EUROPEAN
COMMISSION

Brussels, 26.11.2024
C(2024) 9050 final

COMMISSION OPINION

of 26.11.2024

on the Draft Budgetary Plan of Cyprus

{SWD(2024) 950 final}

(only the Greek text is authentic)

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GENERAL CONSIDERATIONS

1. Regulation (EU) No 473/2013 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 EU economic governance framework.
2. Article 6 of Regulation (EU) No 473/2013 requires euro area 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 30 April 2024, the new economic governance framework entered into force. The main objectives of the new framework are to promote sound and sustainable public finances, sustainable and inclusive growth and resilience through reforms and investments. The framework helps to make the EU more competitive and better prepared for future challenges by supporting progress towards a green, digital, inclusive, and resilient economy.
4. In order to simplify the Union fiscal framework and increase transparency, a single operational indicator, anchored in debt sustainability, serves as a basis for setting the fiscal path and for carrying out annual fiscal surveillance for each Member State. That single operational indicator is the nominal growth rate of net expenditure[1].
5. The Recovery and Resilience Facility[2] 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'). The Facility is expected to 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.

[1] According to Article 2(2) of Regulation (EU) 2024/1263, 'net expenditure' means government expenditure net of interest expenditure, discretionary revenue measures, expenditure on programmes of the Union fully matched by revenue from Union funds, national expenditure on co-financing of programmes funded by the Union, cyclical elements of unemployment benefit expenditure, and one-offs and other temporary measures.

[2] 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. 17–75.

CONSIDERATIONS CONCERNING CYPRUS

6. On 15 October 2024, Cyprus submitted its Draft Budgetary Plan for 2025 to the Commission and to the Eurogroup. On that basis, the Commission adopts this opinion in accordance with Article 7 of Regulation (EU) No 473/2013, and taking into account the Council Recommendation on economic, budgetary, employment and structural policies of Cyprus of 21 October 2024[3]. This opinion is adopted by the Commission together with the Commission Recommendation for a Council Recommendation setting the net expenditure path of Cyprus for the years 2025 to 2028[4], which the Commission expects the Council to act upon in a timely manner.

7. On 21 October 2024, upon the Commission recommendation for Council Recommendation on the economic, social, employment, structural and budgetary policies of Cyprus of 19 June 2024[5], the Council recommended Cyprus, in line with the requirements of the reformed Stability and Growth Pact, to limit the growth in net expenditure in 2025 to a rate consistent with, inter alia, putting the general government debt on a plausibly downward trajectory over the medium term and respecting the 3% of GDP deficit Treaty reference value.

8. On 15 October 2024, Cyprus submitted to the Commission its medium-term fiscal-structural plan in line with Regulation (EU) 2024/1263[6]. The plan commits to net expenditure growth not exceeding 6.0% in 2025, 5.0% in 2026, 5.4% in 2027 and 4.3% in 2028. The Commission has assessed the medium-term fiscal-structural plan of Cyprus and recommended to the Council adopt a recommendation setting the net expenditure growth ceilings contained therein. The Draft Budgetary Plan for 2025 is the first step in the implementation of the medium-term fiscal-structural plan.

9. According to the Draft Budgetary Plan, Cyprus's real GDP is projected to grow by 3.1% in 2025 (3.7% in 2024), while inflation is forecast at 2.0% in 2025 (2.2% in 2024). According to the European Commission Autumn 2024 Forecast, Cyprus's real GDP is projected to grow by 2.8% in 2025 (3.6% in 2024), while inflation is forecast at 2.1% in 2025 (2.2% in 2024). The main differences between both sets of projections concern the 2025 outlook, with the Draft Budgetary Plan projecting stronger domestic demand, notably higher investment spending and general government consumption. As regards potential output, the estimates are broadly aligned. Nevertheless, the benchmark revision of the national accounts which occurred after the submission of the Draft Budgetary Plan, resulted in a positive level-shift in growth and employment in historical years, which is taken into account in the European Commission Autumn 2024 Forecast but not in Cyprus's Draft Budgetary Plan. Overall, the macroeconomic scenario underpinning the budgetary projections in the Draft Budgetary Plan appears to be more favourable than the Commission's forecast for 2025 (while it is broadly in line for 2024). Cyprus complies with the requirement of Article 4(4) of Regulation (EU) No 473/2013, since

[3] Not yet published.

[4] Commission Recommendation for a Council Recommendation endorsing the national medium-term fiscal-structural plan of Cyprus, 26.11.2024, COM(2024)710 final.

[5] Commission Recommendation for a Council Recommendation on the economic, social, employment, structural and budgetary policies of Cyprus, 19.6.2024, COM(2024)613 final.

[6] Regulation (EU) 2024/1263 of the European Parliament and of the Council of 29 April 2024 on the effective coordination of economic policies and multilateral budgetary surveillance and repealing Council Regulation (EC) No 1466/97, OJ L, 30.4.2024, ELI: http://data.europa.eu/eli/reg/2024/1263/oj.

the Draft Budgetary Plan is based on independently endorsed macroeconomic forecasts.

10. Based on the Commission's estimates, the fiscal stance[7] is projected to be contractionary at 0.3% of GDP in 2025, following a contractionary fiscal stance of 1.1% in 2024. This measure of fiscal stance appropriately considers the impact on aggregate demand of expenditure financed by non-repayable support (grants) from the Recovery and Resilience Facility and other EU funds.

11. According to the Draft Budgetary Plan, Cyprus's general government surplus is projected to decrease to 2.7% of GDP in 2025 (3.9% in 2024), while the general government debt-to-GDP ratio is set to decrease to 64.1% at the end of 2025 (68.9% at the end of 2024). According to the Draft Budgetary Plan, net expenditure is projected to grow by 6.5% in 2024 and 5.8% in 2025. The growth rate of net expenditure in 2025 according to the Draft Budgetary Plan is below the growth rate in the medium-term fiscal-structural plan submitted by Cyprus on 15 October 2024. In turn, according to the European Commission Autumn 2024 Forecast, Cyprus's general government surplus is projected to decrease to 2.7% of GDP in 2025 (3.5% in 2024), while the general government debt-to-GDP ratio is set to decrease to 61.4% at the end of 2025 (66.4% at the end of 2024). The decrease in the government surplus is driven by projected lower tax revenue growth in line with developments in wages and consumption. The forecast does not assume additional receipts from improvements in tax administration and the resolution of tax cases backlog, which could further improve revenue collection. At the same time, total expenditure is expected to grow faster than revenue due to still strong wage and pension increases carried over from 2024 and a higher public investment. According to the European Commission Autumn 2024 Forecast, net expenditure is projected to grow by 3.9% in 2024 and 4.2% in 2025. The main differences between both sets of projections for the government surplus, debt and net expenditure reflect GDP and fiscal accounts revisions for historical data up to 2023, which were taken into account in the Commission forecast while they were not taken into account in the Draft Budgetary Plan as they were made available after the plan's submission. Concerning the projection for net expenditure the differences reflect in particular the statistical treatment of the retroactive payment of the state to the civil servants' pension scheme that changed after the submission of the Draft Budgetary Plan. In the Commission forecast this payment of 1.1% of GDP is affecting negatively the 2023 general government expenditure and balance. However, in Cyprus's Draft Budgetary Plan it has an annual negative effect of around 0.4% of GDP in each of the 2024-2026 budget expenditure and balances. Concerning the projections of government debt the differences mainly reflect, the different balances in 2024, the significant denominator effect from the GDP revision upwards by almost 4%. Moreover, the European Commission Autumn 2024 Forecast also projects lower interest expenditures in line with the interest rate and public debt reduction trends. The risks to achieving the fiscal objectives for 2025 set out in the Draft Budgetary Plan are tilted to the upside, and mainly relate to tax revenue. Downside risks may arise from implementation

[7] 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.

challenges of some large investment projects that may burden public budget through called guarantees and other claims.

12. The Draft Budgetary Plan assumes that expenditure amounting to 1% of GDP will be financed by non-repayable support ("grants") from the Recovery and Resilience Facility in 2025, compared to 0.7% of GDP in 2024. Expenditure supported by Recovery and Resilience Facility grants enables high-quality investment and productivity-enhancing reforms without a direct impact on the general government balance and debt of Cyprus. The Draft Budgetary Plan also assumes expenditure supported by loans from the Recovery and Resilience Facility, amounting to 0.1% of GDP in 2025, compared with below 0.1% of GDP in 2024.

13. The Draft Budgetary Plan includes policy measures with fiscal impact in 2025. On the revenue side, these include the reduction of the tax rate on received and credited interests from 30% to 17% and the imputed revenue from the non-indexation of the personal income tax brackets. On the expenditure side, the measures include the full year effect of the 15% increase of the basic salary in the public sector as of October 2024, subsidies for the installation of solar panels on buildings and housing support schemes for vulnerable households. According to the Commission estimates, the overall additional impact of the revenue measures increases the government surplus by 0.2% of GDP in 2025.

14. According to the European Commission 2024 Autumn Forecast, Cyprus's net expenditure is projected to increase by 4.2% in 2025, which corresponds to a cumulative growth of 8.3% in 2024 and 2025 taken together. The Commission is of the view that these net expenditure growth rates are in line with the Council recommendation of 21 October 2024 to limit the growth in net expenditure in 2025 to a rate consistent with putting the general government debt on a plausibly downward trajectory and respecting the 3% of GDP deficit Treaty reference value over the medium term. Moreover, those net expenditure growth rates would be appropriate initial steps towards the implementation of the medium-term fiscal structural plan.

15. According to the European Commission Autumn 2024 Forecast, nationally financed public investment is projected to decrease to 2.2% of GDP in 2025 (from 2.4% of GDP in 2024). In turn, public expenditure on EU funded programmes, including Recovery and Resilience Facility grants, is expected to increase to 1.4% of GDP in 2025 (from 1.0% of GDP in 2024).

16. The Draft Budgetary Plan includes medium-term budgetary projections until 2027. The general government surplus is projected to decrease to 2.6% of GDP in 2026 and to 2.1% in 2027. In turn, the general government debt is projected to decrease to 58.8% in 2026 and 53.3% in 2027. These projections assume a continued strong real GDP growth of around 3%, HICP inflation of around 2%, prudent revenue growth in line with the macroeconomic developments and no new expenditure increasing measures beyond 2025.

17. Overall, the Commission is of the opinion that the Draft Budgetary Plan of Cyprus is in line with the Council Recommendation of 21 October 2024. According to the European Commission Autumn 2024 Forecast, Cyprus's net expenditure growth in 2025 is consistent with what was recommended by the Council on 21 October 2024.

The progress made with the implementation of the Council's country-specific recommendations will be assessed by the Commission in spring 2025, in the context of the European Semester Spring Package.

Table 1. Key macroeconomic and fiscal figures

#	Variables		2023	2024		2025	
			Outturn	DBP	COM	DBP	COM
1	Real GDP	% change	2.6	3.7	3.6	3.1	2.8
2	HICP inflation	% change	3.9	2.2	2.2	2.0	2.1
3	General government balance	% GDP	2.0	3.9	3.5	2.7	2.7
4	Primary balance	% GDP	3.3	5.4	4.7	4.3	3.8
5	General government gross debt	% GDP	73.6	68.9	66.4	64.1	61.4
6	Fiscal stance (**)	% GDP	-2.4		1.1		0.3
7	Net expenditure growth (annual)	% change		6.5	3.9	5.8	4.2
8	Net expenditure growth (cumulative)	% change				12.7	8.3
			Commission Recommendation for a Council Recommendation setting the net expenditure path of Cyprus				
9	Maximum growth rates of net expenditure (*)	% change			Annual	**6.0**	
10		% change			Cumulative	**8.9**	

Notes :
* According to the Commission Recommendation for a Council Recommendation setting the net expenditure path of Cyprus for the years 2025 to 2028.
** The fiscal stance is measured as the change in general government primary expenditure, net of the incremental budgetary impact of both discretionary revenue measures and COVID-19 pandemic-related temporary emergency measures, excluding cyclical unemployment expenditure, but including the change in 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 GDP growth rate in nominal terms. A negative (positive) sign indicates an excess (shortfall) of primary expenditure growth over medium-term potential GDP growth, which corresponds to an expansionary (contractionary) fiscal stance. For more details, see Box 1 of the Fiscal Statistical Tables.

Source : European Commission Autumn 2024 Forecast and Draft Budgetary Plan for 2025

Done at Brussels, 26.11.2024

For the Commission
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