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COMMISSION OPINION

of 21.11.2018

on the Draft Budgetary Plan of Cyprus

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GENERAL CONSIDERATIONS

1. Regulation (EU) No 473/2013 sets out provisions for enhanced monitoring of budgetary policies in the euro area for ensuring that national budgets are consistent with the economic policy guidance issued in the context of the Stability and Growth Pact and the European Semester for economic policy coordination.
2. Article 6 of Regulation (EU) No 473/2013 requires Member States to submit annually to the Commission and to the Eurogroup a Draft Budgetary Plan presenting by 15 October the main aspects of the budgetary situation of the general government and its subsectors for the forthcoming year.

CONSIDERATIONS CONCERNING CYPRUS

3. On the basis of the Draft Budgetary Plan for 2019 submitted on 12 October 2018 by Cyprus, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013.
4. Cyprus is subject to the preventive arm of the Stability and Growth Pact and should preserve a sound fiscal position that ensures compliance with the medium-term budgetary objective of a balanced budget in structural terms. As its public debt amounted to 108% of GDP in 2015, the year in which the excessive deficit was corrected, Cyprus also needs to make sufficient progress towards compliance with the debt reduction benchmark in 2018 and ensure compliance with the debt reduction benchmark as of 2019.
5. According to the Commission 2018 autumn forecast, the Cypriot economy is expected to grow by 3.9% in 2018 and 3.5% in 2019. The macroeconomic scenario underlying the Draft Budgetary Plan projects real GDP growth at 4.0% in 2018 and 3.9% in 2019. The Commission 2018 autumn forecast projects that growth will become more domestically-driven with the outlook on net exports, particularly for 2019, more pessimistic compared with the macroeconomic scenario underlying the Draft Budgetary Plan. Overall, the macroeconomic outlook of the Draft Budgetary Plan is based on plausible macroeconomic projections. Cyprus complies with the requirement of Regulation (EU) No 473/2013 since the draft budget is based on independently endorsed macroeconomic forecasts.
6. The Draft Budgetary Plan projects an improvement of the general government headline surplus from 1.8% of GDP in 2017 to 2.9% of GDP in 2018, which is broadly in line with the Commission 2018 autumn forecast. That improvement is explained by the strong macroeconomic outlook, the favourable labour market developments and buoyant tax revenue. However, both the Draft Budgetary Plan and the Commission 2018 autumn forecast do not yet include the potential deficit-increasing (one-off) impact on the general government balance in 2018 from the banking support measures related to the Cyprus Cooperative Bank Ltd. Those measures are currently being investigated by Cystat and Eurostat. For 2019, the Draft Budgetary Plan targets a general government headline surplus of 3.1% of GDP,

which is also broadly in line with the Commission 2018 autumn forecast. It is mainly driven by the continued cyclical improvement in the economy and the already legislated increases in the social security contribution rates in 2019. The recalculated structural balance¹ based on the information provided in the Draft Budgetary Plan is estimated at 1.8% of GDP in 2018 and 1.2% of GDP in 2019. The Commission 2018 autumn forecast estimates similar structural surpluses of 1.7% of GDP in 2018 and 1.2% in 2019.

7. The Draft Budgetary Plan reports the gradual withdrawal of wage cuts in the public sector starting from 2018 and the introduction of the Estia scheme (i.e. State support for loan repayment of eligible borrowers with non-performing loans backed by primary residences) in 2019 as discretionary measures. The fiscal impact of those deficit-increasing measures is estimated at 0.1% of GDP in 2018 and at 0.2% of GDP in 2019 for the wage cuts, and at 0.1% of GDP in 2019 for the Estia scheme. The estimates of the budgetary impact of those measures appear plausible and are in line with the Commission 2018 autumn forecast. The measures underpinning the Draft Budgetary Plan include the discretionary measures reported in the 2018 Stability Programme, such as the introduction of the VAT rate on building land in 2018 and the rise in social security contributions in 2019. The fiscal impact of those deficit-decreasing measures is estimated at around 0.1% of GDP and 0.4% of GDP in 2019, respectively. Despite the envisaged future increases in taxes on labour, mainly due to legislated rises in social contributions and the introduction of compulsory health insurance contributions, labour tax revenue in Cyprus is still expected to remain below the Union average. Labour and corporate taxes in Cyprus are among the lowest in the Union.

With regard to the fiscal-structural elements of the Recommendation of 13 July 2018 addressed by the Council to Cyprus², which recommended the adoption of key legislative reforms to improve efficiency in the public sector, in particular as regards the functioning of the public administration and the governance of State-owned enterprises and local governments. However, the majority of draft bills have been stalled at the House of Representatives.

8. According to the information provided in the Draft Budgetary Plan, Cyprus is projected to respect its medium-term budgetary objective of a balanced budgetary position in structural terms, with a recalculated structural surplus of 1.8% of GDP in 2018 and 1.2% of GDP in 2019. The Commission 2018 autumn forecast broadly points to the same conclusion. Therefore, Cyprus is assessed to be compliant with the requirements of the preventive arm of the Stability and Growth Pact. 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 Stability and Growth Pact.
9. The Draft Budgetary Plan indicates that government debt-to-GDP ratio will increase to 104.2% in 2018 (due to the banking support measures related to the Cyprus Cooperative Bank Ltd) and decrease to 97.2% in 2019, somewhat below the Commission projection of 105% and 98.4%, respectively. Based on the Draft

¹ Cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

² Council Recommendation of 13 July 2018 on the 2018 National Reform Programme of Cyprus and delivering a Council opinion on the 2018 Stability Programme of Cyprus, OJ C 320, 10.9.2018, p.58.

Budgetary Plan, Cyprus is projected to make sufficient progress towards compliance with the debt reduction benchmark in 2018 (by a margin of more than 4% of GDP above the required adjustment). That projection is broadly in line with the Commission 2018 autumn forecast. The Draft Budgetary Plan does not include sufficient information to assess compliance with the debt reduction benchmark in 2019. Based on the Commission 2018 autumn forecast, the debt reduction benchmark is projected to be met in 2019 (by a margin in excess of 7 % of GDP).

10. Overall, the Commission is of the opinion that the Draft Budgetary Plan of Cyprus is compliant with the provisions of the Stability and Growth Pact. The Commission invites the authorities to implement the 2019 budget.

The Commission is also of the opinion that Cyprus has made no progress with regard to the structural part of the fiscal recommendations contained in the Council Recommendation of 13 July 2018 in the context of the European Semester and thus invites the authorities to accelerate implementation. A comprehensive description of progress made with the implementation of the country-specific recommendations will be made in the 2019 Country Reports and assessed in the context of the country-specific recommendations to be proposed by the Commission in May 2019.

Done at Brussels, 21.11.2018

For the Commission
Pierre MOSCOVICI
Member of the Commission