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**Assessment of the 2018 Stability Programme for
Cyprus**

(Note prepared by DG ECFIN staff)

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1. INTRODUCTION

On 30 April 2018, Cyprus submitted its 2018 Stability Programme (hereafter called Stability Programme), covering the period 2018-2021. The Council of Ministers approved the Stability Programme on 24 April 2017.

Cyprus is currently subject to the preventive arm of the the Stability and Growth Pact (SGP) and should preserve a sound fiscal position which ensures compliance with the Medium-Term Budgetary Objective (MTO). As the debt ratio was 107.5% of GDP in 2015 (the year in which Cyprus corrected its excessive deficit), exceeding the 60% of GDP reference value, Cyprus is also subject to the transitional arrangements as regards compliance with the debt reduction benchmark during the three years following the correction of the excessive deficit (transitional debt rule). In this period it should ensure sufficient progress towards compliance with the debt reduction benchmark. After the transition period, as of 2019, Cyprus is expected to comply with the debt reduction benchmark.

This document complements the Country Report published on 7 March 2018 and updates it with the information included in the Stability Programme. Section 2 presents the macroeconomic outlook underlying the Stability Programme and provides an assessment based on the Commission 2018 spring forecast. The following section presents the recent and planned budgetary developments, according to the Stability Programme. In particular, it includes an overview on the medium term budgetary plans, an assessment of the measures underpinning the Stability Programme and a risk analysis of the budgetary plans based on the Commission forecast. Section 4 assesses compliance with the rules of the SGP, including on the basis of the Commission 2018 spring forecast. Section 5 provides an overview on long-term sustainability risks and Section 6 on recent developments and plans regarding the fiscal framework. Section 7 provides a summary.

2. MACROECONOMIC DEVELOPMENTS

The economy of Cyprus expanded markedly by 3.9% in real terms in 2017. The macroeconomic scenario underlying the Stability Programme projects a nearly equally strong growth in 2018, at 3.8%, before easing somewhat in 2019, to 3.6%. In 2020-2021, growth is expected to continue gradually slowing down, but still to record a very solid 3.2% and 3.0%, respectively. Domestic demand is expected to be the main driver for growth, with gross fixed capital formation playing a key role and expanding between 7 and 16% per year during the programme horizon, while private consumption is expected to be strong but grow at a slower pace than the real GDP. Net exports are expected to continue having a negative impact on growth, albeit this impact is set to diminish rapidly despite domestic-demand driven growth, from -4.5% in 2017 to -0.3% in 2021.

Compared to the 2018 Draft Budgetary Plan, real GDP growth for 2017 in the stability programme is revised by 0.3 percentage point upwards. There is an even larger revision for 2018, which is currently forecast at 3.8% compared to the 3.0% projected in the Draft Budgetary Plan. This is particularly driven by large revisions in gross fixed capital formation, private consumption and imports.

The 2018 and 2019 projections underlying the Stability Programme are slightly more optimistic (by 0.2 and 0.3 percentage points, respectively) than the Commission 2018 spring forecast. The composition of growth in 2018 has a broadly similar pattern, with somewhat weaker growth of domestic demand components and less negative contribution of net exports in the Commission forecast. For 2019, the Commission 2018 spring forecast and the Stability

Programme projections identify the same main drivers of growth. However, the Commission projects lower GDP growth due to a slightly weaker domestic demand and a somewhat more negative contribution of net exports than in the Stability Programme. The unemployment rate in the Stability Programme is projected to fall at a slower pace than in the Commission 2018 spring forecast. The unemployment outlook for 2018 in the Stability Programme, at 9.5%, can be considered conservative, given that the unemployment rate in February 2018 has already fallen to 9.6%.

Inflation in Cyprus has been very subdued and is expected to remain so. In 2017, HICP recorded 0.7% inflation, after several years of deflation. The Stability Programme projects even lower inflation in 2018, at 0.5% and a gradual increase to 2% at the end of the programme horizon. This is somewhat lower (by 0.2 percentage point for both 2018 and 2019) than the Commission 2018 spring forecast.

Table 1: Comparison of macroeconomic developments and forecasts

	2017		2018		2019		2020	2021
	COM	SP	COM	SP	COM	SP	SP	SP
Real GDP (% change)	3.9	3.9	3.6	3.8	3.3	3.6	3.2	3.0
Private consumption (% change)	4.2	4.2	3.4	3.5	2.9	3.0	2.5	2.0
Gross fixed capital formation (% change)	27.8	27.8	13.4	16.3	9.8	10.2	7.4	7.2
Exports of goods and services (% change)	3.4	3.4	2.3	4.4	1.9	4.2	4.0	4.0
Imports of goods and services (% change)	10.1	10.1	4.8	7.4	3.7	5.4	4.2	4.0
<i>Contributions to real GDP growth:</i>								
- Final domestic demand	8.2	8.4	5.4	6.1	4.7	4.8	3.7	3.3
- Change in inventories	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
- Net exports	-4.4	-4.5	-1.8	-2.3	-1.3	-1.2	-0.5	-0.3
Output gap ¹	0.7	0.4	2.3	2.0	3.3	2.8	3.1	3.4
Employment (% change)	3.4	3.4	2.8	3.0	2.8	2.5	2.2	2.0
Unemployment rate (%)	11.1	11.0	9.0	9.5	7.1	8.0	6.5	5.0
Labour productivity (% change)	0.5	0.5	0.8	0.8	0.5	1.0	1.0	1.0
HICP inflation (%)	0.7	0.7	0.7	0.5	1.2	1.0	1.5	2.0
GDP deflator (% change)	1.5	1.5	1.5	1.0	1.7	1.0	1.5	2.0
Comp. of employees (per head, % change)	0.7	0.7	1.4	1.5	2.0	2.0	2.5	3.0
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	-7.6	-6.7	-8.6	-7.1	-9.3	-7.8	-7.9	-7.7
<u>Note:</u>								
¹ In % of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.								
<u>Source :</u>								
Commission 2018 spring forecast (COM); Stability Programme (SP).								

The output gap, as recalculated by the Commission based on the information in the Stability Programme and according to the commonly agreed methodology (recalculated output gap), was 0.4% in 2017, turning positive after several years of a negative gap. This indicates that Cyprus has entered the upswing phase of the economic cycle. According to the Stability Programme, the output gap is expected to widen to 2% in 2018 and continue widening in 2019, reaching 2.8%. The Commission 2018 spring forecast envisages a positive and slightly higher output gap, at 2.3% and 3.3% in 2018 and 2019, respectively.

Overall, the Stability Programme presents plausible macroeconomic assumptions until 2019, with a somewhat more favourable macroeconomic outlook than the Commission 2018 spring forecast for both 2018 and 2019. The risks associated with the macroeconomic assumptions presented in the Stability Programme are tilted to the downside. The main downside risks to the projections are linked to the developments in the banking sector, namely the still very high share of non-performing loans. On the external side, risks remain contained and relate to the economic outlook of the UK, one of the key trading partners of Cyprus; and a potential deterioration in the external environment, including uncertainties on the policy stance of the US and the relationship between the EU and Russia.

3. RECENT AND PLANNED BUDGETARY DEVELOPMENTS

3.1. DEFICIT DEVELOPMENTS IN 2017 AND 2018

In 2017, based on notified data¹, the general government headline balance reached a surplus of 1.8% of GDP (up from 0.3% in 2016), one of the highest in the EU and well above the estimates of the 2018 Draft Budgetary Plan, which projected a surplus of 1.0% of GDP. The 2017 outperformance is explained by a better-than-expected economic growth in 2017, including the buoyant tax intake, and favourable labour market developments. Compared to 2016, total revenue soared by 8.2% in 2017, amounting to 39.9% of GDP and pointing at significant revenue windfalls. Tax revenue turned out stronger than expected in 2017, surging by 8.5% compared to the year before. This was mainly the result of the sizable increase in tax revenue on production and imports (by 11.0%), due to the surge in VAT receipts (by 15.9%). In addition, tax revenue on income and wealth rose markedly (by 4.6%), mainly due to the strong performance of corporate tax receipts (by 10.3%) and despite the negative impact of the abolition of the immovable property tax and the termination of the temporary tax on private sector emoluments in 2017. Furthermore, revenue from social security contributions increased strongly (by 10.5%), as well as other non-tax revenue (by 3.8%). Total expenditure increased by 4.3% compared to 2016, but declined as a percentage of GDP to 38.1%. The rise in expenditure is mainly attributed to increases in compensation of employees (by 4.0%), including the hiring of additional personnel for security forces and the abolition of the temporary contribution on emoluments of public sector employees; intermediate consumption (by 11.9%), partly due to higher energy-related spending and expenditures for pharmaceuticals and desalinated water; social payments (by 2.1%), namely due to increased payments for old age pensions; interest expenditure (by 1.2%); gross fixed capital formation (by 12.3%), and other expenditure (by 13.6%). According to the Stability Programme, Cyprus' (recalculated) structural balance² is estimated to have improved (by 0.3 percentage point of GDP) in 2017, due to the improvement in the headline balance as well as the improving cyclical condition. The output gap is estimated to increase to 0.4% of GDP in 2017, up from -1.1% of GDP in 2016.

¹ Based on data reported to Eurostat in spring 2018, see April 2018 EDP notification. Discussions between Eurostat and the Statistical Service of Cyprus (Cystat) are ongoing regarding the recording of interest expenditure and intermediate consumption. Possible future changes to the recording of those expenditure items would not have an impact on the general government balance, but they would affect the primary balance and interest expenditure.

² Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission on the basis of the information provided in the Stability Programme according to the commonly agreed methodology.

For 2018, the Stability Programme presents a general government headline surplus target of 1.7% of GDP, above the target in the 2018 Draft Budgetary Plan (by 0.7 percentage point of GDP). The revised target mostly results from the carry-over from 2017, the upward revision of the macroeconomic outlook and a further improvement in the labour market. The revenue-to-GDP ratio presented in the Stability Programme appears conservative and is projected to decrease to 39.1% in 2018, a decrease by 0.8 percentage point compared to the previous year. This is notably due to the projected significant decrease in the non-tax revenue item (by 0.6 percentage point of GDP for other revenue) and, to a lesser extent, the projected drop in current taxes on income and wealth (by 0.2 percentage point of GDP) and taxes on production and imports (by 0.1 percentage point of GDP). Total tax revenue is expected to increase by 3.7% compared to 2017, somewhat below nominal GDP (of 4.8%). In turn, the expenditure-to-GDP ratio is projected to decline by some 0.7 percentage point to 37.4%, although it is projected to increase in nominal terms by 3.3% in 2018, compared to a rise of 4.3% in 2017. The decrease of expenditure as a proportion of GDP mostly results from projected expenditure declines in compensation of employees (by 0.2 percentage point of GDP), social payments (by 0.3 percentage point of GDP), gross fixed capital formation (by 0.2 percentage point of GDP) and other expenditure (by 0.3 percentage point of GDP). The changes projected on intermediate consumption and interest expenditure are partly explained by the fact that the authorities' projections in the Stability Programme are not based on 2017 notified data³. According to the Stability Programme, the (recalculated) structural balance is estimated at around 0.6% of GDP in 2018, partly explained by the increase of the positive output gap.

The Commission 2018 spring forecast projects the general government headline balance for 2018 at 2.0% of GDP, compared to a projection of 1.7% of GDP in the Stability Programme. The difference vis-à-vis the programme's target stems from the macroeconomic assumptions based on a higher nominal GDP projection, more dynamic revenue based on track-record (4.3% y-o-y as against 3.0% in the Stability Programme, and compared to 8.2% in 2017) and more conservative assumptions on expenditure. More specifically, the Stability Programme presents, on the revenue side, a lower forecast for non-tax revenue item (i.e. other revenue, by 0.4 percentage point of GDP) and, to a lesser extent, for taxes on production and imports and current taxes on income and wealth (by 0.1 percentage point of GDP, respectively). On the expenditure side, the differences mainly concern a lower forecast for gross fixed capital formation (by 0.3 percentage point of GDP), other expenditure (by 0.3 percentage point of GDP) and compensation of employees (by 0.1 percentage point of GDP). As mentioned above, the differences on intermediate consumption and interest expenditure are partly due to the use of non-notified data for 2017 in the Stability Programme. Finally, according to the Commission 2018 spring forecast, the structural surplus is expected to narrow by 0.6 percentage point of GDP in 2018 compared to the year before, although remaining well above the MTO.

³ Expenditure on intermediate consumption is projected to increase (by 0.5 percentage point of GDP), while interest expenditure is set to decrease (by 0.4 percentage point of GDP) in 2018. For further information on the 2017 notified data, see footnote 1.

3.2. MEDIUM-TERM STRATEGY AND TARGETS

In the 2018 Stability Programme the general government balance is projected to remain in surplus and broadly constant at 1.7% of GDP in 2018 and to steadily increase over the programme period, reaching a surplus of 1.9% of GDP in 2021. The structural balance is estimated to reach 0.4% of GDP in 2018 and to remain above Cyprus' MTO of 0% of GDP over the programme horizon. The Stability Programme states that the MTO remains unchanged and targets a balanced structural position, more stringent⁴ than required by the Pact.

On the basis of the information in the Stability Programme, the recalculated structural balance is estimated at 0.6% of GDP in 2018, after 1.4% of GDP in 2017, and set to narrow further over the programme horizon, but to remain above the MTO throughout.

Compared to the 2018 Draft Budgetary Plan, the headline surplus for 2018 reported in the Stability Programme is higher by 0.4 percentage point of GDP, reflecting the higher-than-expected fiscal outturn for 2017 and a better economic environment. However, as a percentage of GDP, the Stability Programme points to a decline of the headline balance in 2018 (by 0.1 percentage point of GDP) compared to the previous year, unlike the 2018 Draft Budgetary Plan that projected an increase (by 0.3 percentage point of GDP).

The Stability Programme targets the general government surplus to remain constant in 2019 and to slightly increase to below 2% of GDP over the programme period. The revenue-to-GDP ratio is set to decline to 38.9% of GDP in 2019, averaging at 38.3% of GDP over the 2019-2021 period, and where the Stability Programme estimates appear conservative. Tax revenue is projected to increase annually by 3.9% on average over the same period. As reported in the Stability Programme, corporate tax receipts are planned to continue to account on average for about 17.9% of total tax revenue. More specifically for 2019, the projected decrease in revenue as a proportion of GDP is mainly due to a significant drop in the non-tax revenue item (by 0.5 percentage point of GDP for other revenue), for which no detailed explanations are provided in the Stability Programme, that offsets the marked increase in social contributions (by 0.5 percentage point of GDP). The expenditure-to-GDP ratio is projected to decrease to 37.2% of GDP in 2019 and gradually to 35.7% of GDP by 2021. Total expenditure is set to grow below nominal GDP growth. For 2019, the projected decline in expenditure as a proportion of GDP mainly stems from a drop in compensation of employees (by 0.2 percentage point of GDP), assuming that the increase in nominal terms remains stable over the programme horizon at about 2.8% per year and below the nominal GDP growth, and social payments (by 0.2 percentage point of GDP), which offset the increase in other expenditure (by 0.3 percentage point of GDP).

The Commission 2018 spring forecast, under the usual no-policy-change assumption, projects a headline surplus of 2.2% of GDP in 2019, 0.5 percentage point above the authorities' projections. Compared with the Stability Programme, the Commission projections reflect a somewhat different macroeconomic outlook in terms of a higher nominal GDP projection, more dynamic revenue given the track-record (by 0.7 percentage point of GDP against the Stability Programme) and more conservative assumptions on expenditure by extrapolating trends with past policy orientations (by 0.1 percentage point of GDP compared to the Stability Programme). In particular, the Stability Programme presents, on the revenue side, a

⁴ The MTO selected by the Member State is more ambitious than the minimum MTO by more than ½ percentage point. The minimum MTOs are country-specific and calculated based on an agreed methodology.

significantly lower forecast for the non-tax revenue item (i.e. other revenue, by 0.7 percentage point of GDP) and, on the expenditure side, lower forecast for gross fixed capital formation (by 0.4 percentage point of GDP) and compensation of employees (by 0.3 percentage point of GDP) which offset the increase in intermediate consumption. Finally, the Commission 2018 spring forecast points to a deterioration of the structural balance by 0.3 percentage point of GDP in 2019, similar to the decline of the (recalculated) structural balance in the Stability Programme.

Table 2: Composition of the budgetary adjustment

(% of GDP)	2017	2018		2019		2020	2021	Change: 2017-2021
	COM	COM	SP	COM	SP	SP	SP	SP
Revenue	39.9	39.6	39.1	39.6	38.9	38.4	37.6	-2.1
<i>of which:</i>								
- Taxes on production and imports	15.8	15.8	15.7	15.7	15.7	15.6	15.4	-0.4
- Current taxes on income, wealth, etc.	9.6	9.5	9.4	9.4	9.3	9.2	9.1	-0.5
- Social contributions	8.9	8.9	8.9	9.2	9.4	9.4	9.4	0.5
- Other (residual)	5.7	5.4	5.0	5.2	4.5	4.1	3.7	-1.7
Expenditure	38.1	37.6	37.4	37.3	37.2	36.6	35.7	-2.2
<i>of which:</i>								
- Primary expenditure	35.0	34.6	34.6	34.5	34.3	33.7	33.0	-2.3
<i>of which:</i>								
Compensation of employees	12.2	12.1	12.0	12.1	11.8	11.6	11.3	-0.9
Intermediate consumption	3.1	3.1	3.6	3.1	3.5	3.4	3.3	-0.4
Social payments	13.6	13.3	13.3	13.1	13.1	12.9	12.6	-1.0
Subsidies	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.0
Gross fixed capital formation	2.7	2.8	2.5	2.9	2.5	2.5	2.5	-0.1
Other (residual)	3.0	3.0	2.7	3.0	3.0	3.0	3.0	0.1
- Interest expenditure	3.2	3.0	2.8	2.8	2.9	2.9	2.7	0.1
General government balance (GGB)	1.8	2.0	1.7	2.2	1.7	1.8	1.9	0.1
Primary balance	5.0	5.0	4.5	5.1	4.7	4.6	4.6	0.2
One-off and other temporary	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
GGB excl. one-offs	1.8	2.0	1.7	2.2	1.7	1.8	1.9	0.1
Output gap ¹	0.7	2.3	2.0	3.3	2.8	3.1	3.4	3.0
Cyclically-adjusted balance ¹	1.4	0.8	0.6	0.5	0.3	0.1	0.1	-1.4
Structural balance²	1.4	0.8	0.6	0.5	0.3	0.1	0.1	-1.4
Structural primary balance ²	4.6	3.8	3.5	3.3	3.2	3.0	2.9	-1.9

Notes:

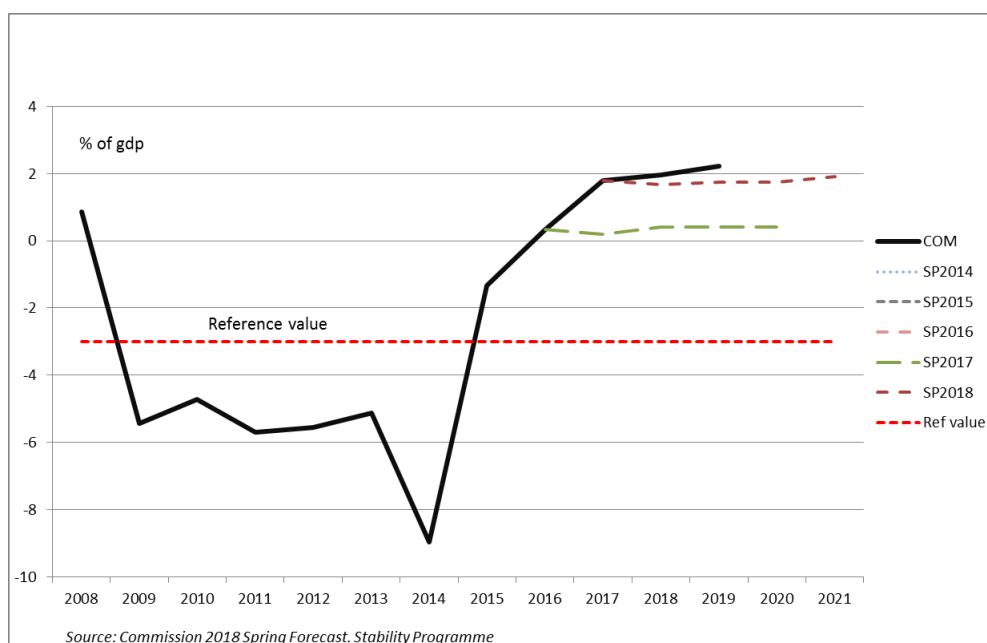
¹Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission on the basis of the programme scenario using the commonly agreed methodology.

²Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

Source:

Stability Programme (SP); Commission 2018 spring forecasts (COM); Commission calculations.

Figure 1: Government balance projections in successive programmes (% of GDP)



3.3. MEASURES UNDERPINNING THE PROGRAMME

The measures underpinning the Stability Programme include the discretionary measures for 2017 reported in the 2018 Draft Budgetary Plan, such as the full abolition of the immovable property tax and the termination of the temporary contribution of public and private employees. According to the Stability Programme, the fiscal impact of these deficit-increasing measures is estimated at around 0.4% of GDP on the revenue side, and at 0.2% of GDP on the expenditure side. Despite these expansionary measures, Cyprus reached a structural surplus in 2017, well above its MTO.

In 2018, the Stability Programme reports the introduction of the VAT rate on property land as a discretionary measure. The fiscal impact of this deficit-decreasing measure is estimated at 0.1% of GDP on the revenue side. In 2019, the rise in social security contributions is taken into account in the Stability Programme as a revenue increase mandated by law, with a fiscal impact estimated at 0.2% of GDP. The Stability Programme does not report any discretionary measure planned for 2020-2021. The budgetary impact of these measures was also taken into account in the Commission 2018 spring forecast.

According to the Stability Programme, Cyprus would be above its MTO over the programme horizon. This is also in line with the Commission 2017 spring forecast.

Main budgetary measures

Revenue	Expenditure
2017	
<ul style="list-style-type: none"> Abolition of the immovable property tax (-0.2% of GDP) Termination of the temporary contribution of private employees (-0.2% of GDP) 	<ul style="list-style-type: none"> Termination of the temporary contribution of public employees (+0.2% of GDP)

2018	
<ul style="list-style-type: none"> • Introduction of the VAT rate on property land (+0.1% of GDP) 	
2019	
<ul style="list-style-type: none"> • Increase in social security contributions (+0.2% of GDP) 	
<p><u>Note:</u> The budgetary impact in the table is the impact reported in the programme, i.e. by the national authorities. A positive sign implies that revenue / expenditure increases as a consequence of this measure.</p>	

3.4. DEBT DEVELOPMENTS

Public debt fell significantly in 2017, dropping below 100 % for the first time since 2013, to 97.5 % of GDP. Cyprus has significantly accelerated its public debt reduction, owing to a high nominal GDP growth, a sizeable general government primary surplus and active debt management operations. The latter entailed repaying part of the debt from the accumulated cash balances (reflected in a negative stock-flow adjustment). In particular, the government repaid part of the debt owed to the CBC (amounting to EUR 615 m, 3.2 % of GDP) in November 2017.

Based on the Stability Programme, public debt is projected to sharply increase in 2018 to 105.6 % of GDP. The increase in 2018 is mainly due to an issuance of a series of government bonds on 3 April 2018 (of EUR 2.35 billions), the proceeds of which were deposited with the Cyprus Cooperative Bank (CCB). The accumulation of liquid assets in the form of deposits at the CCB is expected to be maintained over the forecast horizon, as reflected in a positive stock flow adjustment in 2018 and no corresponding negative adjustment in following years. Under the Stability Programme, public debt-to-GDP ratio is projected to exhibit a sharp downward trend over 2019-2021, mainly due to projected high primary surpluses (above 4.5% of GDP) and relatively high real GDP growth.

Due to the transaction with the CCB, representing a level shift upwards for the public debt trajectory, public debt is projected to be above that expected in the 2017 Stability Programme (Figure 2). Based on the Commission 2018 spring forecast, government debt is expected to follow similar dynamics. The decline in 2019 is projected by the Commission to be somewhat larger compared to the Stability Programme projections, due to more optimistic projections of the inflation and primary balance, partly offset by more pessimistic projection of a higher stock-flow adjustment (in the form of accumulation of financial assets).

Figure 2: Government debt projections in successive programmes (% of GDP)

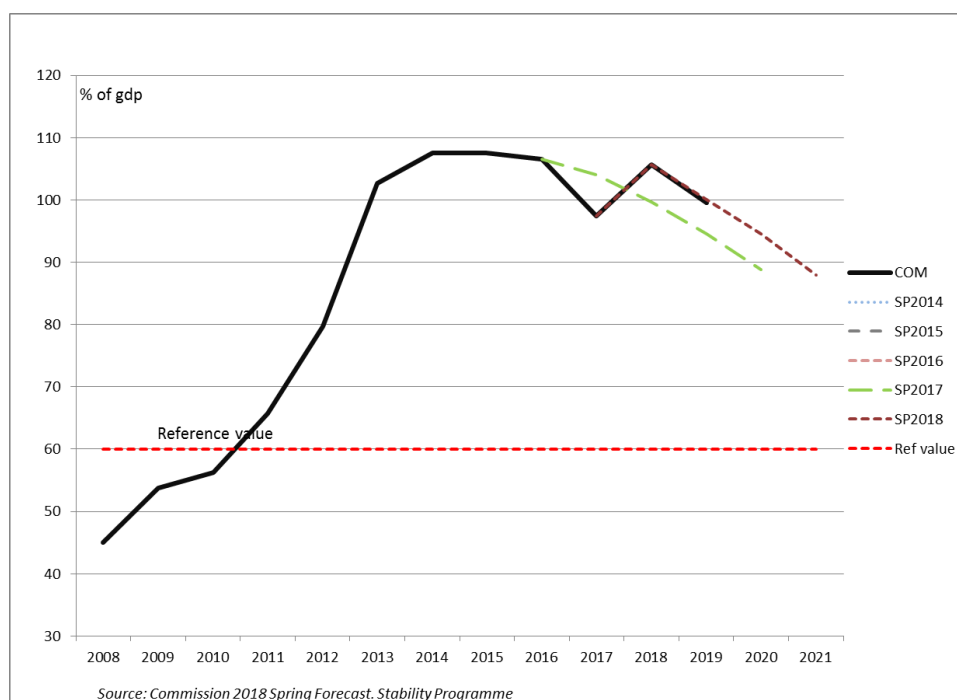


Table 3: Debt developments

(% of GDP)	Average 2012-2016	2017	2018		2019		2020	2021
			COM	SP	COM	SP	SP	SP
Gross debt ratio¹	100.8	97.5	105.7	105.6	99.5	100.0	94.6	88.0
Change in the ratio	8.2	-9.1	8.2	8.1	-6.1	-5.6	-5.4	-6.6
<i>Contributions² :</i>								
1. Primary balance	0.7	-5.0	-5.0	-4.5	-5.1	-4.7	-4.6	-4.6
2. “Snow-ball” effect	4.7	-2.3	-1.7	-1.6	-2.2	-1.7	-1.6	-1.8
<i>Of which:</i>								
Interest expenditure	3.5	3.2	3.0	2.8	2.8	2.9	2.9	2.7
Growth effect	0.6	-3.9	-3.3	-3.5	-3.4	-3.6	-3.0	-2.7
Inflation effect	0.7	-1.5	-1.4	-0.9	-1.7	-1.0	-1.4	-1.8
3. Stock-flow adjustment	2.8	-1.8	15.0	14.3	1.3	0.8	0.9	-0.1
<i>Of which:</i>								
Cash/accruals diff.				0.0		0.0	0.0	0.0
Acc. financial assets				14.3		0.8	0.9	-0.1
<i>Privatisation</i>				0.0		0.0	0.0	0.0
Val. effect & residual				0.0		0.0	0.0	0.0

Notes:

¹ End of period.

² The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.

Source:

Commission 2018 spring forecast (COM); Stability Programme (SP), Commission calculations.

3.5. RISK ASSESSMENT

As analysed in Section 2, the real GDP growth projections put forward in the Stability Programme for 2018 and 2019 are higher than the Commission 2018 spring forecast. Despite the recent strong performance of the Cypriot economy, risks to the macroeconomic outlook appear to be tilted to the downside in both years, mainly due to domestic factors, in particular the high levels of non-performing loans in the banking sector and the low profitability of banks. There are also external risks, such as those related to the economic outlook of the UK, as one of the Cyprus' most significant trading partners, and the potential deterioration of the policy stance of the US and the relationship between the EU and Russia. In addition, the concentration of investment in construction and transport equipment (ship registration in particular) casts doubts on the extent of its positive impact on potential growth in the medium to long term.

As analysed in Section 3, the fiscal projections in the 2018 Stability Programme for 2018 and 2019 are more conservative than the Commission 2018 spring forecast. Despite the generally more optimistic macroeconomic assumptions in the Stability Programme, the budgetary projections appear to be markedly conservative, in particular on revenue. According to the Stability Programme, the effect to the fiscal outlook from risks related to macroeconomic outcomes, interest rates developments and contingent liabilities are somewhat mitigated by upside risks, namely on the prospects in tax revenue.

However, risks to the baseline fiscal projections remain and are mostly on the downside, mainly regarding the potential impact of possible support measures to the banking system, possible spending pressures on public wages, uncertainties about the outcome of court cases and concerns about the durability of the recent over-performance in revenue. The materialisation of contingent liabilities in relation to the banking sector may create downward risks to the fiscal outlook over the programme horizon, in particular to the expenditure projections.⁵ Additionally, it is difficult to predict the impact of the ongoing sale of the Cyprus Cooperative Bank on the national accounts due to uncertainties on the sale and the complexity linked to its statistical treatment. Concerning expenditure on compensation of employees, it could prove difficult to maintain the moderate salary increases projected in the Stability Programme, below the nominal GDP growth, given the unfreezing of promotions, the provision of Cost of Living Allowance (COLA), the annual increments and the extension of employment of seasonal personnel from 8 months to 11 months per year.⁶ Furthermore, there are uncertainties about the outcome of court cases concerning the constitutionality of the public sector wage and benefit cuts during the crisis, as rulings in favour of claimants could significantly impact public finances. On the revenue side, the important share of corporate tax revenue in Cyprus as a percentage of GDP (compared to the EU average)⁷ poses a potential risk to public finances, as the respective tax base is influenced by relocation decision of enterprises. The Stability Programme states that corporate taxes continue to account on average for about 17.9% of total tax revenue over the programme period, in line with previous years. Nonetheless, it is important to note that the forecasts in previous Stability Programmes

⁵ Such risks could derive from, for example, the ongoing sale process of the Cyprus Cooperative Bank and the setting up of the "ESTIA" project, as mentioned in the Stability Programme.

⁶ The overall wage bill developments in the public and broader public sector are governed by collective agreements with the Unions, whereby a wage setting mechanism monitors and regulates wage bill growth below nominal GDP growth for 2017-2018. According to the Stability Programme, in the absence of any amendments to the current agreements, the mechanism will continue to be in effect.

⁷ For further information, see the 2018 Country Report for Cyprus, section 4.1.3.

have proven to be more conservative than the actual fiscal outturns, mainly due to higher-than-expected economic growth. Finally, it is worth noting that Eurostat is currently discussing with the Statistical Service of Cyprus the recording of interest expenditure and intermediate consumption and, therefore, the potential impact of the revision to the envisaged budgetary plans remains unclear.⁸

Regarding risks related to debt developments, Cyprus' still high level of public debt makes government debt projections sensitive to variations in economic growth and to the expected size of budget surpluses. In addition, there are downside risks linked to potential future changes to market conditions, such as higher interest expenditure due to unanticipated increases in the borrowing costs. This is mitigated by relatively low annual debt principal repayment needs until 2021 (below 7 % of GDP) and the high level of government cash buffers. The sizeable contingent liabilities also pose an additional risk.

4. COMPLIANCE WITH THE PROVISIONS OF THE STABILITY AND GROWTH PACT

Box 1. Council Recommendations addressed to Cyprus

On 11 July 2017, the Council addressed recommendations to Cyprus in the context of the European Semester.⁹ In particular, in the area of public finances the Council recommended Cyprus to remain at its medium-term budgetary objective in 2018 and to use windfall gains to accelerate the reduction of the general government debt ratio.

4.1. Compliance with the debt criterion

After it corrected its excessive deficit in 2015, Cyprus is in the transition period for the following three years (until 2018) and should ensure sufficient progress towards compliance with the debt reduction benchmark. This implies that, during this period, it is required to make sufficient progress as defined by the minimum linear structural adjustment (MLSA) towards compliance with the debt reduction benchmark at the end of the transition period. As from 2019, as its public debt exceeds the 60% of GDP reference of the Treaty, Cyprus has to comply with the debt reduction benchmark.

Until end 2018, Cyprus is in a transition period and, based on the Stability Programme, Cyprus is making sufficient progress towards compliance with the debt reduction benchmark in 2017 and 2018. In particular, the estimated change in the structural balance in 2017 was higher than the MLSA by 1 % of GDP. For 2018, the Stability Programme's projections point to a similar result, by a margin of 1.6 % of GDP above the required adjustment. This is broadly in line with the Commission 2018 spring forecast, according to which the change in the structural balance is also expected to exceed the required MLSA in 2018 by 2 % of GDP. Based on the Stability Programme, in 2019, Cyprus is expected to meet the debt reduction benchmark, as its debt-to-GDP ratio is expected to be below the debt benchmark, with a gap to the debt benchmark of -8% of GDP. Based on the Commission 2018 spring forecast, Cyprus is also expected to respect the benchmark in 2019 (with a gap to the debt benchmark of -4.2 % of GDP).

⁸ For further information, see footnote 1.

⁹ Council Recommendation of 11 July 2017 on the 2017 National Reform Programme of Cyprus and delivering a Council opinion on the 2017 Stability Programme of Cyprus, OJ C 261, 9.8.2017.

Table 4: Compliance with the debt criterion

	2017	2018		2019	
		SP	COM	SP	COM
Gross debt ratio	97.5	105.6	105.7	100.0	99.5
Gap to the debt benchmark ^{1,2}				-8.0	-4.2
Structural adjustment ³	0.2	-1.0	-0.6		
<i>To be compared to:</i>					
Required adjustment ⁴	-0.8	-2.6	-2.6		
Notes:					
¹ Not relevant for Member States that were subject to an EDP procedure in November 2011 and for a period of three years following the correction of the excessive deficit.					
² Shows the difference between the debt-to-GDP ratio and the debt benchmark. If positive, projected gross debt-to-GDP ratio does not comply with the debt reduction benchmark.					
³ Applicable only during the transition period of three years from the correction of the excessive deficit for EDP that were ongoing in November 2011.					
⁴ Defines the remaining annual structural adjustment over the transition period which ensures that - if followed – Member State will comply with the debt reduction benchmark at the end of the transition period, assuming that COM (S/CP) budgetary projections for the previous years are achieved.					
<i>Source :</i>					
<i>Commission 2018 spring forecast (COM); Stability Programme (SP), Commission calculations.</i>					

4.2. Compliance with the MTO

Cyprus is subject to the preventive arm of the Stability and Growth Pact. The general government balance reached a surplus of 1.8% of GDP in 2017 and it is expected to remain in surplus throughout the programme period¹⁰. This is confirmed by the Commission 2018 spring forecast for the years 2018 and 2019.

Based on outturn data, Cyprus' structural balance reached a surplus of 1.4% of GDP in 2017, well above the medium-term objective of a balanced budgetary position in structural terms. According to the information provided in the Stability Programme, Cyprus is expected to remain above its medium-term objective also in 2018 and 2019, with the recalculated structural surplus projected at 0.6% of GDP in 2018 and at 0.3% of GDP in 2019.

¹⁰ While possible future changes to the recording of interest expenditure, following discussions between Eurostat and Cystat (see footnote 1), would affect the computation of the general government expenditure aggregate, this is not expected to have an impact on the assessment of Cyprus' compliance with the MTO, as Cyprus' structural balance reached a surplus in 2017, with a significant margin above the MTO.

This is confirmed based on the Commission 2018 spring forecast, which projects higher structural surpluses of 0.8% of GDP in 2018 and 0.5% of GDP in 2019 under a no-policy-change assumption.¹¹

Cyprus is therefore projected to be compliant with the requirements of the preventive arm of the Pact in both 2018 and 2019. Beyond 2019, the Stability Programme indicates that the structural balance is set to remain above the MTO over the programme period.

¹¹ For an explanation of the differences between the Stability Programme and the Commission 2017 spring forecast projections, see section 3.1 and 3.2.

Table 5: Compliance with the requirements under the preventive arm

(% of GDP)	2017	2018		2019	
Initial position¹					
Medium-term objective (MTO)	0.0	0.0		0.0	
Structural balance ² (COM)	1.4	0.8		0.5	
Structural balance based on freezing (COM)	0.4	0.8		-	
Position vis-a-vis the MTO³	At or above the MTO	At or above the MTO		At or above the MTO	
(% of GDP)	2017	2018		2019	
	COM	SP	COM	SP	COM
Structural balance pillar					
Required adjustment ⁴	Compliance				
Required adjustment corrected ⁵					
Change in structural balance ⁶					
One-year deviation from the required adjustment ⁷					
Two-year average deviation from the required adjustment ⁷					
Expenditure benchmark pillar					
Applicable reference rate ⁸	Compliance				
One-year deviation adjusted for one-offs ⁹					
Two-year deviation adjusted for one-offs ⁹					
PER MEMORIAM: One-year deviation ¹⁰					
PER MEMORIAM: Two-year average deviation ¹⁰					
Notes					
<p>¹ The most favourable level of the structural balance, measured as a percentage of GDP reached at the end of year t-1, between spring forecast (t-1) and the latest forecast, determines whether there is a need to adjust towards the MTO or not in year t. A margin of 0.25 percentage points (p.p.) is allowed in order to be evaluated as having reached the MTO.</p> <p>² Structural balance = cyclically-adjusted government balance excluding one-off measures.</p> <p>³ Based on the relevant structural balance at year t-1.</p> <p>⁴ Based on the position vis-à-vis the MTO, the cyclical position and the debt level (See European Commission: Vade mecum on the Stability and Growth Pact, page 38.).</p> <p>⁵ Required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.</p> <p>⁶ Change in the structural balance compared to year t-1. Ex post assessment (for 2017) is carried out on the basis of Commission 2018 spring forecast.</p> <p>⁷ The difference of the change in the structural balance and the corrected required adjustment.</p> <p>⁸ Reference medium-term rate of potential GDP growth. The (standard) reference rate applies from year t+1, if the country has reached its MTO in year t. A corrected rate applies as long as the country is adjusting towards its MTO, including in year t.</p> <p>⁹ Deviation of the growth rate of public expenditure net of discretionary revenue measures, revenue increases mandated by law and one-offs from the applicable reference rate in terms of the effect on the structural balance. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.</p> <p>¹⁰ Deviation of the growth rate of public expenditure net of discretionary revenue measures and revenue increases mandated by law from the applicable reference rate in terms of the effect on the structural balance. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.</p>					
<i>Source:</i>					
<i>Stability Programme (SP); Commission 2018 spring forecast (COM); Commission calculations.</i>					

5. FISCAL SUSTAINABILITY

Cyprus does not appear to face fiscal sustainability risks in the short run. Nonetheless, there are indications that the macro-financial and competitiveness side of the economy poses potential challenges.¹²

Based on the Commission 2018 spring forecast and a no-fiscal policy change scenario beyond the forecast horizon, government debt, at 97.5% of GDP in 2017, is expected to decrease (to 66.9% in 2028)¹³, thus remaining above the 60% of GDP Treaty threshold. Over this horizon, government debt is projected to peak in 2018, at 105.7% of GDP, due to an issuance of a series of government bonds on 3 April 2018 (of EUR 2.35 billions), the proceeds of which were deposited with the Cyprus Cooperative Bank. Sensitivity analysis shows similar risks.¹⁴ Overall, this highlights medium risks for the country from debt sustainability analysis in the medium term. The full implementation of the Stability Programme would put debt on a similarly decreasing path by 2028, also expected to remain above the 60% of GDP reference value in 2028.

The medium-term fiscal sustainability risk indicator S1¹⁵, at -0.6 % of GDP, indicates low risks in the medium term (a negative value indicates that no upfront fiscal adjustment effort is needed to bring the debt to below the 60% of GDP reference value by 2032). In spite of the currently high level of government debt, the latter would decline notably when assuming a continuation of the structural primary surplus. The full implementation of the Stability Programme would put the sustainability risk indicator S1 at -0.4 percentage point of GDP, also indicating low medium-term risk.

Overall, risks to fiscal sustainability over the medium term are medium, due to medium risks attached to the debt sustainability analysis. Fully implementing the fiscal plans in the Stability Programme would confirm those risks.

The long-term fiscal sustainability risk indicator S2, being negative (-1.3 % of GDP), points to low fiscal sustainability risks. This is mainly due to the strong initial budgetary position in terms of the projected structural primary surplus in 2019. Full implementation of the Stability Programme would put the S2 indicator at -1.0 percentage points of GDP, also indicating low long-term risk.

¹² This conclusion is based on the short-term fiscal sustainability risk indicator S0. See the note to Table 6 for a definition of the indicator.

¹³ The projected costs of ageing used to compute the debt projections and the fiscal sustainability indicators S1 and S2 are based on the updated projections, endorsed by the EPC on 30 January 2018, and to be published in the forthcoming Ageing Report 2018.

¹⁴ Sensitivity analysis includes several deterministic debt projections, as well as stochastic projections (see Debt Sustainability Monitor 2017 for more details).

¹⁵ See the note to Table 6 for a definition of the indicator.

Table 6: Sustainability indicators

<i>Time horizon</i>	Commission Scenario		Stability / Convergence Programme Scenario	
Short Term	LOW risk			
S0 indicator ^[1]	0.44			
Fiscal subindex	0.19	LOW risk		
Financial & competitiveness subindex	0.57	HIGH risk		
Medium Term	MEDIUM risk			
DSA ^[2]	MEDIUM risk			
S1 indicator ^[3]	-0.6	LOW risk	-0.4	LOW risk
<i>of which</i>				
Initial Budgetary Position	-3.5		-2.7	
Debt Requirement	3.0		2.5	
Cost of Ageing	-0.1		-0.2	
<i>of which</i>				
Pensions	0.6		0.4	
Health-care	0.1		0.1	
Long-term care	0.0		0.0	
Other	-0.7		-0.7	
Long Term	LOW risk		LOW risk	
S2 indicator ^[4]	-1.3		-1.0	
<i>of which</i>				
Initial Budgetary Position	-2.2		-1.8	
Cost of Ageing	0.9		0.9	
<i>of which</i>				
Pensions	1.9		1.7	
Health-care	0.3		0.3	
Long-term care	0.2		0.2	
Other	-1.4		-1.2	
Source: Commission services; 2018 stability/convergence programme.				
Note: the 'Commission' scenario depicts the sustainability gap under the assumption that the structural primary balance position evolves according to the Commissions' spring 2018 forecast covering until 2019 included. The 'stability/convergence programme' scenario depicts the sustainability gap under the assumption that the budgetary plans in the programme are fully implemented over the period covered by the programme. Age-related expenditure as given in the 2018 Ageing Report.				
[1] The S0 indicator of short term fiscal challenges informs the early detection of fiscal stress associated to fiscal risks within a one-year horizon. To estimate these risks S0 uses a set of fiscal, financial and competitiveness indicators selected and weighted according to their signalling power. S0 is therefore a composite indicator whose methodology is fundamentally different from the S1 and S2 indicators, which quantify fiscal adjustment efforts. The critical threshold for the overall S0 indicator is 0.46. For the fiscal and the financial-competitiveness sub-indexes, thresholds are respectively at 0.36 and 0.49*.				
[2] Debt Sustainability Analysis (DSA) is performed around the no fiscal policy change scenario in a manner that tests the response of this scenario to different shocks presented as sensitivity tests and stochastic projections*.				
[3] The S1 indicator is a medium-term sustainability gap; it measures the upfront fiscal adjustment effort required to bring the debt-to-GDP ratio to 60 % by 2032. This adjustment effort corresponds to a cumulated improvement in the structural primary balance over the 5 years following the forecast horizon (i.e. from 2020 for Commission scenario and from last available year for the SCP scenario); it must be then sustained, including financing for any additional expenditure until the target date, arising from an ageing population. The critical thresholds for S1 are 0 and 2.5, between which S1 indicates medium risk. If S1 is below 0 or above 2.5, it indicates low or high risk, respectively*.				
[4] The S2 indicator is a long-term sustainability gap; it shows the upfront and permanent fiscal adjustment required to stabilise the debt-to-GDP ratio over the infinite horizon, including the costs of ageing. The critical thresholds for S2 are 2 and 6, between which S2 indicates medium risk. If S2 is below 2 or above 6, it indicates low or high risk, respectively*.				
* For more information see Fiscal Sustainability Report 2015 and Debt Sustainability Monitor 2017.				

6. FISCAL FRAMEWORK

The national fiscal rules are laid down in the Fiscal Responsibility and Budgetary Framework Law, containing in particular a structural budget balance rule with a corrective adjustment mechanism, and a debt rule. As regards the structural balance rule (prescribing conformity with the country's MTO for each year), Cyprus recorded a structural surplus of 1.2% of GDP in 2017 according to the Stability Programme submitted by the authorities, significantly above its MTO of a balanced structural position. Over the period 2018-2021, based on the Stability Programme's projections taken at face value, the structural balance is planned to remain in surplus averaging around 0.3% of GDP, thus overperforming the MTO.

As regards the debt rule (which is in line with the Stability and Growth Pact requirement on debt reduction), Cyprus is currently in the transition period (2016-2018) and achieved the minimum linear structural adjustment, based on the information provided in the Stability Programme (see Section 4.1. for details). Following the transition period, the debt reduction benchmark applies.

As a result, based on the information provided in the Stability Programme, the past, planned and forecast fiscal performance in Cyprus appears to comply with the requirements of the applicable national numerical fiscal rules.

The macroeconomic forecasts underlying the Stability Programme had been submitted to the independent Fiscal Council for endorsement. On 25 April 2018, the Council concluded in a public letter¹⁶ to the Minister of Finance that the macroeconomic forecast underlying the Stability Programme was deemed to be sufficiently conservative. More specifically, as stated in the Stability Programme, the Council concluded that the headline GDP and budget balance figures as forecast by the Ministry of Finance were considered realistic for the programming period under consideration. In its public letter the Council flagged some risks, mainly linked to the limited progress in implementing reforms in the public and private sector, the challenges faced by the banking sector and the potential deterioration of the external environment. The Council's detailed assessment is expected to appear in its 2018 spring report.¹⁷

The Stability Programme explicitly states that it should be considered as Cyprus national medium-term fiscal plan (NMTFP). Nevertheless, neither the Stability Programme nor the National Reform Programme include indications on the expected economic returns on non-defence public investment projects that have significant budgetary impact.

7. SUMMARY

In 2017, Cyprus recorded headline and structural budget surpluses, overachieving the provisions of the Stability and Growth Pact. Cyprus also made sufficient progress towards compliance with the debt criterion as defined by the minimum linear structural adjustment (MLSA) in 2017.

According to both the information provided in the Stability Programme and the Commission 2018 spring forecast, Cyprus is expected to remain above its medium-term objective in 2018 and 2019. In addition, according to the Stability Programme and the Commission 2018 spring

¹⁶[http://www.fiscalcouncil.gov.cy/fiscalcouncil/fiscalcouncil.nsf/All/77D1E2A3EF35323AC22582860027CF80/\\$file/%CE%B4%CE%B5%CE%BB%CF%84%CE%AF%CE%BF%20%CF%84%CF%8D%CF%80%CE%BF%CF%85%20Eng%201.pdf](http://www.fiscalcouncil.gov.cy/fiscalcouncil/fiscalcouncil.nsf/All/77D1E2A3EF35323AC22582860027CF80/$file/%CE%B4%CE%B5%CE%BB%CF%84%CE%AF%CE%BF%20%CF%84%CF%8D%CF%80%CE%BF%CF%85%20Eng%201.pdf)

¹⁷ Spring report 2018, Fiscal Council (forthcoming).

forecast, Cyprus is also expected to make sufficient progress towards compliance with the debt reduction benchmark in 2018 and respect the benchmark in 2019. Therefore, Cyprus is projected to meet the requirements under the preventive arm of the Stability and Growth Pact in both 2018 and 2019. At the same time, expenditure developments should be monitored carefully, especially in light of possible future risks to the robustness of revenues, to safeguard fiscal sustainability in line with the SGP.

8. ANNEX

Table I. Macroeconomic indicators

	2000-2004	2005-2009	2010-2014	2015	2016	2017	2018	2019
Core indicators								
GDP growth rate	4.0	3.0	-1.8	2.0	3.4	3.9	3.6	3.3
Output gap ¹	1.9	3.8	-4.0	-4.2	-1.5	0.7	2.3	3.3
HICP (annual % change)	3.1	2.2	1.9	-1.5	-1.2	0.7	0.7	1.2
Domestic demand (annual % change) ²	4.8	4.2	-3.1	2.9	5.1	8.3	5.2	4.5
Unemployment rate (% of labour force) ³	4.2	4.6	11.6	15.0	13.0	11.1	9.0	7.1
Gross fixed capital formation (% of GDP)	20.2	24.6	16.4	13.0	17.4	21.1	23.0	24.3
Gross national saving (% of GDP)	14.5	7.7	10.7	12.8	11.9	12.4	13.3	14.0
General Government (% of GDP)								
Net lending (+) or net borrowing (-)	-3.6	-0.9	-6.0	-1.3	0.3	1.8	2.0	2.2
Gross debt	59.7	54.8	82.4	107.5	106.6	97.5	105.7	99.5
Net financial assets	-29.8	-28.3	-51.7	-76.5	-75.2	n.a	n.a	n.a
Total revenue	33.6	38.3	37.4	39.3	38.9	39.9	39.6	39.6
Total expenditure	37.1	39.2	43.4	40.7	38.6	38.1	37.6	37.3
<i>of which: Interest</i>	3.1	2.8	2.8	3.8	3.3	3.2	3.0	2.8
Corporations (% of GDP)								
Net lending (+) or net borrowing (-)	2.7	-9.2	5.6	8.8	2.0	-0.2	0.2	0.2
Net financial assets; non-financial corporations	-202.4	-160.7	-204.0	-233.6	-210.7	n.a	n.a	n.a
Net financial assets; financial corporations	-5.3	9.6	15.1	59.2	53.8	n.a	n.a	n.a
Gross capital formation	7.6	8.3	7.1	6.5	8.5	11.0	11.2	11.3
Gross operating surplus	29.2	21.8	21.1	21.4	20.6	19.9	20.1	20.2
Households and NPISH (% of GDP)								
Net lending (+) or net borrowing (-)	-4.3	-6.5	-5.1	-8.6	-7.0	-9.3	-10.9	-11.9
Net financial assets	129.0	124.0	110.3	106.7	109.9	n.a	n.a	n.a
Gross wages and salaries	34.0	36.8	38.3	35.8	36.1	35.7	35.5	35.4
Net property income	5.9	5.1	1.1	0.9	1.3	0.2	0.1	-0.1
Current transfers received	16.6	18.8	21.0	20.1	20.5	20.6	20.2	20.0
Gross saving	4.2	6.1	1.2	-3.3	-1.6	-2.8	-2.7	-2.7
Rest of the world (% of GDP)								
Net lending (+) or net borrowing (-)	-5.2	-16.6	-5.7	-1.1	-4.7	-7.6	-8.6	-9.3
Net financial assets	108.5	55.4	130.3	144.1	122.2	n.a	n.a	n.a
Net exports of goods and services	1.9	-5.3	-1.6	0.8	-0.8	-4.0	-5.0	-5.8
Net primary income from the rest of the world	-8.6	-11.7	-2.9	0.7	-1.6	-1.9	-1.9	-1.9
Net capital transactions	0.5	0.4	0.4	0.3	0.2	0.4	0.4	0.4
Tradable sector	41.6	34.5	33.7	34.3	34.5	34.6	n.a	n.a
Non tradable sector	48.1	52.5	54.7	53.6	52.9	52.1	n.a	n.a
<i>of which: Building and construction sector</i>	8.0	9.6	5.1	3.1	3.3	3.9	n.a	n.a
Real effective exchange rate (index, 2000=100)	86.2	98.8	98.6	88.3	87.8	88.6	89.6	89.5
Terms of trade goods and services (index, 2000=100)	99.3	100.0	99.9	99.4	99.5	101.0	101.7	102.3
Market performance of exports (index, 2000=100)	113.7	93.7	106.7	110.8	111.9	109.9	107.1	104.8
Notes:								
¹ The output gap constitutes the gap between the actual and potential gross domestic product at 2005 market prices.								
² The indicator on domestic demand includes stocks.								
³ Unemployed persons are all persons who were not employed, had actively sought work and were ready to begin working immediately or within two weeks. The labour force is the total number of people employed and unemployed. The unemployment rate covers the age group 15-74.								
Source:								
AMECO data, Commission 2018 spring forecast								