecast to record a decrease of 9.4% in 2023, and fall as a percentage of GDP at 1.3% from 1.5% in 2022.

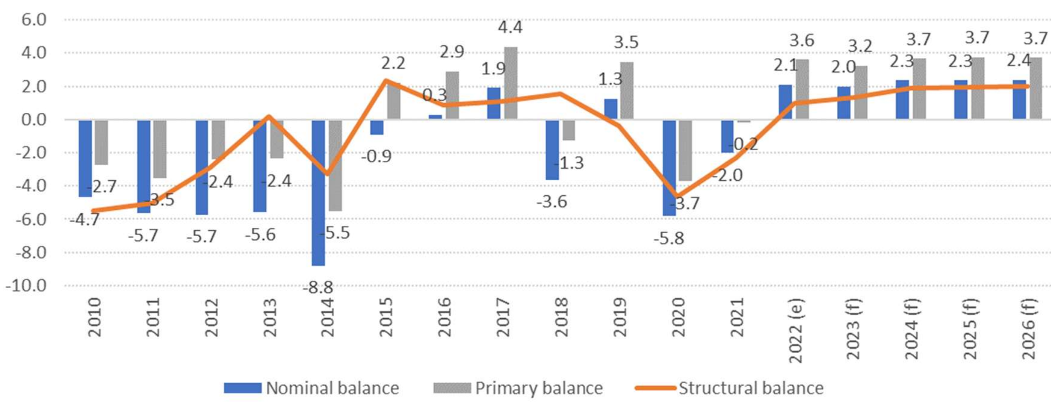
Gross capital formation as a percent of GDP is forecast to exhibit an increase of 0.4 percentage points, and to reach 3% from 2.6% of GDP in 2022. The y-o-y increase of 25.4% in this expenditure category, in value terms, is mainly attributed to the impact of the RRF.

Finally, category 'other expenditure' is estimated to drop to 3.2% of GPD during 2023 from 3.5% of GDP the year before and to marginally decrease in value terms by 0.5%

3.4 Medium-Term Budget Balance 2024-2026

Taking into account the baseline macroeconomic scenario, the expected impact from the withdrawal of the energy-related measures, as well as the increase of the contribution rates in the context of the Social Security Fund as from January 2024, it is expected that the budget position will improve further from 2024 onwards reaching a surplus of about 2.3% of GDP on average over 2024-2026.

Figure 10: Nominal, Primary and Structural Balance (% GDP)



Source: CYSTAT, MOF

Total revenue in nominal terms is projected to record a y-o-y growth of 6.8% in 2024, mainly as a result of the increase in social security contributions, as the rates in the context of the SSF will increase according to the relevant Law, and then grow further by 4.3% in 2025 and in 2026, respectively. As a percent of GDP, total revenue is forecast to reach 42.7% in 2024, and drop at 42.3% in 2025 and 41.9% of GDP in 2026.

On the expenditure side, it is forecast that public spending will increase by 5.9% in 2024 compared to the year before, and then exhibit y-o-y increases of 4.2% in 2025 and 2026, respectively. As a percent of GDP, total expenditure is forecast to reach 40.4% in 2024 from 40.2% in 2023, and then fall at 39.9% of GDP in 2025 and 39.5% of GDP in 2026.

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	2015	2016	2017	2018	2019	2020	2021	2026 (f)
General public services	22.4	21.0	20.1	16.3	18.8	19.4	17.3	16.3
Defence	3.6	4.1	5.6	4.4	4.5	4.6	4.4	4.1
Public order and safety	4.2	4.4	4.5	3.9	4.3	4.4	4.2	4.1
Economic affairs	8.7	7.0	6.7	22.8	11.3	8.4	9.8	8.0
Environmental protection	0.9	0.7	0.8	0.6	0.7	0.7	0.8	2.3
Housing and community amenities	4.4	3.9	4.2	3.5	3.9	4.0	3.4	3.4
Health	6.3	6.7	6.8	6.2	9.2	9.6	13.7	15.9
Recreation, culture and religion	2.2	2.3	2.4	1.9	2.4	2.4	2.1	2.6
Education	13.9	14.6	14.4	11.8	13.5	14.0	13.3	12.3
Social protection	33.4	35.4	34.6	28.6	31.3	32.4	31.0	31.0
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 8.2 percentage points of GDP, declining to 72.9% of GDP at end-2024 compared to 81.1 of GDP at the end of the year before, and continue its downward trend during 2025 and 2026, falling to 67.3% and 60.1% 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 3.8% in 2023, from a growth of 3.9% in 2022, and further by 3.4% in 2024 and by 3.3% in 2025 and 2026, respectively.

As a result of the real and potential GDP estimated evolution, the output gap was positive in 2022 reaching 2.3% of GDP from 0.6% in 2021. From 2022 onwards, the output gap is expected to remain positive, though at a lesser extent, reaching 0.7% of GDP in 2026.

Cyclically adjusted balance (CAB) in 2022 is estimated at about 1% of GDP, where in 2023 is it expected to record further improvement by 0.3 p.p. and to reach 1.3% of GDP. By the end of the programming period 2025-2026 the CAB is forecast to remain positive reaching 2% 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.

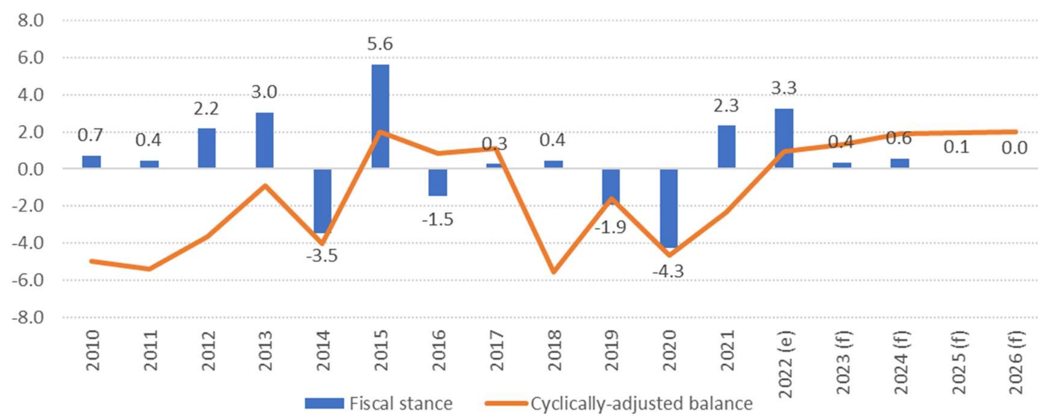
Table VII: Cyclical developments

in percentage of GDP	2022	2023	2024	2025	2026
Real GDP growth (%)	5.6	2.8	3.0	3.1	3.2
Net lending of general government	2.1	2.0	2.3	2.3	2.4
Interest expenditure	1.5	1.3	1.3	1.4	1.3
One-off and other temporary measures	0.0	0.0	0.0	0.0	0.0
Potential GDP growth (%)	3.9	3.8	3.4	3.3	3.3
Output gap	2.3	1.3	0.9	0.7	0.7
Cyclical budgetary component	1.2	0.7	0.5	0.4	0.3
Cyclically-adjusted balance	1.0	1.3	1.9	2.0	2.0
Cyclically-adjusted primary balance	2.4	2.6	3.2	3.3	3.4
Structural balance	1.0	1.3	1.9	2.0	2.0

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, the structural balance for the period 2024-26 achieves the medium-term budgetary objective, averaging at 2% of GDP.

Figure 11: 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) 2023-2025 which was approved by the Council of Ministers in October 2022 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, among others, 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 2022

The total borrowed amount of the Republic of Cyprus in 2022 reached €1,290 mn of which the main source of funding came mainly through the issuance of European Medium-Term Note (EMTN) totaling €1.0 bn. The remaining funding was mainly done through bilateral loans granted by European Commission (EC) under SURE instrument and European Investment Bank (EIB) for new and ongoing infrastructure projects. A detailed statement of the annual financing in 2022 per source is presented in the table below.

Table VIII: Net annual financing per source, 2022

	€ mn
Treasury Bills	137
Funding from EC (RRF, SURE)	29
Retail bonds	24
Euro Medium Term Notes	1,000
EIB loans	100
Total net annual financing	**1,290**

Notes: (a) The outstanding amount of €137 mn, as at the 31st of December 2022, is a roll-over amount on a quarterly basis. (b) An amount of €85 mn has been disbursed as a grant under National Recovery and Resilience Plan (NRRP).

Financing in 2023

The Annual Funding Plan 2023, which was approved by the Minister of Finance in November 2022, is presented in table IX below. The funding needs of 2023 are estimated at €1.5 bn and mostly concerns long-term debt redemptions.

The main funding of the Annual Funding Plan 2023 has already been completed through a single-tranche euro denominated issuance of the order of €1 bn in April 2023. The transaction closed successfully with a bid cover ratio larger than 12 times of the requested amount, with diversified offers from worldwide investors and a coupon rate of 4.125% at a re-offer yield 4.219%.

During the year, an amount up to €180 mn are expected to be received from EIB and Council of Europe Development Bank (CEDB) as disbursements for new and ongoing projects. In February 2023 an amount of €32.75 mn of €180 mn was disbursed from CEDB. Additionally, an amount up to €200 mn, as a grant, is expected to be disbursed from EC under the NRRP. 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, 2023

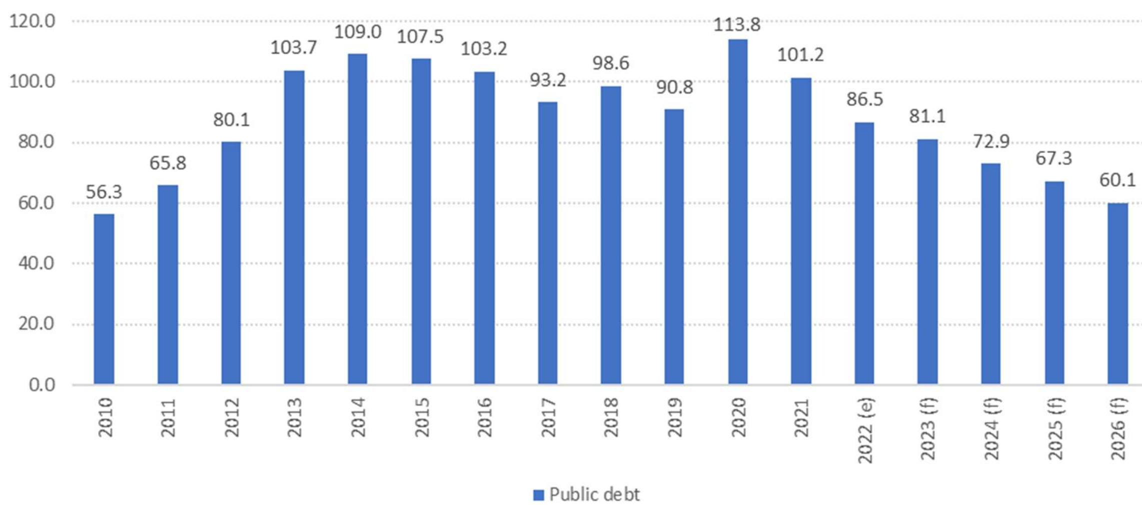
Financing source	AFP 2022 up to € mn
Treasury Bills	300[2]
Retail bonds	40
Euro Medium Term Notes (EMTN)	1,000
EIB-CEB loans	180
Use of cash reserves	200
Total net annual financing[1]	1,720

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=The maximum borrowing amount was originally set at €100 mn per monthly auction. It is noted that during the recent TB's issuances the total nominal value of accepted offers was lower than the said amount in order to retain the borrowing cost at an acceptable level since the monetary policies taken by ECB put pressure to TB's yields.

As presented in Figure 13 below, the general government debt to GDP ratio in 2022 decreased to 86.5% compared to 101.2% the year before. The reduction of the debt to GDP was attributed to the utilization of a significant amount of cash reserves to cover a part of gross financing needs in 2022, as well as to the increase of the nominal GDP. Based on the Ministry of Finance projections, the downgrade path of debt ratio is expected to continue in the following years reaching around 60.1% by the end of 2026.

Figure 12: Debt ratio



Source: Ministry of Finance

Debt developments

The general government debt is estimated at €23.4 bn or as a percentage of GDP at 81.1% as at the end of 2023, as presented in Table X below. The expected reduction of general government debt by 5.4 percentage points is attributed to the expected increase of nominal GDP, as public debt in nominal terms, and in line with the Annual Funding Plan 2023, is forecast to remain broadly at the same levels as in the year before. During the programming period 2024-2026, debt-to-GDP ratio is projected to continue its downward trend declining to about 72.9%, 67.3% and 60.1% by year end 2024, 2025 and 2026 respectively. The debt-to-GDP ratio is projected to exhibit a reduction of 8.2 percentage points in 2024 compared to 2023, 5.6 percentage points in 2025 compared to 2024 and 7.2 percentage points in 2026 compared to 2025.

Table X: General government debt 2022-2026

in percentage of GDP	2022	2023	2024	2025	2026
Gross debt ratio	86.5	81.1	72.9	67.3	60.1
Change in debt ratio	-14.7	-5.4	-8.2	-5.6	-7.2
Primary balance	3.6	3.2	3.7	3.7	3.7
Interest expenditure	1.5	1.3	1.3	1.4	1.3
Stock-flow adjustment	-12.6	-3.4	-5.9	-3.3	-4.8

Source: Ministry of Finance

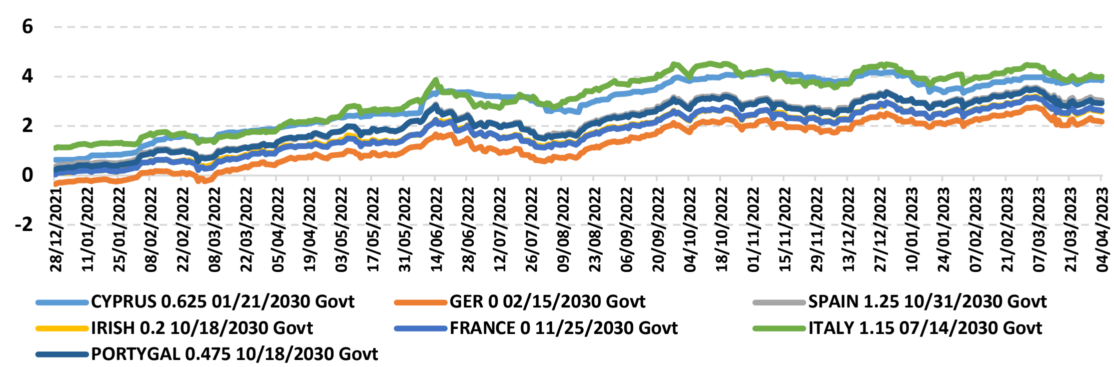
The Stock-Flow Adjustment (SFA) analyses the factors contributing to changes in government debt, other than government deficits/surpluses. The main items include the accumulation or running down of financial assets and the so called "snow ball" effect. The substantial negative stock flow adjustment in 2022, equivalent to -12.6% of GDP, reflects the significant reduction of the cash buffer accumulated the year before. In 2023 onwards, the stock flow adjustment remains negative, yet at a lesser extent, owing to further decreases in financial assets used for the repayment of debt.

Spreads – secondary market yields (from 1/1/2022 to 31/3/2023)

As presented in Figure 14 below, the 10-year 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 of selected European countries, presenting small step ups after each time ECB's monetary policy announcements.

In February 2022, when the war started in Ukraine, an obvious upset occurred, with a sharp increase in all yield curves, and Cypriot curve climbing to the levels of the Italian curve, deviating significantly from the Portuguese and the Irish curve. The Cyprus 10-year bond performed very well and had tightened further during the summer months, starting from June, recording a small down drop and shift of the yield curve underpinned by the good economic performance. Although after ECB's announcements to increase basic interest rate, small step ups occurred in September, in October and in December of 2022.

Figure 13: Secondary market yields levels of Cyprus and selected euro area States (10-year government bonds)



Source: Bloomberg

In 2022, these figures also resulted by the number of upgrades and confirmations about the Cyprus' sovereign ratings from Credit Rating Agencies (CRAs). More specific, two CRAs upgraded Cyprus sovereign rating by one notch, to BBB, in the investment category, one CRA changed the outlook, from stable to positive, sending message for a possible upgrade within the next 12 months, and the fourth CRA confirmed the rating in the investment category with a stable outlook.

In 2023 Fitch Credit Rating Agency upgraded the sovereign rating by one notch, to BBB, whilst the three other CRAs affirmed the sovereign rating of the Cyprus Republic.

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.

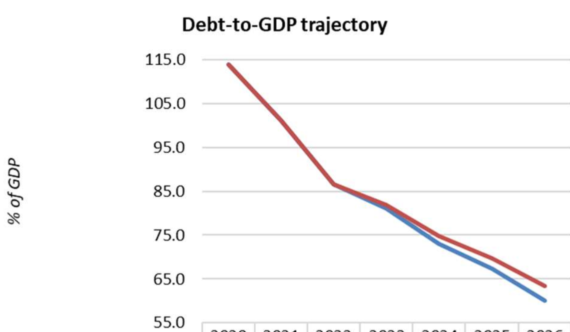
Sensitivity analysis

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.

<u>Scenario 1: Higher interest rate by 50 basis points annually</u>

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 63.4% by 2026, compared to 60.1% under the baseline scenario.

Figure 14: Debt to GDP trajectory under the higher interest rate sensitivity scenario



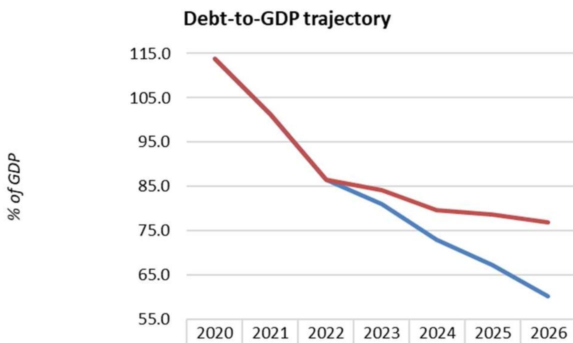
	2020	2021	2022	2023	2024	2025	2026
Baseline scenario	113.8	101.2	86.5	81.1	72.9	67.3	60.1
Higher interest rate scenario	113.8	101.2	86.5	81.9	74.7	69.8	63.4

Source: Ministry of Finance

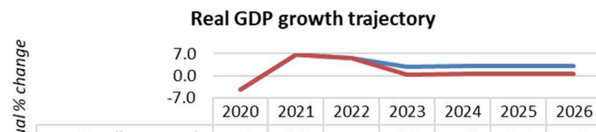
<u>Scenario 2: Lower real GDP growth by half of the 10-year historical standard deviation</u>

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 2020-2026. The debt ratio projects a sustainable path over the medium term, reaching 76.9% by 2026, exhibiting a deviation of about 16.8 percentage points of GDP compared to the projected outcome under the baseline scenario, due to the negative growth rates during 2013-2014 and in 2020. It is noted that, excluding these negative growth rates, debt-to-GDP ratio reaches 63.5% by 2026 under this scenario.

Figure 15: Debt to GDP, real GDP growth and primary balance as % of GDP trajectories under the lower real growth rate sensitivity scenario



	2020	2021	2022	2023	2024	2025	2026
Baseline scenario	113.8	101.2	86.5	81.1	72.9	67.3	60.1
Lower growth scenario	113.8	101.2	86.5	84.1	79.7	78.7	76.9



	2020	2021	2022	2023	2024	2025	2026
Baseline scenario	-4.4	6.6	5.6	2.8	3.0	3.1	3.2
Lower growth scenario	-4.4	6.6	5.6	0.3	0.6	0.6	0.7

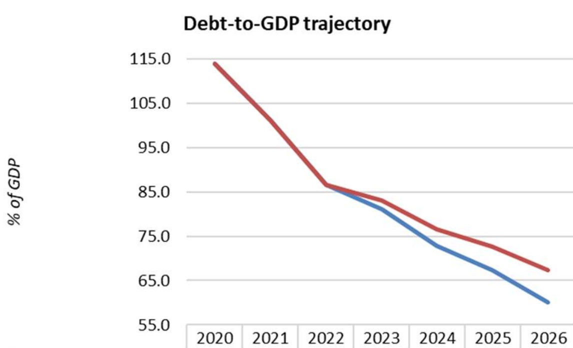
	2020	2021	2022	2023	2024	2025	2026
Baseline scenario	-3.7	-0.2	3.6	3.2	3.7	3.7	3.7
Lower growth scenario	-3.7	-0.2	3.6	2.3	1.7	0.8	-0.2

Source: Ministry of Finance

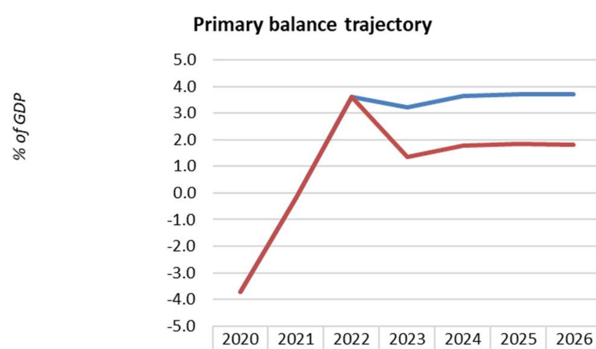
Scenario 3: Lower primary balance by half of the 10-year historical standard deviation

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 2026 is expected to be higher than the baseline, there is still a downward trend, where debt ratio declines to 67.3% by 2026.

Figure 16: General government debt and primary balance trajectories under the lower primary balance sensitivity scenario (% of GDP)



	2020	2021	2022	2023	2024	2025	2026
Baseline scenario	113.8	101.2	86.5	81.1	72.9	67.3	60.1
Lower primary balance scenario	113.8	101.2	86.5	83.0	76.6	72.7	67.3



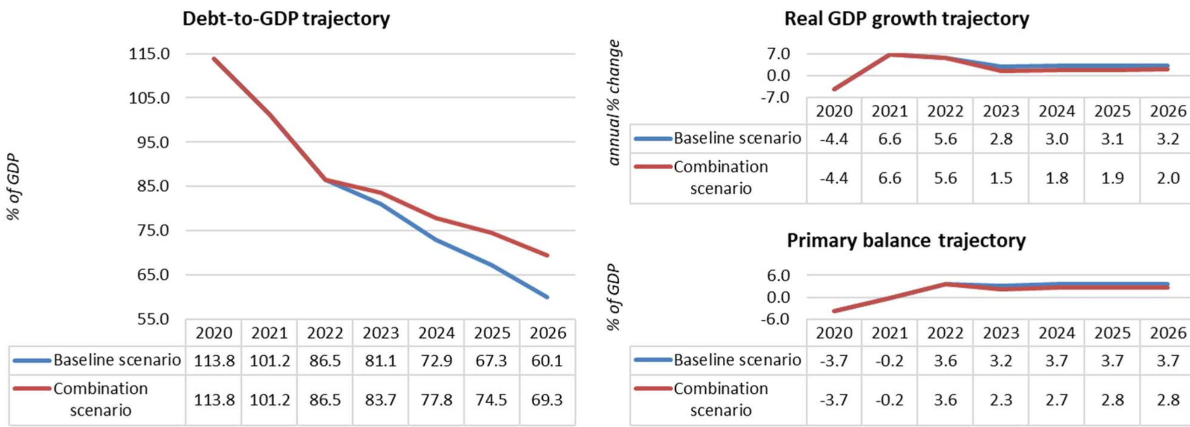
	2020	2021	2022	2023	2024	2025	2026
Baseline scenario	-3.7	-0.2	3.6	3.2	3.7	3.7	3.7
Lower primary balance scenario	-3.7	-0.2	3.6	1.3	1.8	1.8	1.8

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 2026 is expected to be higher than the baseline, there is still a downward trend, declining to 69.3% by 2026.

Figure 17: Debt to GDP, real GDP growth and primary balance as % of GDP trajectories under the combination sensitivity scenario



Debt-to-GDP trajectory (% of GDP)

	2020	2021	2022	2023	2024	2025	2026
Baseline scenario	113.8	101.2	86.5	81.1	72.9	67.3	60.1
Combination scenario	113.8	101.2	86.5	83.7	77.8	74.5	69.3

Real GDP growth trajectory (annual % change)

	2020	2021	2022	2023	2024	2025	2026
Baseline scenario	-4.4	6.6	5.6	2.8	3.0	3.1	3.2
Combination scenario	-4.4	6.6	5.6	1.5	1.8	1.9	2.0

Primary balance trajectory (% of GDP)

	2020	2021	2022	2023	2024	2025	2026
Baseline scenario	-3.7	-0.2	3.6	3.2	3.7	3.7	3.7
Combination scenario	-3.7	-0.2	3.6	2.3	2.7	2.8	2.8

Source: Ministry of Finance

CHAPTER 5: SUSTAINABILITY OF PUBLIC FINANCES

Chapter 5 illustrates the overall situation regarding the sustainability of public finances. In this chapter we perform a more detailed analysis 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 this analysis, it is assumed that the budgetary situation evolves in line with the Stability Programme (SP) targets of 2023-2026. Thereafter, the projected changes in age-related expenditure and revenue are cumulated to the 2026 general government expenditure and revenue ratios to obtain the projected long-term paths for the general government balance.

It is noted 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.

Table XI below, presents the key demographic and labour market assumptions for 2030-2060 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*	2030	2040	2050	2060
Total Fertility Rate	1.36	1.38	1.42	1.46	1.49
Life Expectancy at birth					
Males	80.4	82.1	83.3	84.5	85.6
Females	84.4	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**

** Data for 2020 are historical.*

The population in Cyprus is projected to increase by 0.2 mn during the projection period, from 0.9 mn in 2020 to 1.1 mn in 2060. Fertility rates, which have decreased during the period 2000-2014, are projected to increase over the projection period from 1.36 in 2020 to 1.49 in 2060. Life expectancy increases significantly. Gains in life expectancy during the period 2020-2060 are 5.2 years for males and 4.9 years for females.

On the labour market, the total participation rate (15-64) 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 (ages 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]	9.0	9.5	9.9	10.0	10.7
Total Amount of Contributions[2]	7.9	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.

The results in Table 7 presented in the Appendix, indicate that over the period 2020-2060, public pension spending, as percentage of GDP, is expected to increase from 9.0% in 2020 to 10.7% in 2060. This is mainly due to the significant deterioration of the old-age dependency ratio. This negative contribution from demographics, is partially offset by 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, pension contributions are expected to increase from 7.9% of GDP in 2020 to around 10.0% of GDP in 2040-2060, 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 36.8% of GDP in 2020 to 44.4% of GDP in 2050 and then to decline to 39.5% in 2060.

As a total, all age-related expenditure including spending on healthcare, long-term care and education (which are based on the 2021 Ageing Report) are projected to decrease from 21.9% in 2020 to 19.6% of GDP in 2060.

In specific, 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 projected to increase during 2020-2060, from 0.3% 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 attributed 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 to hover around 0.3% of GDP across the projection period.

As a result of the above developments, total general government expenditure will decrease from 44.6% of GDP in 2020 to 40.7% in 2060. Following the termination of all COVID-19 support measures and the continued improvement of the economy, the ratio will be projected to be on a downward path until 2026. Afterwards, it is expected to increase to 40.7% of GDP by 2060 mainly due to the increase in the pension expenditure. General government revenue is projected to increase from 38.8% of GDP in 2020 to 43.1% of GDP in 2060 due to the increase in pension contributions.

APPENDIX: STABILITY TABLES

Table 1a. Macroeconomic prospects

		2022	2022	2023	2024	2025	2026
		€ mn	rate of change	rate of change	rate of change	rate of change	rate of change
1. Real GDP	B1*g	24,229.9	5.6	2.8	3.0	3.1	3.2
2. Nominal GDP	B1*g	27,011.7	12.5	6.7	5.6	5.3	5.4
3. Private consumption expenditure	P.3	14,931.7	7.7	2.2	1.8	2.0	2.3
4. Government consumption expenditure	P.3	4,639.4	3.5	1.9	3.4	3.0	3.0
5. Gross fixed capital formation	P.51	4,661.6	6.6	1.7	6.3	6.0	5.8
6. Changes in inventories and net acquisition of valuables (% of GDP)	P.52 + P.53	403.1	3.0	0.0	0.0	0.0	0.0
7. Exports of goods and services	P.6	22,457.7	14.3	3.7	3.1	2.6	2.4
8. Imports of goods and services	P.7	22,994.7	19.5	2.7	2.9	2.4	2.2
Contributions to real GDP growth							
9. Final domestic demand		24,232.7	6.6	2.1	2.9	2.9	3.1
10. Changes in inventories and net acquisition of valuables	P.52 + P.53	403.1	3.0	0.0	0.0	0.0	0.0
11. External balance of goods and services	B.11	-537.0	-4.1	0.9	0.1	0.2	0.1

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

	2022	2022	2023	2024	2025	2026
	Level	rate of change	rate of change	rate of change	rate of change	rate of change
1. GDP deflator	111.5	6.5	3.8	2.4	2.1	2.1
2. Private consumption deflator	110.9	8.0	3.0	2.2	2.0	2.0
3. HICP[1] [2015=100]	110.2	8.1	3.2	2.5	2.0	2.0
4. Public consumption deflator	110.5	5.3	5.0	2.4	1.8	1.8
5. Investment deflator (GFCF)	116.0	8.6	3.3	2.3	2.0	2.0
6. Export price deflator (goods and services)	110.7	4.5	3.2	2.4	2.1	2.1
7. Import price deflator (goods and services)	108.6	3.9	3.0	2.3	2.0	2.0

Table 1c. Labour market developments

	ESA Code	2022 Level	2022 rate of change	2023 rate of change	2024 rate of change	2025 rate of change	2026 rate of change
1. Employment. persons (thousands)[1]		458.1	2.9	1.0	1.4	1.6	1.8
2. Employment. hours worked[2] (thousands)		829,361	4.1	1.4	1.7	1.8	2.0
3. Unemployment rate (%)[3]		32.8	6.8	6.5	5.8	5.3	5.0
4. Labour productivity. persons[4]		52,894.9	2.7	1.8	1.6	1.5	1.4
5. Labour productivity. hours worked[5]		29.2	1.5	1.4	1.3	1.3	1.2
6. Compensation of employees (€ mn)	D.1	11,383.3	7.0	9.1	6.6	6.5	6.4
7. Compensation per employee (in €)		27,906.4	3.8	8.0	5.2	4.8	4.5

[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	**2022**	**2023**	**2024**	**2025**	**2026**
1. Net lending/borrowing vis-à-vis the rest of the world	B.9	-8.9	-7.5	-7.0	-6.6	-6.3
of which:						
- *Balance on goods and services*		-0.4	0.7	0.9	1.2	1.4
- *Balance of primary incomes and transfers*		-8.7	-8.4	-8.1	-8.0	-7.9
2. Net lending/borrowing of the private sector	B.9	-2.2	-9.5	-9.4	-9.0	-8.7
3. Net lending/borrowing of general government	EDP B.9	2.1	2.0	2.3	2.3	2.4
4. Statistical discrepancy		0.0	0.0	0.0	0.0	0.0

Table 2a: General government budgetary prospects

% of GDP	ESA Code	2022	2022	2023	2024	2025	2026
Net lending (EDP B.9) by sub-sector		**€mn**					
1. General government	S.13	570.2	2.1	2.0	2.3	2.3	2.4
2. Central government	S.1311	45.9	0.2	0.1	0.6	0.7	0.8
3. State government	S.1312	M	M	M	M	M	M
4. Local government	S.1313	5.9	0.0	0.0	0.0	0.0	0.0
5. Social security funds	S.1314	518.4	1.9	1.8	1.7	1.6	1.5
General government (S13)							
6. Total revenue	TR	11,321.5	41.9	42.2	42.7	42.3	41.9
7. Total expenditure	TE[1]	10,751.3	39.8	40.2	40.4	39.9	39.5
8. Net lending/borrowing	EDP B.9	570.2	2.1	2.0	2.3	2.3	2.4
9. Interest expenditure	EDP D.41	402.4	1.5	1.3	1.3	1.4	1.3
10. Primary balance[2]		972.6	3.6	3.2	3.7	3.7	3.7
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)		6,836.8	25.3	25.4	25.3	25.1	25.0
12a. Taxes on production and imports	D.2	3,959.8	14.7	14.7	14.6	14.4	14.3
12b. Current taxes on income. wealth. etc	D.5	2,876.5	10.6	10.7	10.7	10.7	10.7
12c. Capital taxes	D.91	0.5	0.0	0.0	0.0	0.0	0.0
13. Social contributions	D.61	3,112.7	11.5	11.7	12.4	12.6	12.7
14. Property income	D.4	110.3	0.4	0.4	0.4	0.3	0.3
15. Other [4]		1,261.7	4.7	4.7	4.7	4.2	3.9
16=6. Total revenue	TR	11,321.5	41.9	42.2	42.7	42.3	41.9
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)[5]		9,949.5	36.8	37.1	37.7	37.7	37.7
Selected components of expenditure							
17. Compensation of employees + intermediate consumption	D.1+P.2	4,390.0	16.3	16.5	16.5	16.4	16.3
17a. Compensation of employees	D.1	3,158.6	11.7	11.9	11.9	11.8	11.7
17b. Intermediate consumption	P.2	1,231.4	4.6	4.6	4.6	4.6	4.6
18. Social payments (18=18a+18b)		4,229.5	15.7	15.8	16.1	16.4	16.6
of which Unemployment benefits[6]		72.0	0.3	0.2	0.2	0.2	0.2
18a. Social transfers in kind supplied via market producers	D.6311. D.63121. D.63131	925.9	3.4	3.5	3.2	3.2	3.2
18b. Social transfers other than in kind	D.62	3,303.6	12.2	12.3	12.9	13.2	13.3
19=9. Interest expenditure	EDP D.41	402.4	1.5	1.3	1.3	1.4	1.3
20. Subsidies	D.3	104.2	0.4	0.4	0.3	0.2	0.2
21. Gross fixed capital formation	P.51	691.3	2.6	3.0	2.8	2.4	2.3
22. Other[6]		933.9	3.5	3.2	3.2	3.1	2.8
23=7. Total expenditure	TE[1]	10,751.3	39.8	40.2	40.4	39.9	39.5
p.m.: Government consumption (nominal)	P.3	5,078.5	18.8	18.7	18.7	18.7	18.7

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

	2022	2022	2023	2024	2025	2026
	Level (€mn)	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
1. Total revenue at unchanged policies	11,251.8	41.7	41.5	41.3	40.7	40.2
2. Total expenditure at unchanged policies	11,122.0	41.2	41.4	41.8	41.2	40.6

Table 2c. Amounts to be excluded from benchmark

	2022	2022	2023	2024	2025	2026
	Level (€ mn)	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
1. Expenditure on EU programmes fully matched by EU funds revenue	140.0	0.5	0.4	0.8	0.6	0.4
2. Cyclical unemployment benefit expenditure	-14.4	-0.1	0.0	0.0	0.0	0.0
3. Effect of discretionary revenue measures	69.7	0.3	0.7	1.4	1.5	1.7
4. Revenue increases mandated by law	-	-	-	-	-	-

Table 3. General Government expenditure by function

% of GDP	**COFOG Code**	**2021**	**2026**
1. General public services	1	6.9	6.4
2. Defence	2	1.8	1.6
3. Public order and safety	3	1.7	1.6
4. Economic affairs	4	5.2	3.2
5. Environmental protection	5	0.4	0.9
6. Housing and community amenities	6	1.9	1.4
7. Health	7	6.8	6.3
8. Recreation, culture and religion	8	0.7	1.0
9. Education	9	5.5	4.9
10. Social protection	10	12.5	12.2
11. Total expenditure (=item 3=22 in Table 2a)	TE	43.5	39.5

Table 4. General government debt developments

% of GDP	ESA Code	2022	2023	2024	2025	2026
1. Gross debt		86.5	81.1	72.9	67.3	60.1
2. Change in gross debt ratio		-14.7	-5.4	-8.2	-5.7	-7.2
Contributions to changes in gross debt						
3. Primary balance	B.9+D.41	3.6	3.2	3.7	3.7	3.7
4. Interest expenditure	D.41	1.5	1.3	1.3	1.4	1.3
5. Stock-flow adjustment		-12.6	-3.4	-5.9	-3.3	-4.8
of which:						
- Differences between cash and accruals		-0.9	-0.3	0.1	0.2	0.2
- Net accumulation of financial assets		-0.5	2.2	-1.7	0.2	-1.6
p.m.: Implicit interest rate on debt						
6. Liquid financial assets[8]		28.7	29.1	25.9	24.8	21.9
7. Net financial debt (7=1-6)		57.8	52.0	47.0	42.5	38.2

Table 5. Cyclical Developments

% of GDP	ESA Code	2022	2023	2024	2025	2026
1. Real GDP growth (%)		5.6	2.8	3.0	3.1	3.2
2. Net lending of general government	B.9	2.1	2.0	2.3	2.3	2.4
3. Interest expenditure	D.41	1.5	1.3	1.3	1.4	1.3
4. One-off and other temporary measures[1]		0.0	0.0	0.0	0.0	0.0
5. Potential GDP growth (%)		3.9	3.8	3.4	3.3	3.3
contributions:						
- labour		1.2	1.3	0.9	0.9	0.9
- capital		1.1	1.0	1.1	1.2	1.3
- total factor productivity		1.5	1.5	1.3	1.2	1.1
6. Output gap		2.3	1.3	0.9	0.7	0.7
7. Cyclical budgetary component		1.2	0.7	0.5	0.4	0.3
8. Cyclically-adjusted balance (2 - 7)		1.0	1.3	1.9	2.0	2.0
9. Cyclically-adjusted primary balance (8 + 3)		2.4	2.6	3.2	3.3	3.4
10. Structural balance (8 - 4)		1.0	1.3	1.9	2.0	2.0

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

Table 6. Divergence from previous update

	ESA Code	2022	2023	2024	2025	2026
Real GDP growth (%)						
Previous update		2.7	3.8	3.4	3.0	n.a.
Current update		5.6	2.8	3.0	3.1	3.2
Difference		2.9	-1.0	-0.4	0.1	n.a.
General government net lending (% of GDP)	B.9					
Previous update		0.5	0.8	1.9	2.1	n.a.
Current update		2.1	2.0	2.3	2.3	2.4
Difference		1.6	1.2	0.4	0.2	n.a.
General government gross debt (% of GDP)						
Previous update		93.9	88.2	81.0	76.7	n.a.
Current update		86.5	81.1	72.9	67.3	60.1
Difference		-7.4	-7.1	-8.1	-9.4	n.a.

Table 7. Long-term sustainability of public finances

% of GDP	2007	2010	2020	2030	2040	2050	2060
Total expenditure	37.6	41.7	44.6	39.5	40.0	40.0	40.7
Of which: **age-related expenditures**	15.1	17.8	21.9	18.4	18.9	18.8	19.6
Pension expenditure	6.0	6.8	9.0	9.5	9.9	10.0	10.7
Social security pension	4.0	4.7	6.6	8.2	8.9	9.5	10.5
Old-age and early pensions	2.9	3.6	5.4	6.7	7.2	7.8	8.8
Other pensions (disability, survivors)	1.1	1.2	1.2	1.5	1.7	1.7	1.7
Occupational pensions (if in general government)[1]	2.0	2.1	2.3	1.3	1.0	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	0.3	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	37.0	38.8	42.3	43.2	43.2	43.1
Of which: property income	0.6	1.4	0.5	0.3	0.3	0.3	0.3
Of which: from pensions contributions (or social contributions if appropriate)	5.8	6.8	7.9	9.2	10.1	10.1	10.0
Pension reserve fund assets	32.7	35.9	36.8	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	1.8	2.1	0.8	1.9	1.8	1.7
Real GDP growth	5.1	2.3	-4.4	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	2022	2023
Public guarantees	5.2	4.9
Of which: linked to the financial sector	1.7	1.6

Table 8. Basic assumptions

	2022	2023	2024	2025	2026
EA: Short-term interest rate (3-months money markets)	0.3	3.1	2.8	…	…
EA: Long-term interest rate (10-year government bonds, Germany)	1.1	2.1	2.1	…	…
USD/€ exchange rate (annual average)	1.04	1.08	1.09	1.09	1.10
Nominal effective exchange rate of the EU (% change)	-4.0	3.3	0.0	…	…
World growth excluding EU (in PPP terms)	3.1	3.0	3.3	…	…
EU 28 GDP growth	3.5	0.8	1.6	2.2	2.0
Growth of relevant foreign markets [UK]	4.0	-0.3	1.0	2.2	2.0
World import volumes. excluding EU	4.4	2.4	3.6	…	…
Oil prices (Brent. USD/barrel)	100.7	84.8	79.9	76.0	73.0

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

% of GDP	2022	2023	2024	2025	2026
Revenue from RRF grants					
1. RRF GRANTS as included in the revenue projections	0.1	0.4	0.9	0.8	0.6
2. Cash disbursements of RRF GRANTS from EU	0.3	0.7	0.8	0.6	0.4
Expenditure financed by RRF grants					
3.TOTAL CURRENT EXPENDITURE	0.1	0.1	0.3	0.2	0.2
4. TOTAL CAPITAL EXPENDITURE	0.1	0.3	0.7	0.6	0.5
of which:					
- Gross fixed capital formation	0.0	0.2	0.4	0.3	0.3
- Capital transfers	0.0	0.1	0.2	0.3	0.2
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	2022	2023	2024	2025	2026
Cash flow from RRF loans projected in the programme					
1. Disbursements of RRF LOANS from EU	0.0	0.0	0.2	0.3	0.0
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	0.0
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