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COMMISSION OPINION

of 21.11.2023

on the Draft Budgetary Plan of Cyprus

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(Only the Greek text is authentic)

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GENERAL CONSIDERATIONS

1. Regulation (EU) No 473/2013¹ lays down provisions for enhanced monitoring of budgetary policies in the euro area, in order to ensure 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, by 15 October, setting out the budgetary targets for the forthcoming year, and outlining the main aspects underlying the budgetary outlook for general government and its subsectors.
3. On 8 March 2023, the Commission adopted a Communication² providing fiscal policy guidance for 2024, which confirmed that the general escape clause of the Stability and Growth Pact will be deactivated at the end of 2023.
4. On 26 April 2023, the Commission presented three legislative proposals³ to implement a comprehensive reform of the EU fiscal framework. The central objective of the proposals is to strengthen public debt sustainability and to promote sustainable and inclusive growth through reforms and investments. In its proposals, the Commission aims at improving national ownership, simplifying the framework and moving towards a greater medium-term focus, combined with effective and more coherent enforcement. According to the Council Conclusions adopted on 14 March 2023⁴ and on 27 October 2023⁵, the objective is to conclude the legislative work in 2023. As a new legal framework, based on the outcome of the ongoing economic governance review, is not yet in place, the current legal framework continues to apply. The fiscal component of the Spring 2023 country-specific recommendations

¹ Regulation (EU) No 473/2013 of the European Parliament and of the Council of 21 May 2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area, (OJ L 140, 27.5.2013, pp. 11).

² Communication from the Commission to the Council, 'Fiscal policy guidance for 2024', 8.3.2023, COM(2023) 141 final.

³ Commission Proposal for a Regulation of the European Parliament and of the Council on the effective coordination of economic policies and multilateral budgetary surveillance and repealing Council Regulation (EC) No 1466/97, 26.4.2023, COM(2023) 240 final; Commission Proposal for a Council Regulation amending Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure, 26.4.2023, COM(2023) 241 final; Commission Proposal for a Council Directive amending Directive 2011/85/EU on requirements for budgetary frameworks of the Member States, 26.4.2023, COM(2023) 242 final.

⁴ Council Conclusions on 'Orientations for a reform of the EU economic governance framework' of the ECOFIN Council meeting, 14.3.2023, 6995/1/23 – REV 1.

⁵ European Council meeting (26 and 27 October 2023) – Conclusions, EUCO 14/23.

included elements of the legislative proposals of 26 April 2023 that were consistent with the existing legislation.

5. As announced in its fiscal policy guidance for 2024⁶, the Commission will propose to the Council to open deficit-based excessive deficit procedures in spring 2024, when justified on the basis of the outturn data for 2023, in line with the existing legal provisions. Member States were invited to take this into account when executing their 2023 budgets and preparing their Draft Budgetary Plans for 2024.
6. The Recovery and Resilience Facility⁷ provides financial support for the implementation of reforms and investments, notably to promote the green and digital transitions. The Facility also aims at increasing the resilience of the Union's energy system by reducing dependence on fossil fuels and diversifying energy supply at Union level ('REPowerEU objectives')⁸. The Facility will strengthen the resilience and potential growth of Member States' economies, which contributes to job creation and sustainable public finances. Part of this support takes the form of non-repayable financial support ("grants"), entailing a fiscal impulse financed by the Union. Together with cohesion policy funds and the Just Transition Mechanism, the Facility is supporting a fair and inclusive recovery in the EU, in line with the European Pillar of Social Rights.
7. Economic policy should continue to tackle the risks linked to high inflation and address long-term challenges. Despite declining, inflation in the euro area remains a concern. It is essential that inflation continues to fall and that inflation expectations remain well anchored, with consistent monetary and fiscal policies, while remaining agile in the face of high uncertainty. In particular, emergency energy support measures taken to respond to the energy price shock should be wound down, using the related savings to reduce the government deficits, as soon as possible in 2023 and 2024. Should renewed energy price increases necessitate new or continued support measures, these should be targeted at protecting vulnerable households and firms, as well as be fiscally affordable and preserve incentives for energy savings. Furthermore, Member States should continue to preserve nationally financed public investment and ensure the effective absorption of grants under the Recovery and Resilience Facility and of other EU funds, in particular to foster the green and digital transitions.

CONSIDERATIONS CONCERNING CYPRUS

8. On 16 October 2023, Cyprus submitted its Draft Budgetary Plan for 2024. On that basis and taking into account the Council Recommendation to Cyprus of 14 July 2023⁹, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013.

⁶ Communication from the Commission to the Council, 'Fiscal Policy Guidance 2024', 8.3.2023, COM(2023) 141 final.

⁷ Regulation (EU) 2021/241 of the European Parliament and of the Council of 12 February 2021 establishing the Recovery and Resilience Facility, (OJ L 57, 18.2.2021, p. 17).

⁸ Regulation (EU) 2023/435 of the European Parliament and of the Council of 27 February 2023 amending Regulation (EU) 2021/241 as regards REPowerEU chapters in recovery and resilience plans and amending Regulations (EU) No 1303/2013, (EU) 2021/1060 and (EU) 2021/1755, and Directive 2003/87/EC (OJ L 63, 28.2.2023, p. 1).

⁹ Council Recommendation on the 2023 National Reform Programme of Cyprus and delivering a Council opinion on the 2023 Stability Programme of Cyprus, OJ C 312, 1.9.2023, p. 116-124.

9. According to the Draft Budgetary Plan, Cyprus's real GDP is projected to grow by 2.9% in 2024 (2.4% in 2023), while HICP inflation is forecast at 2.5% in 2024 (4.1% in 2023). In turn, according to the Commission 2023 autumn forecast, Cyprus's real GDP is projected to grow by 2.6% in 2024 (2.2% in 2023), while inflation is forecast at 3.0% in 2024 (4.1% in 2023).

The main differences between the two sets of HICP inflation projections reflect the assumption of the Commission for higher oil prices and higher second-round effects of the wage indexation.

Overall, the macroeconomic scenario underpinning the budgetary projections in the Draft Budgetary Plan appears to be in line with the Commission's 2023 autumn forecast for 2023 and 2024.

Cyprus complies with the requirement of Article 4(4) of Regulation (EU) No 473/2013, since the Draft Budgetary Plan is based on independently endorsed macroeconomic forecasts.

10. According to the Draft Budgetary Plan, Cyprus's general government surplus is projected to increase to 2.8% of GDP in 2024 (from 2.5% in 2023), which is mainly driven by stronger economic growth and an increase in the social security contribution rate partially compensating for a number of discretionary measures adopted in 2023 with an estimated cost of 0.6% of GDP in 2023 and 0.3% of GDP in 2024. The general government debt-to-GDP ratio is set to decrease to 74.7% at the end of 2024 (from 81.8% at the end of 2023).

In turn, according to the Commission 2023 autumn forecast, Cyprus's general government surplus is projected to decrease slightly to 2.1% of GDP in 2024 (from 2.3% in 2023), while the general government debt-to-GDP ratio is set to decrease to 71.5% at the end of 2024 (from 78.4% at the end of 2023).

The main differences between the two sets of projections for government surpluses reflect the inclusion in the Commission forecast of the mortgage-to-rent scheme for vulnerable households offered by KEDIPES, a state-owned asset management company, based on estimates that became available after the submission of the Draft Budgetary Plan and several measures announced on 19 October 2023, i.e. also after the submission of the Draft Budgetary Plan, including extension of energy support measures and some additional housing policy measures. The two sets of debt projections take into account different outturn data for 2022, which were made available after the submission of the Draft Budgetary Plan. In particular, since the debt-to-GDP ratio in 2022 turned out to be lower by 2.6 percentage points (85.6%) than indicated in the Draft Budgetary Plan (88.2%), this revision affected favourably the debt projections in the Commission's 2023 autumn forecast for the subsequent years. Moreover, the Commission debt projections are also favourably affected by the higher inflation expected in the Commission forecast and higher stock-flow adjustment in 2024. Thus, notwithstanding lower primary balances in the Commission projections, public debt is forecast to be lower.

11. Based on the Commission's estimates, the fiscal stance¹⁰ is projected to be contractionary at 0.4% of GDP in 2024, following an expansionary fiscal stance of -0.9% in 2023.
12. The Draft Budgetary Plan assumes that expenditure amounting to 0.8% of GDP will be financed by non-repayable support ("grants") from the Recovery and Resilience Facility in 2024, compared to 0.3% of GDP in 2023. Expenditure financed by Recovery and Resilience Facility grants will enable high-quality investment and productivity-enhancing reforms without a direct impact on the general government balance and debt. This is broadly in line with the assumptions underlying the Commission 2023 autumn forecast. The Draft Budgetary Plan also assumes expenditure backed by loans from the Recovery and Resilience Facility, amounting to 0.2% of GDP in 2024, compared with zero in 2023.
13. According to the Commission 2023 autumn forecast, taking into account the information contained in the Draft Budgetary Plan, the measures adopted to mitigate the economic and social impact of the increase in energy prices are expected to be largely wound down by the end of 2023, and some measures are planned to remain in place until the end of the first quarter of 2024. The Commission's assumptions regarding the phasing out of measures are different from what is in the Draft Budgetary Plan as the government announced the re-introduction of some measures after the submission of the Draft Budgetary Plan.

In addition, the Draft Budgetary Plan reports on measures taken for 2024 that are not directly related to energy price developments. It is an adjustment in the public wage indexation (Cost of Living Allowance, COLA), increasing the automatic inflation indexation from 50% to 66.7% of previous year's inflation as of 1 June 2023 and an increase in the rate of social security contributions as of 1 January 2024. The aggregate impact of these measures is surplus increasing and estimated by the Commission at around 0.1 % of GDP in 2024 and is expected to have a permanent impact on public finances.

14. On 14 July 2023, the Council recommended that Cyprus maintain a sound fiscal position in 2024.

According to the Commission 2023 autumn forecast, Cyprus's structural surplus is projected at 1.9% of GDP in 2024, from 1.2% in 2023, thereby remaining above the country's medium-term budgetary objective (MTO) of a structural balance of 0.0% of GDP. This is in line with what was recommended by the Council.

15. Moreover, the Council recommended that Cyprus take action to wind down the emergency energy support measures in force as soon as possible in 2023 and 2024. The Council further specified that, should renewed energy price increases necessitate new or continued support measures, Cyprus should ensure that these were targeted at protecting vulnerable households and firms, fiscally affordable, and preserve incentives for energy savings.

¹⁰ The fiscal stance is measured as the change in general government primary expenditure, net of the incremental budgetary impact of discretionary revenue measures, excluding one-off and cyclical unemployment expenditure, but including expenditure financed by non-repayable support (grants) from the Recovery and Resilience Facility and other EU funds, relative to medium-term (10-year) average potential GDP growth rate, expressed as a ratio to nominal GDP.

According to the Commission 2023 autumn forecast, the net budgetary cost¹¹ of energy support measures is projected at 0.5% of GDP in 2023 and 0.0% in both 2024 and 2025. This is in line with what was recommended by the Council.

16. In addition, the Council recommended that Cyprus preserve nationally financed public investment and ensure the effective absorption of Recovery and Resilience Facility grants and other EU funds, in particular to foster the green and digital transitions.

According to the Commission 2023 autumn forecast, nationally financed public investment is projected to increase to 2.8% of GDP in 2024 (from 2.5% of GDP in 2023) and, therefore, it is expected to be preserved. This is in line with what was recommended by the Council. In turn, public expenditure financed from revenues from EU funds, including Recovery and Resilience Facility grants, is expected to increase to 1.7% of GDP in 2024 (from 1.2% of GDP in 2023).

17. Furthermore, on 14 July 2023, the Council also recommended that, for the period beyond 2024, Cyprus continue to pursue investment and reforms conducive to higher sustainable growth and preserve a prudent medium-term fiscal position. The Draft Budgetary Plan includes medium-term budgetary projections until 2026. The general government surplus is projected to decrease from 2.8% of GDP in 2025 to 2.6% in 2026. In turn, the general government debt is projected to decrease to 69.5% of GDP in 2025 and 63% in 2026. General government investment is projected to decrease to around 2.5% of GDP in 2025. These projections assume the implementation of investments contained in the Recovery and Resilience Plan and the National Energy and Climate Plan which encompass the main national policies for sustainable growth and competitiveness.

18. According to the Commission 2023 autumn forecast, Cyprus is projected to achieve its MTO in 2024.

Moreover, according to the Commission 2023 autumn forecast, and taking into consideration the information included in Cyprus's Draft Budgetary Plan, the emergency energy support measures are expected to be wound down as soon as possible in 2023 and 2024.

Furthermore, Cyprus is expected to preserve nationally financed public investment. Cyprus should also continue to ensure the effective absorption of Recovery and Resilience Facility grants and other EU funds.

Overall, the Commission is of the opinion that the Draft Budgetary Plan of Cyprus is in line with the Council Recommendation of 14 July 2023.

At the same time, the Commission projects Cyprus's headline budget surplus at 2.1% of GDP in 2024, while the government debt ratio is projected at 71.5% in 2024, above the Treaty reference value of 60% of GDP but almost 30 percentage points of GDP below the ratio at end 2021.

A comprehensive description of progress made with the implementation of the Council's country-specific recommendations will be included in the 2024 Country

¹¹ The figure represents the level of the annual budgetary cost of those measures, including revenue and expenditure and, where applicable, net of the revenue from taxes on windfall profits of energy suppliers.

Report and assessed in the context of the Council's country-specific recommendations to be recommended by the Commission in spring 2024.

Table: Key macroeconomic and fiscal figures

	2022	2023		2024	
	Outturn	DBP	COM	DBP	COM
Real GDP (% change)	5.1	2.4	2.2	2.9	2.6
HICP inflation (%; annual average)	8.1	4.1	4.1	2.5	3.0
General government balance (% of GDP)	2.4	2.5	2.3	2.8	2.1
Primary balance (% of GDP)	3.9	3.9	3.7	4.3	3.5
General government gross debt (% of GDP; at end-year)	85.6	81.8	78.4	74.7	71.5
	COM	COM		COM	
Fiscal stance (*) (% of GDP)	0.2	-0.9		0.4	
Fiscal adjustment (**) (% of GDP)	0.8	-1.2		0.9	
Change in total net budgetary cost of energy support measures (***) (% of GDP)	0.6	-0.1		-0.5	
Growth in net nationally financed primary expenditure (% change) (A)				4.3	
Recommended maximum growth rate of net nationally financed primary expenditure (****) (% change) (B)				n.a.	
Difference from recommended growth in net nationally financed primary expenditure (pps.) (B-A)				n.a.	
Impact on fiscal adjustment of deviation in net nationally financed primary expenditure compared with the Council recommendation (*****) (% of GDP)				n.a.	

Notes:

(*) Change in general government primary expenditure, net of the incremental budgetary impact of discretionary revenue measures (and COVID-19 pandemic-related temporary emergency measures), excluding one-off and cyclical unemployment expenditure, but including expenditure financed by non-repayable support (grants) from the Recovery and Resilience Facility and other EU funds, relative to the medium-term (10-year) average potential nominal GDP growth rate. A negative (positive) sign indicates an excess (a shortfall) of net primary expenditure growth over medium-term potential GDP growth, corresponding to an expansionary (a contractionary) fiscal stance.

(**) Change in general government primary expenditure, net of the incremental budgetary impact of discretionary revenue measures (and COVID-19 pandemic-related temporary emergency measures), excluding one-off and cyclical unemployment expenditure, as well as expenditure financed by non-repayable support (grants) from the Recovery and Resilience Facility and other EU funds, relative to the medium-term (10-year) average potential nominal GDP growth rate. A negative (positive) sign indicates an excess (a shortfall) of net nationally financed primary expenditure growth over medium-term potential GDP growth, corresponding to an expansionary (a contractionary) fiscal adjustment.

(***) Energy support measures less revenue from new taxes and levies on windfall profits by energy producers.

(***) According to the Council Recommendation ‘on the 2023 National Reform Programme of Cyprus and delivering a Council opinion on the 2023 Stability Programme of Cyprus’, (OJ C 312, 1.9.2023, p. 116).

(****) Excess in growth of net nationally financed primary expenditure over the recommended maximum growth rate, expressed as a percentage of GDP.

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For the Commission
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