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COMMISSION OPINION

of 20.11.2019

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, 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 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 15 October 2019, Cyprus submitted the Draft Budgetary Plan for 2020. On that basis, 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 which ensures compliance with its medium-term budgetary objective of a balanced budgetary position in structural terms.[1] As its public debt, at 100.6% of GDP in 2018, exceeds the 60% of GDP reference value of the Treaty, Cyprus also needs to comply with the debt reduction benchmark.

5. According to the Commission 2019 autumn forecast, the Cypriot economy is expected to grow by 2.9% in 2019 and 2.6% in 2020. The macroeconomic scenario underlying the Draft Budgetary Plan projects slightly higher real GDP growth at 3.2% in 2019 and 2.9% in 2020. The Commission 2019 autumn forecast for 2019 and 2020 reflects a more pessimistic outlook, in particular on investment and net exports, compared with the macroeconomic scenario underlying the Draft Budgetary Plan. Overall, the macroeconomic assumptions underpinning the Draft Budgetary Plan are plausible in 2019 and 2020. 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 plans an improvement of the general government headline balance from a deficit of 4.4 % of GDP in 2018, due to the one-off impact of the banking support measures, to a surplus of 3.8% of GDP in 2019, which is in line with the Commission 2019 autumn forecast. The budgetary improvement reflects the favourable macroeconomic and labour market situation, buoyant tax revenue and the increases in social contribution rates. For 2020, the Draft Budgetary Plan projects a general government headline surplus of 2.7% of GDP, which is also in line with the

[1] Council recommendation of 9 July 2019 on the 2019 National Reform Programme of Cyprus and delivering a Council opinion on the 2019 Stability Programme of Cyprus, OJ C 301, 5.9.2019, p. 80.

Commission 2019 autumn forecast. The recalculated structural balance[2] based on the information provided in the Draft Budgetary Plan is estimated at 1.7% of GDP in 2019 and 0.4% of GDP in 2020. The Commission 2019 autumn forecast projects broadly similar structural surpluses of 1.7% of GDP in 2019 and 0.6% in 2020.

7. In 2020, the fiscal stance is expected to be expansionary, based on the structural balance estimates, according to both the Draft Budgetary Plan and the Commission 2019 autumn forecast. According to the Draft Budgetary Plan, the revenue is to increase by 2.4 percentage points of GDP and the expenditure by 3.6 percentage points. Despite the 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 EU average, whereas the tax wedge is expected to remain significantly below the Union's average. Labour and corporate taxes in Cyprus are among the lowest in the EU. The Draft Budgetary Plan does not report any new budgetary measure.

   With respect to the Recommendation of 9 July 2019 addressed by the Council to Cyprus to adopt and implement legislative reforms to improve efficiency in the public sector, in particular as regards the functioning of the public administration and local governments, several draft bills have been approved by the Council of Ministers but are pending approval at the House of Representatives. With regards to the governance of State-owned enterprises, several measures that were adopted in 2019 by the Council of Ministers are still expected to be implemented gradually.

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 1.7% of GDP in 2019 and 0.4% of GDP in 2020. The Commission 2019 autumn forecast points to a similar assessment. Therefore, Cyprus is expected 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 decline from 97.4% in 2019 to 91.1% in 2020, above the Commission's projection of 93.8% and 87.8%, respectively. It should be noted that compared to the Draft Budgetary Plan, the Commission 2019 autumn forecast uses more recent and upwardly revised data for nominal GDP in 2018, which contributed to a lower projection of the debt-to-GDP ratio. Based on the Draft Budgetary Plan, the debt reduction benchmark is projected to be met in 2019 and 2020, by margins of 6.8% and 7.1% of GDP respectively. Taking this into account, the Commission 2019 autumn forecast is broadly in line with the Draft Budgetary Plan.

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 2020 budget.

    The Commission is also of the opinion that Cyprus has made limited progress with regard to the structural part of the fiscal recommendations contained in the Council

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

Recommendation of 9 July 2019 in the context of the European Semester and thus invites the authorities to accelerate progress. A comprehensive description of progress made with the implementation of the country-specific recommendations will be made in the 2020 Country Reports and assessed in the context of the country-specific recommendations to be proposed by the Commission in spring 2020.

Done at Brussels, 20.11.2019

For the Commission
Pierre MOSCOVICI
Member of the Commission