INTERNATIONAL MONETARY FUND

IMF Country Report No. 24/137

CYPRUS

May 2024

2024 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR CYPRUS

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2024 Article IV Consultation with Cyprus, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its May 22, 2024, consideration of the staff report that concluded the Article IV consultation with Cyprus.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on May 22, 2024, following discussions that ended on March 29, 2024, with the officials of Cyprus on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on May 10, 2024.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Cyprus.

The documents listed below have been or will be separately released.

- **Selected Issues**

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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International Monetary Fund
Washington, D.C.

PRESS RELEASE

PR24/186

IMF Executive Board Concludes 2024 Article IV Consultation with Cyprus

FOR IMMEDIATE RELEASE

Washington, DC – **May 28, 2024:** On May 22, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Cyprus and endorsed the staff appraisal.

Cyprus recovered swiftly from the pandemic and has proven resilient to multiple adverse shocks. Growth moderated in 2023 but remained robust, above the euro area (EA) average, supported by a continued recovery in tourism, financial services and expanding ICT activity, and strong investments. Headline inflation has fallen below 2 percent, supported by declining energy prices and tighter monetary policy, but core inflation has been more persistent. Strong fiscal performance continues driven by robust revenue growth and contributing to a large decline in public debt. The banking sector has sizable capital and liquidity buffers, and despite tight financial conditions, risks appear to have declined.

The outlook is positive but near-term are to the downside. Growth is expected to remain stable in 2024, supported by rising real incomes and FDI and EU RRP inflows, before gradually rising to its estimated potential of 3 percent over the medium term, driven by robust investment and structural reforms. The unwinding of negative energy price effects and administrative price measures will push inflation, but high interest rates, negative base effects, and more stable international prices should keep it contained to around 2 percent in 2024. Short-term risks are mostly external and to the downside including a downturn in major tourism markets, an escalation of regional conflicts, and delays in RRP implementation. Medium term risks from climate change are counterbalanced by upside potential from attracting more foreign investment and talent.

Executive Board Assessment[2]

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.IMF.org/external/np/sec/misc/qualifiers.htm

The Executive Directors agreed with the thrust of the staff appraisal. They commended the economy's resilience to multiple adverse shocks. Directors looked forward to continued implementation of sound policies and reforms to support fiscal sustainability, financial stability, and potential growth.

Directors agreed that fiscal policy should aim at reducing debt and maintaining space for long-term spending needs. They concurred that the authorities' planned fiscal stance in 2024 is appropriate and large primary surpluses should be maintained until public debt falls comfortably below 60 percent of GDP. Directors highlighted the sizable long-term spending needs from aging and climate challenges, and called for fiscal space to be preserved to accommodate those needs. Important supporting measures will include phasing out electricity subsidies and VAT exemptions as planned, avoiding further wage indexation, prioritizing investments, implementing healthcare reforms, and strengthening SOE oversight.

Directors noted the high capitalization and liquidity of the banking system. They concurred that financial sector risks appear to have declined, despite tightening financial conditions, while calling for the recent uptick in loan renegotiations to be closely monitored. Directors welcomed the increase in counter-cyclical buffers and called for continued vigilance of systemic real estate risks and non-bank financial institutions. They encouraged the authorities to allow the recently amended foreclosure framework to operate together with the mortgage-to-rent scheme to accelerate the resolution of legacy NPLs.

Directors stressed the importance of structural reforms to support the ongoing diversification of Cyprus's growth model. They called for further judicial and labor market reforms to streamline the business environment and address skill-mismatches. A robust AML/CFT framework, with a single supervisory framework for administrative services and further strengthening of implementation efforts, including in real estate, will also be important to mitigate financial, reputational, and regulatory risks. Policies to promote domestic savings and entrepreneurial opportunities would also help to rebalance the current account while supporting long-term growth.

Directors commended the authorities for Cyprus's ambitious climate objectives. They emphasized that a forceful implementation of energy infrastructure projects, along with additional mitigation measures, are needed to achieve these targets. The authorities' green taxation plans would be helpful in reducing emissions with manageable growth and distributional impacts. But the scope of the carbon tax should be widened and coupled with targeted sectoral policies to achieve faster emission reduction. Careful assessment of climate risks along with an adaptation strategy are also needed to limit the cost of climate change.

Cyprus: Summary of Economic Indicators, 2022–27

	2022	2023	2024	2025	2026	2027
			Projections			
Real Economy	(Percent change, unless otherwise indicated)					
Real GDP	5.1	2.5	2.6	2.8	3.0	3.1
Domestic demand	8.9	5.3	2.5	3.1	3.1	3.1
Consumption	7.2	3.8	3.8	3.0	3.1	3.2
Private consumption	8.6	4.2	3.8	2.9	3.1	3.3
Public consumption	3.1	2.3	3.5	3.1	3.0	3.1
Gross capital formation	15.3	10.8	-1.9	3.5	3.2	2.5
Foreign balance 1/	-3.7	-2.8	0.5	-0.4	-0.2	-0.1
Exports of goods and services	13.6	-1.2	0.0	1.9	2.3	2.7
Imports of goods and services	18.3	1.7	-0.5	2.3	2.4	2.7
Potential GDP growth	4.5	3.3	3.1	3.1	3.2	3.2
Output gap (percent of potential GDP)	1.9	1.1	0.6	0.3	0.1	0.0
HICP (period average) Seasonally Adjusted	8.1	3.9	2.2	2.0	2.0	2.0
HICP (end of period) Seasonally Adjusted	7.6	1.9	2.0	2.0	2.0	2.0
GDP deflator	6.1	4.7	3.7	2.5	2.3	2.3
Unemployment rate (percent, period average)	6.8	6.1	5.9	5.7	5.5	5.3
Employment growth (percent, period average)	4.4	2.8	1.2	1.1	1.1	1.1
Labor force	3.6	2.1	0.9	0.9	0.9	0.9
Public Finance	(Percent of GDP, unless otherwise indicated)					
General government balance	2.7	3.1	2.7	2.5	2.5	1.4
Revenue	41.5	43.3	43.6	43.6	43.5	42.8
Expenditure	38.8	40.2	41.0	41.1	41.1	41.3
Primary Fiscal Balance	4.2	4.5	4.1	4.0	3.9	3.0
General government debt	85.6	77.3	71.1	65.7	60.7	56.7
Balance of Payments						
Current account balance	-7.9	-12.1	-11.1	-10.2	-10.0	-9.6
Trade Balance (goods and services)	0.3	-0.9	-0.9	-0.7	-0.6	-0.5
Exports of goods and services	95.0	89.4	85.9	84.7	83.8	82.9
Imports of goods and services	94.7	90.3	86.8	85.4	84.3	83.4
Goods balance	-21.5	-23.9	-22.3	-21.7	-21.3	-20.9
Services balance	21.8	23.0	21.4	21.0	20.7	20.4
Primary income, net	-7.5	-10.1	-9.5	-8.6	-8.6	-8.2
Secondary income, net	-0.7	-1.1	-0.7	-0.9	-0.9	-0.9
Capital account, net	0.2	0.0	0.3	0.2	0.2	0.1
Financial account, net	-7.2	-9.7	-10.8	-10.0	-9.8	-9.5
Direct investment	-30.4	-12.6	-12.1	-12.0	-11.9	-19.3
Portfolio investment	4.1	10.5	4.7	4.4	3.1	3.0
Other investment and financial derivatives	18.7	-7.6	-3.4	-2.5	-1.1	6.8
Reserves (+ accumulation)	0.3	0.0	0.0	0.0	0.0	0.0
Program financing 2/	0.0	0.0	0.0	-1.0	-2.8	-2.7
Errors and omissions	0.6	2.5	0.0	0.0	0.0	0.0
Saving-Investment Balance						

National saving	28.4	34.2	32.9	32.1	32.1	31.8
Government	6.2	7.3	6.2	6.2	6.1	5.2
Non-government	22.3	26.9	26.7	25.9	25.9	26.5
Gross capital formation	20.5	22.1	21.8	21.9	22.0	22.2
Government	3.4	4.2	3.6	3.7	3.7	3.8
Private	17.1	17.8	18.3	18.2	18.3	18.4
Foreign saving	7.9	12.1	11.1	10.2	10.0	9.6
Memorandum Item:						
Nominal GDP (billions of euros)	27.8	29.8	31.7	33.4	35.2	37.1
Structural primary balance	3.5	3.9	3.9	3.8	3.8	2.9
External debt	609.6	576.0	558.3	523.2	491.0	460.8
Net IIP	-96.2	-96.4	-106.5	-111.1	-113.9	-116.0

Sources: Cystat, Eurostat, Central Bank of Cyprus, and IMF staff estimates.

1/ Contribution to real GDP growth

2/ Program financing (+ purchases, - repurchases) is included under the Financial Account, with consistent sign conversion

INTERNATIONAL MONETARY FUND

CYPRUS

STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION

May 10, 2024

KEY ISSUES

Recent Developments and Outlook: Growth moderated in 2023 with slowing consumption growth, lower services exports to Russia, and fading post-pandemic base effects. But growth has remained above the euro area (EA) average, supported by a continued recovery in tourism, expanding financial services and ICT activity, and strong investments. The labor markets are tight, with unemployment at a near two-decade low. Headline inflation dipped below 2 percent, but core inflation has been more persistent. Growth is expected to stabilize in 2024 and rise to 3 percent in the medium term.

Fiscal Policy: Driven by robust revenue growth, the primary surplus increased further in 2023, contributing to a large decline in public debt. The authorities' planned neutral fiscal stance in 2024 is appropriate. Further out, primary surpluses should be maintained until debt falls comfortably below 60 percent of GDP. Such a stance would preserve fiscal space to accommodate long-term spending pressures, including from aging and climate change. Investment spending should be prioritized while further public wage indexation should be avoided. The phase-out of the fuel excise reductions is welcome and the remaining VAT exemptions and electricity subsidies should be allowed to expire.

Financial Sector Policy: The banking sector has sizable capital and liquidity buffers, and despite tight financial conditions, risks appear to have declined. Strong growth and robust labor and housing markets have supported asset quality. But the pick-up in loan renegotiations warrants close monitoring. The increase in the *positive* neutral Counter-Cyclical Capital Buffer (CCyB) is welcome. But vigilance to real estate risks should continue, given the systemic importance of real estate in the financial system. The recently amended foreclosure framework should accelerate debt resolution and should be left to work with no further changes.

Structural Policies: Further judicial and labor market reforms are necessary to streamline the business environment and reduce skill mismatches, both of which will support the ongoing diversification of Cyprus' growth model. To strengthen the anti-money laundering and countering the financing of terrorism (AML/CFT) framework, a single supervisory framework for administrative services and greater oversight of the real estate sector are needed. The green transition requires completion of the energy infrastructure projects along with further mitigation and adaptation measures.

Approved By:
Mark Horton (EUR) and Boileau Loko (SPR)

The 2024 Article IV Consultation Mission was held in Nicosia during March 19–29, 2024. The mission team comprised Alex Pienkowski (head), Robert Beyer, Moheb Malak (all EUR), and Gabriela Conde Vitureira (MCM). Carlos Acosta (LEG) and Emanuele Massetti (FAD) joined some meetings virtually. Sharon Smith-Tohu and Paul Tershakovec (EUR) supported the mission from headquarters. Nina Stoyanova (Advisor to the Executive Director) joined some of the meetings. The mission met with the Minister of Finance Makis Keravnos, former Central Bank of Cyprus Governor Constantinos Herodotou, Permanent Secretary of the Ministry of Finance George Panteli, and other senior officials, as well as with representatives of the private sector, labor unions, and academia.

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TABLES

ANNEXES

CONTEXT

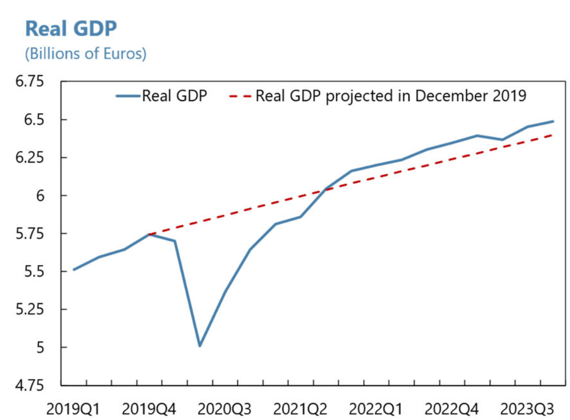
1. **Cyprus recovered swiftly from the pandemic and has proven resilient to multiple adverse shocks.** Strong policy support during the pandemic, supported by fiscal buffers, mitigated economic scarring. Following Russia's invasion of Ukraine, a drop in tourists from Russia was quickly offset by visitors from other countries, although sanctions dampened other services exports to Russia. A decline in Israeli tourists in the wake of the conflict in Israel and Gaza has had a modest impact on growth to date; a fall in Israeli FDI is expected to be temporary. Growth remains among the highest in the euro area (EA)—supported by expanding ICT activity, tourism, and implementation of the Recovery and Resilience Plan (RRP). Despite a change of government last year, policy continuity has been maintained and structural reforms contained in the RRP—which have garnered broad political consensus—remain a priority.

2. **Public debt has fallen significantly.** Cyprus has maintained a sizable structural primary balance since the 2013 crisis, averaging 3.5 percent of GDP, among the largest in the EU. Surpluses and strong growth have lowered debt by more than 30 percentage points of GDP since 2014, falling below 80 percent of GDP in 2023 for the first time in more than a decade. The resulting fiscal space enabled Cyprus to mount an effective policy response to the COVID-19 pandemic and the recent energy price shock.

3. **Private balance sheets are also shrinking.** Combined household and non-financial corporation (NFC) non-equity liabilities have fallen from over 460 percent of GDP in 2014 to below 275 percent in 2023. Legacy NPLs, while still high, have also fallen substantially in recent years. Most are now held outside of the banking sector in credit acquiring companies (CACs), but some small banks continue to hold large stocks, hindering performance.

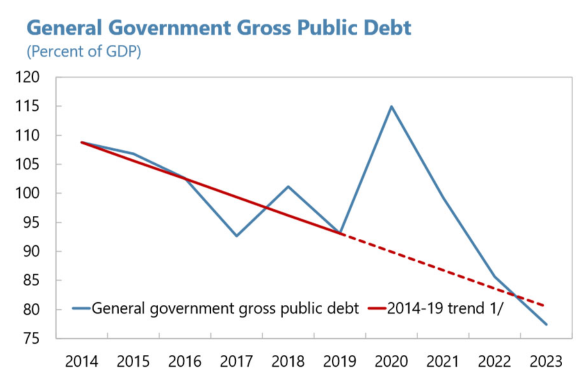
Background

Despite the pandemic and war in Ukraine, GDP now exceeds pre-pandemic projections.



Sources: Cystat, Haver Analytics, and IMF staff calculations.

Public debt is on a firm downward trajectory.



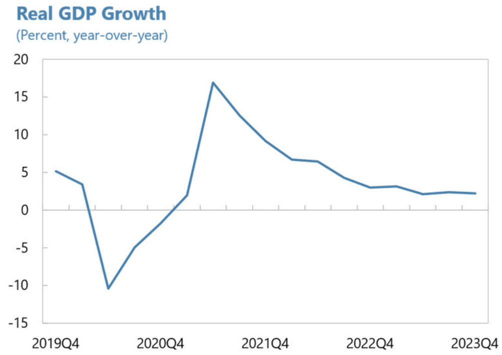
Sources: Cystat, European Commission, Eurostat, Haver Analytics, and IMF staff calculations.
1/ post-Cyprus financial crisis and pre-COVID

RECENT DEVELOPMENTS

4. Growth moderated in 2023 but remained robust (Figure 1). Slowing private consumption growth, lower services exports to Russia, and fading post-pandemic base effects caused growth to moderate from 5.1 percent in 2022 to 2.5 percent in 2023. But a continued recovery in tourism, financial services and expanding ICT activity, and strong (non-shipping sector) private investments meant that growth was still considerably above the 0.4 percent estimated for the EA. The output gap is estimated to have declined but remained in positive territory.

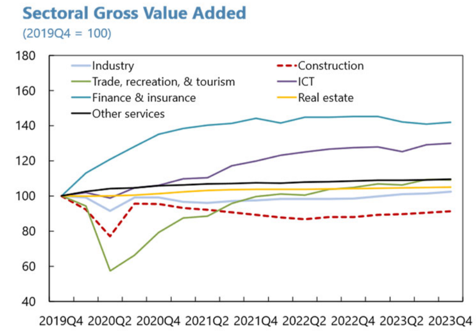
Economic Activity

Growth moderated in 2023...



Sources: Cystat, Haver Analytics, and IMF staff calculations.

...with post-pandemic growth driven by financial services and ICT.



Sources: Cystat, Haver Analytics, and IMF staff calculations.

5. Inflation has dipped below 2 percent. Headline inflation fell from a peak of 10.6 percent in July 2022 to 1.6 percent in March 2024, supported by rapidly-falling energy prices and tighter monetary policy. Core inflation was slightly higher at 2.5 percent in March 2024, with stickiness persisting from robust domestic demand, but still below the 2.9 percent in the EA (Annex I and Selected Issues Paper, SIP, I). Producer prices have been declining since July 2023 and inflation expectations remain contained.

Key Inflation Indicators
(Percent)

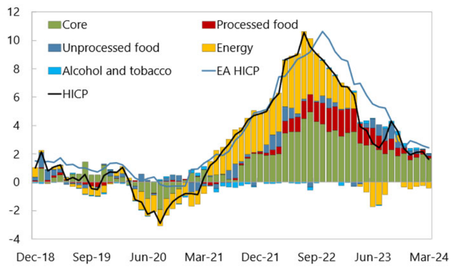
	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
Headline, year-over-year	7.6	6.1	2.8	4.3	1.9	1.6
Headline, 3-mo. MA 1/	-2.5	2.6	6.3	10.7	-11.6	1.3
Core, year-over-year	5.3	5.4	4.0	3.5	2.4	2.5
Core, 3-mo. MA 1/	-0.7	0.2	11.4	3.2	-5.1	0.5

Sources: Eurostat and IMF staff calculations.
1/ Average of previous three months' month-over-month inflation rate, annualized

Inflation

Headline inflation has declined strongly, supported by declining energy prices.

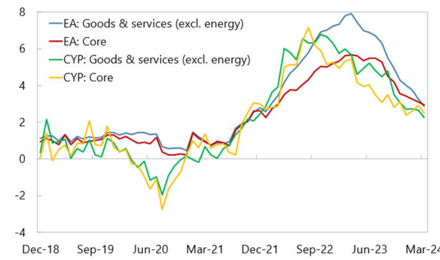
Headline Inflation Contributions
(Percent, year-over-year)



Sources: Eurostat and IMF staff calculations.

Core inflation declined as well but has been stickier.

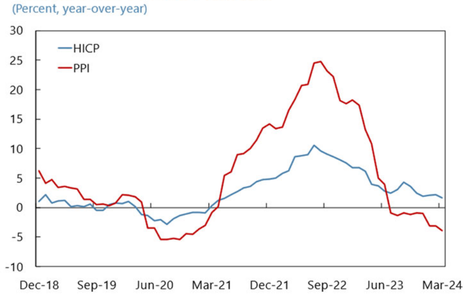
Core and Non-energy Goods and Services Inflation
(Percent, year-over-year)



Sources: Eurostat and IMF staff calculations.

Falling producer prices will support disinflation.

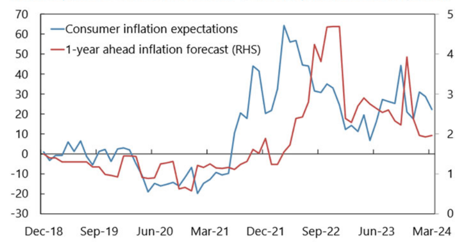
Consumer and Producer Inflation
(Percent, year-over-year)



Sources: Cystat, Haver Analytics, and IMF staff calculations.

Household inflation expectations are moderating.

Consumer Price Expectations and 1-year Inflation Forecast
(Prices expected to increase over the next 12 months, percent balance 1/; percent)



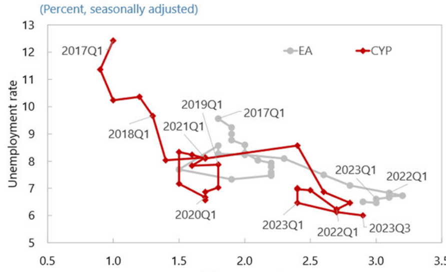
Sources: Consensus Economics, European Commission, and Haver Analytics.
1/ percent balance is the percent of respondents reporting an increase minus the percent reporting a decrease

6. **The labor market remains tight** (Figure 2). Both the employment rate and vacancies hit an all-time high in 2023, while registered unemployment reached its lowest level since the Global Financial Crisis (GFC) at 5.9 percent. Labor shortages increased, especially in the services sector. Wages rose 6.6 percent in 2023—supported by an increase in public wage indexation, the cost-of-living-adjustment (CoLA), to two-thirds of CPI inflation up from half, and a higher minimum wage in services—supporting a recovery in real wages.

Labor Markets

The labor market has been tight.

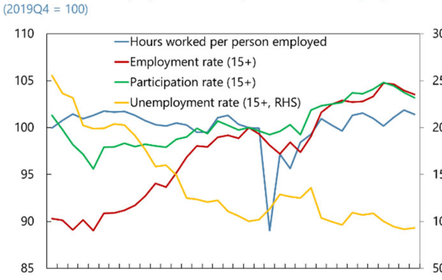
Beveridge Curve
(Percent, seasonally adjusted)



Sources: Cystat, Eurostat, Haver Analytics, and IMF staff calculations.

Unemployment has declined and the employment and participation rates are at a record high.

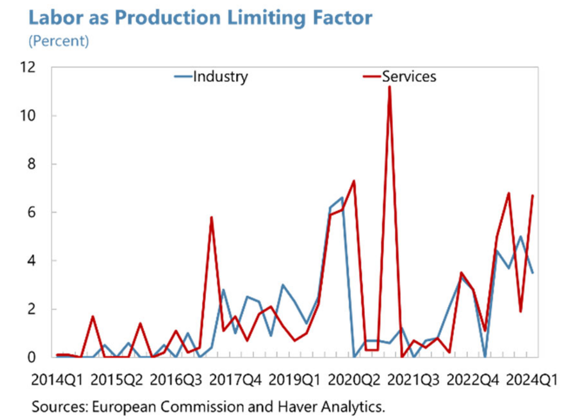
Hours Worked, Employment, Participation, and Unemployment Rates
(2019Q4 = 100)



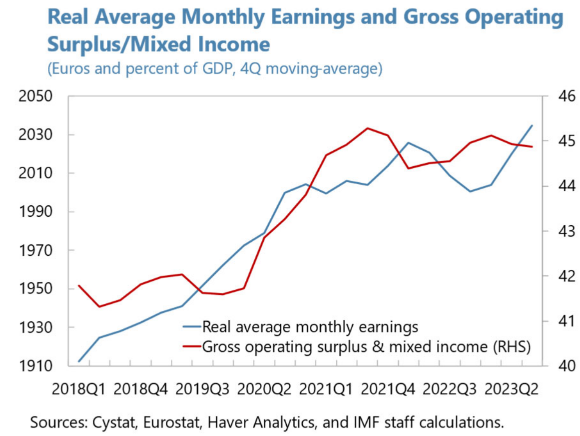
Sources: Cystat, Haver Analytics, and IMF staff calculations.

Labor Markets (concluded)

Labor shortages are increasing as more firms are reporting labor as a limiting factor in production.



Despite increasing real wages, profits remained high in 2023.



7. **Strong fiscal performance continues, driven by revenue buoyancy** (Figure 3). The primary surplus increased further in 2023 to 4.5 percent of GDP, from 3.9 percent in 2022. Robust and diversified revenue growth (12 percent, yoy) has been the key driver, supported by strong economic activity and an accelerated clearance of tax backlogs. VAT is continuing to perform well, partly driven by gains in administration and a declining "VAT gap."[1] Increased revenues more than offset growth in expenditures, including an increased CoLA and several temporary measures—such as extension of electricity and fuel subsidies—most of which are due to expire this year (text table). The trend has continued so far in 2024, with data until February showing the primary surplus improving further, driven again by strong revenues.

Fiscal Measures Implemented After the 2023 Budget

List of measures 1/	Targeted group	Duration	Amount (M€) 2023	Amount (M€) 2024	Budgetary impact (%GDP) 2023	Budgetary impact (%GDP) 2024
Revenues:			26	29	**0.09**	**0.09**
Zeroed VAT rate for food and sanitary products	Untargeted	May 2023 - Jun. 2024	13	16	0.04	0.05
Reinstatement of the reduction of excise duty on fuel 2/	Untargeted	Nov. 2023 - Mar. 2024	13	13	0.04	0.04
Expenditures 3/					**1.18**	**0.10**
Upward revision of COLA	Public sector employees	Permanent	60		0.20	
Extension of electricity subsidies	Some progressivity	Jan. 2023 - Jun. 2024	95	31	0.32	0.10
Hiring temporary teachers	Education sector		12		0.04	
Hosting refugees	Refugees	Overlapping progams	37		0.12	
Purchase of medicines and vaccines (added to other)	Health sector	One-off	0		0.00	
Purchase of building for Ministry of Labor	Public sector	One-off	25		0.09	
Water purchase - cost increase	Untargeted		59		0.20	
University sponserships	Research sector	One-off	81		0.27	
Other			39		0.13	
Capital expenditures			60		0.20	

Sources: Cyprus Ministry of Finance and IMF staff calculations.
1/ Additional medium-term measures were announced targeting housing and renewable energy that were not factored in due to implementation timing uncertainty.
2/ Reduced excise duties on petroleum products, were initally introduced in March 2022 and expired in May 2023 before being reinstated in November.
3/ The additional expenditures were authortized through two supplementary budgets enacted in April and July, amounting to €436 million. Of these additional expenditures, €116 million (0.4 percent of GDP) represent intragovernmental transactions that do not impact the consolidated general government accounts.

[1] Based on the "VAT Gap in the EU" 2023 report by the European Commission. The VAT gap is defined as the difference between an estimated VAT Total Tax Liability (VTTL) and actual VAT revenues collected.

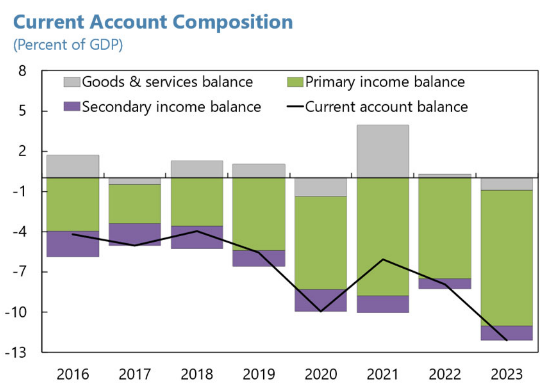
8. Rapidly falling public debt is further strengthening market sentiment. Surpluses and robust nominal growth lowered gross debt to 77 percent of GDP in 2023. Cash buffers (10 percent of GDP) remain ample and Cyprus is now rated as "investment grade" by all major rating agencies. With debt expected to continue to fall, gross financing needs set to remain low, and contingent liability risks diminishing, debt sustainability risks are assessed as 'low', an upgrade since the last Article IV consultation (Annex II).

9. The EU RRP is progressing, but disbursements are behind schedule. As of April 2024, Cyprus had only received 22 percent of its RRP allocation, below the EU average. This is mainly due to a revision of the RRP to incorporate amendments and a REPowerEU component, which interrupted disbursements in 2023. The authorities are working to catch up. Following approval of the revised plan by the European Commission (EC) in December, they submitted a joint 2nd and 3rd payment request and a REPowerEU tranche totaling €173 million (0.6 percent of GDP). Two more requests are planned in 2024.

10. The external current account (CA) continues to be in large deficit. A significant increase in import prices since 2020 was largely offset by rising export prices, particularly in tourism. However, further deterioration in the primary income balance (to -10.1 percent of GDP) widened the CA deficit to 12.1 percent of GDP in 2023. While the external position is assessed as substantially weaker than the level implied by fundamentals (Annex III), the CA deficit has been entirely financed by non-debt creating flows. Moreover valuation effects kept the Net International Investment Position (NIIP) largely unchanged, mitigating risks further.

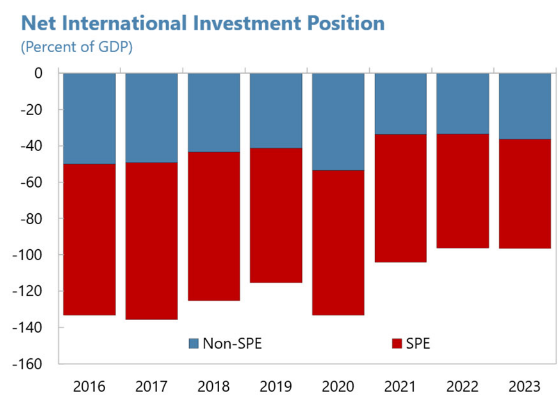
External Sector

The CA deficit widened in 2023…



Sources: Central Bank of Cyprus, Cystat, Haver Analytics, and IMF staff calculations.

…but valuation effects have led the NIIP to improve.



Sources: Central Bank of Cyprus, INE, Haver Analytics, and IMF staff calculations.

11. Financial conditions have tightened amid continued deleveraging (Figure 4). In 2023, financial conditions reached their tightest level since the 2013 crisis. Growth of new loans slowed for both households and NFCs continuing a multi-year deleveraging trend. Instead, NFCs have become increasingly reliant on equity inflows to fund investment (Figure 5).

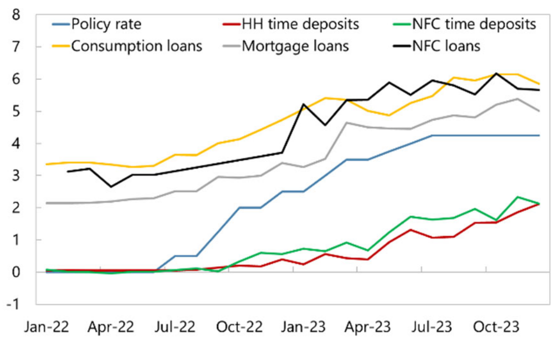
12. House prices kept rising, supported by strong external demand (Figure 6). Despite rising mortgage interest rates, property sales increased, with foreigners accounting for close to half the demand (with non-EU residents more active than EU residents). In tandem, house prices increased further growing by 2.9 percent in 2023. Both the price-to-income and price-to-rent ratio have declined recently and remain below their long-term averages.

13. The financial system has so far benefitted from rising interest rates (Figure 7). Reinforced by a higher interest rate pass-through to lending than to deposit rates, net interest margins increased substantially. This increased bank profits and further strengthened capital adequacy ratios. NPLs have remained broadly stable, but loan renegotiations increased—possibly an indication of pressures to asset quality.

Financial Sector

Bank interest rates increased in line with policy rates…

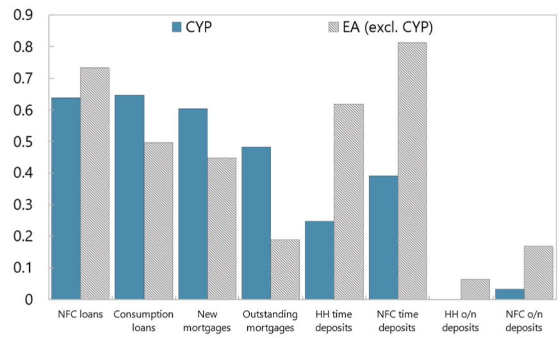
Policy and Bank Retail Rates
(Percent)



Source: ECB.

…but the pass-through has been stronger for lending than deposit rates.

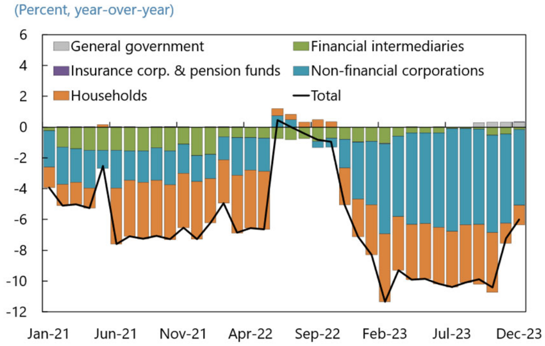
Policy Pass-through to Bank Lending and Deposit Rates
(Δlending rate/Δpolicy rate and Δdeposit rate/Δpolicy rate)



Sources: ECB, Beyer et al. (2024), and IMF staff calculations.

Credit to households and NFCs declined strongly in 2023.

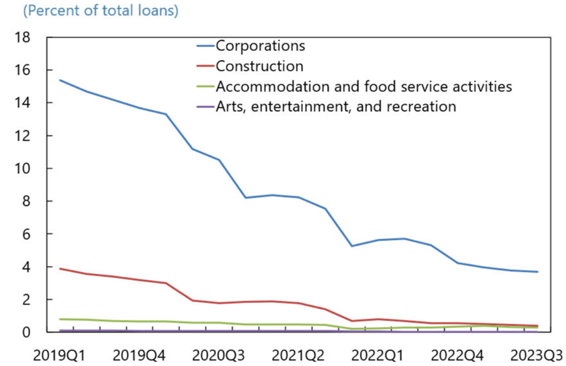
Domestic Credit Growth
(Percent, year-over-year)



Sources: Central Bank of Cyprus, Haver Analytics, and IMF staff calculations.

Non-performing loans continued declining.

Non-performing Loans
(Percent of total loans)



Sources: Central Bank of Cyprus and IMF staff calculations.

OUTLOOK AND RISKS

14. Growth is expected to remain stable in 2024. While tight financial conditions will continue to weigh on activity, a further recovery in real earnings will support consumption, while FDI and RRP inflows will sustain investment. Accordingly, growth is projected at 2.6 percent this year. In the medium term, growth is expected to reach its estimated potential of around 3 percent, driven by robust investment and structural reforms. The CA deficit is expected to remain elevated, as foreign-owned firms continue transferring profits abroad. Nevertheless, external stability risks appear low, as domestic debt continues to fall, and repatriated profits would likely decline in any domestic downturn (supporting the CA). However, the potential implications of the large and prolonged CA deficit on the sustainability of Cyprus' FDI-driven growth model and low domestic savings warrant attention.

Selected Economic Indicator Forecasts, 2023-2026

	2023	2024	2025	2026
	(Percent, year-over-year)			
Real GDP	2.5	2.6	2.8	3.0
HICP (period average, SA)	3.9	2.2	2.0	2.0
	(Percent of GDP)			
General government balance	3.1	2.7	2.5	2.5
General government debt	77.3	71.1	65.7	60.7
Current account balance	-12.1	-11.1	-10.2	-10.0
Nominal GDP (billions of euros)	29.8	31.7	33.4	35.2

Sources: Central Bank of Cyprus, Cystat, Eurostat, Haver Analytics, and IMF staff calculations.

15. Inflation is expected to average just above 2 percent in 2024. Negative energy price effects and administrative price measures, which pushed inflation below 2 percent at the end of 2023, are expected to unwind during the year. But a combination of high interest rates, negative base effects, and more stable international prices should keep inflation contained. The inflation projection is conditioned on some loosening of monetary policy in line with the Spring 2024 WEO and moderate real wage growth—which is expected to be partly absorbed by lower profit margins—and declining inflation expectations to around 2 percent. Risks to the inflation outlook are balanced.

16. Short-term risks are mostly external and to the downside, while uncertainty about the medium term is more balanced (Annex IV). External short-term risks include a downturn in major tourism markets and an escalation of regional conflicts that could slow Cyprus' efforts to reorient its services exports. Domestic risks include delays in the implementation of RRP investments and reforms. Over the medium term, there are large adverse risks from climate change. Rising temperatures, more intense and frequent heatwaves, and sea level rise are expected to continue and could intensify in case of slow global climate action and/or emergence of global climate tipping points. On the other hand, there is upside potential from rebalancing the growth model by attracting more foreign investment and talent and tapping into new export markets.

Authorities' Views

17. Robust growth is expected to continue. The authorities expect real GDP growth to be slightly higher than staff project this year and next, on account of higher expected tourist arrivals, other services exports, and payouts from structural reforms. They view risks to the outlook as broadly balanced, underscoring progress in economic diversification, a key contributor to enhanced resilience. The authorities concur with staff's inflation projections, while emphasizing upside risks from wage growth and oil prices. They expect the current account deficit to remain elevated in the coming years, but attribute this partly to temporary factors, including outflows driven by high bank profitability that will normalize later. They highlighted FDI financing and positive NIIP developments as factors reducing external stability risks.

POLICY PRIORITIES

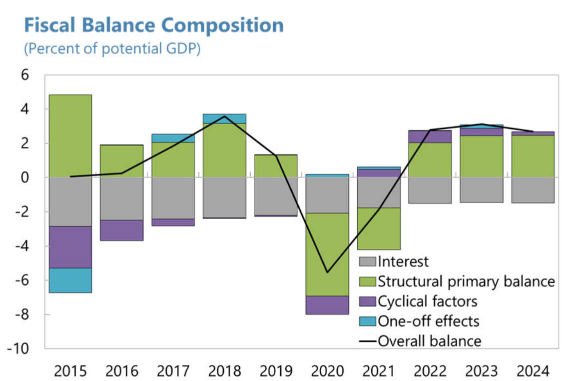
A. Rebuild Fiscal Buffers and Lower Public Debt

18. The authorities' planned neutral fiscal stance in 2024 is appropriate. With receding inflation and robust growth, fiscal policy can pivot from near-term macroeconomic stabilization to long-term priorities of building buffers and fostering productive investments. The 2024 budget appropriately targets overall and primary balance surpluses of 2.8 and 4.3 percent of GDP, respectively, roughly the same as in 2023.

19. Reducing debt and maintaining space for long-term spending needs should guide fiscal policy in the medium term. Large primary surpluses should continue until public debt falls comfortably below 60 percent of GDP (Box 1). The 60-percent threshold is projected to be met in 2027, but should be viewed as a ceiling, with a comfortable buffer below it. In coming years, RRP reforms and grants will support public investments and priority expenditures, helping achieve this objective. Once the debt target has been met, a primary deficit of around 0.5 percent would stabilize debt. However, long-term spending pressures from aging and climate challenges are expected to increase expenditure by around 2.5 percent of GDP by 2030. Hence, fiscal space should be preserved to allow room for these needs when they arrive.

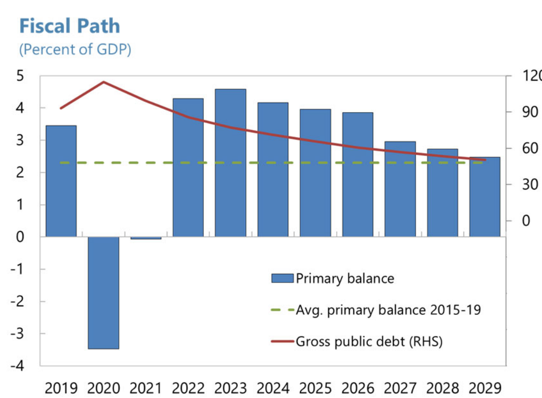
Fiscal Projections

A neutral fiscal stance is targeted in 2024.



Sources: Cystat, European Commission, Eurostat, Haver Analytics, and IMF staff calculations.

Lowering debt and building buffers is the main fiscal objective in the medium-term.



Sources: Cyprus' Ministry of Finance and IMF staff calculations.

Box 1. Cyprus: A Medium-Term Fiscal Anchor for Cyprus

Cyprus should preserve fiscal space to meet long-term spending needs and provide a buffer against shocks. This implies that fiscal planning should leave sufficient space to accommodate new spending pressures from demographic and climate challenges. The plans should also be consistent with stabilizing debt at a level sufficiently below 60 percent to allow a buffer against potential shocks.

Debt should be anchored at a level comfortably below 60 percent of GDP. Given Cyprus' historic vulnerability to large jumps in public debt and market access risks, a prudent public debt anchor is appropriate. As such, targeting a debt level which is comfortably below the 60 percent of GDP threshold would build a sufficient policy buffer to allow a robust fiscal response to shocks without undermining debt sustainability or market confidence.

A modest deficit could be maintained without debt increasing. The standard debt-dynamics relationship suggests that in addition to the primary balance, the 'growth-interest rate differential' is an important debt driver. Over the last decade, this has been favorable in Cyprus, averaging -2.7 percent a year, despite significant variability. However, assuming a conservative "r-g" of -1 percent, and debt at around 50 percent of GDP, a primary deficit of around ½ percent of GDP would stabilize debt. Such a deficit and debt level would ensure Cyprus is in full compliance with the numerical criteria of the EU's new Economic Governance Framework.

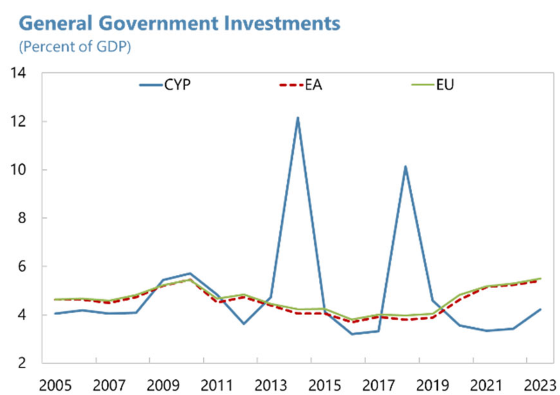
However, long-term spending pressures are expected to be sizable. Public spending on pensions and long-term care are expected to increase by 1.1 and 0.1 percent of GDP, respectively, by 2030 according to the European Commission's Ageing Report 2024. Additionally, future public spending on climate change mitigation and adaptation—while highly uncertain—is currently estimated to range between 0.6–2.2 percent of GDP annually until 2050, according to the authorities' National Energy and Climate Plan (NECP) and IMF staff calculations. Together these would increase expenditure by around 2½ percentage points of GDP by 2030, without accounting for other potential long-term spending demands such as upgrading public infrastructure and defense.

20. Expenditures should prioritize investments, while further wage indexation should be avoided. Capital expenditures should be prioritized in line with the full absorption of RRF funds. Timely completion of RRP milestones, both reforms and investments, is crucial to fully harness benefits and avoid loss of allocations. The public sector wage bill and employment are high relative to EU peers, and upward revision to the CoLA increases public pay indexation. Instead, wage adjustments should be based on macroeconomic and productivity developments. As such, further increases to CoLA indexation should be avoided. And a thorough review of the public sector wage bill should form the basis of a comprehensive reform. The phase-out of the temporary fuel excise reductions is welcome, while VAT exemptions and electricity subsidies should be allowed to expire, as planned, this year.

21. New tax policies are taking place. Green taxation, a key RRP milestone, aims to better align consumer incentives with green objectives (¶39, Annex VI and SIP II). The EU's Minimum Tax Directive mandates a minimum 15 percent CIT rate for multinational enterprises, above Cyprus' rate of 12.5 percent. The ongoing comprehensive review of the tax system is an opportunity to incorporate these changes, while modernizing the system and better aligning it with Cyprus' evolving business model, including by reassessing the effectiveness and sustainability of existing PIT incentives under the headquartering policy.

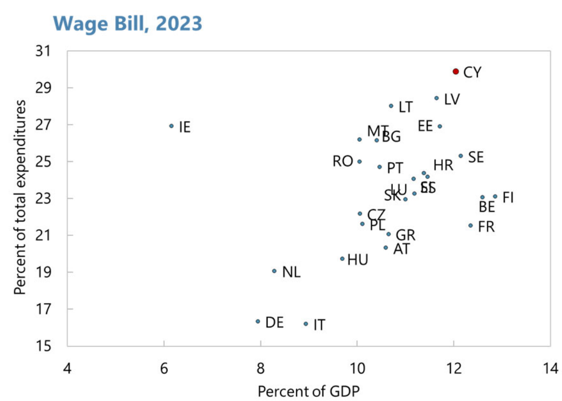
Government Wage Bill and Public Investment

Government investments have lagged other EU countries since the pandemic.



Sources: Eurostat and IMF staff calculations.

The government wage bill in Cyprus is large relative to other EU countries.



Sources: Eurostat, Haver Analytics, and IMF staff calculations.

22. More progress is needed with implementation of the National Health System (NHS) and financial oversight of state-owned enterprises (SOEs). The plan for public hospitals to achieve financial self-sufficiency by 2024 was derailed by the pandemic and a new target date should be promptly set. The new plan should be realistic but ambitious and incorporate lessons learnt so far. The authorities have taken measures to enhance financial oversight and governance of SOEs with tangible results. Further reforms include an updated inventory of public entities, a comprehensive ownership policy, strengthened and institutionalized oversight, and a formalized and transparent institutional structure for SOE board nominations.

Authorities' Views

23. Fiscal space will be preserved to meet upcoming demographic and climate spending commitments. The authorities plan to maintain large primary surpluses and are focused on reducing public debt to below 60 percent of GDP by 2027, thereby achieving full compliance with the EU Economic Governance Framework. They are still considering the steady-state level of public debt and the long-term debt stabilizing primary balance target. The temporary reduction in excise duties on fuel was allowed to expire at end March, but the zero-VAT rates on some food and sanitary products and limited electricity subsidies were temporarily extended to end-June. The authorities are not currently planning further upward revisions of the CoLA. Public hospitals will fully cover their operational cost from 2024; a detailed action plan along with a one-year extension (subject to one-time renewal) were agreed for hospitals to achieve full sufficiency.

B. Financial Sector: Apparent Resilience, but Continued Vigilance

24. The banking system has sufficient capital buffers to withstand severe macroeconomic shocks. Banks are highly capitalized and, according to stress tests conducted by the EBA/ECB, well positioned to manage shocks. Both systemic institutions covered by 2023 stress tests saw improved resilience due to better asset quality and higher income.

25. Despite tighter financial conditions, banking sector risks appear to have declined. While higher interest rates increase risks to asset quality, robust growth, increasing real wages, declining unemployment, and rising property prices have all reduced credit risk. As such, the recent decline in credit growth is attributed mainly to lower demand, rather than credit rationing by banks. While the uptick in loan renegotiations is viewed as indicative of proactive credit cost and risk management, it should be closely monitored. Liquidity risks remain low, as buffers are well above regulatory requirements, the deposit funding base is well diversified, and there is limited asset repricing exposure.

26. Macroprudential buffers have increased, but careful vigilance is needed, especially in relation to the real estate market. The increase in the *neutral* rate of the CCyB to 1 percent, effective June 2024, is welcome. Such a stance builds policy space to help deal with future stress events, including from real estate. Indeed, around two-thirds of bank loans are secured by real estate collateral, exposing institutions to collateral risk. While real estate prices are aligned with fundamentals[2] and LTV and DSTI limits mitigate risks further, careful monitoring is required.

27. Non-Banking Financial Institutions (NBFIs), especially investment funds, also require careful monitoring. Staff welcome the securities markets supervisor's (CySEC) efforts in implementing recent ESMA recommendations, including on strengthening supervisory capacities and increasing resources. Still, potential liquidity mismatches, leverage, and interconnectedness within financial system merit continued close oversight. Real estate risks are diversified, as portfolios are mostly invested abroad.

28. An effective foreclosure framework is fundamental to resolve legacy NPLs. The long-awaited mortgage-to-rent (MtR) scheme started in December with promising uptake. And recent amendments to the foreclosure framework provided increased debtor protection, without significantly increasing resolution times (Box 2). The framework, which should be allowed to operate and not be amended further, will accelerate the reduction in legacy NPLs, especially if the enhanced role of the Financial Ombudsman is operationalized effectively

[2] Beyer, R. and Biljanovska, N., 2023. Residential Property Price Developments and (Mis) alignments in Cyprus. Selected Issues Papers, 2023(043).

Box 2. Cyprus: Evolving Foreclosure Framework

Ineffective implementation of an evolving foreclosure framework has hindered NPL resolution since the 2013 crisis. While the transfer of most NPLs to CACs has reduced financial sector risks, high private debt levels continue to weigh on the economy. Recent modifications of the resolution toolkit aim to accelerate dispute resolution and align incentives for out-of-court settlements.

Cyprus has grappled with high NPLs since the 2013/14 financial crisis. A slow decline in these legacy NPLs is partly attributed to the ineffective implementation of an evolving foreclosure framework. A key challenge has been uneven progress with claims enforcement and collateral recovery due to a lack of a credible threat of foreclosure and lengthy judicial processes. An effective foreclosure framework is critical to address strategic defaults and provide incentives for borrowers to enter restructuring negotiations or avail themselves of insolvency tools.

In 2018, the government strengthened the foreclosure framework and shortened the enforcement period. The new toolkit incentivized greater cooperation for cash repayments and bilateral restructurings. Given Cyprus' lengthy foreclosure procedures, these amendments were critical. While some challenges such as strong protections for guarantors and challenges in the issuance and transfer of title deeds remained unresolved, foreclosures increased for many types of assets.

However, the new toolkit was first weakened and then suspended during the pandemic. Amendments in 2019 introduced new uncertainties and reduced the threat of foreclosures, including greater options to seek court injunctions. Since the pandemic until end-2023, foreclosures were repeatedly frozen due to temporary suspensions of the framework, most recently these were restricted for primary residences up to a value of €350,000.

At end-2023 all suspensions of the framework were effectively lifted. Suspensions were not renewed by Parliament in August 2023, but banks and CACs continued a voluntary suspension for the remainder of 2023, while discussions on this issue continued. New amendments were subsequently introduced that intend to expedite the resolution of disputes and align the incentives of borrowers and debtors towards reaching an out-of-court settlement. In particular: (i) the transparency of the debt claims is enhanced; and (ii) the right to the debtor to resort to the Financial Ombudsman is granted, to verify the amount of the debt claim, prior to foreclosure.

Unperturbed implementation of the current foreclosure framework should speed up resolution of legacy NPLs. The framework remains an extrajudicial process with no further intervention of the courts. The latest round of amendments has garnered broad support by different stakeholders, extending the processing time only marginally. If the recent amendments create stable conditions—so that all tools, including foreclosures, can be used to resolve NPLs—they will support NPL resolution. Resolving more NPLs will foster new and more productive bank lending and strengthen the domestic private sector.

Authorities' Views

29. The financial sector is expected to remain resilient, but there is no room for complacency. The authorities expect strong economic performance and capital buffers to support financial stability, including the impact of anticipated lower interest rates on profitability. They highlighted that the increase in the neutral CCyB to 1 percent is not designed to slow credit growth, but will further enhance resilience. The authorities noted that the updated regulatory framework and additional resources provided to CySEC has further enhanced resilience of NBFIs. They concurred with the need for careful monitoring of loan renegotiations, while viewing the recent uptick as an outcome of ordinary commercial dynamics.

30. The foreclosure framework will support resolution of legacy NPLs. The authorities envisage the expanded role of the FO acting as mediator to be instrumental in achieving negotiated solutions between debtors and financial institutions on legacy NPLs. While finalization of the organizational structure is ongoing, the authorities do not anticipate difficulties in satisfying potential demand for FO interventions.

C. Structural Reforms: Building the Foundation for Long-Term Growth

31. Cyprus is diversifying its growth model. A reorientation of services exports towards Israel and countries in the Middle East and North Africa has cushioned against declining exports to Russia.[3]

32. Professional services are growing in importance, and the nascent ICT sector is growing quickly. Further development of these high-value industries requires a streamlined and stable business environment, an expanded supply of skilled labor, and a robust anti-money laundering and counter-financing of terrorism (AML/CFT) framework.

33. Strengthening the judicial sector would help improve the business environment. Ongoing efforts in the judiciary are needed to reduce the significant backlog of court cases. The implementation of judicial reforms in 2023, along with the restructuring of the top-tier courts and the establishment of the Court of Appeal, are welcome. But more is needed to simplify procedures, enhance physical and technological infrastructure, enforce judgments, and address staffing requirements.

34. Addressing skill-mismatches and increasing labor supply would improve long-term growth prospects. The education system should focus more on digital education and skills, which would allow more Cypriots to benefit from ICT job opportunities. The share of STEM graduates should increase. Stricter activation requirements for job seekers, which are weak compared to other European countries, could strengthen incentives to look for, prepare for, and accept employment. Attracting third-country nationals will play a pivotal role in alleviating sector-specific labor shortages (e.g., in tourism) and in increasing high-skilled labor (e.g., in ICT). Recent revisions of the strategy to

[3] See Annex VI in 2023 IMF Staff Report for more details.

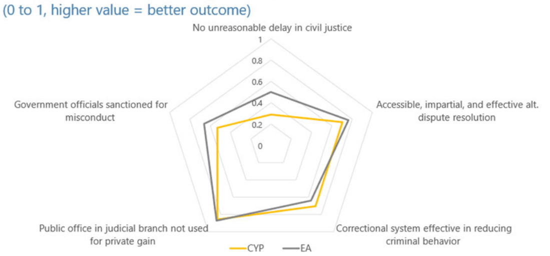
attract foreign businesses appropriately focus on facilitating the movement within the EU (Blue Card) and addressing housing constraints.

35. A stronger domestic private sector would help strengthen the CA (Annex V)**.** Cyprus' FDI-led business model has supported growth but has caused the CA deficit to widen as profit repatriation has grown. Policies to enhance domestic saving and entrepreneurial opportunities could help reverse this trend, while supporting long-term growth. Effective implementation of the foreclosure framework, and targeted policy interventions to resolve NPLs and repair private balance sheets, would support domestic savings. And boosting confidence in the financial sector would facilitate more efficient utilization of households' savings.

Structural Indicators

The Judiciary in Cyprus suffers from delays.

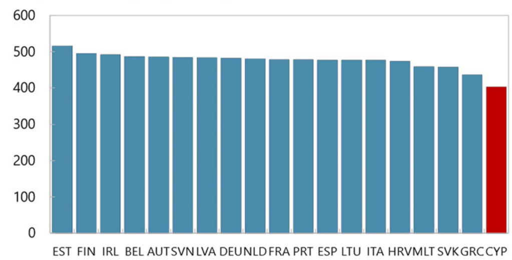
Perceptions about Judiciary, 2023 1/
(0 to 1, higher value = better outcome)



Source: World Justice Project.
1/ The World Justice Project Rule of Law Index provides original data on the rule of law. The 2023 edition covers 142 countries and jurisdictions, relying on more than 149,000 household and 3,400 expert surveys to measure how the rule of law is experienced and perceived in practical, everyday situations

There is large room for Cyprus to improve education outcomes.

Average Math, Reading, and Science PISA Score 1/
(Higher score = higher proficiency)



Sources: OECD PISA and IMF staff calculations.
1/ PISA = OECD program for international student assessment. PISA measures 15-year-olds' ability to use their reading, mathematics and science knowledge and skills to meet real-life challenges.

36. Despite progress, further effort is needed with AML/CFT implementation and sanctions enforcement. Weak AML/CFT implementation provides opportunities to evade sanctions, which creates regulatory and business risks. Ongoing criminal investigations must progress diligently, and any potential measures should be enforced strictly. Cyprus has made progress on AML/CFT, as acknowledged in a recent MONEYVAL follow-up report, and is creating a national sanctions enforcement unit with UK support, expected to be operational by the end of the year. The authorities should continue addressing weaknesses in the effectiveness of the framework by creating a single supervisory framework for administrative services and by strengthening AML/CFT efforts in real estate. Above all, Cyprus needs to strengthen implementation, particularly regarding supervision of gatekeepers (lawyers, accountants, and trust and company service providers). This would mitigate financial, reputational, and regulatory risks and potential impacts on correspondent banking relationships.

Authorities' Views

37. The authorities remain committed to structural reforms in the RRP, which they consider key for achieving faster and a more sustainable growth. They emphasized that implementation of a broad reform of the judicial system is underway, and remaining bottlenecks need to be addressed forcefully. They concur with the need to enhance the education system and have several strategies in place to reduce skill mismatches, promote STEM education, and improve active labor market policies to facilitate transitions into the labor market. They highlighted several activation policies to reduce unemployment, as well as investments in re- and upskilling and school infrastructure in the RRP.

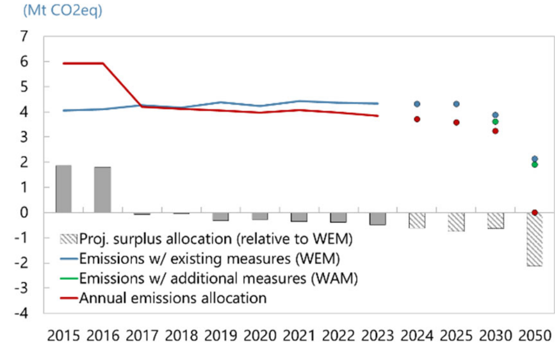
38. Enhancing AML/CFT implementation and sanction enforcement, along with closing remaining gaps in the framework are a high priority. The authorities emphasized progress in improving the AML/CFT framework, including through addressing MONEYVAL recommendations, nearly all of which have been fulfilled. The authorities noted that criminal investigations on several suspicious cases on sanctions evasion are ongoing. They plan to introduce a national sanction enforcement unit at the Ministry of Finance and a single supervisory framework for administrative services on AML/CFT issues, with the details still under consideration. They will consider measures to strengthen AML/CFT in real estate.

D. Investing in Green Transition and Adaptation

39. Greater energy integration and diversification would strengthen security and support the green transition. Cyprus has ambitious plans to connect its electricity network with neighbors, introduce natural gas through an LNG terminal, increase the share of renewable energy sources to one-third by 2030—from 18 percent in 2021—and create an enabling environment for competition in the energy market. While these efforts are commendable, progress is very slow, including from delays in key infrastructure projects. More forceful implementation of plans will be critical for energy efficiency and security, as well as for climate sustainability.

40. Green taxation will help meet climate commitments. Cyprus aims to cut emissions in sectors not covered by the EU Emission Trading System (ETS) by 32 percent by 2030 (compared to 2005) and to reach climate neutrality by 2050. Current projections remain 13 percent above the 2030 target. Implementation of the green taxation package, a key milestone in the RRP, on top of the phaseout of the fuel and electricity subsidies should close about a third of the gap to target. However, it still leaves carbon prices low in several sectors. A wider-scope carbon tax covering all non-ETS sectors—combined with targeted sectoral policies—would go further in closing the gap. Adverse distributional effects on lower-income deciles are expected to be manageable with limited fiscal resources, channeled to well-targeted support measures and PIT tax reductions (Annex VI and SIP II).

Emissions and Allocations 1/
(Mt CO2eq)



Sources: Cyprus' NECP, EEA, and IMF staff calculations.
1/ Data points/patterned bars are projected

41. Climate risks warrant a careful assessment and an adaptation strategy (Annex VII and SIP III)**.** Average temperatures and extreme conditions have been on the rise and are set to climb further. Sea levels will continue to increase, even if global mitigation actions are taken. These trends are expected to harm productivity and induce capital losses and welfare costs. Slow-moving warming alone could reduce the long-run level of GDP by up to 3.3 percent according to some estimates.[4] And it is not possible to rule out much larger losses due to an intensification of heat waves, droughts, and other weather extremes. Sea-level rise will certainly cause additional losses, especially if anticipatory adaptation measures do not reduce potential vulnerabilities. To minimize these risks, the government should focus on: (i) reducing risks from extreme heat on the population, for example by ensuring that early warning systems and contingency plans for severe heat waves are in place; (ii) dealing with long-term and acute water shortages; and (iii) revising coastal development and protection to deal with a certain increase of sea-levels. While public investment is needed to support adaptation in key public sectors of the economy, further progress in economic reforms can boost private investment in adaptation by removing barriers caused by market inefficiencies.

Authorities' Views

42. The authorities are committed to reducing emissions but see important challenges ahead. The implementation of key infrastructure projects is progressing slowly, with LNG imports now expected to begin in late 2025. Also, the need for a minimum level of traditional power generation, the absence of a legal framework to regulate energy storage, and procurement bottlenecks are challenges affecting further progress in the energy transition. The authorities are committed to implementing the green taxation reform but have broader concerns on the potential impact of the transition on the economy. Climate risks are a concern, and the authorities will continue to assess their potential impact on the economy and different adaptation options.

STAFF APPRAISAL

43. Growth has moderated and inflation has normalized. Slowing private consumption growth, lower services exports to Russia, and fading post-pandemic base effects caused growth to moderate in 2023, yet it remained considerably above European peers. The labor market has been tight with unemployment at its lowest since the GFC, and wage growth has been robust. Headline inflation has fallen below 2 percent, but core inflation remains more persistent. The external position in 2023 was substantially weaker than the level implied by fundamentals. Growth is expected to be stable, at around 2½ percent in 2024, supported by rising real incomes and FDI and EU RRP inflows, before gradually reaching 3 percent over the medium term. Short-term risks include a downturn in major tourism markets, an escalation of regional conflicts, and delays in RRP implementation. Over the medium term, large adverse risks from climate change are counterbalanced by upside potential from attracting more foreign investment and talent.

44. Fiscal performance continues to be strong. Robust revenue growth in 2023 more than offset increased expenditures on CoLA and temporary support measures, leading to a rise in the primary surplus. Together with strong nominal growth, fiscal surpluses lowered public debt to 77 percent of GDP, the lowest level since 2014. On the back of expected further declines in debt, low

[4] Estimates from Centorrino, Massetti, and Tagklis (2023) using the econometric model of Kahn et al. (2021). Warming rate calculated using the 90th percentile of the distribution from CMIP6 models using the SSP3-7.0 scenario.

gross financing needs, and diminishing risks, debt sustainability risks are assessed as ‘low’.

45. Fiscal policy should aim to further lower debt and preserve space for long-term needs. Large primary surpluses should continue until public debt falls comfortably below 60 percent of GDP. Fiscal space should be preserved today to accommodate long term spending pressures—including from aging and climate change—which are estimated to be around 2.5 percent of GDP by 2030.

46. Expenditure reforms should be prioritized. Investment spending should ramp up, aligned with full absorption of RRF funds. Public sector wages should reflect macroeconomic and productivity developments, implying that further upward revisions of the CoLA should be avoided. The phase-out of the temporary fuel excise reductions is welcome and the remaining VAT exemptions and electricity subsidies should be allowed to expire as planned.

47. The financial sector is well capitalized with risks appearing to have declined. Banks, with sizable capital and liquidity buffers, are resilient under stress tests. Strong economic growth, tight labor markets, and rising house prices have kept asset quality from deteriorating, despite higher interest rates. But loan renegotiations have picked up, warranting continued vigilance.

48. Macro-prudential policy is appropriate, but real estate risks should be closely monitored. The increase in the positive neutral CCyB is welcome and will build policy space in the face of future shocks. While real estate prices are estimated to be in line with fundamentals, regulatory vigilance is required given the widespread use of real estate as collateral in the financial sector.

49. The foreclosure framework should be left to work. Together with the new mortgage-to-rent scheme, the current framework could accelerate NPL resolution, especially if the Financial Ombudsman role is effectively operationalized. An effective NPL resolution framework will support new lending and strengthen the business environment.

50. Structural reforms in the judicial sector and labor market are critical to long-term growth. To further support the structural transformation of Cyprus’ growth model, improving the business environment and addressing skill shortages and mismatches are paramount. In this regard, recent judicial reforms are welcome, but more is needed to simplify procedures, upgrade infrastructures, and increase staffing. Alongside, the education system should promote digital skills needed to meet ICT job opportunities.

51. A robust AML/CFT framework is critical. Cyprus’ progress on AML/CFT issues, acknowledged in the recent MONEYVAL follow-up report, should continue by further strengthening implementation. A single supervisory framework for administrative services, along with strengthening AML/CFT efforts in the real estate sector, are needed.

52. Completion of energy infrastructure projects is critical to energy security and the climate transition. Infrastructure projects needed to import LNG, upgrade the electricity grid, and link it to neighbors are delayed. Decisive implementation of these projects remains crucial for Cyprus to diversify its energy mix and increase the share of renewables, thus enhancing energy security and reducing emissions.

53. Further measures are needed to meet Cyprus' ambitious climate targets. Current emission projections are 13 percent above the 2030 target. The planned green tax will help lower emissions, but it closes only a third of the gap, without addressing low carbon prices in several sectors. Hence, the scope of the tax should be widened to encompass all non-ETS sectors and coupled with targeted sectoral policies to achieve faster emission reduction. Growth and distributional impacts of the tax are expected to be manageable.

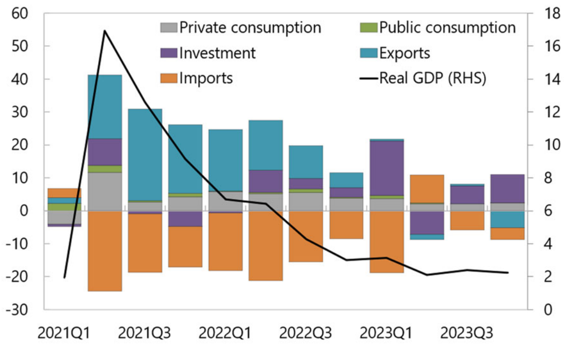
54. Careful assessment and an adaptation strategy are needed to limit the cost of climate change. Extreme heat, drought, and sea level rise pose risks to Cyprus and its economy. For this reason, contingency planning, early warning systems, and careful planning of coastal development and protection should be part an adaptation strategy to minimize these risks. Public investments in adaptation are needed along with reforms to boost private sector climate adaptation.

55. It is proposed that the next Article IV consultation with Cyprus take place on the standard 12-month cycle.

Figure 1. Cyprus: Real Sector

Growth moderated in 2023…

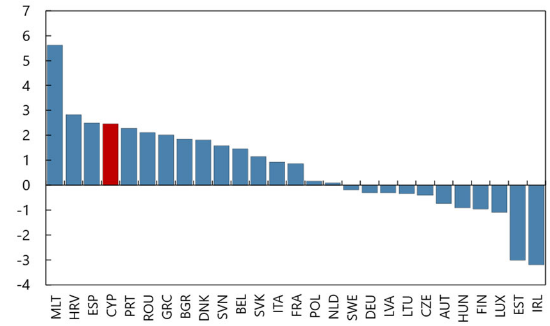
Real GDP Growth Contributions
(Percent, year-over-year)



Sources: Cystat, Haver Analytics, and IMF staff calculations.

…but was still among the highest in the EU…

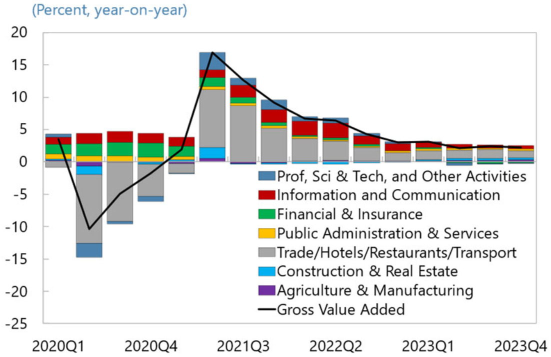
Real GDP Growth, 2023
(Percent, year-over-year)



Sources: April 2024 WEO and IMF staff calculations.

…supported by the tourism and ICT sectors.

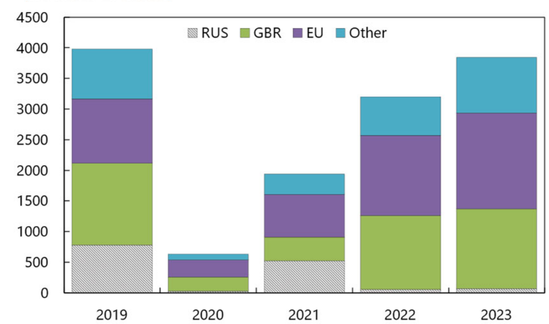
Contributions to Value Added Growth
(Percent, year-on-year)



Sources: Cystat, Eurostat, Haver Analytics, and IMF staff calculations

Tourism arrivals in 2023 nearly reached the 2019 record.

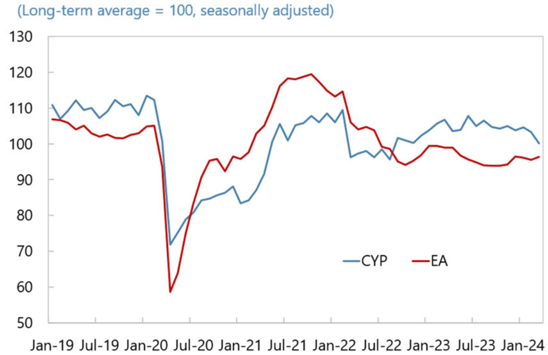
Tourist Arrivals
(Thousands of tourists)



Sources: Cystat and IMF staff calculations.

Confidence indicators in Cyprus remain higher than in the EA…

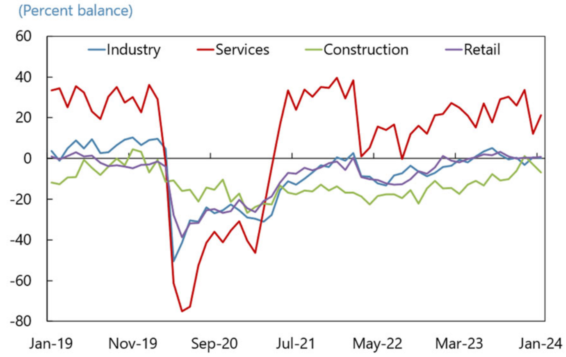
Economic Confidence Indicator
(Long-term average = 100, seasonally adjusted)



Sources: European Commission and Haver Analytics.

…mainly driven by services.

Confidence Indicators
(Percent balance)

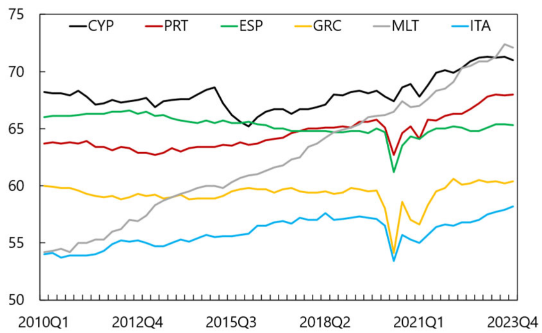


Sources: European Commission, Haver Analytics, and IMF staff calculations.

Figure 2. Cyprus: Labor Market Developments

Labor market participation improved in recent years and remained high in 2023…

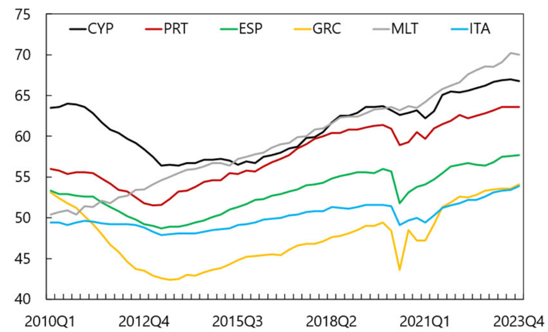
Labor Force Participation Rates
(Percent of total population, ages 15-74)



Sources: Eurostat and Haver Analytics.

…and so did the employment rate.

Employment Rates
(Percent of total population, age 15-74)



Sources: Eurostat and Haver Analytics.

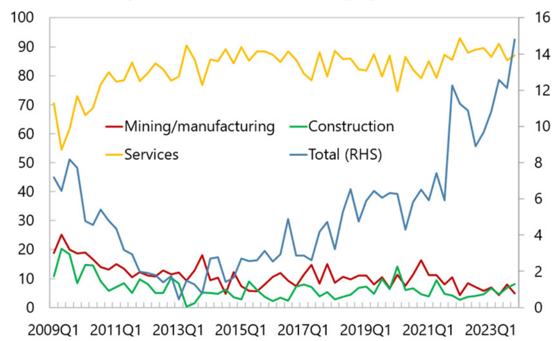
The unemployment rate has declined below pre-Covid levels.

Unemployment Rate
(Percent of total labor force, 15+ years old)

Sources: Cystat and Haver Analytics.

At the same time, job vacancies reached record levels, most of which in services.

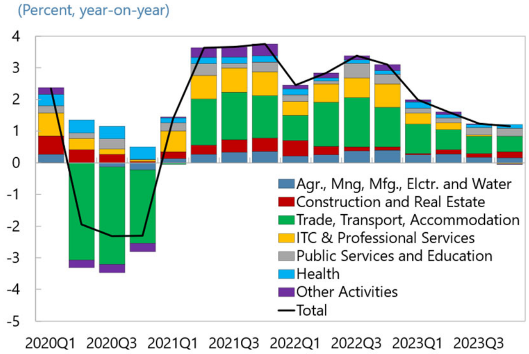
Sectoral Job Vacancies
(Percent of total job vacancies and thousands of people)



Sources: Cystat, Haver Analytics, and IMF staff calculations.

Employment creation slowed across sectors last year.

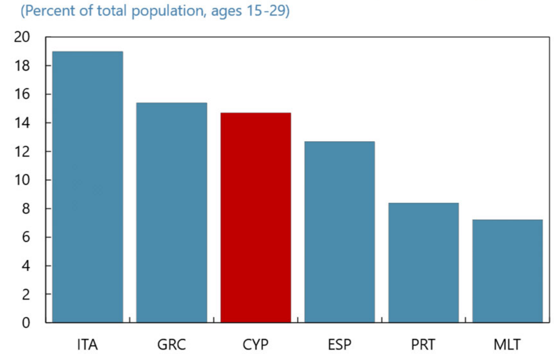
Contribution to Employment Growth
(Percent, year-on-year)



Sources: Cystat, Haver Analytics, and IMF staff calculations.

The share of youth not in employment, education, and training is larger than in some peers.

Youth Not in Employment, Education, or Training, 2022
(Percent of total population, ages 15-29)

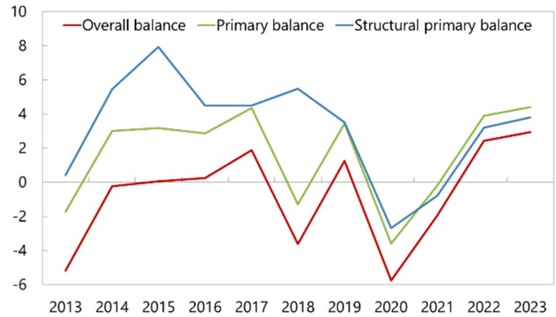


Sources: Eurostat and IMF staff calculations.

Figure 3. Cyprus: Fiscal

Cyprus recorded large overall fiscal surpluses in 2022 and 2023.

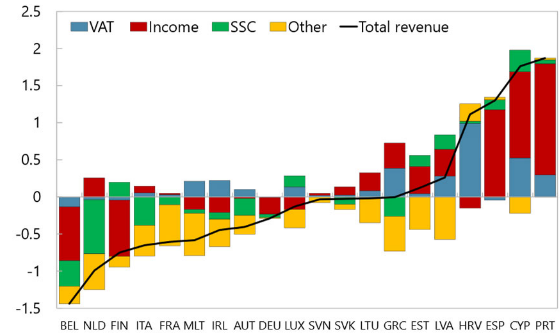
Overall, Primary, and Structural Primary Balances
(Percent of GDP)



Sources: Cystat, European Commission, Eurostat, Haver Analytics, and IMF staff calculations.

Revenue performance has been robust and diversified.

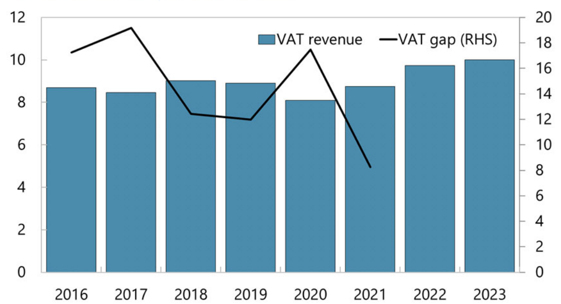
Composition of Changes in Revenue, 2019–2023Q3
(Percent of GDP)



Sources: Eurostat and IMF staff calculations.

With VAT buoyancy continuing to improve.

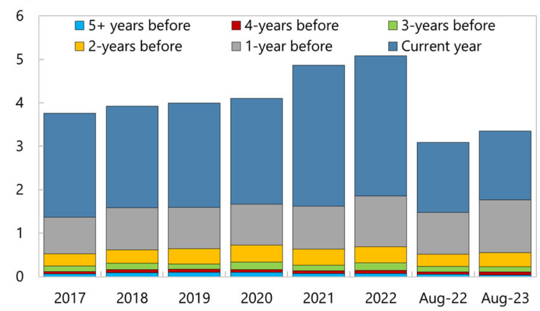
VAT Revenue and Gap
(Percent of GDP and percent of tax base)



Sources: Cystat, European Commission, Eurostat, Haver Analytics, and IMF staff calculations.

And the clearance of tax backlogs has accelerated.

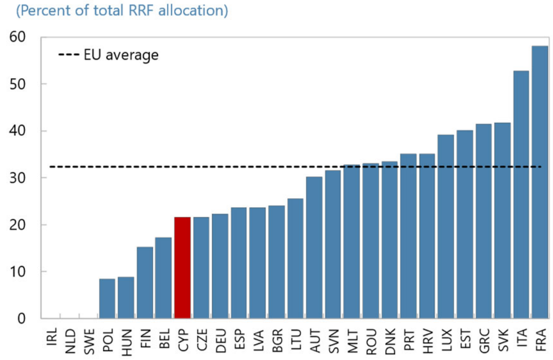
Collected Corporate Income Tax Composition
(Percent of GDP)



Sources: Cyprus' Ministry of Finance, Cystat, Haver Analytics, January 2024 WEO, and IMF staff calculations.

Cyprus' RRF disbursement rate is below the EU average…

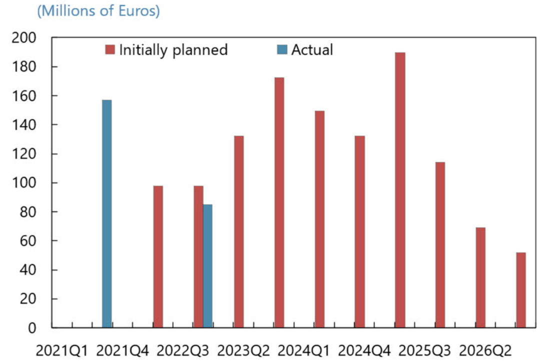
RRF Disbursement
(Percent of total RRF allocation)



Sources: Eurostat, April 2024 REO, and IMF staff calculations.

…as disbursements are behind schedule.

Planned and Actual RRF Disbursments
(Millions of Euros)

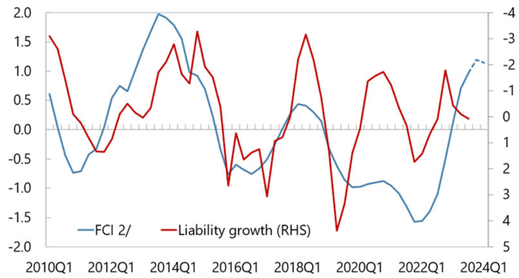


Sources: European Commission and IMF staff calculations.

Figure 4. Cyprus: Financial Conditions Index (FCI)[1]

Financial conditions in Cyprus tightened significantly since 2022…

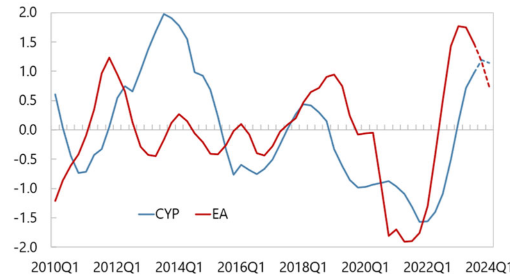
FCI and Liability Growth 1/
(Index and percent, year-over-year)



Source: Borraccia et al., 2023, IMF Working Paper 23/209.
1/ dashed line = projected
2/ increase = tightening

…similar to the euro area average.

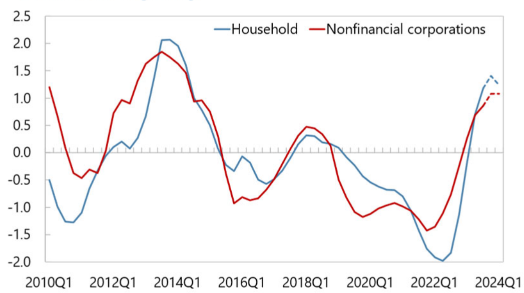
Cyprus and Euro Area: FCI 1/ 2/
(Index)



Source: Borraccia et al., 2023, IMF Working Paper 23/209.
1/ dashed line = projected
2/ increase = tightening

This tigtening impacted both households and NFCs.

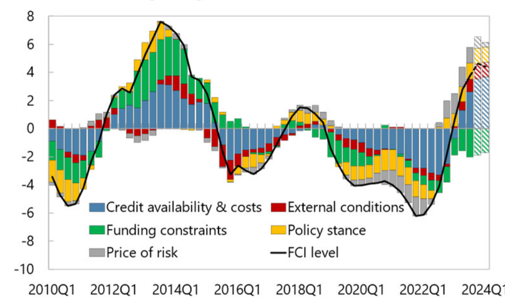
FCI by Sectors 1/
(Index, increase = tightening)



Source: Borraccia et al., 2023, IMF Working Paper 23/209.
1/ dashed line = projected

Credit availability and costs, as well as the price of risk, have been the most important drivers.

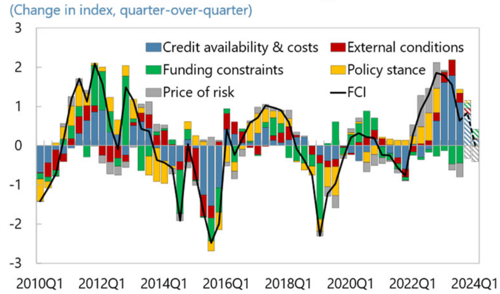
FCI Contributions 1/
(Index, increase = tightening)



Source: Borraccia et al., 2023, IMF Working Paper 23/209.
1/ dashed line/patterned bar = projected

In addition, the policy stance seems to be driving NFCs tightness…

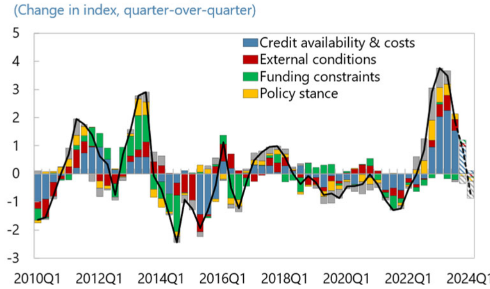
Non-financial Corporation FCI Change Contributions 1/ 2/
(Change in index, quarter-over-quarter)



Source: Borraccia et al., 2023, IMF Working Paper 23/209.
1/ dashed line/patterned bar = projected
2/ increase = tightening

…as well as for households.

Household FCI Change Contributions 1/ 2/
(Change in index, quarter-over-quarter)



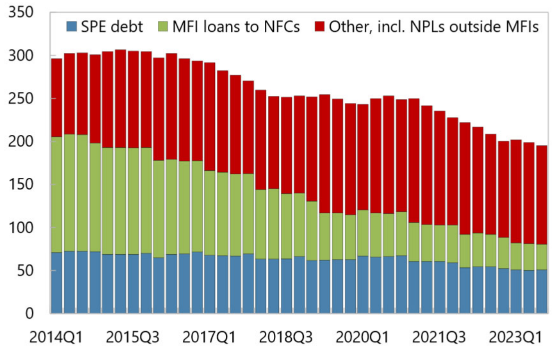
Source: Borraccia et al., 2023, IMF Working Paper 23/209.
1/ dashed line/patterned bar = projected
2/ increase = tightening

[1] Borraccia, G., Espinoza, R.A., Guzzo, V., Jiang, F., Lafarguette, R., Nguyen, H.V., Segoviano Basurto, M. and Wingender, P. 2023. "Financial Conditions in Europe: Dynamics, Drivers, and Macroeconomic Implications." IMF Working Paper 23/209, Washington DC.

Figure 5. Cyprus: Corporate Balance Sheets

NFC debt, especially to monetary and financial institutions (MFIs), has declined significantly over the last decade.

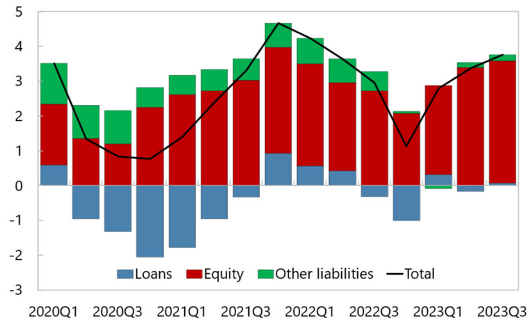
Non-financial Corporation Debt
(Percent of GDP)



Sources: Central Bank of Cyprus, Eurostat, Haver Analytics, and IMF staff calculations.

However, equity financing has supported an overall expansion of NFC balance sheets…

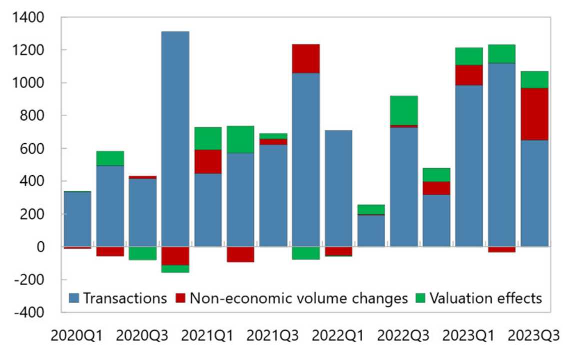
Non-financial Corporation Liabilities Growth Composition
(Percent, year-over-year)



Sources: Eurostat and IMF staff calculations.

…mainly driven by new net equity flows, rather than valuation effects.

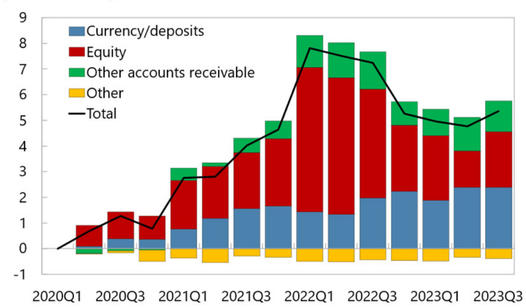
Non-financial Corporation Change in Equity Liabilities
(Millions of Euros)



Sources: Eurostat and IMF staff calculations.

Financial assets have also grown…

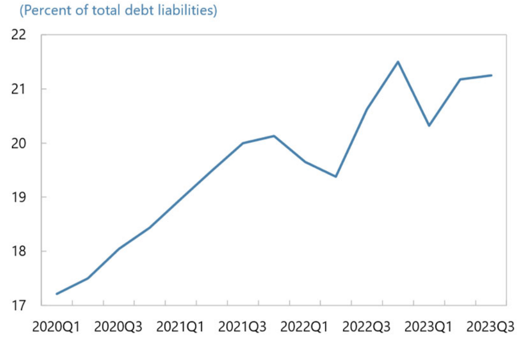
Non-financial Corporation Cumulative Change in Assets 1/
(Billions of Euros)



Sources: Eurostat and IMF staff calculations.
1/ since 2020Q1

…leading to a sustained improvement in NFC liqudity…

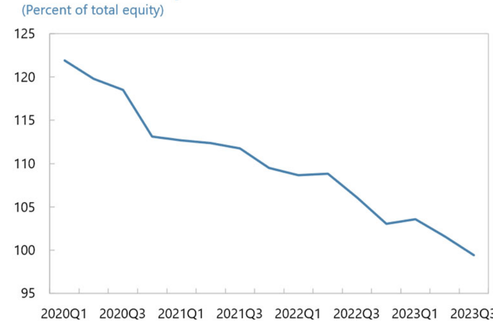
Non-financial Corporation Stock of Cash
(Percent of total debt liabilities)



Sources: Eurostat and IMF staff calculations.

…and continued deleveraging.

Non-financial Corporation Stock of Debt
(Percent of total equity)

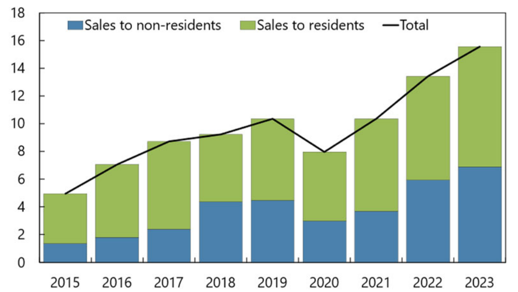


Sources: Eurostat and IMF staff calculations.

Figure 6. Cyprus: Real Estate Market Developments

Property sales continued their upward trend in 2023…

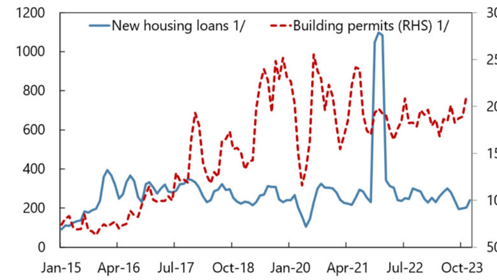
Property Sales
(Thousands)



Sources: Cyprus' Department of Lands and Surveys, Haver Analytics, and IMF staff calculations.

…while housing loans and building permits stayed stable.

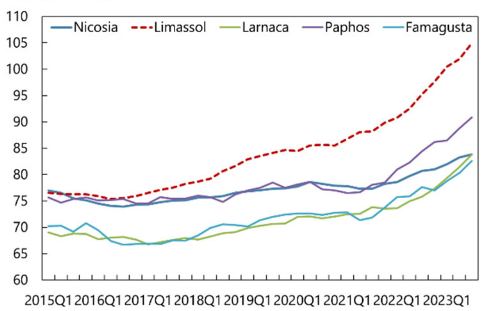
New Housing Loans and Building Permits
(Millions of Euros and millions of sq. meters)



Sources: Cystat, Cyprus' Department of Lands and Surveys, Haver Analytics, and IMF staff calculations.
1/ 3-month MA

Prices continued to increase across regions, with Limassol showing the steepest increase over recent years.

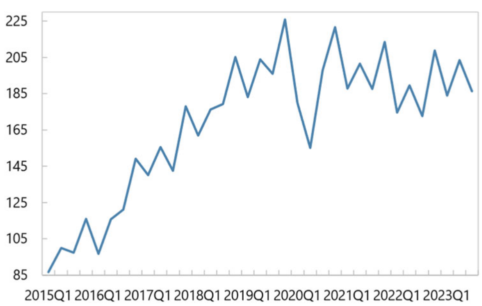
Regional Residential Price Index
(2010Q1 = 100)



Source: Central Bank of Cyprus.

The construction production index has stabilized.

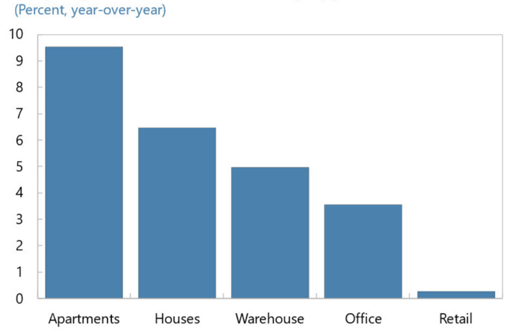
Construction Production Index
(2015 = 100)



Source: Cystat.

Prices increased the most for apartments and houses, but also for offices.

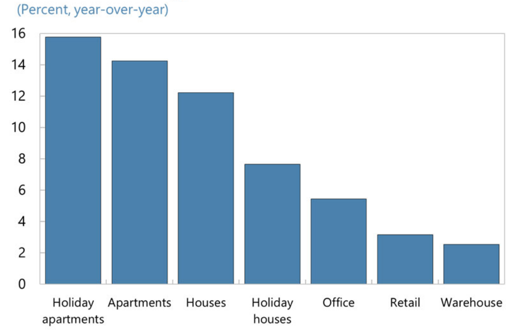
Property Market Price Growth by Type, 2023Q4
(Percent, year-over-year)



Sources: RICS Cyprus Property Index, KPMG, and IMF staff calculations.

Rental prices increased by even more.

Rent Growth by Type, 2023Q4
(Percent, year-over-year)



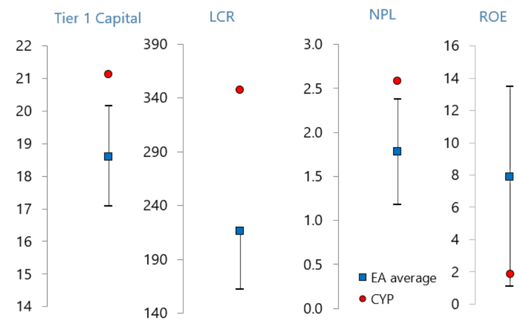
Sources: RICS Cyprus Property Index, KPMG, and IMF staff calculations.

Figure 7. Cyprus: Banking Sector

NPLs are above EU average…

Profitability, Capitalization, Liquidity, and NPL Ratios

(Percent, significant institutions as of 2023Q3)

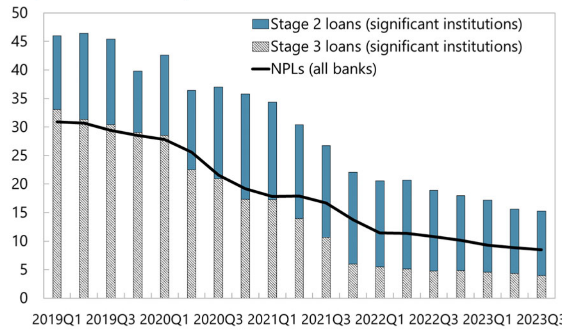


Sources: EBA, ECB, and IMF staff calculations.
1/ whiskers correspond to the 25th and 75th percentiles
2/ ROE data not available for all EA countries

…but most are from legacy debt and have been declining.

Bank Loans by IFRS9 Stage

(Percent of total loans)

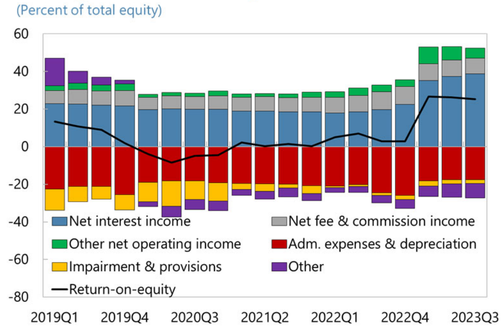


Sources: Central Bank of Cyprus, Haver Analytics, EBA, and IMF staff calculations.

Profitability has improved.

Banking Sector Profitability

(Percent of total equity)

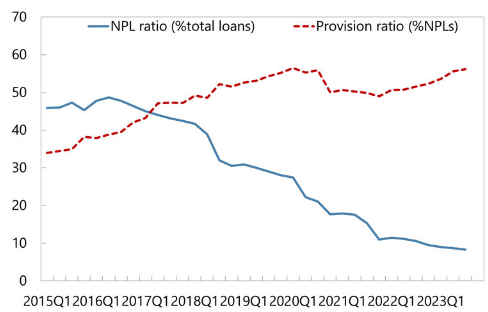


Sources: EBA and IMF staff calculations.

Supporting a further increase in provision coverage ratios.

Non-Performing Loan and Provision Coverage Ratios

(Percent)

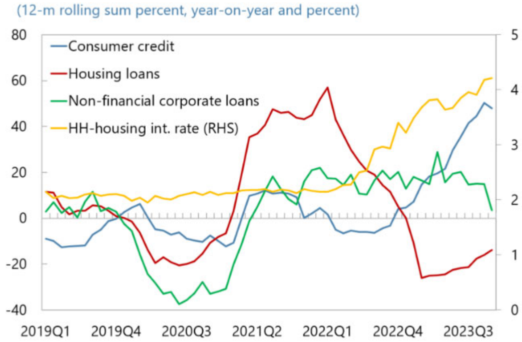


Sources: Central Bank of Cyprus, Haver Analytics, and IMF staff calculations.

Despite higher rates, new consumer credit has grown, but housing loans are shrinking.

Pure New Loans and Interest Rates

(12-m rolling sum percent, year-on-year and percent)

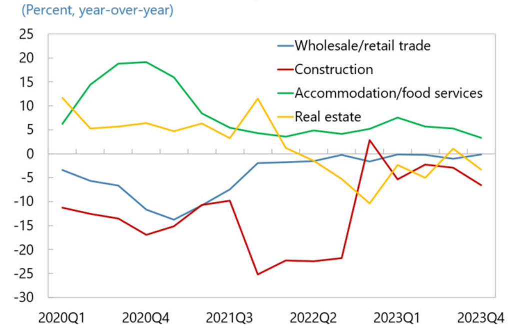


Sources: Central Bank of Cyprus, Haver Analytics, and IMF staff calculations.

And the slow-down in NFC credit is broad based.

Sectoral Non-financial Corporation Credit Growth

(Percent, year-over-year)



Sources: EBA and IMF staff calculations.

Table 1. Cyprus: Selected Economic Indicators, 2020–29

	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
					Projections					
Real Economy	(Percent change, unless otherwise indicated)									
Real GDP	-3.4	9.9	5.1	2.5	2.6	2.8	3.0	3.1	3.1	3.0
Domestic demand	-2.2	5.0	8.9	5.3	2.5	3.1	3.1	3.1	3.1	3.0
Consumption	-2.8	6.0	7.2	3.8	3.8	3.0	3.1	3.2	3.2	3.2
Private consumption	-6.4	5.6	8.6	4.2	3.8	2.9	3.1	3.3	3.3	3.2
Public consumption	11.1	7.6	3.1	2.3	3.5	3.1	3.0	3.1	3.0	3.0
Gross capital formation	0.2	0.9	15.3	10.8	-1.9	3.5	3.2	2.5	2.5	2.2
Foreign balance 1/	-1.2	4.7	-3.7	-2.8	0.5	-0.4	-0.2	-0.1	-0.1	-0.1
Exports of goods and services	1.6	21.6	13.6	-1.2	0.0	1.9	2.3	2.7	2.6	2.6
Imports of goods and services	3.2	15.4	18.3	1.7	-0.5	2.3	2.4	2.7	2.7	2.6
Potential GDP growth	-0.4	4.9	4.5	3.3	3.1	3.1	3.2	3.2	3.1	3.0
Output gap (percent of potential GDP)	-3.2	1.4	1.9	1.1	0.6	0.3	0.1	0.0	0.0	0.0
HICP (period average) Seasonally Adjusted	-1.1	2.3	8.1	3.9	2.2	2.0	2.0	2.0	2.0	2.0
HICP (end of period) Seasonally Adjusted	-0.8	4.8	7.6	1.9	2.0	2.0	2.0	2.0	2.0	2.0
GDP deflator	-1.3	2.7	6.1	4.7	3.7	2.5	2.3	2.3	2.1	2.3
Unemployment rate (percent, period average)	7.6	7.5	6.8	6.1	5.9	5.7	5.5	5.3	5.1	5.0
Employment growth (percent, period average)	0.2	3.4	4.4	2.8	1.2	1.1	1.1	1.1	1.0	0.9
Labor force		3.3	3.6	2.1	0.9	0.9	0.9	0.9	0.8	0.8
Public Finance	(Percent of GDP, unless otherwise indicated)									
General government balance	-5.7	-1.8	2.7	3.1	2.7	2.5	2.5	1.4	1.1	0.9
Revenue	38.5	40.1	41.5	43.3	43.6	43.6	43.5	42.8	42.7	42.7
Expenditure	44.2	41.9	38.8	40.2	41.0	41.1	41.1	41.3	41.6	41.7
Primary Fiscal Balance	-3.6	-0.1	4.2	4.5	4.1	4.0	3.9	3.0	2.7	2.5
General government debt	114.9	99.3	85.6	77.3	71.1	65.7	60.7	56.7	53.4	50.4
Balance of Payments										
Current account balance	-10.0	-6.1	-7.9	-12.1	-11.1	-10.2	-10.0	-9.6	-9.6	-9.4
Trade Balance (goods and services)	-1.4	4.0	0.3	-0.9	-0.9	-0.7	-0.6	-0.5	-0.5	-0.5
Exports of goods and services	80.7	89.4	95.0	89.4	85.9	84.7	83.8	82.9	82.2	80.1
Imports of goods and services	82.0	85.5	94.7	90.3	86.8	85.4	84.3	83.4	82.6	80.5
Goods balance	-19.1	-17.6	-21.5	-23.9	-22.3	-21.7	-21.3	-20.9	-20.5	-20.0
Services balance	17.7	21.6	21.8	23.0	21.4	21.0	20.7	20.4	20.0	19.5
Primary income, net	-7.0	-8.8	-7.5	-10.1	-9.5	-8.6	-8.6	-8.2	-8.1	-8.0
Secondary income, net	-1.6	-1.3	-0.7	-1.1	-0.7	-0.9	-0.9	-0.9	-0.9	-1.0
Capital account, net	-0.1	0.3	0.2	0.0	0.3	0.2	0.2	0.1	0.1	0.1
Financial account, net	-9.1	-6.9	-7.2	-9.7	-10.8	-10.0	-9.8	-9.5	-9.5	-9.4
Direct investment	-33.7	-31.1	-30.4	-12.6	-12.1	-12.0	-11.9	-19.3	-19.1	-18.6
Portfolio investment	-18.3	1.1	4.1	10.5	4.7	4.4	3.1	3.0	2.1	1.0
Other investment and financial derivatives	42.9	21.7	18.7	-7.6	-3.4	-2.5	-1.1	6.8	7.5	8.3
Reserves (+ accumulation)	0.2	1.4	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Program financing 2/	-3.2	0.0	0.0	0.0	0.0	-1.0	-2.8	-2.7	-2.6	-2.6
Errors and omissions	1.0	-1.1	0.6	2.5	0.0	0.0	0.0	0.0	0.0	0.0
Saving-Investment Balance										
National saving	31.1	25.5	28.4	34.2	32.9	32.1	32.1	31.8	32.0	32.1
Government	-2.2	1.5	6.2	7.3	6.2	6.2	6.1	5.2	5.1	5.0
Non-government	33.3	24.0	22.3	26.9	26.7	25.9	25.9	26.5	26.9	27.1
Gross capital formation	21.1	19.5	20.5	22.1	21.8	21.9	22.0	22.2	22.4	22.6
Government	3.5	3.3	3.4	4.2	3.6	3.7	3.7	3.8	3.9	4.1
Private	17.6	16.1	17.1	17.8	18.3	18.2	18.3	18.4	18.5	18.6
Foreign saving	10.0	6.1	7.9	12.1	11.1	10.2	10.0	9.6	9.6	9.4
Memorandum Item:										
Nominal GDP (billions of euros)	22.1	24.9	27.8	29.8	31.7	33.4	35.2	37.1	39.1	41.1
Structural primary balance	-2.7	-0.7	3.5	3.9	3.9	3.8	3.8	2.9	2.7	2.5
External debt	794.8	692.1	609.6	576.0	558.3	523.2	491.0	460.8	434.2	411.1
Net IIP	-133.4	-104.0	-96.2	-96.4	-106.5	-111.1	-113.9	-116.0	-118.5	-119.5

Sources: Cystat, Eurostat, Central Bank of Cyprus, and IMF staff estimates.

1/ Contribution to real GDP growth

2/ Program financing (+ purchases, - repurchases) is included under the Financial Account, with consistent sign conversion

Table 2. Cyprus: Fiscal Developments and Projections, 2020–29 [1/]

(Percent of GDP)

	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
					Projections					
Revenue	38.5	40.1	41.5	43.3	43.6	43.6	43.5	42.8	42.7	42.7
Current revenue	38.0	38.8	40.5	42.2	42.9	42.9	42.8	42.1	42.0	42.0
Tax revenue	22.6	23.6	25.1	25.8	25.3	25.4	25.3	25.3	25.2	25.2
Indirect taxes	13.1	13.6	14.5	14.9	14.7	14.7	14.7	14.6	14.6	14.6
Direct taxes	9.5	10.0	10.5	11.0	10.6	10.6	10.6	10.6	10.6	10.6
Other taxes (capital taxes)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Social security contributions	10.9	11.0	11.2	12.0	12.6	12.6	12.6	12.6	12.6	12.6
Other current revenue	4.5	4.2	4.3	4.3	5.0	4.9	4.9	4.2	4.2	4.2
Capital revenue	0.5	1.2	1.0	1.2	0.7	0.7	0.7	0.7	0.7	0.7
Expenditure	44.2	41.9	38.8	40.2	41.0	41.1	41.1	41.3	41.6	41.7
Current expenditure	40.7	38.6	35.4	36.0	37.4	37.5	37.4	37.5	37.7	37.7
Wages and salaries	13.1	12.0	11.4	12.0	12.1	12.0	12.0	12.0	12.0	12.0
Goods and services	4.1	4.2	4.5	4.0	5.2	5.2	5.2	5.2	5.2	5.3
Social transfers	16.3	15.8	15.2	15.2	15.7	15.7	15.7	15.8	15.8	15.8
Subsidies	2.6	2.3	0.5	0.5	0.7	0.7	0.7	0.7	0.7	0.7
Interest payments	2.1	1.8	1.5	1.4	1.5	1.4	1.4	1.5	1.6	1.5
Other current expenditure	2.4	2.4	2.3	2.8	2.3	2.3	2.3	2.3	2.3	2.4
Capital expenditure	3.5	3.3	3.4	4.2	3.6	3.7	3.7	3.8	3.9	4.1
Capital transfers, payable	0.8	0.7	0.9	0.7	0.7	0.8	0.8	0.8	0.8	0.9
Gross capital formation less NFA disposal	2.8	2.6	2.6	3.5	2.9	2.9	2.9	3.0	3.1	3.2
Overall balance	-5.7	-1.8	2.7	3.1	2.7	2.5	2.5	1.4	1.1	0.9
Statistical discrepancy	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing	-5.7	-1.8	2.7	3.1	2.7	2.5	2.5	1.4	1.1	0.9
Net financial transactions	-5.6	-1.8	2.7	3.2	2.7	2.5	2.5	1.4	1.1	0.9
Net acquisition of financial assets	11.0	-4.3	-0.7	0.8	1.1	0.7	0.9	0.6	0.6	0.6
Currency and deposits	11.0	-4.3	-0.7	0.8	1.1	0.7	0.9	0.6	0.6	0.6
Securities other than shares	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Shares and other equity	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	16.6	-2.5	-3.4	-2.4	-1.6	-1.8	-1.6	-0.9	-0.5	-0.4
Currency and deposits	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Securities other than shares	18.9	-4.0	-3.6	-2.2	-1.5	-0.2	2.0	1.8	2.2	2.1
Loans	-2.3	1.5	0.1	-0.3	0.0	-1.5	-3.6	-2.7	-2.7	-2.5
Other liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:										
Output Gap	-3.2	1.4	1.9	1.1	0.6	0.3	0.1	0.0	0.0	0.0
Primary balance	-3.6	-0.1	4.2	4.5	4.1	4.0	3.9	3.0	2.7	2.5
Structural overall balance	-4.8	-2.4	2.0	2.5	2.5	2.4	2.4	1.4	1.1	1.0
Structural primary balance	-2.7	-0.7	3.5	3.9	3.9	3.8	3.8	2.9	2.7	2.5
Public debt	114.9	99.3	85.6	77.3	71.1	65.7	60.7	56.7	53.4	50.4
Public debt net of cash holding	98.6	88.2	76.3	67.8	61.1	55.5	50.2	46.2	42.9	39.8

Sources: Cyprus' Ministry of Finance and IMF staff estimates.

1/ Accrual basis, unless otherwise indicated

Table 3. Cyprus: General Government Financing Requirements and Sources, 2020–2029

(Millions of Euros, unless otherwise indicated)

	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
					Projections					
Gross borrowing needs	3,888	2,877	1,459	890	1,299	1,100	1,651	1,973	2,507	1,160
Overall deficit	1,235	457	-763	-959	-836	-832	-852	-519	-419	-369
Primary surplus	792	17	-1,170	-1,350	-1,313	-1,321	-1,359	-1,098	-1,068	-1,018
Interest payments	443	440	407	391	477	490	507	580	649	648
Amortization	2,652	2,420	2,222	1,849	2,136	1,932	2,503	2,491	2,926	1,530
Medium- and long-term	1,635	945	1,922	1,712	2,071	1,432	1,403	1,391	1,776	180
Foreign	745	91	1,098	1,104	1,962	1,262	1,109	1,351	1,754	162
Eurobonds	662	0	1,000	1,000	1,850	1,000	1,000	1,250	1,500	0
Russia	0	0	0	0	0	0	0	0	0	0
Other	83	91	98	104	112	262	109	101	254	162
Domestic	891	854	824	608	109	170	294	40	22	18
Short-term	300	1,475	300	137	64	150	100	100	150	300
EU and IMF	717	0	0	0	0	350	1,000	1,000	1,000	1,050
Stock-flow adjustment 1/	0	0	0	0	0	0	0	0	0	0
Gross financing sources	3,647	2,651	1,456	890	1,299	1,100	1,651	1,973	2,507	1,160
Privatization receipts	0	0	0	0	0	0	0	0	0	1
Market access	6,315	1,797	1,290	1,124	1,641	1,338	1,939	2,175	2,721	1,386
Medium- and long-term	4,840	1,497	1,153	1,060	1,491	1,238	1,839	2,025	2,421	1,286
Foreign	4,792	1,454	1,129	1,020	1,100	1,100	1,600	1,900	2,200	1,200
Domestic	48	43	24	40	391	138	239	125	221	86
Short-term	1,475	300	137	64	150	100	100	150	300	100
EU and IMF	0	0	0	0	0	0	0	0	0	0
Use of deposits 2/	-2,669	854	166	-234	-342	-238	-288	-203	-214	-225
Net placement	3,663	-623	-932	-725	-494	-594	-564	-316	-205	-144
Medium and Long Term Debt	3,205	552	-769	-653	-580	-194	436	634	645	1,106
Domestic securities	-842	-811	-800	-569	282	-32	194	85	199	68
Eurobonds	3,838	1,000	0	0	-850	0	500	550	500	1,000
Domestic loans	0	0	0	0	0	0	-250	0	0	0
Foreign loans	209	363	31	-84	-12	-162	-9	-1	-54	38
Short term (net increase)	1,175	-1,175	-163	-73	86	-50	0	50	150	-200
EU and IMF	-717	0	0	0	0	-350	-1,000	-1,000	-1,000	-1,050
Memorandum item:										
Cash holding (eop)	3,616	2,762	2,596	2,829	3,171	3,409	3,697	3,899	4,113	4,338
General government debt (eop)	25,384	24,741	23,776	23,036	22,542	21,948	21,383	21,067	20,862	20,718
General government debt (eop, percent of GDP)	114.9	99.3	85.6	77.3	71.1	65.7	60.7	56.7	53.4	50.4
General government net debt (eop, percent of GDP) 3/	98.6	88.2	76.3	67.8	61.1	55.5	50.2	46.2	42.9	39.8

Sources: Cypriot authorities and IMF staff estimates.

1/ Adjustments for consistency between estimated cash basis fiscal balance and debt data

2/ Minus (-) sign represents accumulation of deposits

3/ General government debt minus cash holding

Table 4. Cyprus: Balance of Payments, 2020–29
(Percent of GDP)

	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
					Projections					
Current Account Balance	-10.0	-6.1	-7.9	-12.1	-11.1	-10.2	-10.0	-9.6	-9.6	-9.4
Trade Balance (Goods and Services)	-1.4	4.0	0.3	-0.9	-0.9	-0.7	-0.6	-0.5	-0.5	-0.5
Goods Balance	-19.1	-17.6	-21.5	-23.9	-22.3	-21.7	-21.3	-20.9	-20.5	-20.0
Exports	13.4	14.8	16.5	14.6	14.2	14.3	14.0	13.8	13.6	13.3
Imports	32.5	32.5	38.0	38.5	36.5	36.0	35.3	34.7	34.2	33.2
Services Balance	17.7	21.6	21.8	23.0	21.4	21.0	20.7	20.4	20.0	19.5
Exports	67.2	74.6	78.5	74.8	71.8	70.4	69.7	69.1	68.5	66.8
Imports	49.5	53.0	56.7	51.8	50.3	49.4	49.1	48.7	48.5	47.3
Primary Income	-7.0	-8.8	-7.5	-10.1	-9.5	-8.6	-8.6	-8.2	-8.1	-8.0
Secondary Income	-1.6	-1.3	-0.7	-1.1	-0.7	-0.9	-0.9	-0.9	-0.9	-1.0
Capital Account	-0.1	0.3	0.2	0.0	0.3	0.2	0.2	0.1	0.1	0.1
Financial Account (- financing)	-9.1	-6.9	-7.2	-9.7	-10.8	-10.0	-9.8	-9.5	-9.5	-9.4
Direct Investment	-33.7	-31.1	-30.4	-12.6	-12.1	-12.0	-11.9	-19.3	-19.1	-18.6
Portfolio Investment	-18.3	1.1	4.1	10.5	4.7	4.4	3.1	3.0	2.1	1.0
Financial Derivatives	-1.9	-0.3	-0.6	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Other Investment	44.8	22.0	19.3	-7.4	-3.2	-2.3	-0.9	7.0	7.7	8.4
Reserves (+ accumulation)	0.2	1.4	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Errors and Omission	1.0	-1.1	0.6	2.5	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:										
Current Account Balance, adjusted for SPEs 1/	-9.4	-7.4	-9.1	-11.5	...	...	...	...	...	...
Program Financing 2/	-3.2	0.0	0.0	0.0	0.0	-1.0	-2.8	-2.7	-2.6	-2.6
Private Net Capital Flows 3/	8.5	-13.7	-7.3	-8.1	...	...	...	...	...	...
o/w Portfolio Investment	1.3	-0.3	4.4	10.1	...	...	...	...	...	...
o/w Other Investment	42.9	2.5	19.3	-5.4	...	...	...	...	...	...
o/w MFIs	2.7	-4.1	8.3	0.9	...	...	...	...	...	...
o/w Non-MFIs	40.2	7.8	11.0	-6.3	...	...	...	...	...	...
Gross External Debt	794.8	692.1	609.6	576.0	558.3	523.2	491.0	460.8	434.2	411.1
o/w Short-term Debt	153.1	133.9	95.3	87.3	86.2	84.1	82.7	82.0	82.4	83.8

Sources: Central Bank of Cyprus, Eurostat, and IMF staff estimates.

1/ Treating Special Purpose Entities (SPEs) as non-residents.

2/ Program financing (+ purchases, - repurchases) is included under the Financial Account, with consistent sign conversion.

3/ Private net capital flows (- inflows, + outflows) are defined to exclude the public-sector flows (the central-bank flows and part of the general-government flows). It is not possible to exclude all general government-related flows from "other investment" in the published data because of secondary confidentiality issues (i.e., these data are suppressed to preserve the confidentiality of data pertaining to other sectors that could otherwise be indirectly deduced).

Table 5. Cyprus: External Financing Requirements and Sources, 2020–29

(Millions of Euros)

	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
					Projections					
GROSS FINANCING REQUIREMENTS	**44,941**	**41,195**	**34,300**	**34,904**	**38,891**	**39,161**	**40,752**	**42,337**	**43,769**	**43,985**
Current account deficit ("-" = CA surplus)	2,202	1,514	2,203	3,607	3,514	3,419	3,532	3,563	3,740	3,885
Medium- and long-term debt amortization	8,225	5,564	5,040	4,466	8,025	7,295	7,106	7,313	6,816	4,585
Public sector	757	91	1,098	1,104	1,962	1,262	1,109	1,351	1,754	162
Banks	341	238	241	170	178	179	179	180	181	181
Other private	7,127	5,235	3,701	3,193	5,885	5,854	5,818	5,783	4,881	4,242
Short-term debt amortization	33,809	34,117	27,058	26,831	27,352	28,097	29,113	30,460	32,213	34,464
Public sector	69	1,990	2,440	3,017	3,730	4,612	5,702	7,049	8,716	10,776
Central Bank	69	1,990	2,440	3,017	3,730	4,612	5,702	7,049	8,716	10,776
General government and SOEs	0	0	0	0	0	0	0	0	0	0
Banks	9,568	10,709	8,304	7,711	8,086	8,496	8,951	9,460	10,039	10,705
Other private	24,172	21,417	16,314	16,104	15,536	14,989	14,460	13,951	13,459	12,984
EU and IMF	705	0	0	0	0	350	1,000	1,000	1,000	1,050
SOURCES OF FINANCING	**44,941**	**41,195**	**34,300**	**34,904**	**38,891**	**39,161**	**40,752**	**42,337**	**43,769**	**43,985**
Capital account (net)	-21	78	53	-7	82	67	71	32	32	32
Foreign direct investment (net)	7,454	7,748	8,446	3,749	3,837	4,001	4,182	7,165	7,470	7,669
Cypriot investment abroad	-30,063	-2,213	-7,496	-13,359	-12,347	-12,820	-13,359	-16,739	-17,450	-17,911
Foreign investment in Cyprus	-22,609	5,535	950	-9,177	-8,510	-8,820	-9,177	-9,574	-9,980	-10,241
New borrowing and debt rollover	37,992	25,672	29,578	32,007	35,136	36,076	36,542	36,809	36,239	34,624
Medium and long-term borrowing	3,874	-1,386	2,747	4,655	7,039	6,962	7,428	7,696	7,126	5,511
General government	4,792	1,454	1,129	1,020	1,100	1,100	1,600	1,900	2,200	1,200
Banks	-33	495	-164	252	177	183	184	185	187	188
Other private	-885	-3,335	1,782	3,383	5,762	5,679	5,644	5,610	4,739	4,123
Short-term borrowing	34,117	27,058	26,831	27,352	28,097	29,113	29,113	29,113	29,113	29,113
Public sector	1,990	2,440	3,017	3,730	4,612	5,702	5,702	5,702	5,702	5,702
Central Bank	1,990	2,440	3,017	3,730	4,612	5,702	5,702	5,702	5,702	5,702
General government and SOEs	0	0	0	0	0	0	0	0	0	0
Banks	10,709	8,304	7,711	8,086	8,496	8,951	8,951	8,951	8,951	8,951
Other private	21,417	16,314	16,104	15,536	14,989	14,460	14,460	14,460	14,460	14,460
Other	-484	7,696	-3,777	-844	-163	-982	-43	-1,669	29	1,659
Of which: Net errors and omissions	218	-274	154	736	0	0	0	0	0	0
FINANCING GAP	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
ESM	0	0	0	0	0	0	0	0	0	0
IMF	0	0	0	0	0	0	0	0	0	0
ROLLOVER RATES										
General government	633%	1601%	103%	92%	56%	87%	144%	141%	125%	741%
Central bank	2881%	123%	124%	124%	124%	124%	100%	81%	65%	53%
Private	76%	58%	89%	100%	99%	99%	99%	99%	99%	99%
Banks	108%	80%	88%	106%	105%	105%	100%	95%	89%	84%
Non-financial corporations	66%	49%	89%	98%	97%	97%	99%	102%	105%	108%

Sources: Eurostat, Central Bank of Cyprus, and IMF staff estimates.

Table 6. Cyprus: Financial Soundness Indicators, 2015–23 1/

(Percent, unless otherwise indicated)

	2015	2016	2017	2018	2019	2020	2021	2022	2023
Capital Adequacy									
Total capital ratio	16.6	16.8	16.3	17.5	19.9	20.4	20.7	21.3	23.9
Tier I capital ratio	16.0	16.4	15.4	16.5	19.0	19.3	19.4	19.8	21.4
Asset Quality									
Non-performing loans (NPLs) to total gross loans 2/	45.3	46.4	42.5	30.5	28.0	17.7	11.0	9.5	7.9
Non-performing loans (NPLs) to total gross loans (local operations) 3/	45.8	47.2	43.7	30.3	27.9	17.7	11.0	9.5	7.9
Provisions to NPLs	38.3	42.1	47.2	51.6	55.2	50.1	49.0	52.3	54.9
Restructured loans classified as NPLs to total NPLs	40.1	40.8	40.9	44.8	44.6	43.7	49.6	44.1	45.1
Earnings and Profitability									
Return on assets 4/	-0.6	-0.3	-1.1	0.2	0.3	-0.3	-0.1	0.3	1.8
Return on equity 4/	-7.4	1.7	-11.2	6.1	3.4	-3.9	0.5	4.8	24.1
Net interest income to gross income ratio	81.2	75.3	70.7	67.1	68.5	67.6	71.9	69.1	77.2
Net fees and commissions income to gross income ratio	13.8	14.6	16.4	19.6	20.5	19.7	25.3	25.6	14.9
Net interest margin	2.8	2.6	2.3	1.8	1.9	1.8	1.5	1.6	3.0
Liquidity									
Cash, trading and available-for-sale assets to total assets ratio	19.8	22.9	27.9	27.6	29.3	28.8	39.6	40.7	39.8
Others									
Total loans and advances to total assets ratio	73.6	69.1	64.1	54.6	53.8	51.0	42.5	40.1	39.3
Total deposits (other than from credit institutions) to total assets ratio	65.1	74.9	75.6	79.2	82.8	80.7	75.1	79.4	78.1

Source: Central Bank of Cyprus.

1/ Unless otherwise specified, these FSIs cover consolidated accounts of domestic and foreign banks operating in Cyprus up to 2023Q3. The data on asset quality ratios is up to 2023Q4.

2/ Based on the European Banking Association's definition of NPLs. As of end-2014, banks report NPLs as per the EU's regulation on reporting NPLs and forborne exposures. The main changes with respect to the previous definition are that the minimum probation period for forborne loans remaining classified as NPLs has increased from 6 to 12 months.

3/ Local operations are confined to banks active in the local market, excluding overseas branches and subsidiaries of Cyprus-based banks.

4/ Annual return. The last observation is the year-to-date return.

Annex I. Disinflation and Monetary Transmission in Cyprus[1]

Inflation dropped in 2023 due to the diminishing impact of supply-side shocks and moderating demand. But some domestic price pressures persist, mostly from non-fiscal aggregate demand. As real wages recover, maintaining stable inflation requires a normalization of profit shares. ECB tightening has significantly impacted interest rates, including for outstanding mortgages. Deposit rates saw delayed and smaller increases, likely driven by high banking sector liquidity and low competition. Continued commitment to containing aggregate demand is supporting the final stage of disinflation.

1. Inflation declined markedly in 2023. Headline inflation has been sensitive to energy price pressures from Russia's war in Ukraine and the strong rebound in tourism after the pandemic.[2] Inflation pressures became more broad-based over time, also driving up core inflation, boosted by robust wage growth. HICP inflation declined below 2 percent in December 2023, but core inflation only to 2.4 percent. Inflation of goods and services with low import content, a good measure of domestic price pressures, has been stickier at 4.1 percent in December.[3]

2. Persistently high core inflation in 2023 was driven by both demand and supply. A Bayesian Vector-Error-Correction model (BVAR) attributes the post-pandemic inflation surge to both supply and demand factors, with the latter dominating most of the time.[4] Supply factors peaked in 2022Q3 and then declined, but still accounted for around a third of excess core inflation last year (i.e., deviation of inflation from target). Demand factors, while also declining since the second half of 2022, proved stickier. This finding is confirmed by a bottom-up decomposition of core inflation drivers into four groups developed during the COVID-19 pandemic: prices sensitive to supply chain disruptions, those reflective of pent-up demand during re-opening, rent, and others. The significant impact of demand aligns with lingering effects of monetary and fiscal policy easing in response to the pandemic.

3. By the end of last year, remaining demand pressures were likely dominated by non-fiscal factors. This can be estimated with a BVAR estimation including fiscal policy, although the identification of different factors gets more uncertain when different shocks are present at the same time, as arguably was the case during the pandemic and subsequent recovery. With that in mind, the impact of fiscal policy shocks on core inflation is estimated to have dropped below one percentage point since 2023Q2 and turned negative quarter-over-quarter at the end of last year. The partial yet substantial reduction in non-fiscal demand pressures has likely been supported by monetary tightening.

[1] This Annex is based on Beyer, R. (2024). "Disinflation and Monetary Transmission in Cyprus". International Monetary Fund, Selected Issue Paper.
[2] Beyer, R. (2023). Causes and Implications of Elevated Inflation in Cyprus (No. 2023/042). International Monetary Fund, Selected Issues Paper.
[3] Fröhling, A., O'Brien, D., and S. Schaefer. (2022). A new Indicator of Domestic Inflation for the Euro Area. ECB Economic Bulletin, Issue 4/2022. Frankfurt am Main.
[4] We estimate different models based on Davoodi, H., Nguyen, A. D. M. and Poplawski-Ribeiro, M. (2023). Fiscal and Non-fiscal Drivers of Inflation: A Decomposition Analysis." Internal IMF-FAD Toolkit and Note, International Monetary Fund, Fiscal Affairs Department, Washington DC.

4. So far, inflation has been accompanied by higher unit profits and lower labor costs. In 2022, nearly three-quarters of the inflation was driven by unit profits. The remaining portion came from higher unit taxes, with a negligible contribution from unit labor costs. Following the spike in energy prices, firms have hence passed on more than just the immediate nominal import cost shock. The increasing profit share implies that firms have so far been relatively more shielded from inflation than wage earners.

5. The pass-through of ECB tightening to outstanding mortgages in Cyprus significantly exceeds the euro area average. While the pass-through to new lending rates in Cyprus aligns broadly with other European countries, impacting investment, the pass-through to outstanding mortgages is more than twice as strong, driven by a high share of flexible rate mortgages. This share has not decreased over the past decade, unlike in most other countries. But despite the high share, only around half of the policy rate change has been passed on to outstanding mortgages, due to constraints on mortgage rate adjustments and the reference to a bank base rate (partly tied to deposit rates) in some cases.

6. Robust real estate demand has somewhat offset the impact of higher interest rates on aggregate demand. Due to a high share of mortgages in household debt, pass-through to outstanding mortgages plays an important role in transmitting monetary policy to output and prices.[5] Usually, higher mortgage rates lower disposable income (due to higher interest rate payments) and wealth (due to declining house prices), thus lowering aggregate demand. However, robust external demand for housing have sustained house prices so far.

7. Deposit pass-through has been lower and slower than in other countries. Only a quarter of rate hikes has been passed on to household time deposits, and nothing to household overnight deposits.[6] The deposit pass-through has been somewhat higher for corporations, likely reflecting more sophisticated financial planning and more bargaining power. Structural characteristics, such as low competition and high banking sector liquidity, likely contribute to the limited deposit pass-through in Cyprus.[7]

8. Implications of the findings are as follows: (i) Remaining demand pressures should serve as a caution against expansionary policies; (ii) mitigation of transmission to the real estate sector should not be hindered; (iii) low competition in the banking sector and its interaction with financial literacy warrant further analysis; (iv) to achieve sustained disinflation the profit share will likely need to decline to historic norms; and (v) as wage dynamics will determine the inflation outlook, public sector wage growth should be controlled and further indexation be avoided.

[5] International Monetary Fund. (2024a). World Economic Outlook, April 2024. Washington, DC

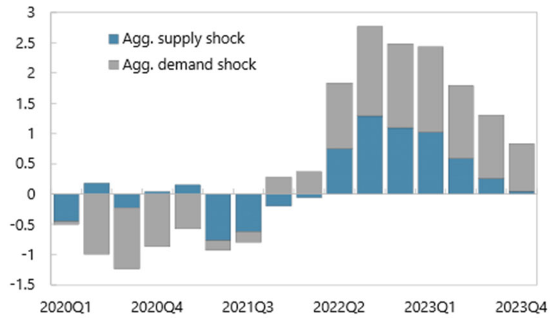
[6] The share of time deposits somewhat increased, slightly raising average deposit rates.

[7] Beyer, R., Chen, R., Li, C., Misch, F., Ozturk, E. O., & Ratnovski, L. (2024). Monetary Policy Pass-Through to Interest Rates: Stylized Facts from 30 European Countries. *IMF Working Papers*, *WP/24/9*.

Figure 1. Cyprus: Disinflation and Monetary Pass-Through

Core inflation has been mainly driven by demand factors…

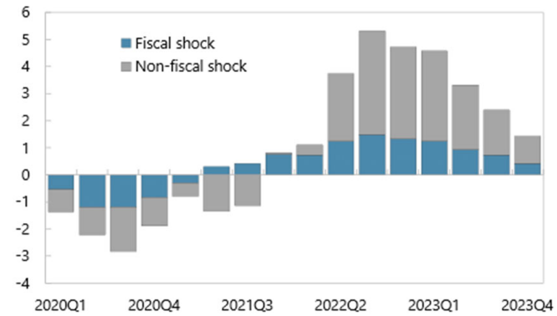
Historical Decomposition of Excess Core Inflation 1/
(Percent, year-over-year)



Sources: Eurostat and IMF staff calculations based on IMF FAD Toolkit.
1/ excess inflation = deviation from deterministic trend

…and remaining demand pressures are mostly non-fiscal.

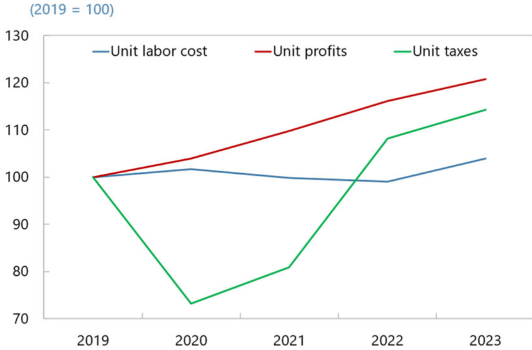
Decomposition of Excess Core Inflation 1/
(Percent, year-over-year)



Sources: Eurostat and IMF staff calculations based on IMF FAD Toolkit.
1/ excess inflation = deviation from deterministic trend

Unit Profits increased, while unit labor costs declined…

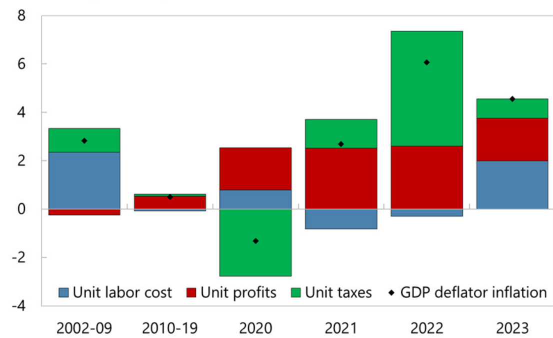
Unit Labor Cost, Profits, and Taxes
(2019 = 100)



Sources: Cystat and IMF staff calculations.

…but both added equally to the GDP deflator last year.

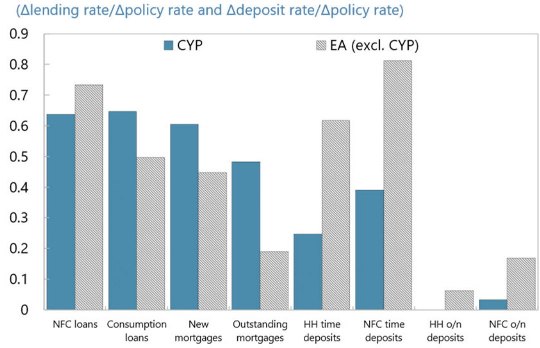
GDP Deflator Inflation Composition
(Percent, year-over-year)



Sources: Eurostat, OECD, and IMF staff calculations.

Pass-through is high for mortgages but low for deposits…

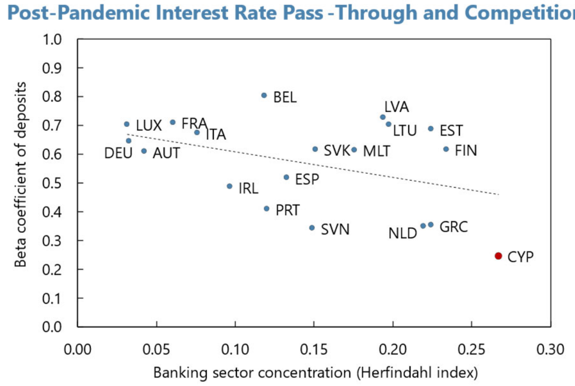
Policy Pass-Through to Bank Lending and Deposit Rates
(Δlending rate/Δpolicy rate and Δdeposit rate/Δpolicy rate)



Sources: ECB, Beyer et al. (2024), and IMF staff calculations.

…with low banking competition contributing to the latter.

Post-Pandemic Interest Rate Pass-Through and Competition



Source: Beyer et al. (2024).

Annex II. Sovereign Risk and Debt Sustainability Framework

Table 1. Cyprus: Risk of Sovereign Stress

Horizon	Mechanical signal	Final assessment	Comments
Overall	...	Low	The overall risk of sovereign stress is assessed to be 'low', an upgrade since the last review. This improvement is driven by the rapidly falling debt profile, robust growth, high cash buffers, and diminsihing risks as NPLs have gradullay moved out of the banking sector and economic volatility has reduced.
Near term 1/			
Medium term	Low	Low	Medium term risks are judged to be low as large and sustained fiscal surpluses, robust growth, and favorable financing terms lower debt over the medium term. Debt remains managable under a banking crises shock, supported by a benign debt stock composition, low GFNs and sizable preexisting cash buffers.
Fanchart	Moderate	...	
GFN	Low	...	
Stress test	Bank. Crisis	...	
Long term	...	Moderate	Long term spending pressures are moderate. Pensions and long-term care will add 1.2 percent of GDP annually by 2030, according to the European Commission's Aging Report 2021. Climate change related spending is estimated between 0.6 – 2.2 percent of GDP, according to the authorities NECP and IMF staff calculations. Together these would require around 2.5 percent of GDP in fiscal space annually, without accounting for other long-term spending needs. The risk is mitigated by a strong starting fiscal balance and the authorities' recent track record of fiscal discipline.
Debt stabilization in the baseline			Yes

DSA Summary Assessment

Cyprus's debt-GDP ratio has fallen below 80 percent of GDP in 2023, a decline of 30 percentage points of GDP since 2020 thanks to large primary surpluses, robust growth and favorable market conditions. The debt stock is well managed with an average maturity of about 7 years, no foreign currency debt, a limited share of floating interest rate debt on concessional basis. In addition, Cyprus has accumulated strong cash buffers of around 10 percent of GDP . The authorities plan to sustain primary surpluses over the medium term and debt is expected to decline further and building a buffer to meet longer term challenges. Risks have also declined, as NPLs have gradullay moved out of the banking sector and economic volatility has reduced.

Source: Fund staff.
Note: The risk of sovereign stress is a broader concept than debt sustainability. Unsustainable debt can only be resolved through exceptional measures (such as debt restructuring). In contrast, a sovereign can face stress without its debt necessarily being unsustainable, and there can be various measures—that do not involve a debt restructuring—to remedy such a situation, such as fiscal adjustment and new financing.
1/ The near-term assessment is not applicable in cases where there is a disbursing IMF arrangement. In surveillance-only cases or in cases with precautionary IMF arrangements, the near-term assessment is performed but not published.
2/ A debt sustainability assessment is optional for surveillance-only cases and mandatory in cases where there is a Fund arrangement. The mechanical signal of the debt sustainability assessment is deleted before publication. In surveillance-only cases or cases with IMF arrangements with normal access, the qualifier indicating probability of sustainable debt ("with high probability" or "but not with high probability") is deleted before publication.

Table 2. Cyprus: Debt Coverage and Disclosures

						Comments
1. Debt coverage in the DSA: 1/	CG	GG	NFPS	CPS	Other	
1a. If central government, are non-central government entities insignificant?					n.a.	
2. Subsectors included in the chosen coverage in (1) above:						
Subsectors captured in the baseline					Inclusion	
1 Budgetary central government					Yes	
2 Extra budgetary funds (EBFs)					Yes	
3 Social security funds (SSFs)					Yes	
4 State governments					No	Not applicable
5 Local governments					Yes	
6 Public nonfinancial corporations					No	
7 Central bank					No	
8 Other public financial corporations					No	
3. Instrument coverage:	Currency & deposits	Loans	Debt securities	Oth acct. payable 2/	IPSGSs 3/	
4. Accounting principles:	Basis of recording		Valuation of debt stock			
	Non-cash basis 4/	Cash basis	Nominal value 5/	Face value 6/	Market value 7/	
5. Debt consolidation across sectors:		Consolidated		Non-consolidated		

Subsector groupings: CPS (1–8); NFPS (1–6); GG: expected (1–5); CG (1–3).

Color code: chosen coverage; Missing from recommended coverage; Not applicable

Reporting on Intra-Government Debt Holdings

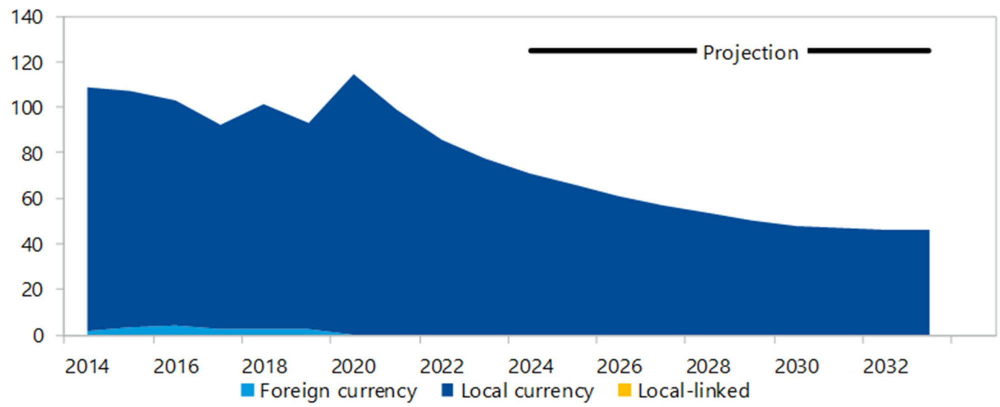
Issuer \ Holder	Budget. central govt	Extra-budget. funds (EBFs)	Social security funds (SSFs)	State govt.	Local govt.	Nonfin. pub. corp.	Central bank	Oth. pub. fin corp	Total
1 Budget. central govt			46.2						46.2
2 Extra-budget. funds									0
3 Social security funds									0
4 State govt.									0
5 Local govt.									0
6 Nonfin pub. corp.									0
7 Central bank									0
8 Oth. pub. fin. corp									0
Total	0	0	46.2	0	0	0	0	0	46.2

1/ CG=Central government; GG=General government; NFPS=Nonfinancial public sector; PS=Public sector.
2/ Stock of arrears could be used as a proxy in the absence of accrual data on other accounts payable.
3/ Insurance, Pension, and Standardized Guarantee Schemes, typically including government employee pension liabilities.
4/ Includes accrual recording, commitment basis, due for payment, etc.
5/ Nominal value at any moment in time is the amount the debtor owes to the creditor. It reflects the value of the instrument at creation and subsequent economic flows (such as transactions, exchange rate, and other valuation changes other than market price changes, and other volume changes).
6/ The face value of a debt instrument is the undiscounted amount of principal to be paid at (or before) maturity.
7/ Market value of debt instruments is the value as if they were acquired in market transactions on the balance sheet reporting date (reference date). Only traded debt securities have observed market values.

Public debt is consolidated at the general government level. Intra-governmental debt is significant as the social security funds hold 46.2 percent of GDP in central government debt. Public entities beyond the GG perimiter are not deemed a material fiscal risk. Government guarantees are not included in public debt.

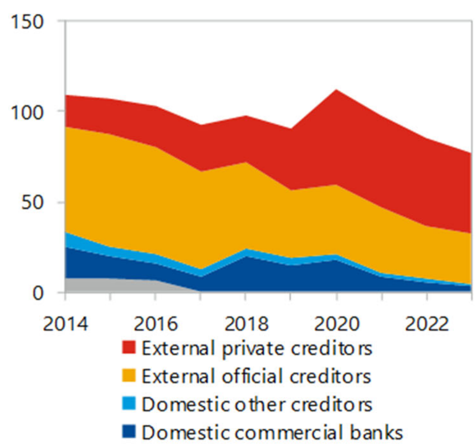
Figure 1. Cyprus: Public Debt Structure Indicators

Debt by Currency (Percent of GDP)



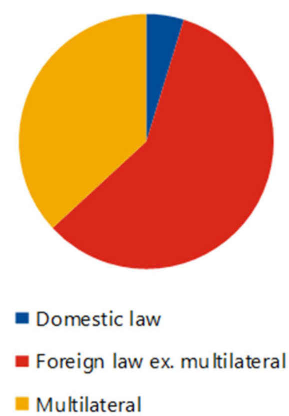
Note: The perimeter shown is general government.

Public Debt by Holder (Percent of GDP)



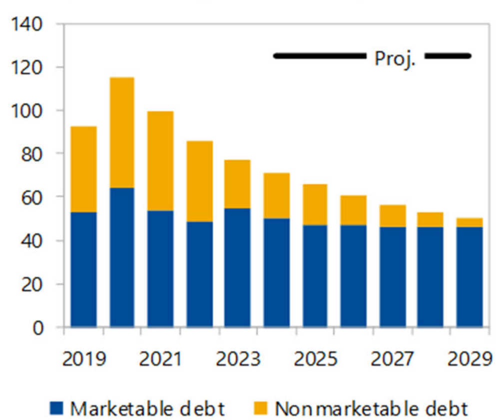
Note: The perimeter shown is general government.

Public Debt by Governing Law, 2023 (percent)



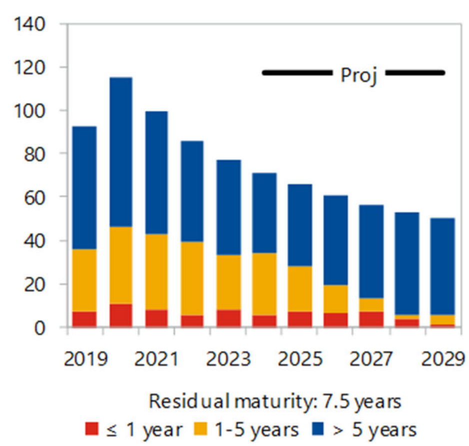
Note: The perimeter shown is general government.

Debt by Instruments (Percent of GDP)



Note: The perimeter shown is general government.

Public Debt by Maturity (Percent of GDP)



Note: The perimeter shown is general government.

Public debt is largely owed to non-residents, but with long maturities and wholly denominated in local currency. About a third is held by multilaterals, including the ESM, EIB, EC and CEB.

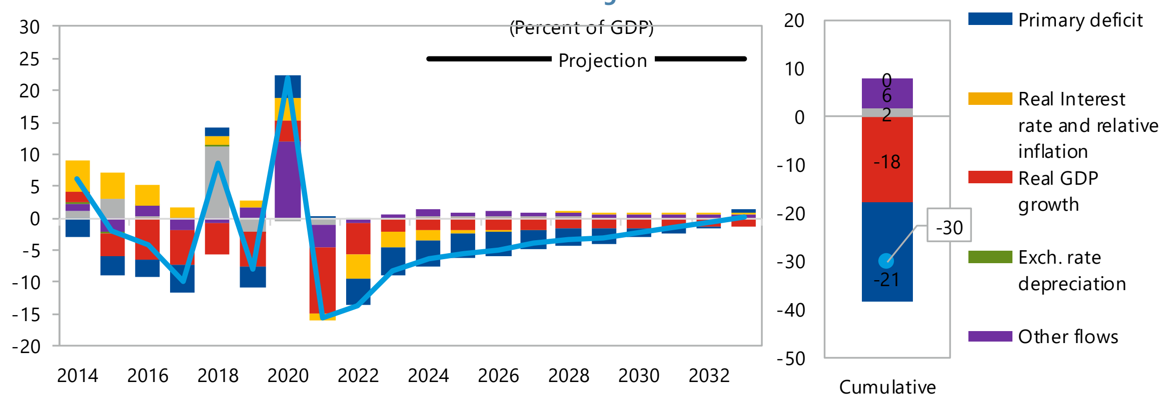
Table 3. Cyprus: Baseline Scenario

(Percent of GDP, unless indicated otherwise)

	Actual	Medium-term projection						Extended projection			
	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
Public debt	77.3	71.1	65.7	60.7	56.7	53.4	50.4	48.1	46.7	46.0	46.2
Change in public debt	-8.3	-6.2	-5.4	-4.9	-4.0	-3.3	-3.0	-2.3	-1.4	-0.6	0.1
Contribution of identified flows	-8.1	-6.5	-5.7	-5.2	-4.3	-3.7	-3.2	-2.3	-1.4	-0.6	0.1
Primary deficit	-4.4	-4.1	-3.9	-3.8	-2.9	-2.7	-2.4	-1.6	-0.9	-0.2	0.6
Noninterest revenues	43.2	43.6	43.6	43.5	42.7	42.7	42.6	42.6	42.6	42.6	42.6
Noninterest expenditures	38.8	39.5	39.7	39.7	39.8	40.0	40.2	41.0	41.7	42.4	43.2
Automatic debt dynamics	-4.4	-3.5	-2.4	-2.2	-1.9	-1.5	-1.3	-1.1	-1.0	-1.0	-0.9
Real interest rate and relative inflat	-2.3	-1.5	-0.5	-0.3	-0.1	0.2	0.2	0.3	0.4	0.4	0.4
Real interest rate	-2.3	-1.5	-0.5	-0.3	-0.1	0.2	0.2	0.3	0.4	0.4	0.4
Relative inflation	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real growth rate	-2.1	-2.0	-1.9	-1.9	-1.8	-1.7	-1.5 .	-1.5	-1.4	-1.4	-1.3
Real exchange rate	0.0	...	...	...	...	...	... .	...	...	...	...
Other identified flows	0.7	1.0	0.6	0.7	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
(minus) Interest Revenues	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Other transactions	0.8	1.1	0.7	0.8	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Contribution of residual	-0.2	0.3	0.3	0.3	0.3	0.3	0.2	0.0	0.0	0.0	0.0
Gross financing needs	2.7	3.6	2.8	4.2	4.8	5.9	2.5	0.7	0.8	1.7	2.3
of which: debt service	7.2	7.7	6.8	8.1	7.8	8.7	5.0	2.4	1.8	2.0	1.8
Local currency	7.2	7.7	6.8	8.1	7.8	8.7	5.0	2.4	1.8	2.0	1.8
Foreign currency	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memo:											
Real GDP growth (percent)	2.5	2.6	2.8	3.0	3.1	3.1	3.0	3.0	3.0	3.0	3.0
Inflation (GDP deflator; percent)	4.7	3.7	2.5	2.3	2.3	2.1	2.3	2.3	2.3	2.3	2.3
Nominal GDP growth (percent)	7.3	6.4	5.4	5.3	5.5	5.2	5.3	5.3	5.3	5.3	5.3
Effective interest rate (percent)	1.8	1.6	1.8	1.8	2.2	2.5	2.7	3.0	3.1	3.2	3.3

Contribution to Change in Public Debt

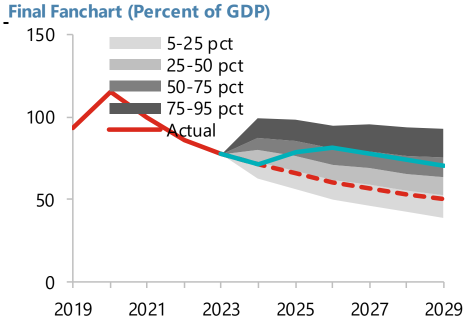
(Percent of GDP)



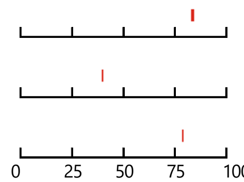
Public debt is on a downward trajectory driven by sizable primary deficits, healthy economic growth and favorable financing costs. Gross financing needs are contained due to the primary surpluses, a long average maturity of debt and a smooth amortization schedule. The authorities aim to maintain the fiscal surpluses to lower debt further.

Figure 2. Cyprus: Medium-Term Risk Assessment

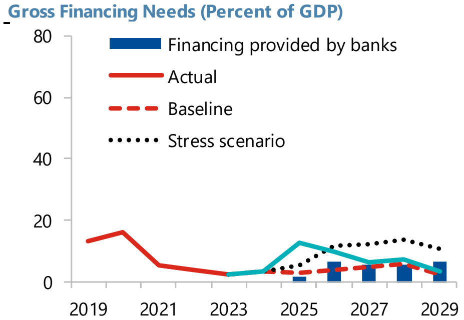
Final Fanchart (Percent of GDP)



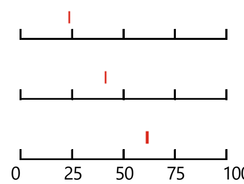
	Value	Contrib 1/	Percentile in peer group 2/
Debt fanchart module			
Fanchart width *(percent of GDP)*	53.7	0.8	
Probability of debt non-stabilizaiton *(percent)*	1.5	0.0	
Terminal debt-to-GDP x institutions index	24.4	0.5	
Debt fanchart index (DFI)		1.3	
Risk signal: 3/		Moderate	



Gross Financing Needs (Percent of GDP)



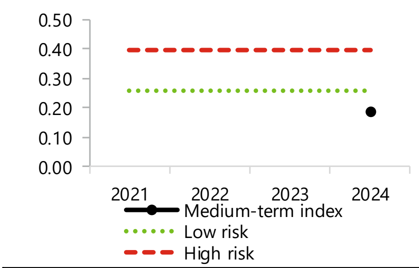
	Value	Contrib 1/	Percentile in peer group 2/
Gross financing needs (GFN) module			
Average baseline GFN *(percent of GDP)*	4.0	1.4	
Initial Banks' claims on the gen. govt *(pct bank assets)*	4.0	1.3	
Chg. In banks' claims in stress *(pct banks' assets)*	5.2	1.7	
GFN financeability index (GFI)		4.4	
Risk signal: 4/		Low	



Triggered stress tests (stress tests not activated in gray)

Banking crisis | Commodity prices | Exchange rate | Contingent liab. | Natural disaster

Medium-Term Index (Index Number)



Medium-term risk analysis

	Value	Value (normalized)	Weight	Contribution
Debt fanchart index	1.3	0.3	0.5	0.1
GFN finaceability index	4.4	0.1	0.5	0.0
Medium-term index		0.2		
Risk signal: 5/		Low		
Final assessment:		Low		

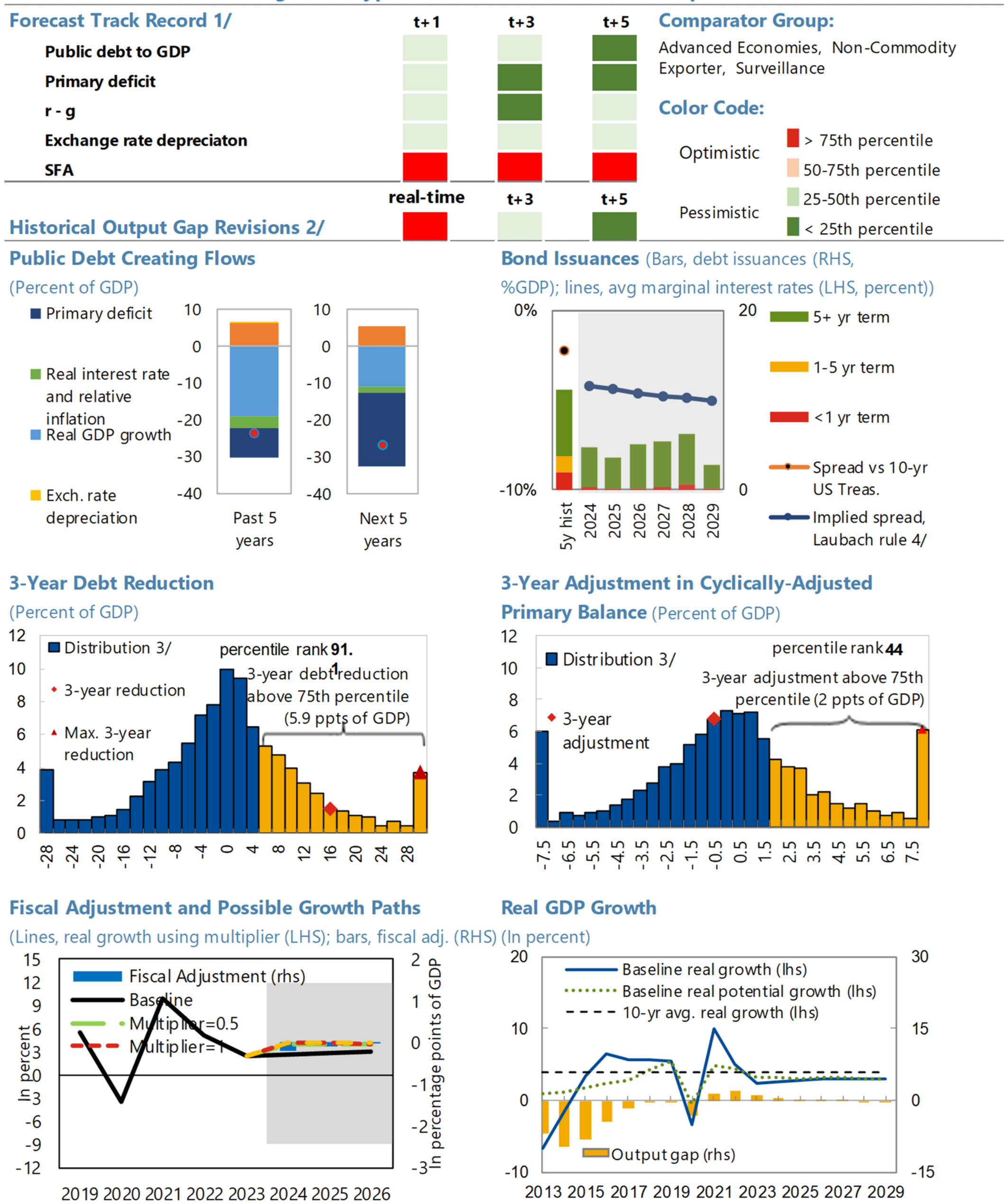
Prob. of missed crisis, 2024-2029, if stress not predicted: 9.1 pct.
Prob. of false alarms, 2024-2029, if stress predicted: 58.0 pct.

The debt fanchart module points to moderate risk due to a relatively wide fanchart as historical draws span crises years. Meanwhile, the GFN module signals low risk. The banking stress test, assuming a direct first round effect of 6.8 percent of GDP in line with standard calibration assumptions for advanced economics, appear managable with GFNs remaining below 15 percent of GDP and debt still on a declining path. Risks from banking stress are further mitigated by the role of the EU Single Resolution Mechanism. Accordingly, medium term risks are assessed to be low in line with the mechanical signal.

Source: IMF staff estimates and projections.

1/ See Annex IV of IMF, 2022, Staff Guidance Note on the Sovereign Risk and Debt Sustainability Framework for details on index calculation.
2/ The comparison group is advanced economies, non-commodity exporter, surveillance.
3/ The signal is low risk if the DFI is below 1.13; high risk if the DFI is above 2.08; and otherwise, it is moderate risk.
4/ The signal is low risk if the GFI is below 7.6; high risk if the DFI is above 17.9; and otherwise, it is moderate risk.
5/ The signal is low risk if the GFI is below 0.26; high risk if the DFI is above 0.40; and otherwise, it is moderate risk.

Figure 3. Cyprus: Realism of Baseline Assumptions



The realism tools give a balanced signal. Historically, projections have been broadly pessimistic, and debt has fallen much faster than expected. The anticipated change in debt over the next 5-years is comparable to the previous 5-years. The 3-year reduction is lower than the historical maximum 3-year reduction for Cyprus. And debt reduction is driven by an already high primary balance -which is reflected in the change in cyclically adjusted primary balance being well within the 75th percentile of the associated distribution- and the authorities' committment to sustain fiscal surpluses.

Source: IMF Staff.

1/ Projections made in the October and April WEO vintage.

2/ Calculated as the percentile rank of the country's output gap revisions (defined as the difference between real time/period ahead estimates

3/ Data cover annual obervations from 1990 to 2019 for MAC advanced and emerging economies. Percent of sample on vertical axis.

4/ The Laubach (2009) rule is a linear rule assuming bond spreads increase by about 4 bps in response to a 1 ppt increase in the projected debt-to-GDP ratio.

Table 4. Cyprus: Triggered Modules

Large amortizations	Pensions	Climate change: Adaptation	Natural Resources
	Health	Climate change: Mitigation	

Table 5. Cyprus: Long-Term Risk Assessment: Large Amortization

Projection	Variable	Risk Indication
Medium-term extrapolation	GFN-to-GDP ratio	
	Amortization-to-GDP ratio	
	Amortization	
Medium-term extrapolation with debt stabilizing primary balance	GFN-to-GDP ratio	
	Amortization-to-GDP ratio	
	Amortization	
Historical average assumptions	GFN-to-GDP ratio	
	Amortization-to-GDP ratio	
	Amortization	
Overall Risk Indication		

Box 1. Cyprus: Long-Term Risk and Government Guarantees Analyses

Long Term Risk Analysis

Long term fiscal pressures in Cyprus are moderate and can be fully absorbed by the currently available fiscal space, if preserved. Costs of ageing are expected to rise by 1.1, 2.9 and 4 percent of GDP annually by 2030, 2050 and 2070 respectively, according to the European Commission Ageing Report 2024. The main contribution comes from the gross increase in pension payments, which is expected to be partially offset by rising contributions. The increase in health and long-term care costs are small, given relatively modest changes in demography, and are expected to be offset by declining spending on education.

Long-term Cost of Ageing (Baseline)
(Percent of GDP)

	2022	2030	2050	2070	2022-30	2022-50	2022-70
Gross public pensions (1)	8.2	9.3	11	11.8	1.1	2.8	3.6
Public pension contributions	8.2	9	10	10			
Pension system balance 1/	0	-0.3	-1	-1.8	-1.1	-2.8	-3.6
Healthcare (2)	7.5	7.6	8.1	8.3	0.1	0.6	0.8
Long-term care (3)	0.2	0.2	0.3	0.3	0	0.1	0.1
Education (4)	5	4.9	4.4	4.5	-0.1	-0.6	-0.5
Total cost of ageing (1+2+3+4)	20.9	22	23.8	24.9	1.1	2.9	4

Sources: 2024 EU Ageing Report and IMF staff calculations.
1/ contributions minus gross expenditure

Climate-change related spending needs are highly uncertain. These mainly include investments in greening the power, transport, and residential sectors. The share of these spending needs to be covered by public finances adds another layer of uncertainty. For Cyprus, estimates of annual public spending needs required to achieve net zero by 2050 range from 0.6 to 2.2 percent of GDP annually.

Annual Required Climate Mitigation Expenditure by 2050
(Percent of GDP)

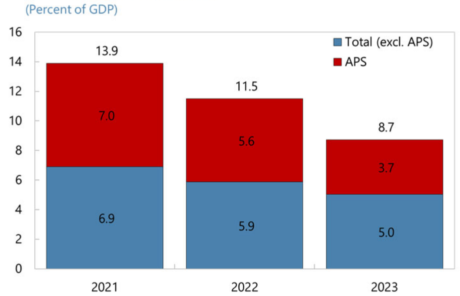
	Total investments	of which: Public investments	Public sector share
NECP estimate, of which:	8.8	0.6	7.3
Power generation	0.8	0.0	
Energy storage	0.0	0.0	
Sustainable mobility	0.5	0.2	
Private transport	4.3	0.0	
Residential/commercial sector	2.9	0.3	
Industry	0.3	0.0	
IMF staff estimate			
Upper bound		2.2	
Lower bound		1.0	

Sources: NECP authorities and IMF staff calculations.

Government Guarantees Analysis

Government guarantees in Cyprus stood at 8.7 percent of GDP at end-2023 and have been steadily declining from 13.9 percent at end-2021. These include an asset protection scheme (APS) under which the government guarantees obligations by KEDIPES to compensate Hellenic Bank (HB) for 90 percent of losses on a portfolio of acquired non-performing loans, in return for an annual fee paid by HB. The remaining guarantees mainly back loans by public entities and banks, which for the most part are being regularly serviced. Of total guaranteed loans, 92 percent were performing at end-2022.

Government Guarantees
(Percent of GDP)



Sources: Cyprus' Ministry of Finance and IMF staff calculations.

Outstanding Guarantees Composition, 12/31/2022

	Amount (M€)	Percent of total amount	Number of guarantees	Percent of GDP
Loans	1,499	46.9	2,961	5.4
Corporate	15	0.5	52	0.1
Public interest entities	737	23.1	69	2.7
Local authorities	208	6.5	98	0.7
Retail	120	3.7	2,693	0.4
Banks	420	13.1	49	1.5
EC-Sure	38	1.2	1	0.1
EFSF debt	57	1.8	1	0.2
Asset protection scheme	38	1.2	2	0.1
Other	1,561	48.9	1	5.6
Total	3,193		2,966	11.5

Sources: Cypriot authorities and IMF staff calculations.

Annex III. External Sector Assessment

Overall Assessment: The external position of Cyprus in 2023 is assessed substantially weaker than the level implied by fundamentals, while policies contributed positively. The larger estimated current account (CA) gap relative to last year is partly due to the import of physical assets of special purpose entities (SPEs) in the shipping sector and higher repatriation of income from foreign-owned financial companies. Supported by expected improvements in the terms of trade, the CA deficit is expected to decline, albeit slowly and remain at a high level, driven by the primary income balance. This will somewhat improve the external position over the medium term. The net international investment position (NIIP) is projected to worsen by around 20 percent of GDP over the projection period.

Potential Policy Responses: The large CA deficit is largely driven by foreign-owned firms transferring profits abroad, resulting in an increasingly negative primary income balance, and hence a symptom of Cyprus' growth model and recent strong economic performance. The tight fiscal stance supports the external balance. Private sector deleveraging, including through resolution of legacy NPLs, and higher private savings could provide additional support in the medium run. Structural reforms to raise productivity and enhance competitiveness—supported by the RRP—will be crucial to improve the business environment and the external position in the long term.

Foreign Assets and Liabilities: Position and Trajectory

Background. The NIIP improved before the pandemic from -163 percent of GDP in 2014 to -115 percent in 2019. It deteriorated to -133 percent in 2020 reflecting the widening of the CA deficit and GDP denominator effects. The NIIP recovered to -97 percent of GDP in 2023. Excluding the contribution of SPEs, the underlying NIIP improved from -78 percent of GDP in 2014 to -36 percent by 2023Q4. Gross liabilities declined to 1,790 percent of GDP in 2023, with around one third in the form of external debt. Under the IMF staff's baseline scenario, the NIIP is projected to deteriorate by about 20 percent of GDP in the medium term.

Assessment. While the deterioration in the NIIP during the pandemic has been reversed, the NIIP remains weak. However, the size of the NIIP reflects Cyprus' role as a financial center and the effects of SPEs and remains broadly sustainable when excluding SPEs.

2023 (% GDP)	NIIP: -96.6	Gross Ass.: 1577	Debt Ass.: 519	Gross Liab.: 1790	Debt Liab.: 587

Current Account

Background. The overall CA deficit (which averaged -4.9 percent during 2017-19) widened substantially in 2020, mainly due to lower services exports and a larger deficit in primary income. After recovering in 2021 (largely due to a higher services balance), the CA balance deteriorated substantially in 2022 and 2023 amid a significant deterioration in the net primary income balance and the trade balance (partly due to high energy prices in 2022 and exceptionally high net ship imports by SPEs in 2023).

Assessment. The EBA model estimates a CA norm of -1.3 percent of GDP, against an adjusted CA estimate of -7.8 percent of GDP, considering cyclical contributions (-0.2), temporary factors to account for the registration of a large vessel in 2023Q1 (-2.5 percent), and natural disasters (-1.6). Policy gaps—reflecting deviations between current and desired policy settings in Cyprus relative to the world—contribute 2.0 percentage points, mostly driven by a tighter fiscal stance than the rest of the world. Based on the CA model, IMF staff assesses the CA gap to be -6.4 percent of GDP for 2023, which implies that the external position was substantially weaker than the level warranted by fundamentals.

	CA model 1/	REER model 1/	ES model
		(in percent of GDP)	
CA-Actual	**-12.1**		
Cyclical contributions (from model) (-)	-0.2		
Additional temporary/statistical factors (-) 2/	-2.5		
Natural disasters and conflicts (-)	-1.6		
Adjusted CA	**-7.8**		
CA Norm (from model) 3/	**-1.3**		
CA Gap	**-6.4**	**1.6**	**2.1**
o/w Relative policy gap	2.0		
Elasticity	-0.6		
REER Gap (in percent)	**11.2**	**-2.8**	**-3.3**

1/ Based on the EBA-lite 3.0 methodology

2/ The additional adjustment accounts for the temporary impact of a spike in the imports of mobile transport equipment (i.e. vessels) in 2023Q1.

3/ Cyclically adjusted, including multilateral consistency adjustments.

Real Exchange Rate

Background. The CPI-based REER remained broadly stable in 2020 and 2021. It depreciated by 1.3 percent in 2022—on the back of lower inflation differentials and euro depreciation against the USD—and gained again in 2023 (+0.7 percent).

Assessment. The REER gap derived from the IMF staff's CA gap assessment, with an estimated elasticity of -0.6, suggests a REER overvaluation of 11.2 percent in 2023. The REER and ES models suggest a small REER gap of -2.8 and -3.3 percent, respectively. Considering all model estimates and the uncertainties around them—and putting a higher weight on the CA model than the REER and ES models as it better reflects the recent weakening of the external balance—staff's assessment is of a slight overvaluation (in line with the CA model).

Capital and Financial Accounts: Flows and Policy Measures

Background. Mirroring the increasing CA deficit, net capital inflows increased in 2022 and 2023, amounting to 7.2 percent of GDP and 9.7 percent of GDP, respectively. Higher FDI net flows more than made up for lower net portfolio flows. The increase in net private inflows was only partially offset by a decline in public inflows.

Assessment. With sizable external debt of the public and private sectors, Cyprus remains exposed to financial market risks. Tightening financial conditions could increase vulnerability.

FX Intervention and Reserves Level

Background. The euro has the status of a global reserve currency.

Assessment. Reserves held by the euro area are typically low relative to standard metrics, but the currency is free floating.

Annex IV. Risk-Assessment Matrix[1]

Risks	Likelihood	Expected Impact	Policy Responses
Conjunctural risks			
Intensification of regional conflicts. Escalation or spread of the conflict in Gaza and Israel, Russia's war in Ukraine, and/or other regional conflicts or terrorism disrupt trade (e.g., energy, food, tourism, supply chains), remittances, FDI and financial flows, payment systems, and increase refugee flows.	**High**	**High** Slowdown in economic activity. Negative spillovers to banks' balance sheet and profitability. Dislocation of resources and labor across sectors.	Encourage market diversification, solidify new growth opportunities from higher value-added sectors, and a transition to a more digital and green economy. Proactively monitor developments in at-risk sectors. Allow automatic stabilizers to work and, if needed, prepare targeted and temporary additional support measures.
Commodity price volatility. A succession of supply disruptions (e.g., due to conflicts, export restrictions, and OPEC+ decisions) and demand fluctuations causes recurrent commodity price volatility, external and fiscal pressures in EMDEs, cross-border spillovers, and social and economic instability.	**High**	**High** Given high oil intensity and import dependency, higher oil prices would worsen the current account and lower disposable income and investment.	Allow automatic stabilizers to work. Let commodity prices pass-through, but provide resources for temporary and targeted measures to shield the most vulnerable. Closely monitor inflation.
Monetary policy miscalibration. Amid high economic uncertainty, major central banks loosen policy stance prematurely, hindering disinflation, or keep it tight for longer than warranted, causing abrupt adjustments in financial markets, and weakening the credibility of central banks.	**Medium**	**Medium** Disinflation is progressing faster in Cyprus than the EA and too tight monetary policy for too long could harm activity and result in significant undershooting of inflation.	If needed, temporarily use fiscal policy to support domestic demand, but announce credible medium-term fiscal plans. Closely monitor the financial system to promptly address any signs of distress. Support vulnerable households.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path. The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. The conjunctural shocks and scenarios highlight risks that may materialize over a shorter horizon (between 12 to 18 months) given the current baseline. Structural risks are those that are likely to remain salient over a longer horizon.

Risks	Likelihood	Expected Impact	Policy Responses
Abrupt global slowdown. Global and idiosyncratic risk factors cause a synchronized sharp growth downturn, with recessions in some countries, adverse spillovers through trade and financial channels, and market fragmentation triggering sudden stops in EMDEs. • **Europe:** Intensifying fallout from Russia's war in Ukraine, supply disruptions, tight financial conditions, and real estate market corrections exacerbate economic downturn.	**Medium** **Medium**	**Medium** High exposure to the European business cycle through tourism flows. Lower tourism arrivals and/or revenues has negative impact on domestic activity. Generally weaker external demand can further depress growth momentum and reduce investment inflows.	Stick to prudent budgetary policies. Provide targeted support to the vulnerable. Advance structural reforms to maximize efficiency and competitiveness. Expand active labor market policies to facilitate labor reallocation to expanding sectors. Nurture new segments to support economic growth.
Structural Risks			
Deepening geoeconomic fragmentation. Broader conflicts, inward-oriented policies, and weakened international cooperation result in a less efficient configuration of trade and FDI, supply disruptions, protectionism, policy uncertainty, technological and payments systems fragmentation, rising shipping and input costs, financial instability, a fracturing of international monetary system, and lower growth.	**High**	**Medium** Disruptions through trade and financial flows. More binding domestic and external financing constraints. Higher energy insecurity.	Improve competitiveness via structural reforms. Invest in new infrastructure, technology, and labor skills. Rebuild fiscal and financial buffers. Stay the course with RRP reform objectives.
Extreme climate events. Extreme climate events cause more severe than expected damage to infrastructure (especially in smaller vulnerable economies) and loss of human lives and livelihoods, amplifying supply chain disruptions and inflationary pressures, causing water and food shortages, and reducing growth.	**Medium**	**Medium** Imperil the tourism sector. Lower potential growth. Rising reconstruction costs. induce hefty costs and financial losses.	Push forward with economic diversification. Accelerate the transition to climate neutral policies. Invest into adaptation to enhance resilience and mobilize private and public resources.

Risks	Likelihood	Expected Impact	Policy Responses
Domestic Risks			
Slow NPLs resolution. Progress in reducing legacy NPLs (largely offloaded to Credit Acquiring Companies) stalls.	High	**Medium** High private sector indebtedness heightens macro-financial risks amid higher interest rates.	Enforce the foreclosure framework and avoid undermining credit discipline. Avoid further changes of the foreclosure framework. Proactively recognize and manage credit risk, monitor asset quality and payment ability, and make provisions against potential loan losses.
Sustained fiscal pressures. Public employees demand higher salaries to compensate for a temporary loss in real incomes and full indexation. Ongoing NHS reform leads to higher expenses.	Medium	**Medium** Slower debt reduction path and lower fiscal space available for productive investments.	Resist pressures to relax control over the public wage bill. Push forward with NHS full reform implementation. Implement strategies to ringfence the financial viability and discipline of public healthcare providers.

Annex V. Sectoral Drivers of the Current Account in Cyprus

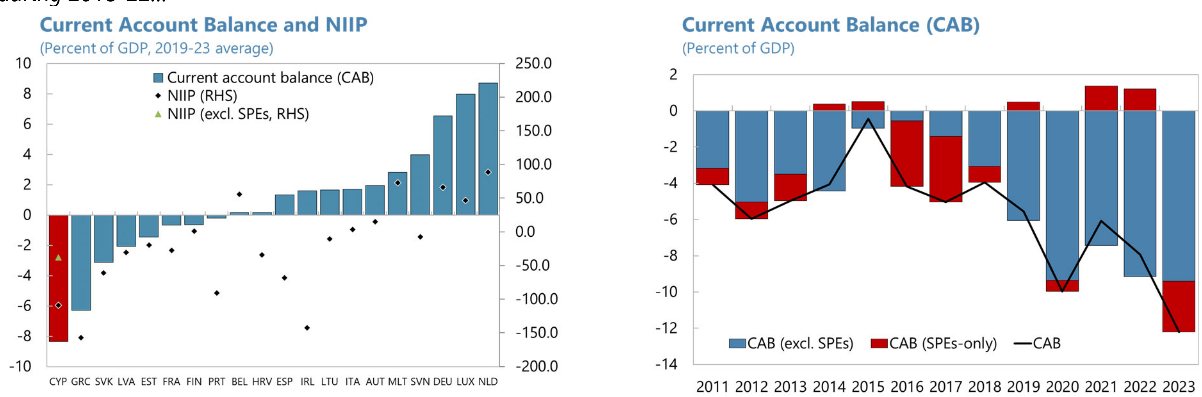
Cyprus has a sizable current account (CA) deficit that is among the largest in the EU. Despite significant fiscal consolidation since the 2013 financial crisis, the CA deficit increased further. Chronic saving-investment (S-I) deficits of households and non-financial corporations (NFCs), along with declining surpluses of financial corporations (FCs), have been the key drivers. Complementing fiscal discipline and the ongoing private sector deleveraging by addressing the structural factors behind Cyprus' S-I deficits would help reduce the CA deficit.

1. Cyprus' already sizable CA deficit has grown in recent years. Cyprus recorded the largest CA deficit among EU countries on average between 2019 and 2023. The deficit has increased from 0.3 percent of GDP in 2015 to 7.9 percent in 2022 and further to 12.1 percent in 2023, despite a record tourism season and a sizable fiscal surplus. Cyprus is host to numerous special purpose entities (SPEs) mainly in the financial and shipping sectors whose operations distort macroeconomic and external sector statistics. In particular, shipping SPEs weigh on both the current account and NIIP through the importation of physical assets, financed by foreign liabilities, and the repatriation of income.

Figure 1. Cyprus: Current Account

Cyprus had the largest CA deficit in the EU on average during 2018-22…

…and the deficit has grown in recent years



Sources: Central Bank of Cyprus, Eurostat and IMF staff calculations.

Source: Central Bank of Cyprus.

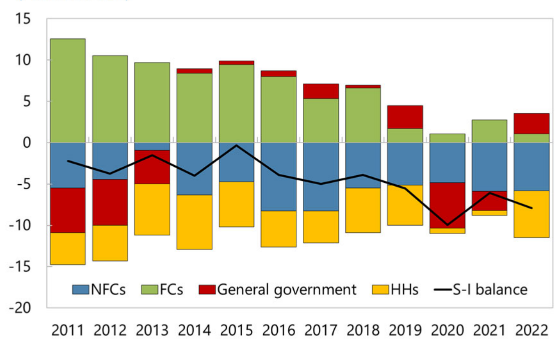
2. An assessment of savings and investment sheds light on the sectoral drivers of the CA balance. The S-I approach focuses on the accounting identity whereby the CA balance equals the difference between aggregate savings and gross fixed capital formation (GFCF) from a national accounts perspective. Savings are the difference between gross domestic income (GDI) and final consumption. GDI is the sum of various sources of income net of costs including property income payments, taxes, social contributions, and other current transfers. GFCF denotes acquisition of tangible and intangible fixed assets used in production. Each of these variables can in turn be allocated across households, NFCs, FCs, and the government. For sectors which are not final consumers, like NFCs and FCs, savings equal to gross disposable income.

Table 1. Cyprus: Household and Corporation Income and Savings

Households	Corporations
(a) Compensation of employees (+)	(a) Gross value added
(b) Gross operating surplus and mixed income (+)	(b) Compensation of employees (-)
(c) Property income, net (+/-)	(c) Property income, net (+/-)
Interest, net (+/-)	Interest, net (+/-)
Distributed income of corporations (+/-)	Distributed income of corporations (+/-)
Rent (+/-)	Reinvested earnings on direct foreign investment (+/-)
Other (+/-)	Rent (+/-)
(d) Taxes, social contributions and other transfers, net (-)	Other (+/-)
Taxes on production and imports, net of subsidies (-)	(d) Taxes, social contributions and other transfers, net (-)
Taxes on income and wealth (-)	Taxes on production and imports, net of subsidies (-)
Social contributions and benefits, net (-)	Taxes on income and wealth (-)
Other current transfers, net	Social contributions and benefits, net (-)
= Gross domestic income (a+b+c+d)	Other current transfers, net
- Final consumption expenditure	**= Gross domestic income (a+b+c+d)**
= Savings	**=Savings**

Source: ESA 2010.

3. The private sector is driving the CA deficit. A sectoral decomposition of the S-I gap shows that households and NFCs have been the main contributors to the aggregate deficit. These have historically been partially offset by large FCs surpluses. However, in recent years, FCs surpluses have dwindled, which more than offset improvements in the government's S-I balance and led to a deterioration in the CA.



Savings-Investment Balance
(Percent of GDP)
Sources: Eurostat, Haver Analytics, and IMF staff calculations.

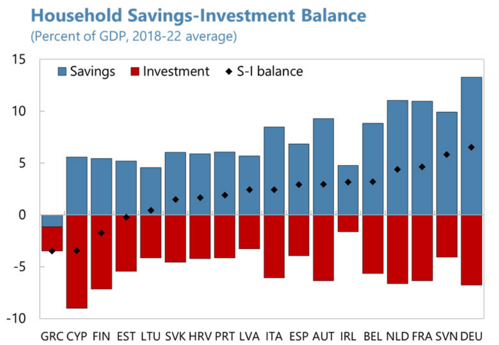
4. Low savings channeled into physical assets underpin the households S-I gap. Households in Cyprus have the second largest S-I deficit in the EU. The gap is in part a result of low savings, a common phenomenon in a number of southern European countries, though not exclusive to them. Several factors contribute to low saving rates, including the level, trends and distribution of per capita income and consumption, as well as demographic and other factors.[1] In addition, the household investment rate is the highest in the EU, which contrasts with household accumulation of financial assets being the lowest in the EU. Household investments in the EU are closely correlated with investments in dwellings, for which Cyprus leads its peers despite Cyprus already having the lowest housing overcrowding rate in the EU and the second highest share of underoccupied dwellings. This suggests that Cypriot

[1] Dybczak, K., et al. 2023. "Household Savings in Selected Southern European Countries." IMF Working Paper No. 23/150, International Monetary Fund, Washington DC.

households may prefer holding physical assets, such as real estate, as a store of value over accumulating financial assets; something that could in part be attributed to distrust in the financial sector in the wake of the crises, shallow financial markets, and the potential for generating rental income during the tourism season.

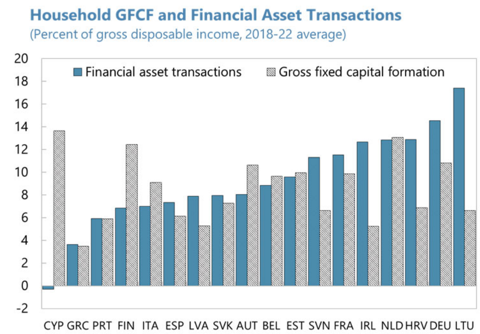
Figure 2. Cyprus: Household Savings and Investment

Deficit due to low savings and high investments.



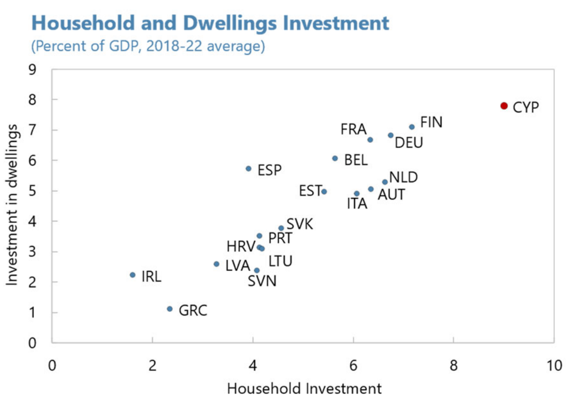
Sources: Eurostat, Haver Analytics, and IMF staff calculations.

Cypriot households prefer physical to financial investments.



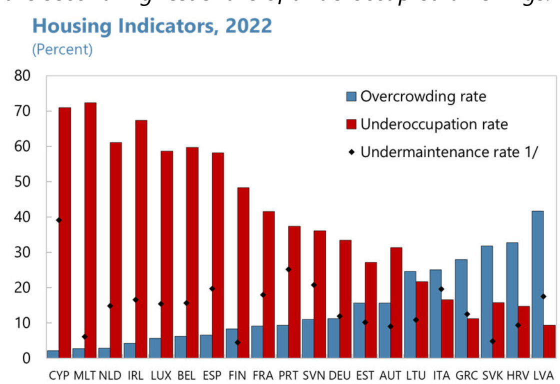
Sources: ECB, Eurostat, Haver Analytics, and IMF staff calculations.

Households investments are closely correlated with investments in dwellings in Europe.



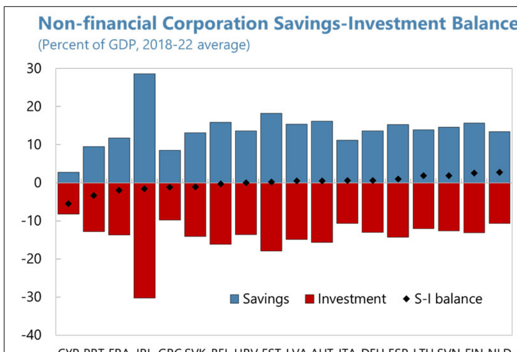
Sources: Eurostat, Haver Analytics, and IMF staff calculations.

Cyprus has the lowest housing overcrowding rate and the second highest share of underoccupied dwellings.



Source: Eurostat.
1/ as of 2020

5. Low NFCs profitability contributes to a deep S-I deficit, even with a very low investment rate. The NFCs S-I deficit has been the largest drag on the CA balance in recent years. NFCs saving (GDI) is significantly lower than in other EU countries. This in part due to a relatively small NFCs sector in Cyprus, measured in terms of GVA per capital or as a share of economy-wide GVA (Panel 1, Chart 6). Also, Cypriot firms are among the least profitable in the EU, measured in terms of GDI-to-GVA ratio

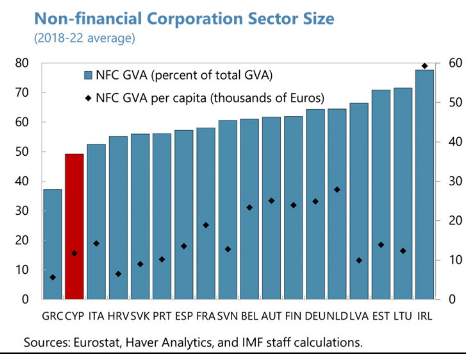


Sources: Eurostat, Haver Analytics, and IMF staff calculations.

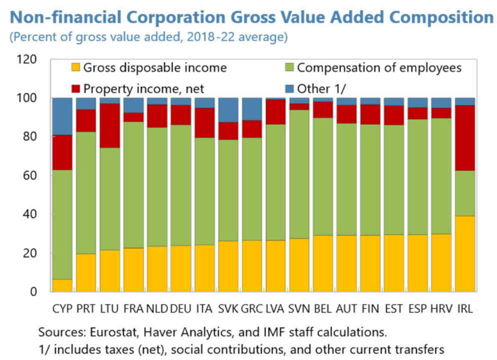
(Panel 1, Chart 7). A decomposition of GVA in Cyprus attributes the low profitability to a bigger share directed to the payment of taxes (highest in EU) and property income payments (third highest). Low profitability leaves little resources to invest, with the investment rate also being the lowest in the EU. Even with such a low investment rate, the sector's S-I balance is the lowest in the EU.

Figure 3. Cyprus: Non-financial Corporation Savings and Investment

NFCs are a relatively small share of output…



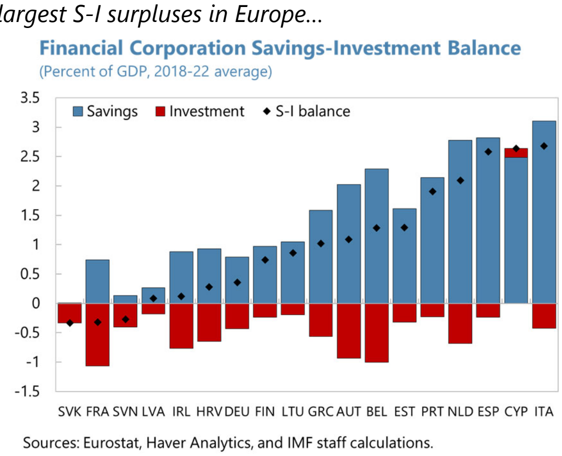
…with the lowest GDI to GVA ratio in Europe



6. **FCs surpluses have supported the CA but have declined recently.** As a financial hub, the financial sector plays a substantial role in the Cypriot economy. The sector has for long generated surpluses that partially offset other sectors' deficits. However, the surpluses have been declining since the GFC, in line with the operating income of FCs relative to GDP. (Panel 1, Chart 8). This reflects (i) a decline in surpluses in absolute terms, as financial sector profitability suffered in the wake of the GFC, and (ii) a decline relative to GDP as the sector deleveraged and Cyprus diversified its economy. Additionally, since 2018, surpluses have been pressured by declining net property income and a rising taxation burden, as is the case for NFCs (Panel 1, Chart 9). Going forward, continued financial sector deleveraging and the severing of financial ties with Russia could weigh further on FCs surplus and the CA.

Figure 4. Cyprus: Financial Corporations Savings and Investment

As a financial center, FCs in Cyprus had one of the largest S-I surpluses in Europe…



…but the surpluses have been declining…

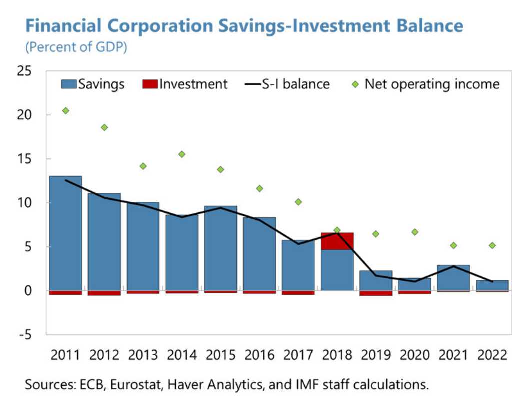
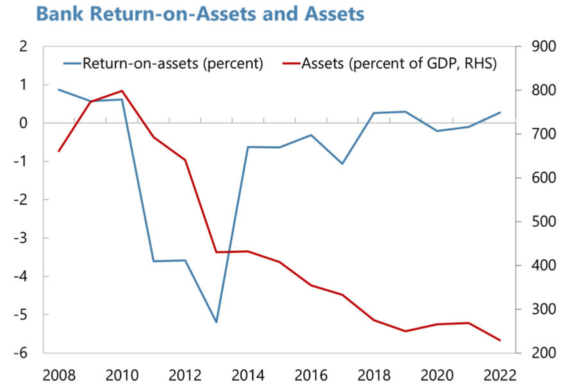


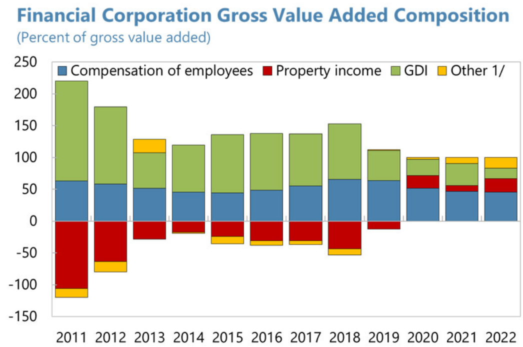
Figure 4. Cyprus: Financial Corporations Savings and Investment (concluded)

… due to weak profitability and deleveraging…



Sources: Cystat, ECB, Haver Analytics, and IMF staff calculations.

…as well as rising property income payments and taxes.

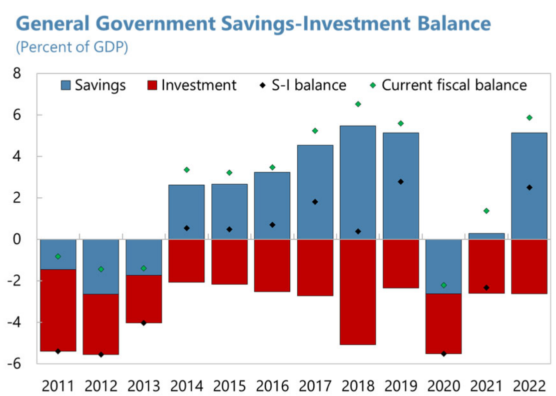


Sources: Eurostat, Haver Analytics, and IMF staff calculations.
1/ includes taxes (net), social contributions, and other current transfers

7. **An improved fiscal stance has supported the government S-I balance.** The government balance turned into a surplus since 2014, thanks to fiscal consolidation and contained investment expenditure. And in recent years, the general government S-I position has been among the highest in Europe. However, the improvement coincided with a deterioration in private S-I balance which more than offset the improvement in the government's balance. Which raises questions on whether fiscal consolidation, driven by higher tax revenue, may have weighed on private sector balances by raising their tax burden and hence reducing their disposable income and savings.

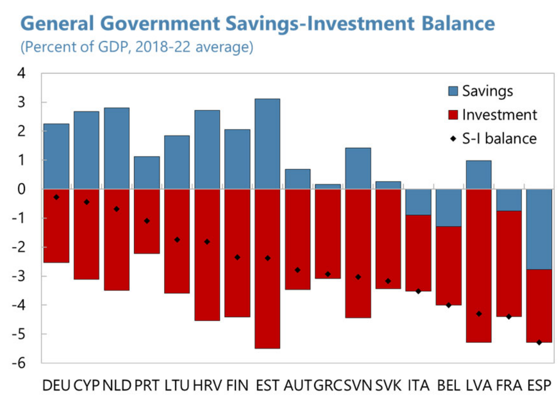
Figure 5. Cyprus: General Government Savings and Investment

Government's S-I balance turned into a surplus in 2014 owing to fiscal consolidation and contained investments…



Sources: Eurostat, Haver Analytics, and IMF staff calculations.

…and is currently among the highest in Europe.



Sources: Eurostat, Haver Analytics, and IMF staff calculations.

8. **Structural and financial reforms are key to remedy the CA deficit.** Enhancing the business environment, competitiveness and promoting innovation and productivity would raise private sector disposable incomes and, hence, saving rates. Alongside, targeted policy

interventions aimed at repairing the balance sheets of vulnerable borrowers and SMEs would further support households and NFCs saving rates. Boosting confidence in the financial sector would facilitate a more efficient utilization of households' savings and, together with effective implementation of the foreclosure framework, support FCs income. The RRP offers an opportunity to boost government investments in a S-I neutral manner and should be fully utilized. Meanwhile, maintaining fiscal discipline and avoiding major expenditure expansions is critical to avoid further exacerbating the saving-investments gap.

Annex VI. Green Taxation: Along the Path to Climate Mitigation in Cyprus

Cyprus has set ambitious climate targets, but achieving these will be challenging. Carbon taxation is a crucial tool to meet these objectives, especially given Cyprus' low existing carbon prices relative to European peers. The green taxation reform is a positive step, with manageable economic and distributional impacts. In its current form, it is expected to close about one-third of Cyprus' emissions gap, but still leaves carbon prices low in several sectors. A uniform carbon tax, across more sectors—combined with targeted sectoral policies and measures to mitigate distributional impacts—would go further in achieving Cyprus' targets.

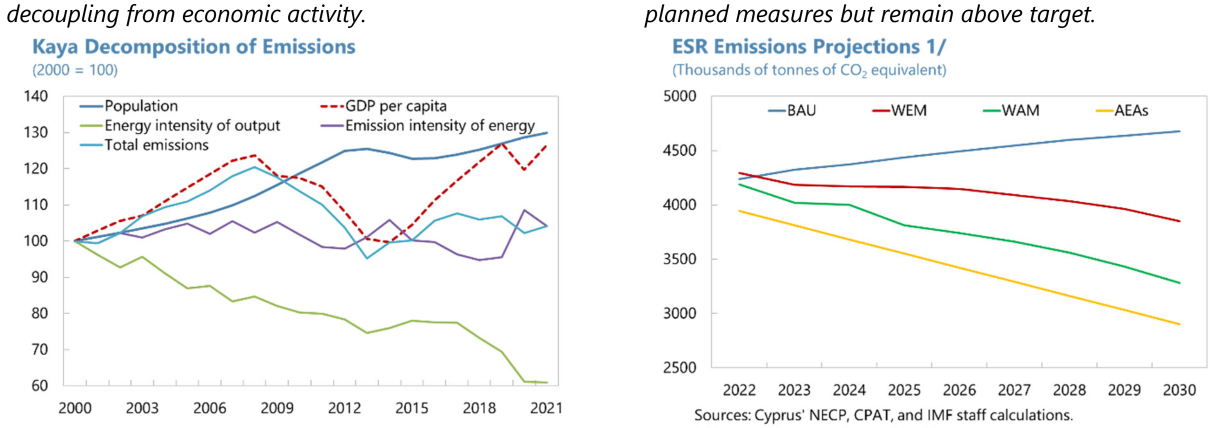
1. **Cyprus has committed itself to ambitious climate targets in alignment with the EU.** Cyprus prepared a long-term, low-GHG-emission development strategy aiming to achieve climate neutrality by 2050. And raised its emission reduction target for non-ETS sectors in the NECP to 32 percent by 2030 compared to 2005. The Cyprus RRP includes a significant climate component, of which the planned green taxation reform is a key policy initiative.

2. **Climate mitigation has progressed, but more is needed to achieve its targets.** The steady rise in emissions was halted and a decoupling of emissions from growth is underway. However, Cyprus still relies on oil and petroleum products for 90 percent of its energy and emissions have exceeded annual allocations in recent years. Current and planned policies, including completion of several important energy infrastructure projects would lower emissions. However, emissions would remain 13 percent above target by 2030 with little projected decline in emissions in non-ETS sectors other than transport. Meeting the target requires timely implementation of planned measures as well as coming up with additional ones.

Figure 1. Cyprus: Emissions Profile

A steady rise emissions began to reverse amid a decoupling from economic activity.

Emissions are projected to decline with current and planned measures but remain above target.



Sources: Eurostat, WEO, and IMF staff calculations.

Sources: Cyprus' NECP, CPAT, and IMF staff calculations.
1/ 13% gap between AEAs and WAM

3. **Raising relatively low carbon prices through carbon taxation is key for climate mitigation.** Carbon taxation is the most economically efficient approach to mitigation as it incentivizes lower and more efficient energy consumption, while promoting innovation and

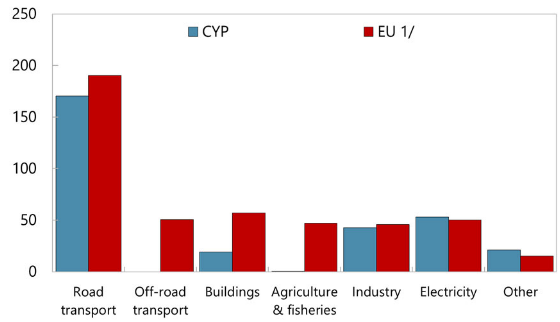
adoption of low-carbon technologies. In Cyprus, carbon prices are relatively low in non-ETS sectors compared to the rest of Europe, a reflection of relatively low fuel taxation rates. The green tax reform includes, among other elements, the introduction of a carbon tax for fuels used in non-ETS sectors.

Figure 2. Cyprus: Carbon Prices and Emissions in Non-ETS Sectors

Carbon prices are low in some non-ETS sectors.

Sectoral Effective Carbon Rate, 2021

(Euros per tonne of CO_2 equivalent)

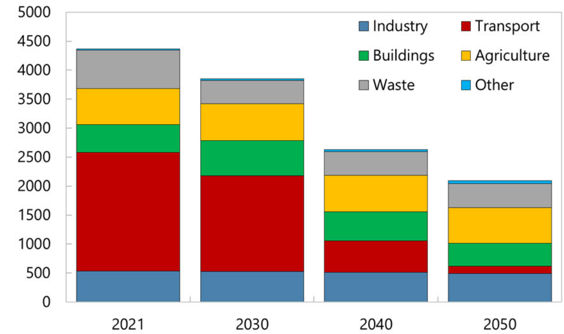


Source: OECD.
1/ excludes BGR, HRV, MLT, and ROU

Emissions from non-ETS sectors other than transport are not expected to see much decline.

WEM Scenario: Sectoral Emissions Projections

(Thousands of tonnes of CO_2 equivalent)



Sources: EEA and IMF staff calculations.

4. **Carbon taxation is an important reform, with manageable economic and distributional impacts.** Current plans take the form of a fuel excise duty top-up in the transport and non-ETS industry sectors with differentiated rates and schedules. Using the IMF-WB CPAT tool to assess its impact, the tax is expected to reduce emissions by an additional 3.8 percent by 2030, thus closing about a third of the current gap to target. The tax is expected to generate an additional 0.4 percent of GDP, net of base erosion effects. Negative impacts on growth are expected to be limited and transitory. Household consumption would decline by 0.4 percent proportionally across income groups. A quarter (third) of the revenues would be sufficient to fully offset the impact on the four (five) lowest income deciles if channeled via well-targeted social transfers and PIT tax allowances or exemptions.

Table 1. Cyprus: Green Taxation Reform Proposed Carbon Tax Rates

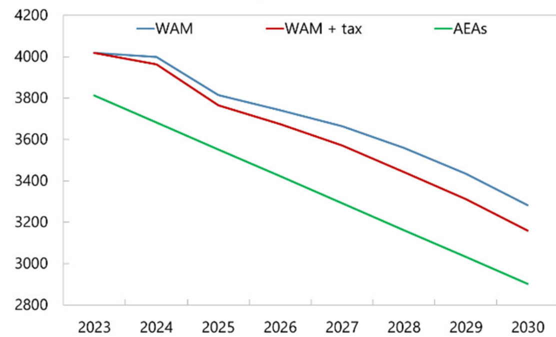
	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
Motor fuels										
€/liter	0.05	0.07	0.10	0.14	0.19	0.21	0.22	0.23	0.24	0.25
€/tonCO_2eq.	20.1	28.1	40.2	56.3	76.3	84.4	88.4	92.4	96.4	100.5
Non-ETS industry										
€/liter	0.07	0.11	0.14	0.17	0.19	0.20	...	...	...	...
€/tonCO_2eq.	26.7	42.0	53.4	64.9	72.5	76.3	...	...	...	...

Sources: Cypriot authorities and IMF staff calculations.

Figure 3. Cyprus: Green Tax Plan Impact Assessment

The tax is expected to close a third to target.

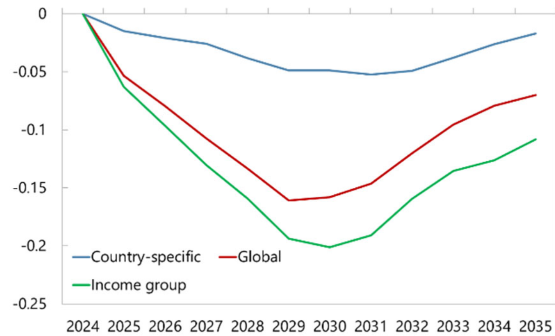
Impact on Emissions
(Thousands of tonnes of CO_2 equivalent)



Sources: CPAT and IMF staff calculations.

Transitory aggregate demand impact ranges from 0.1–0.2 percentage points.

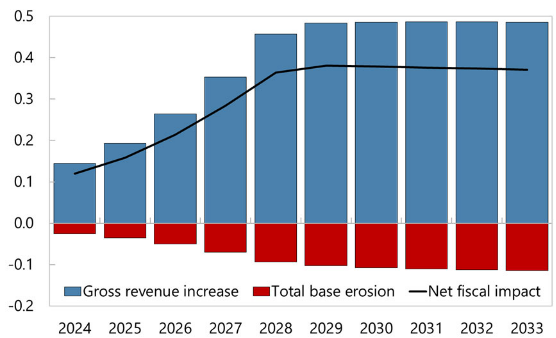
Growth Impact Under Different Fiscal Multiplier Assumptions
(Percent difference relative to baseline)



Sources: CPAT and IMF staff calculations.

The tax will generate more revenues and faster base erosion.

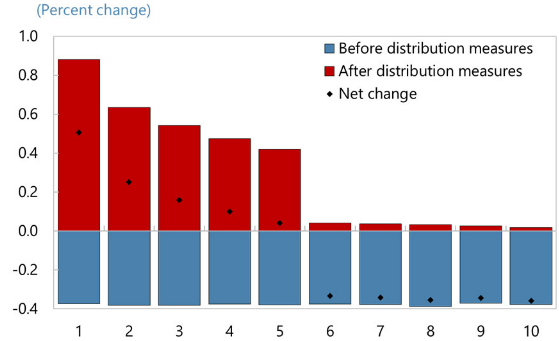
Fiscal Impact
(Percent of GDP)



Sources: CPAT and IMF staff calculations.

Consumption impact is expected to be proportional, to be offset with redistribution measures to lower income deciles.

Consumption Change by Income Decile 1/
(Percent change)



Sources: CPAT and IMF staff calculations.
1/ includes redistribution

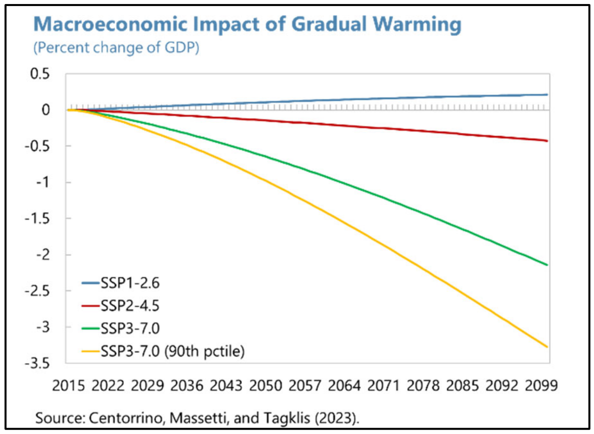
5. **A more uniform carbon tax with a wider scope would go further in achieving emission targets.** The current plan only goes so far in reducing projected emissions and still leaves carbon prices low in most non-ETS sectors. A uniform carbon tax across more sectors would have several advantages over the current proposal, including raising the currently low carbon prices in the rest of the non-ETS sectors, enhancing abatement efficiency while minimizing economic costs, and ensuring a smoother transition to ETS II. Applying the carbon taxation rates currently envisaged for the transport sector more widely and uniformly to all non-ETS sectors would have 1.5 times the emission reduction impact relative to the current plan, closing half of the gap to the 2030 target. The impact on household consumption would be higher and slightly more regressive, while fiscal revenues are comparable to the current plan, implying that a larger share of the revenues, third (half), would need to be channeled to the bottom four (five) income distribution deciles for protection purposes.

6. Targeted sectoral policies could have a complementary role, despite being less efficient than carbon pricing. Fully closing the emissions gap through carbon pricing *alone* requires tax rates that are 2.5 times those currently planned, which would be more economically and socially challenging. Targeted sectoral policies such as feebates or regulations are often less efficient than carbon taxation due to the absence of a clear price signal which depresses abatement effectiveness and the lack of additional fiscal revenue to address distributional impacts. Nevertheless, there could be scope for these policies to complement carbon pricing in a multi-pronged strategy to achieve Cyprus' mitigation targets.

Annex VII. Addressing Climate Change in Cyprus: Policy Options and Strategies

1. **Warming, drought, heavy-rainfall events, and sea-level rise already affect Cyprus and will likely intensify in the future.** The warming trend observed from the 1950s is expected to continue at least until mid-century even with strong mitigation efforts globally. With temperatures steadily rising (Figure 1), summers have become increasingly intense, characterized by prolonged periods of extreme heat and more frequent heatwaves. This uptick in extreme heat poses significant challenges for agriculture, public health, and infrastructure. It is certain that sea level rise will persist (Figure 3), posing a significant threat to key infrastructure along the coast.

2. **Hotter temperatures are expected to significantly reduce GDP.** A range of models suggest that a gradually warming climate could reduce real per capita GDP by 3 to 5 percent by 2100 (SIP III). This warming scenario accounts for larger-than-expected warming rates, but the impact from changes in extreme weather and sea-level rise are not included. Climatological disasters are not currently thought to pose large risks and are not projected to increase substantially, but large uncertainties remain.

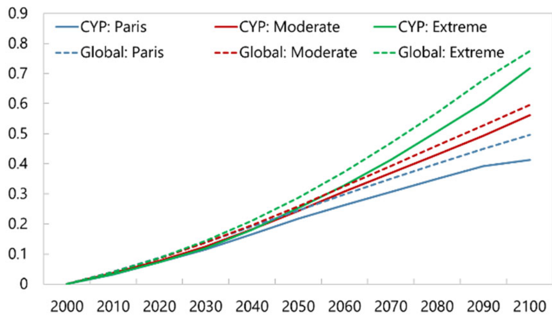


3. **This will be compounded by the economic cost of sea-level rise (SLR).** IMF staff estimates and other studies indicate that SLR can cause damages up to ½ percent of GDP annually after 2050, assuming a moderate emission scenario, with large uncertainties. The EU-funded project, PESETA IV, estimates higher costs due to larger storm surge projections. In a more extreme projection, economic costs of up to 5 percent of GDP in 2100 are estimated, a very large potential loss. These differences reflect large uncertainties in estimating SLR impacts.

4. **Adaptation can greatly contain SLR losses at modest cost, but the optimal mix of protection and planned retreat remains uncertain and deserves more granular analysis.** An adaptation strategy that combines protection and planned retreat from areas at risk of inundation would cut the overall cost of sea-level rise (including adaptation costs) by 75 percent to approximately 0.1 percent of annual GDP by mid-century. The cost of other adaptations can be contained by focusing on cost-effective measures. Cost-benefit-analysis can be challenging, but even preliminary and incomplete assessments are useful to identify trade-offs and the most attractive policy options using a transparent and systematic approach.

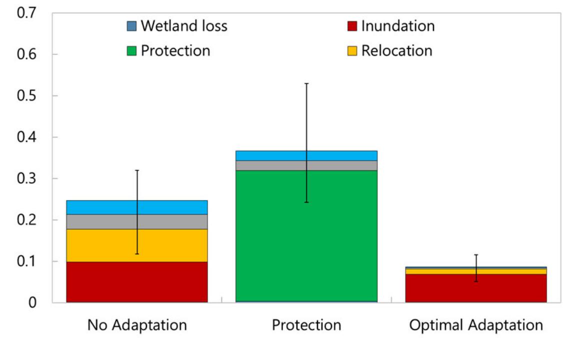
Figure 1. Cyprus: Projections and Costs of Sea Level Rise

Change in Sea Level Scenarios 1/
(Meters)



Sources: Diaz (2016), Kopp et al. (2014), and IMF staff calculations.
1/ since 2000

Cost of Sea Level Rise, 2020-2099
(Percent of GDP)



Sources: Diaz (2016), Kopp et al. (2014), and IMF staff calculations.

Note: Using a state-of-the-art model of sea-level rise costs and adaptation, IMF staff estimates the cost of local sea-level in Cyprus corresponding to the RCP 4.5 scenario in Kopp et al (2014) assuming three policy scenarios: (i) no planned adaptation – society reacts to sea-level rise by relocating, no protection is built and capital losses are large; (ii) Protection – society plans construction of cost-effective protection against sea-level rise by anticipating its effects without relocating people or assets; and (iii) Optimal Adaptation – society plans a mix of protection and retreat anticipating sea-level-rise, by comparing costs and benefits of each option and choosing the strategy with the largest net present value. Cumulative undiscounted costs divided by cumulative undiscounted GDP. Whiskers on top of each bar indicate the range of total cost using the 5th and 95th percentile of the probabilistic distribution of sea-level rise. Due to the highly non-linear nature of coastal impacts, adaptation costs, and effectiveness of adaptation measures, ranges are not always symmetric around total costs.

5. **To be effective and efficient, adaptation to climate change must be an integral part of development planning.** With many competing needs, the government must carefully allocate resources across all possible uses, including adaptation to climate change, while considering the distributional effects of its programs. This requires: (i) concentrating government efforts and resources in key areas; and (ii) collecting information on the effectiveness of spending across alternative programs and on how spending affects distinct groups in society. The government can prioritize adaptation policies with positive externalities, by removing market imperfections and policies that hinder efficient private adaptation, and by ensuring a just transition.

Annex VIII. Status of Article IV Recommendations

Past Policy Recommendation	Policy Actions
Fiscal Policies	
Implement a moderately contractionary fiscal stance in 2023	**Implemented**. The structural primary balance increased by an estimated 0.5 percent of GDP in 2023.
Avoid upward revisions to CoLA	**Not Implemented**. CoLA indexation was raised from 50 percent to 67 percent.
Respond to new shocks through automatic stabilizers and temporary, targeted, and non-price distorting measures	**Partially Implemented**. Generalized fuel and electricity subsidies were extended, but partially phased out in March 2024. A zero VAT rate for selected items was introduced.
Ensure timely disbursements of RRP funds	**Partially Implemented**. No payments were made in 2023, partly due to delayed completion of milestones. The authorities submitted the 2nd and 3rd payment requests in December 2023.
Strengthen government capacity to oversee SOEs and ensure the autonomy of their boards	**Partially Implemented**. The authorities requested IMF TA on SOE governance and are working to implement the recommendations.
Financial Sector Policies	
Ensure effective implementation of the foreclosure framework	**Partially Implemented**. A proposal to suspend foreclosures was voted down in Parliament but the amended framework has only recently become operational, and its effectiveness is still to be assessed.
Publicly disclose aggregate CACs statistics	**Partially Implemented**. Data is shared with the Central Bank of Cyprus and Ministry of Finance and is incorporated into debt statistics. But more detailed data on aggregate CAC statistics is not separately published.
Introduce a transparent price setting procedure for repurchases under the MtR Scheme	**Implemented**. The MtR scheme launched in December 2023 including defined procedures for repurchases
Advance out-of-court NPL restructuring procedures	**Implemented**. An out of court procedure was established, overseen by the Financial Ombudsman
Raise the neutral CCyB	**Implemented**. The authorities increased the neutral CCyB to 1 percent effective June 2024
Strengthen oversight of NBFIs	**Implemented**. CySEC has implemented ESMA recommendations and is working on enhancing

Past Policy Recommendation	Policy Actions
	capacity and resources to strengthen supervision.
Continue to address AML/CFT and sanctions compliance frameworks	**Partially Implemented**. Latest MONEYVAL follow-up report highlights progress in the AML/CFT legal framework and work is ongoing to setup a national sanctions enforcement unit but more efforts are needed.
Structural Policies	
Strengthen rule of law, combat corruption and reduce backlog of court cases	**Partially Implemented**. More judges were hired in 2023. Top-tier courts were restructured, and a Court of Appeal was established. However, the backlog of court cases remains large and physical and technological infrastructure require upgrading.
Increase labor supply and reduce skill mismatches	**Partially Implemented**. A strategy to attract and domicile foreign talent is being implemented and efforts to further streamline immigration are ongoing but weak activation requirements and STEM graduates remain challenges.
Enhance energy connectivity and liberalize electricity market	**Not Implemented**. The Euroconnector and LNG terminal projects were delayed by contractual issues. No progress has been made on electricity market liberalization.
Introduce a carbon tax	**Not Implemented**. Carbon tax plans were pushed to 2024.

Annex IX. Data Issues

Table 1. Cyprus: Data Adequacy Assessment for Surveillance

Data Adequacy Assessment Rating 1/							
A							
Questionnaire Results 2/							
Assessment	National Accounts	Prices	Government Finance Statistics	External Sector Statistics	Monetary and Financial Statistics	Inter-sectoral Consistency	Median Rating
	A	A	A	B	A	A	A
Detailed Questionnaire Results							
Data Quality Characteristics							
Coverage	A	A	A	A	A		
Granularity 3/	A		A	B	A		
			A		A		
Consistency			A	B		A	
Frequency and Timeliness	A	A	A	B	A		

Note: When the questionnaire does not include a question on a specific dimension of data quality for a sector, the corresponding cell is blank.
1/ The overall data adequacy assessment is based on staff's assessment of the adequacy of the country's data for conducting analysis and formulating policy advice, and takes into consideration country-specific characteristics.
2/ The overall questionnaire assessment and the assessments for individual sectors reported in the heatmap are based on a standardized questionnaire and scoring system (see IMF *Review of the Framework for Data Adequacy Assessment for Surveillance*, January 2024, Appendix I).
3/ The top cell for "Granularity" of Government Finance Statistics shows staff's assessment of the granularity of the reported government operations data, while the bottom cell shows that of public debt statistics. The top cell for "Granularity" of Monetary and Financial Statistics shows staff's assessment of the granularity of the reported Monetary and Financial Statistics data, while the bottom cell shows that of the Financial Soundness indicators.

A	The data provided to the Fund is adequate for surveillance.
B	The data provided to the Fund has some shortcomings but is broadly adequate for surveillance.
C	The data provided to the Fund has some shortcomings that somewhat hamper surveillance.
D	The data provided to the Fund has serious shortcomings that significantly hamper surveillance.

Rationale for staff assessment. Staff assess the data provided to the Fund to be adequate for surviellance with no major data weaknesses affecting staff's analysis of macroeconomic and financial risks. External Sector Statistics for Cyprus are complicated by the large presence of Special Purpose Entities. While the data is broadly adequate for surveillance, the accuracy and timeliness of initial data could be improved.

Changes since the last Article IV consultation. The authorities are progressing with transaction-based house price indices.

Corrective actions and capacity development priorities.

Use of data and/or estimates different from official statistics in the Article IV consultation. No data or estimates different from official statistics were used. Climate analysis relied on widely recognized and authoritative datasets for global weather and climate information including by the European Centre for Medium-Range Weather Forecasts (ECMWF) and the Climate Research Unit (CRU).

Other data gaps. None

Table 2. Cyprus: Data Standards Initiatives

Cyprus subscribes to the Special Data Dissemination Standard (SDDS) since December 2009 and publishes the data on its National Summary Data Page. The latest SDDS Annual Observance Report is available on the Dissemination Standards Bulletin Board (https://dsbb.imf.org/).

Table 3. Cyprus: Common Indicators Required for Surveillance
As of April 26, 2024

	Data Provision to the Fund				Publication under the Data Standards Initiatives through the National Summary Data Page			
	Date of Latest Observation	Date Received	Frequency of Data[6]	Frequency of Reporting[6]	Expected Frequency[6,7]	Cyprus[8]	Expected Timeliness[6,7]	Cyprus[8]
Exchange Rates	Current	Current	D	D	D	D	...	...
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Mar-24	Apr-24	M	M	M	M	1W	3W
Reserve/Base Money	Feb-24	Mar-24	Q	Q	M	M	2W	2W
Broad Money	Feb-24	Mar-24	Q	Q	M	M	1M	1M
Central Bank Balance Sheet	Feb-24	Mar-24	Q	Q	M	M	2W	2W
Consolidated Balance Sheet of the Banking System	Feb-24	Mar-24	Q	Q	M	M	1M	1M
Interest Rates[2]	Current	Current	D	D	D	D	...	NA
Consumer Price Index	Mar-24	Apr-24	M	M	M	M	1M	3M
Revenue, Expenditure, Balance and Composition of Financing[3]–General Government[4]	Feb-24	Apr-24	Q	Q	A	Q	2Q	3M
Revenue, Expenditure, Balance and Composition of Financing[3]–Central Government	Feb-24	Apr-24	Q	Q	M	M	1M	1M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Feb-24	Apr-24	Q	Q	Q	Q	1Q	1M
External Current Account Balance	2023: Q4	Mar-24	Q	Q	Q	Q	1Q	1Q
Exports and Imports of Goods and Services	Feb-24	Apr-24	M	M	M	Q	8W	1Q
GDP/GNP	2023: Q4	Mar-24	Q	Q	Q	Q	1Q	70D
Gross External Debt	2023: Q4	Mar-24	Q	Q	Q	Q	1Q	1Q
International Investment Position	2023: Q4	Mar-24	Q	Q	Q	Q	1Q	1Q

[1] Includes reserve assets pledged or otherwise encumbered, as well as net derivative positions.
[2] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Frequency and timeliness: ("D") daily; ("W") weekly or with a lag of no more than one week after the reference date; ("M") monthly or with lag of no more than one month after the reference date; ("Q") quarterly or with lag of no more than one quarter after the reference date; ("A") annual.; ("SA") semiannual; ("I") irregular; ("NA") not available or not applicable; and ("NLT") not later than.
[7] Encouraged frequency of data and timeliness of reporting under the e-GDDS and required frequency of data and timeliness of reporting under the SDDS and SDDS Plus. Any flexibility options or transition plans used under the SDDS or SDDS Plus are not reflected. For those countries that do not participate in the IMF Data Standards Initiatives, the required frequency and timeliness under the SDDS are shown for New Zealand, and the encouraged frequency and timeliness under the e-GDDS are shown for Eritrea, Nauru, South Sudan, and Turkmenistan.
[8] Based on the information from the Summary of Observance for SDDS and SDDS Plus participants, and the Summary of Dissemination Practices for e-GDDS participants, available from the IMF Dissemination Standards Bulletin Board (https://dsbb.imf.org/). For those countries that do not participate in the Data Standards Initiatives, as well as those that do have a National Data Summary Page, the entries are shown as "..."

INTERNATIONAL MONETARY FUND

CYPRUS

STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

May 10, 2024

Prepared By | European Department (In consultation with other departments)

CONTENTS

FUND RELATIONS

(As of March 31, 2024)

Membership Status: Joined December 21, 1961; Article VIII

General Resources Account:	**SDR Million**	**Percent of Quota**
Quota	303.80	100.00
IMF's Holdings of Currency	218.75	72.00
Reserve Tranche Position	85.06	28.00

SDR Department:	**SDR Million**	**Percent of Allocation**
Net cumulative allocation	423.98	100.00
Holdings	426.59	100.61

Outstanding Purchases and Loans: None

Financial Arrangements:

Type	**Approval Date**	**Expiration Date**	**Amount Approved (SDR million)**	**Amount Drawn (SDR million)**
EFF	May 15, 2013	Mar 6, 2016	891.0	792.00
Stand-By	Jul 16, 1980	Jul 15, 1981	8.5	8.5

Projected Payments to the Fund (SDR millions; Projected from 2022)

	Principal	**Charges/Interest**	**Total**
2024	0	0.01	0.01
2025	0	0.01	0.01
2026	0	0.01	0.01
2027	0	0.01	0.01
2028	0	0.01	0.01

Exchange Rate Arrangement and Exchange Restrictions:

Cyprus is a member of the euro area, and its currency—the euro—floats freely and independently against other currencies. Cyprus has accepted the obligations of Article VIII, Sections 2, 3, and 4, and maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions except for restrictions in place for security reasons notified to the Fund pursuant to Decision No. 144-(52/51).

Last Article IV consultation, Post-Program Monitoring discussions, and program relations:

Article IV. Cyprus is currently on a standard 12-month consultation cycle. The last Article IV consultation was concluded on May 25, 2022 (IMF Country Report No. 22/151).

EFF. Cyprus's three-year, SDR 891 million (293 percent of current quota) Extended Arrangement under the Extended Fund Facility (EFF) was approved by the IMF Executive Board on May 15, 2013. The total amount drawn was SDR 792 million (260.7 percent of quota). The EFF arrangement was coordinated with the European Stability Mechanism (ESM), which disbursed €6.3 billion. The ninth (and penultimate planned) review was completed on January 23, 2016 (IMF Country Report No. 16/26). The EFF arrangement was cancelled by the authorities on March 7, 2016, about two months before it was scheduled to expire. The cancellation coincided with the expiration of the three-year ESM program.

PPM and repurchases. The Fund initiated PPM on March 18, 2016. Board consideration of the Third Post-Program Monitoring (PPM) discussions was concluded on June 3, 2019 (IMF Country Report No. 19/151). An early repurchase on July 11, 2017 reduced outstanding Fund credit to Cyprus to SDR 570 million (187.5 percent of quota), which is below standard PPM-eligibility thresholds. The Board approved a one-year PPM extension on August 2, 2017, June 4, 2018, and June 3, 2019. Cyprus repaid early its remaining balance of EFF credit in February 2020, and successfully exited the Fund's PPM.

Safeguards. A safeguards assessment was finalized in August 2013 in the context of an EFF arrangement approved in May 2013. The assessment found a weak governance framework at the CBC and a strained balance sheet given the large ELA exposure. The CBC addressed most of the recommendations made in the areas of audit and control oversight, financial reporting transparency, and internal audit. The CBC continues to publish its audited financial statements in a timely manner. Legislative efforts currently underway are expected to address the remaining safeguards recommendations to strengthen the central bank's governance and financial autonomy.

Technical Assistance:

Department	Purpose	Date
FAD	Revenue administration	October–November 2014
FAD	Revenue administration	January–February 2015
FAD	Functional review of Ministry of Finance	February 2015
FAD	Government guarantees	February 2015
MCM	Cooperative credit sector restructuring	February–March 2015
FAD	Public financial management	March 2015
STA	Balance of payments	March–April 2015
FAD	Public financial management	August 2015
MCM	NPL management	August–September 2015
MCM	Macro-financial modeling	September 2015
MCM	NPL management	September 2015
FAD	Public financial management	September–October 2015

MCM	Financial aspects of reunification	November 2015
FAD	Revenue administration	November–December 2015
MCM	Central bank governance	December 2015
STA	Statistical aspects of reunification	December 2015
FAD	Fiscal aspects of reunification	December 2015
MCM	Financial aspects of reunification	December 2015
MCM	Financial aspects of reunification	January 2016
MCM	Financial aspects of reunification	February 2016
STA	Statistical aspects of reunification	February 2016
FAD	Fiscal federalism workshop	February 2016
FAD	Fiscal aspects of reunification	February–March 2016
MCM	Debt management	March 2016
FAD	Public financial management	March–April 2016
MCM	Financial aspects of reunification	April 2016
FAD	Revenue administration	April–May 2016
STA	Statistical aspects of reunification	May 2016
MCM	Cooperative credit sector restructuring	May 2016
MCM	Financial aspects of reunification	May 2016
MCM	Cooperative credit sector restructuring	June–July 2016
MCM	Financial aspects of reunification	June–July 2016
FAD	Revenue administration	October 2016
FAD	Spending review	October 2016
FAD	Fiscal aspects of reunification	November 2016
STA	Sectoral Accounts and Balance Sheets	January 2017
FAD	Revenue administration	March 2017
FAD	Spending review	April–May 2017
MCM	Financial stability	July 2017
MCM	NPL management	July 2017
MCM	Macro-prudential policy	September 2017
LEG	Insolvency legal framework workshop	September 2017
FAD	Spending review	September–October 2017
FAD	Revenue administration	October 2017
MCM	NPL management	November 2017
MCM	Financial stability	December 2017
FAD	Revenue administration	December 2017
FAD	Spending review	February 2018
LEG	Legal framework for NPL resolution	March 2018
FAD	Spending review and public financial management	September 2018
MCM	Debt Portfolio Risk Management	November 2018
FAD	Policy Based Budget	September 2019
LEG	Judicial Training Workshop on Insolvency	December 2019

MCM	Stress Testing	December 2020
MCM	Debt and Cash Management	December 2020
STA	Property Price Statistics	April-May 2021
RES	Residential Property Price Valuations	March-April 2023
FAD	SOE governance	March 2023
STA	Property Price Statistics	June 2023
MCM	Debt Management	February 2024
FAD	Public Wage Bill	June 2024

Two FAD long-term resident advisors provided technical assistance on public financial management (from February 2014 to October 2016) and on revenue administration (from July 2015 to December 2016).

Statement by Paul Hilbers, Executive Director for Cyprus,
and Luc Dresse, Alternate Executive Director
May 23, 2024

On behalf of the authorities of the Republic of Cyprus, we extend our gratitude to the mission team, led by Mr. Alex Pienkowski, for the comprehensive report and fruitful discussions during the Article IV mission. The Cypriot authorities broadly share staff's assessment of the current economic challenges and take note of the policy recommendations, which are in line with the authorities' policy agenda.

Economic development and outlook

The Cypriot economy has shown resilience and flexibility amidst a multitude of adverse shocks. The authorities expect real GDP growth to be slightly higher than what staff project for 2024 (2.6 percent) and 2025 (2.8 percent), on account of higher expected tourist arrivals, other services exports, and payouts from structural reforms. Domestic demand is expected to remain a significant driver of economic growth in the coming years, reflecting the resilience of the labor market and the expected recovery of real disposable income. Russia's war against Ukraine and the Middle East conflict remain downside risks to GDP growth. The authorities view risks as broadly balanced against the backdrop of progress in diversification of tourism markets and of financial and other business services exports. The available data on the effect of the Middle East conflict point to a lower than originally foreseen impact on tourism and construction.

Overall, continued labor market resilience has not created wage-price spiral dynamics in the economy. Unemployment declined significantly to 6.1 percent in 2023 and is expected to decrease further to 5.8 percent in 2024. HICP inflation declined to 3.9 percent in 2023 and is expected to ease further and fluctuate around the 2 percent mark during the period 2024-2025. Inflation is decelerating following the gradual correction in oil prices, the normalization of food and non-energy industrial goods (NEIG) prices and the lagged impact of past monetary policy tightening.

The current account deficit in Cyprus is financed by non-debt flows, largely reflecting operations of foreign-owned companies. The deficit widened to 12.1 percent of GDP in 2023, partly due to the increase in the trade deficit of goods. This was largely influenced by increases in net transactions of mobile transport equipment (mainly ships) and elevated imports for home consumption. The outflows of higher profits on FDIs were another driver of the deficit. The authorities anticipate that factors such as outflows driven by high bank profitability will be temporary and will normalize gradually. They expect the current account deficit to decline in the coming years.

Fiscal Policy

Cyprus implements a prudent fiscal policy, with large surpluses and a rapidly declining public debt ratio. The fiscal surplus amounted to 3.1 percent of GDP in 2023, while government debt declined to 77.3 percent of GDP. Support measures introduced during the COVID-19 and cost-of-living crises have almost all been dismantled, and the remaining measures to reduce VAT rates on certain basic products and electricity subsidies will expire in June. The authorities remain committed to maintaining a robust medium-term primary surplus for the period 2024-2026, and to reducing public debt to 60 percent of GDP in 2026.

A comprehensive study of the current tax framework is in progress and due to be completed in July 2025, to pave the way for major tax reform. The tax reform is expected to reduce tax inequality, enhance transparency, simplify the tax system, and reduce the administrative compliance burden. It is expected to strengthen the overall competitiveness of the economy while maintaining fiscal neutrality. The new tax regime will also include green and digital transition elements, aligned with the Recovery and Resilience Plan, European Union tax trends, and international standards. The initial phase, expected in 2024, will introduce a carbon tax on fuels on top of excise and polluting industries, not covered by ETS, alongside compensatory measures to alleviate the impact on affected households.

The authorities appreciate continued IMF engagement aiming at strengthening the capacity of public institutions. The last technical assistance project focused on study of the state wage bill and its possible optimization. The authorities have received technical assistance by the IMF to further enhance the governance framework of the State-Owned Entities, in line with international standards. Based on the experts' findings, an action plan has been formulated, which will be submitted to the Council of Ministers soon.

Financial Sector

Financial stability is supported by robust economic performance and by a resilient financial sector, with ample capital buffers and liquidity. The increase in the neutral countercyclical capital buffer (CCyB) to 1 percent will further strengthen resilience. The updated regulatory framework and additional resources provided to the securities markets supervisor (CySEC) will further enhance resilience of non-bank financial institutions (NBFIs). The authorities concurred with the need for careful monitoring of loan renegotiations, while viewing the recent uptick as an outcome of commercial dynamics.

Against the backdrop of high interest rates, new lending in 2023 remained strong and broadly unchanged in comparison to the total new lending activity of 2022. The banking sector's substantial profits partly reflect higher pass-through to lending than to deposit rates. Consequently, the CET1 ratio increased to record levels (21.3 percent) in 2023. As a result, the system's buffer availability (above Pillar 2 Guidance) has increased to 8.1 percent, enhancing the capacity of the banking sector to absorb unexpected losses. Cypriot banks have also made notable progress in building up their MREL capacity with Tier 2 and senior bond issuances in 2022 and 2023. They now comply with the MREL targets set by the Single Resolution Board.

Banks continue to work on resolving legacy NPLs. The NPL ratio in Cyprus, albeit still high, is steadily on a declining trend, reaching 7.9 percent in December 2023. Although property prices appear in line with fundamentals and there is no sign of risks materializing so far, the authorities are committed to monitoring developments, as significant exposure to the real estate sector may bring about collateral revaluation risks.

The resolution of the legacy NPLs problem lies in both the mortgage-to-rent scheme and the implementation of a foreclosure framework with check-and-balance. The mortgage-to-rent scheme for vulnerable lenders came into effect in December 2023, aiming to help homeowners at risk of losing their property due to mortgage arrears. The fiscal cost of the plan is estimated at 0.9 percent of GDP over the next two years. Amendments to the foreclosure framework were adopted in 2023, comprising measures aimed at streamlining the foreclosure proceedings and enhancing transparency. A separate law was also amended, strengthening the governance structure of the Financial Ombudsman and broadening the scope of the Financial Ombudsman's (FO) powers to appoint a mediator who can work towards restructuring loans. The authorities envisage the expanded role of the FO acting as mediator to be instrumental in achieving negotiated solutions between debtors and financial institutions on legacy NPLs. While finalization of the organizational structure is ongoing, the authorities do not anticipate difficulties in satisfying potential demand for FO interventions.

Digitalization is gaining momentum in the banking sector. In parallel with the reduction in banking staff and branches, Cypriot banks have been promoting the use of their online services and mobile apps. The banking sector is experiencing a surge in digital banking services, with increased adoption of online banking and mobile payment solutions.

Structural Reforms

The Resilience and Recovery Plan (RRP) forms the backbone of the authorities' structural policy agenda. The authorities implement the RRP, a 5-year plan, comprising a diverse mix of structural reforms and investments, which aim at enhancing the long-term growth potential of the country. The RRP includes actions that will lead to a more diverse and sustainable economy, including measures to advance the green transition and digitalization.

The challenges of the green transition and adaptation need to be carefully managed. In addition to implementation of the green taxation reform, initiatives focus on developing and adopting green technologies, energy efficiency, renewable energy sources, electrification, and circular economy promotion. The authorities concur with staff that implementation of energy infrastructure projects is key to strengthening energy security and promoting a climate-neutral and sustainable economy. They will continue to assess the potential impact of climate risks and different adaptation options.

The implementation of a broad reform of the judicial system is underway. This includes the restructuring of top-tier courts and the establishment of a new Court of Appeals. Progress has also been made in the reduction of the backlog of court cases. The authorities concur with the need to enhance the education system and have several strategies in place to reduce skill mismatches, promote STEM education, and improve active labor market policies to facilitate the transition into the labor market. They highlight several activation policies to reduce unemployment, as well as investments in re- and upskilling and school infrastructure in the RRP.

With regard to AML/CFT, Cyprus is largely aligned with MONEYVAL international standards. According to MONEYVAL's follow-up assessment of December 2023, Cyprus is fully or largely compliant with 37 out of the 40 FATF recommendations and rated as partially compliant with 3 Recommendations. MONEYVAL has underscored in a relevant press release of 2 May 2024 that Cyprus has improved its compliance with FATF Recommendation 15 (new technologies) and noted progress in improving compliance with Recommendation 8 (non-profit organizations). It also notes that Cyprus has met the general expectation of having remedied most of the technical compliance deficiencies at the end of its third year of follow up.