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**Assessment of the 2020 Stability Programme for
Cyprus**

(Note prepared by DG ECFIN staff)

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EXECUTIVE SUMMARY

- On 6 April 2020, the Commission provided guidelines to the Economic and Financial Committee on how the format and content of the 2020 Stability and Convergence Programmes can be streamlined in light of the exceptional circumstances related to the Covid-19 pandemic. This assessment takes into account the severe constraints that Member States faced in providing the information usually required in their Programmes. The assessment focuses on the near term in light of the high uncertainty attached to the projections.
- After economic growth of 3.2% in 2019, the Stability Programme and the Commission 2020 spring forecast assume a sharp contraction in economic activity in 2020, with GDP dropping by 7% and 7.4%, respectively. Economic activity is expected to rebound in 2021. The macroeconomic outlook presented in the Stability Programme is broadly similar to the one in the Commission forecast.
- The Stability Programme and the Commission forecast project a substantial deterioration of public finances in 2020, followed by a partial recovery in 2021. The higher headline budget deficit foreseen in 2020 in the Commission forecast (-7% of GDP) compared to the Stability Programme (-4.3% of GDP) reflects more conservative assumptions on the revenue collection and the no-policy change assumption underlying the Commission projections. The Commission's estimate of the cost of the measures adopted in the context of the pandemic is in line with that of the authorities.
- Deficit-increasing measures adopted to fight the pandemic and dampen its socio-economic effects are estimated in the Stability Programme to amount 4.4% of GDP. They comprise, inter alia, an additional budget for healthcare expenditure, wage subsidies, income support to the self-employed, and the temporary suspension of specific social contributions. Liquidity measures adopted include the suspension of VAT for a duration of two months.
- Public debt stood at 95.5% of GDP in 2019. In the Stability Programme 2020, the public debt-to-GDP ratio is projected to reach 116.8% of GDP in 2020, whereas the Commission projects the public debt-to-GDP ratio to reach 115.7% of GDP.
- The macroeconomic and fiscal outlook are affected by high uncertainty due to the outbreak of the COVID-19 pandemic.

1. INTRODUCTION

This document assesses the economic and budgetary projections contained in the 2020 Stability Programme of Cyprus covering the period 2020-2023 (hereafter called the Programme), which was submitted on 7 May 2020¹. The Stability Programme explicitly states that it should be considered as Cyprus national medium-term fiscal plan (NMTFP). The note also assesses Cyprus compliance with the preventive arm of the Stability and Growth Pact in 2019. The government approved the programme on 7 May 2020.

Cyprus is currently subject to the preventive arm of the Stability and Growth Pact (SGP). As the debt ratio was 95.5% of GDP in 2019, exceeding the 60% of GDP reference value, Cyprus is also subject to the debt reduction benchmark.

On 20 March 2020, the Commission adopted a Communication on the activation of the general escape clause of the Stability and Growth Pact. The clause, as set out in Articles 5(1), 6(3), 9(1) and 10(3) of Regulation (EC) 1466/97 and Articles 3(5) and 5(2) of Regulation (EC) 1467/97, facilitates the coordination of budgetary policies in times of severe economic downturn. In its Communication, the Commission shared with the Council its view that, given the expected severe economic downturn resulting from the COVID-19 outbreak, the current conditions permit the activation of the clause. On 23 March 2020, the Ministers of Finance of the Member States agreed with the assessment of the Commission. The activation of the general escape clause allows for a temporary departure from the adjustment path towards the medium-term budgetary objective, provided that this does not endanger fiscal sustainability in the medium term. For the corrective arm, the Council may also decide, on a recommendation from the Commission, to adopt a revised fiscal trajectory. The general escape clause does not suspend the procedures of the Stability and Growth Pact. It allows Member States to depart from the budgetary requirements that would normally apply while enabling the Commission and the Council to undertake the necessary policy coordination measures within the framework of the Pact.

Cyprus is among those Member States that have triggered national escape clauses to suspend budgetary constraints set by their national fiscal rules, as part of the effort to accommodate the budgetary implications of the outbreak

2. MACROECONOMIC DEVELOPMENTS

The economy of Cyprus expanded strongly in 2019 by 3.2% in real terms. Consumption and exports were the main drivers. Since 11 March 2020, the authorities have gradually introduced restrictive measures in order to protect citizens from the pandemic. Since mid-March, economic activity has significantly slowed down, especially in wholesale and retail trade, construction, transport, tourism related sectors, arts, recreation and entertainment activities and the education sector.

¹ The Stability Programme contains only short-term budgetary projections. The minimum guidelines for Stability and Convergence Programmes submitted in spring 2020 were set out in the Note for the Alternates of the Economic and Financial Committee of 6 April 2020 on 'Guidelines for a Streamlined Format of the 2020 Stability and Convergence Programmes in light of the Covid-19 Outbreak'. The programme was submitted on 7 May 2020, after the deadline of 30 April established by the Regulation.

The Programme acknowledges upfront the exceptionally high uncertainty underlining the forecast scenario presented. The baseline macroeconomic scenario underlying the Programme projects a contraction in real GDP by 7% in 2020, based on a two-month lockdown (until the end April 2020) assumption, followed by an assumed gradual relaxation starting from May until July and a recovery in the last five months of the year. Exports of goods and services are expected to be affected the most due to a plunge of tourism demand. Private consumption is also expected to dip, whereas the decline in investment is set to be more gradual. In 2021, a rebound is forecast by 6%. A more optimistic scenario than the baseline is mentioned with a fall in real GDP of around 5% according to which private consumption, investment and exports suffer a less severe downturn than in the baseline scenario. In case of a second wave of outbreak by next autumn and longer periods of lockdown and travel bans, the authorities estimate a contraction of the real GDP up to 13% in 2020. Under the baseline scenario, the Programme projects inflation to average at -0.3% in 2020, stemming from the low energy prices.

According to the Commission spring 2020 forecast, real GDP is set to decrease by 7.4% in 2020 with a rebound of 6.1% in 2021. Overall, the assumptions underlying the macroeconomic scenarios of the Programme (baseline) and the Commission forecast are similar. The main difference, albeit not a large one, is an expected larger contraction of net exports by the Commission. The Commission forecast of domestic demand is slightly more optimistic than the one of the Programme. With regards to sectors of economic activity, tourism and shipping are expected to be hit the most in the Programme. By contrast, the outbreak is expected to have only a limited impact on agriculture, food and pharmaceutical industries, communication, professional services and real estate. Lockdown measures were less restrictive for the essential sectors of food and pharmaceuticals. Whereas, communication and professional services are expected to rely on teleworking and rents are expected to be paid, at least in the short term. On inflation, the Commission's projections and underlying assumptions are very close to the ones of the Programme.

The Programme presents both upside and downside risks to the baseline scenario. The upside risks are due to the early and targeted measures taken by the authorities to contain the spread of the virus, along with measures to strengthen the national health system and mitigate the economic effects of the crisis, which may result in a more contained demand shock. The downside risks are related to possible extended periods of lockdown, a second wave of outbreak in 2020 and the vulnerability of the tourism sector in the context of the pandemic. The risks discussed by the Commission are tilted more to the downside and beyond the uncertainties surrounding the evolution of the COVID-19 outbreak, the large private and public sector debt overhang is also considered a risk to a prolonged economic downturn.

The macroeconomic forecast underpinning the Programme was endorsed by the independent Fiscal Council on 22 April 2020. The Council concluded that the projections for macroeconomic variables was "within acceptable limits", noting that the scenario is considered optimistic.

Table 1: Comparison of macroeconomic developments and forecasts

	2019		2020		2021		2022	2023
	COM	SP	COM	SP	COM	SP	SP	SP
Real GDP (% change)	3.2	3.2	-7.4	-7.0	6.1	6.0	n.a.	n.a.
Private consumption (% change)	3.0	3.0	-6.7	-7.2	5.1	n.a.	n.a.	n.a.
Gross fixed capital formation (% change)	0.1	0.1	-6.1	-5.3	5.3	n.a.	n.a.	n.a.
Exports of goods and services (% change)	2.0	2.0	-21.8	-26.1	16.8	n.a.	n.a.	n.a.
Imports of goods and services (% change)	1.5	1.5	-15.2	-21.3	13.7	n.a.	n.a.	n.a.
<i>Contributions to real GDP growth:</i>								
- Final domestic demand	3.6	3.8	-2.8	-3.5	5.1	n.a.	n.a.	n.a.
- Change in inventories	-0.7	-0.8	0.0	0.0	0.0	n.a.	n.a.	n.a.
- Net exports	0.3	0.3	-4.6	-3.5	1.0	n.a.	n.a.	n.a.
Output gap ¹	5.9	4.7	-3.5	n.a.	0.7	n.a.	n.a.	n.a.
Employment (% change)	3.1	n.a.	-2.5	n.a.	2.3	n.a.	n.a.	n.a.
Unemployment rate (%)	7.1	n.a.	8.6	n.a.	7.5	n.a.	n.a.	n.a.
Labour productivity (% change)	0.1	n.a.	-5.0	n.a.	3.7	n.a.	n.a.	n.a.
HICP inflation (%)	0.5	0.5	-0.2	-0.3	1.0	1.0	n.a.	n.a.
GDP deflator (% change)	0.6	0.6	0.5	-0.3	0.9	1.0	n.a.	n.a.
Comp. of employees (per head, % change)	2.9	n.a.	-5.4	n.a.	6.6	n.a.	n.a.	n.a.
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	-5.0	n.a.	-10.3	n.a.	-9.5	n.a.	n.a.	n.a.

Note:

¹In % of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.

Source:

Commission 2020 spring forecast (COM); Stability Programme (SP).

3. RECENT AND PLANNED BUDGETARY DEVELOPMENTS

3.1. DEFICIT DEVELOPMENTS AND MEDIUM-TERM STRATEGY AND TARGETS²

The headline government budget balance was in a surplus of 1.7% of GDP in 2019, lower than the headline surplus of 3.8% of GDP planned in the Draft Budgetary Plan 2020. The difference was mostly due to the negative budgetary impact of a change to the Income Tax Law which allowed the conversion of specific Deferred Tax Assets (DTAs) into Deferred Tax Credits (DTCs)³, implying one-off spending of 1.3% of GDP in 2019. Total revenue grew by 7.6% compared to 2018, reflecting still high buoyancy of tax revenue as well as increases in social contribution rates in 2019. The decrease

² In light of the activation of the general escape clause, the measures taken in response to the coronavirus outbreak in 2020 are not treated as one-off and are thus not excluded from the estimation of the structural budget balance.

³ The amendment is currently only applicable to Bank of Cyprus (BoC). These specific DTAs stem from the transfer of income tax losses to the BoC in 2013 as part of Laiki Bank's resolution.

in total expenditure (-5.6%) in 2019 is however due to the impact of one-off spending related to the sale of the Cooperative Cypriot Bank (7.4% of GDP) in 2018. Once excluding these one-off operations, total expenditure increased strongly, by above 8%, driven mainly by the growth in compensation of public employees and the roll-out of the first phase of National Health Insurance System (NHIS) reform.

For 2020, the Programme targets a headline budget deficit of -4.3% of GDP, including savings amounting to 0.8% of GDP expected to be undertaken by the government by suspending selected public investment projects. The total cumulative net impact of the measures adopted to fight the pandemic amounts to 4.4% of GDP, of which 4.1 percentage points stem from additional expenditure meant to support the health sector (about 0.5% of GDP) and a broader set of measures aiming at limiting the socio-economic impact of the pandemic (about 3.7% of GDP). The Programme treats COVID-19 measures as one-off. Expenditure is expected to increase to 48.5% of GDP in 2020 from 39.5% in 2019. Revenue is expected to increase from 41.2% in 2019 to 44.3% of GDP in 2020 as the expected decrease in tax collection is planned to be partially compensated by higher social contributions due to increased rates due to the roll-out of the second phase of the NHIS reform in 2020.

In 2021, the Programme projects a lower deficit at 0.4 % of GDP. In 2022-2023, the objective of the Programme is to take advantage of the fully regained growth potential, which according to the authorities would allow to achieve sufficiently high primary surpluses to meet the Medium Term Objective⁴.

The Commission 2020 spring forecast projects a headline budgetary deficit at 7% of GDP in 2020. The difference with the Programme is explained for the most part by the following features of the Commission forecast: i) the slightly more conservative macroeconomic scenario, ii) higher tax revenue elasticities leading to a higher expected decrease in revenue, and iii) a higher expected public investment. The estimated impact of the measures to fight the pandemic in the Commission forecasts are in line with those of the authorities.

⁴ Cyprus' MTO is a balanced structural budget, which is more stringent than required by the Pact as it is more ambitious than the minimum MTO by more than ½ percent point.

Table 2: General government budgetary position

(% of GDP)	2019	2020		2021		2022	2023	Change: 2019-2023
	COM	COM	SP	COM	SP	SP	SP	SP
Revenue	41.2	42.9	44.3	44.2	n.a.	n.a.	n.a.	n.a.
<i>of which:</i>								
- Taxes on production and imports	15.2	14.9	15.0	15.0	n.a.	n.a.	n.a.	n.a.
- Current taxes on income, wealth, etc.	9.5	9.1	9.5	9.1	n.a.	n.a.	n.a.	n.a.
- Social contributions	10.7	11.6	11.8	12.1	n.a.	n.a.	n.a.	n.a.
- Other (residual)	5.8	7.4	8.0	7.9	n.a.	n.a.	n.a.	n.a.
Expenditure	39.5	49.9	48.5	45.9	n.a.	n.a.	n.a.	n.a.
<i>of which:</i>								
- Primary expenditure	37.0	47.5	46.1	43.9	n.a.	n.a.	n.a.	n.a.
<i>of which:</i>								
Compensation of employees+Intermediate consumption								
Compensation of employees	12.5	14.4	14.3	14.4	n.a.	n.a.	n.a.	n.a.
Intermediate consumption	5.4	7.5	7.3	7.4	n.a.	n.a.	n.a.	n.a.
Social payments	12.9	17.0	16.6	17.1	n.a.	n.a.	n.a.	n.a.
Subsidies	0.3	0.4	0.3	0.4	n.a.	n.a.	n.a.	n.a.
Gross fixed capital formation	1.7	1.7	0.9	1.9	n.a.	n.a.	n.a.	n.a.
Other (residual)	4.2	6.5	6.6	2.7	n.a.	n.a.	n.a.	n.a.
- Interest expenditure	2.5	2.4	2.4	2.1	n.a.	n.a.	n.a.	n.a.
General government balance (GGB)	1.7	-7.0	-4.3	-1.8	-0.4	n.a.	n.a.	n.a.
Primary balance	4.2	-4.6	-1.8	0.3	n.a.	n.a.	n.a.	n.a.
One-off and other temporary measures	-1.3	0.0	0.0	0.0	0.0	0.0	0.0	1.3
GGB excl. one-offs	3.0	-7.0	-4.3	-1.8	-0.4	n.a.	n.a.	n.a.
Output gap ¹	5.9	-3.5	n.a.	0.7	n.a.	n.a.	n.a.	n.a.
Cyclically-adjusted balance ¹	-1.2	-5.2	n.a.	-2.1	n.a.	n.a.	n.a.	n.a.
Structural balance²	0.1	-5.2	n.a.	-2.1	n.a.	n.a.	n.a.	n.a.
Structural primary balance ²	2.6	-2.8	n.a.	0.0	n.a.	n.a.	n.a.	n.a.
Gross debt ratio	95.5	115.7	116.8	105.0	103.2	n.a.	n.a.	n.a.

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 2020 spring forecasts (COM); Commission calculations.

3.2. MEASURES UNDERPINNING THE PROGRAMME

The Programme presents the policy response undertaken in the context of the COVID-19 outbreak, and describes the measures adopted in order to fight the pandemic and dampen its socio-economic effects. The measures are assumed to be temporary and to revert or end in 2021. According to the authorities, the overall package adopted is expected to have a temporary impact of 4.4% of GDP on public finances in 2020, of which 4.1% of GDP stems from additional expenditure measures⁵.

An additional budget up to 0.5% of GDP was adopted to strengthen the public health sector to combat the pandemic in view of supporting spending and investment in: (i) employment of additional medical, nursing, and support staff, (ii) equipment and infrastructure, (iii) ambulance services, (iv): centre of testings and (v) helpdesk.

The government response provides significant resources to stabilise the income of employees and self-employed in the face of suspended business activities. The most substantial scheme in terms of budgetary impact is a 3-month 'business suspension scheme', which is expected to add 2.7% of GDP of spending in 2020. The scheme provides wage subsidies equivalent to up to 70% of each employee's salary in view of avoiding layoffs of employees in businesses that fully or partly suspend their operations. The other main support schemes (also due to last 3 months) involve: i) an income support for self-employed people whose activity is suspended (0.3% of GDP); ii) subsidised leave for parents when schools, nurseries and childcare services are suspended (0.3% of GDP); and iii) subsidised sick leave to compensate individuals in quarantine and vulnerable workers (0.2% of GDP).

On the revenue side, the government suspended the increase in NHIS contributions related to the second phase of the NHIS reform from April to June. Foregone contributions are estimated at 0.3% of GDP in 2020. In addition, the Programme mentions that VAT payments are deferred for a duration of 2 months in order to support the liquidity of businesses. Zero fiscal cost is assumed from this measure as suspended obligations are expected to be paid back gradually by the end of 2020, assuming that they remain due in the first place.

Overall, the measures taken by Cyprus are in line with the guidelines set out in the Commission Communication on a coordinated economic response to the COVID-19 outbreak⁶. The measures appear timely, temporary and targeted at cushioning the shock induced by COVID-19. The full implementation of those measures, followed by a refocusing of fiscal policies towards achieving prudent medium term fiscal positions when economic conditions allow, will contribute to preserving fiscal sustainability in the medium term. However, an important draft bill for guarantees of a total of up to EUR 1.5 billion for new loans to firms and self-employed has been pending

⁵ The Programme mentions that another package of measures, which include additional support to businesses in the form of grants and sizeable guarantees for new loans, was approved by the government but is pending parliament approval.

⁶ https://ec.europa.eu/info/sites/info/files/communication-coordinated-economic-response-covid19-march-2020_en.pdf

parliament approval for several weeks. The efficiency of such a scheme in helping businesses suffering from suspended activities to access liquidity could be jeopardised if not applied swiftly and could also lead to a higher default rate (reflecting bankruptcies), implying in turn a larger fiscal cost.

Table 3: Discretionary measures adopted in response to COVID-19 outbreak

List of measures	Description	ESA Code	Adoption Status	Budgetary impact (% of GDP - change from previous year)		
				2020	2021	
Special absence leave	Subsidised leave to parents for taking care of children.	D.75	Adopted	-0.3	0.3	
Operation suspension scheme	Wage subsidy to workers	D.75	Adopted	-2.7	2.7	
Small business support scheme	Support to businesses that employ up to 5 people, provided they keep their employees.	D.75	Adopted	-0.3	0.3	
Sickness allowance	Support to vulnerable employees (sick or above 65).	D.75	Adopted	-0.2	0.2	
Strengthening of the public health sector	Spending and investment in employment of additional medical staff, equipment and infrastructure	P.2	Adopted	-0.5	0.5	
Suspended contributions	Suspension of the increase in NHIS contributions (April-June 2020).	D.6 rev	Adopted	0.3	-0.3	
Overseas student allowance	€750 allowance to students attending university overseas.	D.75	Adopted	-0.1	0.1	
Tourism support	Additional budget for the implementation of actions to support the sector	D.75	Adopted	-0.1	0.1	
Suspension of VAT payment	Liquidity measure: suspended VAT payment for a duration of 2 months. No fiscal impact assumed.		Adopted	0	0	
				Total	-4.4	4.4

Source: Stability Programme

3.3. DEBT DEVELOPMENTS

In 2019, the public debt ratio decreased to 95.5% of GDP from 100.6% in 2018 due to a sizeable headline budget surplus (1.7% of GDP) and robust nominal output growth (3.8%), which were partly negatively offset by the stock-flow adjustment (0.4% of GDP).

In the Programme, the public debt-to-GDP ratio is projected to reach 116.8% of GDP in 2020. The pronounced increase in the debt-to-GDP ratio reflects recent bond

issuances.⁷ According to the authorities, these transactions allow for a significant cash reserve to cover not only the financing needs of the next 9 months but also the potentially higher-than-projected financing needs that might arise due to the financial impact of the Covid-19 pandemic. The Programme expects public debt to decrease to 103.2% of GDP in 2021.

Table 4: Debt developments

(% of GDP)	Average 2014-2018	2019	2020		2021		2022	2023
			COM	SP	COM	SP	SP	SP
Gross debt ratio¹	102.9	95.5	115.7	116.8	105.0	103.2		
Change in the ratio	-0.7	-5.1	20.2	21.3	-10.7	-13.6	n.a.	n.a.
<i>Contributions²:</i>								
1. Primary balance	-0.6	-4.2	4.6	1.8	-0.3	n.a.	n.a.	n.a.
2. “Snow-ball” effect	-0.4	-1.2	9.5	9.9	-5.5	n.a.	n.a.	n.a.
<i>Of which:</i>								
Interest expenditure	2.8	2.5	2.4	2.4	2.1	n.a.	n.a.	n.a.
Growth effect	-3.3	-3.1	7.6	7.2	-6.6	-6.5	n.a.	n.a.
Inflation effect	0.1	-0.5	-0.5	0.3	-0.9	-1.1	n.a.	n.a.
3. Stock-flow adjustment	0.3	0.4	6.1	9.5	-4.9	n.a.	n.a.	n.a.
<i>Of which:</i>								
Cash/accruals diff.								
Acc. financial assets								
Privatisation								
Val. effect & residual								

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 2020 spring forecast (COM); Stability Programme (SP), Commission calculations.

The debt projection in the Commission 2020 spring forecast is closely in line with those presented in the Programme. According to the Commission 2020 spring forecast, government debt is expected to follow similar dynamics, increasing to 115.7% of GDP in 2020 and reflecting the expected headline government balance deficit (-7% of GDP), negative nominal growth, and a sizeable debt-increasing stock-flow adjustment (6.1% of GDP) due to the expected increase in cash reserves in 2020. In 2021, the debt-to-GDP ratio is expected to decrease significantly, mainly on

⁷ The government issued in January 2020 a 10-year EMTN of EUR 1000 million and a 20-year EMTN of EUR 750 million, and another 7-year EMTN of EUR 1250 million and one 30-year EMTN amounting to EUR 500 million in April 2020. The government revised in April 2020 its Annual Financing Program for 2020 from EUR 2.35 billion to EUR 5.5 billion.

account a favourable snowball effect (5.5% of GDP) and debt-reducing stock-flow adjustment (-4.9% of GDP), while the headline budget deficit is expected to narrow.

3.4. RISK ASSESSMENT

The macroeconomic and fiscal outlook are affected by high uncertainty due to the outbreak of the COVID-19 pandemic. The pandemic could become more severe and last longer than assumed, requiring more stringent and longer lasting containment measures. This would result in worse economic and fiscal outcomes. It could also require further fiscal policy measures. That would result in worse fiscal outcomes but help to mitigate the economic impact.

There are also specific risks underlying the budgetary projections, namely explicit contingent liabilities, and potential financing needs of public hospitals during the first years of the implementation of the National Health Insurance System.

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

4.1. Compliance with deficit criterion

According to the Programme, Cyprus' general government deficit is expected to reach 4.3% of GDP in 2020, thereby exceeding the Treaty reference value of 3% of GDP. This provides prima facie evidence of the existence of an excessive deficit in Cyprus for the purposes of the Treaty and the Stability and Growth Pact. The Commission has therefore prepared a report under Article 126(3) TFEU analysing whether or not Cyprus is compliant with the deficit criterion of the Treaty. Overall, the analysis suggests that the deficit criterion as defined in the Treaty and in Regulation (EC) No 1467/1997 is not fulfilled.

4.2. Compliance with the debt criterion

Cyprus' general government gross debt stood at 95.5% of GDP at the end of 2019, above the 60% of GDP Treaty reference value. According to the notified data, Cyprus did not comply with the debt reduction benchmark in 2019, as the gap to the benchmark is 0.1% of GDP. This provides evidence that there appears to be prima facie a risk of the existence of an excessive deficit in Cyprus in the sense of the Treaty and the Stability and Growth Pact. The Commission has therefore prepared a report under Article 126(3) TFEU analysing whether or not Cyprus is compliant with the debt criterion of the Treaty. Overall, the analysis suggests that the debt criterion as defined in the Treaty and in Regulation (EC) No 1467/1997 is complied with.

Based on the Commission forecasts, the debt benchmark is expected not to be met in 2020, and to be respected in 2021. There is not sufficient information to compute the debt benchmark based on the Programme in 2020-2021.

4.3. Compliance with the MTO in 2019⁸

Cyprus' structural balance showed a surplus of 0.1% of GDP in 2019, above the medium-term objective of a balanced budgetary position in structural terms.

⁸ The possible retroactive impact on output gap estimates as a result of the recession induced by the COVID-19 outbreak and the possibility of abnormal responses of government revenues to major swings in economic activity underline that compared to the structural balance the expenditure benchmark is likely to provide a more reliable and predictable indicator in times of severe economic downturn.

Table 6: Compliance with the requirements under the preventive arm

	(% of GDP)	2019	2020	2021		
Background budgetary indicators¹						
(1)	Medium-term objective (MTO)	0.0	0.0	0.0		
(2)	Structural balance ² (COM)	0.1	-5.2	-2.1		
Setting the required adjustment to the MTO						
(3)	Structural balance based on freezing (COM)	1.7				
(4) = (1) - (3)	Position vis-a-vis the MTO ³	At or above the MTO				
(5)	Required adjustment ⁴	Compliance				
(6)	Required adjustment corrected ⁵					
(8)	Corresponding expenditure benchmark ⁶					
Compliance with the required adjustment to the MTO						
		COM	COM	SP	COM	SP
Structural balance pillar						
(8) = Δ (2)	Change in structural balance ⁷	-2.0				
(9) = (8) - (6)	One-year deviation from the required adjustment ⁸	Compliance				
	Two-year average deviation from the required adjustment ⁸					
Expenditure benchmark pillar						
(10)	Net public expenditure annual growth corrected for one-offs ⁹	Compliance				
(11) = (10) - (8)	One-year deviation adjusted for one-offs ¹⁰					
	Two-year deviation adjusted for one-offs ¹⁰					
Finding of the overall assessment						
Compliance with the debt criterion						
Transition period						
	Required structural adjustment (MLSA) ¹¹	n.a.	n.a.	n.a.	n.a.	n.a.
	Structural adjustment ¹²	n.a.	n.a.	n.a.	3.1	n.a.
After transition period						
	Gap to the debt benchmark ^{13,14}	0.1	3.0	-0.4	n.a.	

Legend

'Compliance' - the recommended structural adjustment or a higher adjustment is being observed.

'Some deviation' - a deviation from the recommended structural adjustment is being observed, but it is below the threshold for a significant deviation.

'Significant deviation' - a deviation which has reached or breached the threshold for a significant deviation (i.e. 0.5% of GDP over one year, 0.25% of GDP over two years on average).


Notes

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.

² Structural balance = cyclically-adjusted government balance excluding one-off measures.

³ Based on the relevant structural balance at year t-1.

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.).

⁵ Required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.

⁶ 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.

⁷ Change in the structural balance compared to year t-1. Ex post assessment (for 20XX-1) is carried out on the basis of Commission 20XX spring forecast.

⁸ The difference of the change in the structural balance and the corrected required adjustment.

⁹ Net public expenditure annual growth (in %) corrected for discretionary revenue measures, revenue measures mandated by law and one-offs (nominal)

¹⁰ 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.

¹¹ 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.

¹² Applicable only during the transition period of three years from the correction of the excessive deficit for EDP that were ongoing in November 2011.

¹³ 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.

¹⁴ 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.

Source:

Stability Programme (SP); Commission 2020 spring forecast (COM); Commission calculations.