



European  
Commission

ISSN 2443-8014 (online)

# Post-Programme Surveillance Report

## Cyprus, Spring 2024

INSTITUTIONAL PAPER 289 | JUNE 2024

EUROPEAN ECONOMY

*Economic and  
Financial Affairs*

**European Economy Institutional Papers** are important reports analysing the economic situation and economic developments prepared by the European Commission's Directorate-General for Economic and Financial Affairs, which serve to underpin economic policy-making by the European Commission, the Council of the European Union and the European Parliament.

## **DISCLAIMER**

The views expressed in unofficial documents do not necessarily represent the views of the European Commission.

## **LEGAL NOTICE**

Neither the European Commission nor any person acting on behalf of the European Commission is responsible for the use that might be made of the information contained in this publication.

This paper exists in English only and can be downloaded from [https://ec.europa.eu/info/publications/economic-and-financial-affairs-publications\\_en](https://ec.europa.eu/info/publications/economic-and-financial-affairs-publications_en).

Luxembourg: Publications Office of the European Union, 2024

PDF ISBN 978-92-68-13842-7 ISSN 2443-8014 doi:10.2765/606180 KC-BC-24-016-EN-N

---

© European Union, 2024

Reuse is authorised provided the source is acknowledged. The reuse policy of European Commission documents is regulated by Decision 2011/833/EU (OJ L 330, 14.12.2011, p. 39). For any use or reproduction of material that is not under the EU copyright, permission must be sought directly from the copyright holders.

CREDIT

Cover photography: © iStock.com/benslimanhassan

European Commission  
Directorate-General for Economic and Financial Affairs

# **Post-Programme Surveillance Report**

Cyprus, Spring 2024

## ACKNOWLEDGEMENTS

This Post-Programme Surveillance assessment was prepared in the Directorate-General for Economic and Financial Affairs of the European Commission under the guidance of Declan Costello, Deputy Director General, Luc Tholoniati, Director, Maarten Masselink, Head of Unit for Cyprus, and Monika Sherwood, Deputy Head of Unit for Cyprus. <sup>(1)</sup>

Contributors: Polona Cigoj, Mona Papadakou and Angeliki Paritsi from the Directorate General Economic and Financial Affairs, and Anna Grochowska, Marios Christodoulou and Marcus Sonntag from the Directorate General for Financial Stability, Financial Services, and Capital Markets. Editorial assistance was provided by Patricia Bernardos Schepers.

The report was prepared in liaison with staff from the ECB <sup>(2)</sup>. Staff from the European Stability Mechanism (ESM) also provided comments.

This report reflects information available and policy developments that have taken place until 30 April 2024. Therefore, the macroeconomic and budgetary projections, including those underlying the debt sustainability analysis, are in line with the Commission 2024 spring forecast released on 15 May 2024 (with a cut-off date of 30 April 2024).

Comments on the report would be gratefully received and should be sent, by mail or email, to:

Maarten Masselink

European Commission

Directorate-General for Economic and Financial Affairs

Head of Unit responsible for Cyprus

B-1049 Brussels

E-mail: [ECFIN-F1-PPS-CYPRUS@ec.europa.eu](mailto:ECFIN-F1-PPS-CYPRUS@ec.europa.eu).

---

<sup>(1)</sup> The executive summary of this report was adopted as Commission Communication C(2024)4003 on 18 June 2024. The rest of the report reflects the findings of the staff working document SWD(2024)403 accompanying that communication.

<sup>(2)</sup> European Central Bank (ECB) staff participated in this mission, and the drafting of this report, in accordance with the ECB's competences and thus provided expertise on financial sector policies and macro-critical issues, such as headline fiscal targets and sustainability and financing needs.

## EXECUTIVE SUMMARY

**The 16th post-programme surveillance mission to Cyprus took place in person from 19 to 22 March 2024.** This mission involved European Commission staff in liaison with European Central Bank (ECB) staff. European Stability Mechanism (ESM) staff participated on aspects relating to the ESM's Early Warning System.

**The macroeconomic outlook remains positive amidst geopolitical uncertainty.** Following a moderation in 2023 to 2.5%, economic growth is expected to accelerate to 2.8% and 2.9% in 2024 and 2025 respectively. At the same time, with a continued expected decline in the prices of energy and other commodities and impact from monetary policy restrictions, headline inflation is forecast to slow down to around 2% in the coming years. The labour market has been performing strongly, with employment increasing. Domestic demand is expected to remain the key growth driver, with private consumption profiting from abating inflation and partial wage indexation, and investment supported by several large projects. External demand for services is expected to continue increasing, albeit at a slower pace. The large current account deficit is set to narrow, but to remain around 11% of the GDP linked to continued projected deficits on the primary income account. The geopolitical developments have so far had only a limited impact on Cyprus, mainly through the inflation channel. Downside growth risks related to the persistent international uncertainty remain, together with some upside risks as companies and individuals from affected areas in the Middle East tend to relocate investments from those areas to safer destinations in the EU, including Cyprus.

**The fiscal position is expected to remain strong with significant budgetary surpluses in the coming years.** The general government surplus was 3.1% of GDP in 2023 driven by strong revenue increases, despite elevated expenditure growth on public wages, pensions and the health system. Continued tax rich growth combined with a phasing out of the remaining measures linked to the energy crisis are expected to maintain a significant budget surplus for the coming years.

**Rising interest rates and widening lending margins boosted Cypriot banks' profits to an all-time high in 2023, outperforming other banking sectors in the EU.** Cypriot banks are well-capitalised, have ample liquidity thanks to a stable deposit base, and their lending business remained resilient in 2023, despite higher interest rates. Non-performing exposures reduced further, although risks in some lending segments have risen somewhat and renegotiations have become more frequent. The current level of profitability is unlikely to be sustained when interest rates return to their long-run average. The Cypriot residential property market remains resilient and house prices continue to increase, driven by foreign, as well as local demand. Cypriot banks have significant exposure to the commercial real-estate sector, however, a series of mitigating factors including among others strict underwriting standards, limit the risks. In the face of macroprudential risks, the Central Bank of Cyprus upholds a tight stance and announced an increase of the Countercyclical Capital Buffer to 1.0% with effect from June 2024.

**The foreclosures framework has been safeguarded against dilutions and it is now crucial to allow it to operate without interference.** Recent legislative amendments improve transparency and promote the out-of-court resolution of non-performing loans, while the mortgage-to-rent scheme offers an additional safety net to eligible borrowers in default. These developments should enable effective implementation of the foreclosure framework. Maintaining a functional foreclosure framework is important to continue to reduce the volume of non-performing loans in the economy and to ensure payment discipline across the loan portfolio.

**Cyprus retains the capacity to service its debt and has significantly reduced its debt-to-GDP ratio in recent years.** Prudent fiscal policies and economic growth were the main drivers of the reduction in the public debt, and projections indicate continued improvements over the coming years. According to the debt sustainability analysis, Cyprus is assessed to face low risks in the short and long term and medium in the medium term. Government financing needs for 2024 remain low and are

supported by a projected significant primary surplus and a significant cash reserve. The increase in borrowing costs has until now had only a limited impact on the overall debt-servicing costs, also given the relatively long maturity of the debt portfolio and the declining debt ratio. Cyprus continues to enjoy favourable market perception with investment grade status by all major credit-rating agencies.

## CONTENTS

1.	Introduction	2
2.	Macroeconomic developments	3
3.	Public finance developments	5
4.	Financial sector developments	7
4.1.	Banking sector developments	7
4.2.	Other financial sector topics	11
5.	Sovereign financing and capacity to repay	14
A1.	Main macroeconomic indicators	16
A2.	Debt Sustainability Analysis	17

### LIST OF TABLES

4.1.	Soundness indicators for the banking sector in Cyprus	10
A2.1.	Debt sustainability analysis - Cyprus	19
A2.2.	Heat map of fiscal sustainability risks - Cyprus	19

### LIST OF GRAPHS

4.1.	NPL ratio and breakdown of changes	9
------	------------------------------------	---

# 1. INTRODUCTION

**Staff from the European Commission, in liaison with staff from the ECB, undertook from 19 to 22 March 2024 the sixteenth post programme surveillance (PPS) mission to Cyprus.** Staff from the European Stability Mechanism (ESM) participated in these meetings on aspects related to the ESM's Early Warning System. Under PPS, the Commission carries out regular review missions to euro area Member States that have had a financial assistance programme. The objective of the PPS mission is to assess the economic, fiscal and financial situation to ensure the Member State maintains its capacity to service its debt <sup>(3)</sup>.

**Following a request by Cyprus on 25 June 2012, a three-year economic adjustment programme was agreed between the Cypriot authorities and the European Commission, the ECB and the IMF on 2 April 2013. Cyprus exited its economic adjustment programme in March 2016.** The programme included an ambitious reform agenda and measures designed to decisively address the financial, fiscal, and structural challenges facing the Cypriot economy so as to return to a sustainable growth path. It provided financial assistance of up to EUR 10 billion (the ESM providing up to EUR 9 billion and the IMF contributing around EUR 1 billion). Cyprus eventually used EUR 7.3 billion (EUR 6.3 billion from the ESM and EUR 1 billion from the IMF). Cyprus fully repaid its IMF loan in February 2020.

**This report reflects information available on, and policy developments until, 30 April 2024.** The macroeconomic and budgetary projections (including those underlying the debt sustainability analysis) are in line with the Commission's 2024 Spring Economic Forecast released on 15 May 2024 (with a cut-off date of 30 April 2024).

---

<sup>(3)</sup> Under Regulation (EU) No 472/2013, PPS will continue until at least 75% of the financial assistance received under the programme has been repaid. Under the current repayment schedule, PPS on Cyprus will last until 2030.



## 2. MACROECONOMIC DEVELOPMENTS

**In 2023, economic activity remained dynamic.** Real GDP grew by 2.5% in 2023 following strong growth during recovery from the COVID-19 crisis, recording 5.1% in 2022 and 9.9% in 2021. Domestic demand, in particular private consumption, remained the key driver of growth benefiting from dynamic employment growth and large increases in wages, partly due to automatic wage indexation<sup>(4)</sup>. Investment growth, when the registration of ships is not taken into account, remained at 4.4% in 2023. Residential construction grew by 5.8% in 2023, supported by the extension of the mortgage interest subsidy scheme and demand generated by the influx of foreign companies. The growing influx of foreign investment also benefited the export sector. At the same time, imports increased strongly given the high import content of domestic demand. Continued geopolitical tensions negatively affected external demand for financial and business services. Nevertheless, tourism has almost fully recovered post-COVID-19 with arrivals approaching the levels of record year 2019.

**Economic growth is set to strengthen further on account of better investment and export performance.** GDP growth is forecast at 2.8% in 2024 and 2.9% in 2025. Investment in Cyprus is projected to benefit from sizeable private investment projects, many of which are ongoing in the areas of real estate, tourism and transport, retail, education, health and energy, as well as from the acceleration of investments financed under the Recovery and Resilience Plan (RRP). Further increases in real disposable income together with declining inflation are forecast to support private consumption, albeit at a lower rate than in the last years. A continuous increase in tourism arrivals combined with a recovery and expansion of business and financial services is expected to support the export performance.

**Risks to economic growth are slightly to the downside, in particular, due to the uncertainty in oil price developments and the interest rate environment.** Given the relatively high dependency on oil in the total energy mix, increases in oil prices can negatively impact economic growth and the current account deficit. Furthermore, a continued high interest rate environment could pose a risk to the overall quality of loan portfolios, especially in critical sectors for the economy such as tourism, trade and construction. At the same time, there are some upside risks as companies and individuals from affected areas in the Middle East tend to relocate investments from those areas to safer destinations in the EU, including Cyprus.

**The labour market benefits from the positive economic environment and the ongoing diversification of the economy.** Employment increased by 1.5% and unemployment dropped to 6.1% in 2023 from 6.8% in 2022. Employment growth is particularly strong in services such as Information and Communications Technology (ICT) and retail and tourism-related sectors. Employment in financial and insurance activities is also recovering, while in 2023 there was also a rise in employment in household activities. Labour and skill shortages remain common, and a large part of the increase in employment is due to the inflow of foreign workers. In sectors such as ICT, the proportion of non-Cypriot citizens to total employment is close to 45% and a large part of employment is brought by foreign companies benefiting from the headquartering policy. The expected expansion of economic activity is set to further support the labour market. Employment is expected to increase by around 1.4% in 2024 and 2025. The unemployment rate is expected to decrease to 5.6% in 2024 and further fall to 5.4% in 2025. Wages increased by more than 6% in 2023 driven mostly by inflation

---

<sup>(4)</sup> Cyprus has in place an automatic cost-of-living allowance indexation on wages (COLA). Under the scheme, the wages and salaries of employees in the broader public sector and about 30% of the private sector covered by collective agreements are adjusted every January for the year-on-year percentage change (only if positive) in the consumer price index (CPI), excluding any increases in consumption taxes, and only if GDP rose during the second and third quarters of the previous year. The adjustment coefficient increased to 66.7% as of 2024 (from 50% previously) following a renewed collective agreement in May 2023 among the social partners. The scheme covers in total about 45% of all employees. In 2023, wages increased by 5.3% through COLA adjustment (50% of the 2022 Consumer Price Index in January and additionally 16.7% in June).

indexation and to some extent by a tight labour market. Wage growth is expected to moderate in line with inflation developments.

**Inflation in Cyprus has been decelerating and is expected to converge towards the 2% ECB target next year.** Harmonised Index of Consumer Prices (HICP) inflation slowed down to 3.9% in 2023, from 8.1% in 2022, mainly reflecting lower energy prices and the effect of monetary tightening. Core inflation (excluding energy and food prices) also decelerated yet still remained elevated at 4.4% in 2023 mainly due to the pass-through of previous increases in energy and food prices to the prices of services combined with a buoyant demand for services. Inflation is set to moderate to 2.4% in 2024 and to 2.1% in 2025, in line with a continued expected decline in prices for energy and other commodities. By contrast, wage indexation is expected to exert some upward pressure on HICP inflation excluding energy and food. Upside risks to the inflation outlook increased due to the uncertainty in the global energy markets, in particular for oil.

**The current account deficit has increased to historically high levels and is expected to remain elevated in the coming years.** The current account deficit climbed to 7.9% of GDP in 2022 and further increased to 12.1% in 2023. This is due to both structural and temporary factors.<sup>(5)</sup> Overall, Cyprus's reliance on energy imports, alongside imports of raw materials and consumer goods, contributed to the widening trade in goods deficit in an environment of high energy prices. Moreover, in 2023, the widening of the trade deficit reflected a large transfer of economic ownership of transport equipment, mainly ships, which are registered as imports of goods. At the same time, the primary income deficit continued widening to 10.1% of GDP in 2023 mainly as a result of the profits (distributed dividends and retained earnings) by foreign-owned companies, including banks. After several years of negative results, the mostly foreign owned banking sector of Cyprus recorded strong profitability in 2023, which weighs negatively on the primary income deficit. As nominal domestic demand growth is set to moderate, bank profitability is expected to stabilise and external trade balance is set to improve, the current account deficit is forecast to narrow to 11.2% of GDP in 2024 and 10.8% in 2025. This is still well above the historical levels of 4-5% of GDP. Cyprus's external deficit is mainly financed by foreign direct investment (FDI), even when excluding the impact of special purpose entities (SPE). A disproportionate share of foreign investments compared to its real economy (GDP) may entail a possible risk related to aggressive tax planning and anti-money laundering practices. In this respect, measures tackling aggressive tax planning in the national recovery and resilience plan are very important. Moreover, a large share of the profits generated by foreign companies are not reinvested but tend to be repatriated abroad contributing to high primary income deficits.

---

<sup>(5)</sup> See also In-Depth Review 2024 – Cyprus, Institutional Paper 273, March 2024.

### 3. PUBLIC FINANCE DEVELOPMENTS

**Cyprus continued its strong fiscal performance in 2023.** The general government surplus improved further to 3.1% of GDP in 2023 following a surplus of 2.7% in 2022. The good fiscal performance is mainly due to the continued strong growth of revenues, which more than offset double-digit expenditure growth. Budget prospects remain positive as surpluses are projected to be sustained in the medium-term.

**Revenue increases in Cyprus are mainly driven by tax rich growth and inflation.** Revenues increased by 11.9% in 2023. Strong wage increases and higher employment rates contributed to growth of above 10% on revenue from labour tax and social security contributions. Indirect taxes, especially VAT receipts, also grew considerably (by around 10%) thanks to buoyant consumption and continued elevated inflation. At the same time, together with the continued important foreign investment flows that expand the corporate tax base, a large backlog of cases continued being resolved contributing to significant revenue from corporate income tax. Part of the growth in total tax revenues which exceeded the growth rates of underlying tax bases can be linked to improved tax collection, mainly by faster processing of and thus reducing the backlog of tax declarations, and digitalising VAT payments.

**Higher public wage and social spending were the main components of the strong increase in public expenditure in 2023.** Wage indexation significantly affected the public wage bill. As a result, the compensation of employees increased by 12.8% in 2023. Pensions increased twice in 2023 according to the average wage developments and inflation resulting in a 7.6% increase in social payments. Energy-related measures, in particular subsidies on electricity expenditure and a reduction of excise duties on gasoline and diesel, that were introduced in response to the energy crisis continued to burden expenditure (by 0.4% of GDP in 2023). Some of these measures have been phased out in the first half of 2024. Public investment expenditure increased by 46.2%, benefiting from the implementation of large infrastructure projects and partially from the acceleration of RRF implementation.

**The budget balance is expected to remain in surplus over the coming years.** According to the Commission's 2024 Spring Economic Forecast, the general government surplus in Cyprus is expected to slightly decrease to 2.9% of GDP in 2024 and remain at the same level in 2025. One of the positive drivers of the budget balance is the planned phasing-out of the remaining measures addressing high energy prices by summer 2024. Social security contributions will continue increasing strongly, as their rates increased as of January 2024. At the same time, revenue increases are partly offset by the government-subsidised mortgage-to-rent scheme for vulnerable households offered through KEDIPES<sup>(6)</sup> and a number of other housing policy measures.

**The debt-to-GDP ratio is forecast to continue declining over the coming years.** From a peak of 114.9% in 2020, the debt-to-GDP ratio is expected to drop to 65.4% in 2025, on the back of continued high nominal GDP growth and significant primary surpluses, notwithstanding pressures from higher costs of funding for the State (see Section 5 on sovereign financing and the debt sustainability analysis in Annex 2).

**The risks to the fiscal outlook are broadly balanced.** Contingent fiscal risks from the financial sector have been alleviated with the stabilisation of the foreclosure framework. Budget overruns by extending the support measures addressing energy prices cannot be excluded as often the decision on their extension was taken shortly before their planned termination. On the positive side, high

---

<sup>(6)</sup> The scheme transfers assets from the private sector (banks and credit-acquiring companies) to the state-owned asset management company KEDIPES, which in turn offers rent subsidies to eligible households. For a more detailed description of the scheme, see subsection The Cyprus Asset Management Company Ltd (KEDIPES) in Section 4 Financial sector developments.

elasticities of taxes could continue as a result of the inflow of foreign direct investment and the ongoing effort from Cypriot authorities to further improve the tax administration. Further improvements to the fiscal picture may come from the application of a domestic minimum top-up tax (increasing the effective tax rate to 15%) for all Pillar 2 <sup>(7)</sup> companies, mainly large multinational enterprises. A related draft bill was submitted in Parliament by the government, to be applied as from 1 January 2024, but it has not yet been adopted.

---

<sup>(7)</sup> Under an OECD inclusive framework, more than 140 countries agreed to enact a two-pillar solution to address the challenges arising from the digitalisation of the economy. Pillar 2 introduces a global minimum effective tax rate (ETR) where multinational groups with a consolidated revenue of over EUR 750 million are subject to a minimum ETR of 15% on income arising in low-tax jurisdictions. Pillar 2 is enshrined legislatively in an EU directive (Council Directive 2022/2523 of 14 December 2022 on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the Union).

## 4. FINANCIAL SECTOR DEVELOPMENTS

### 4.1. BANKING SECTOR DEVELOPMENTS

#### Profitability

**The Cypriot banking sector achieved record profits in 2023, mainly driven by rising interest rates that boosted their net interest income.** Aggregate profits of Cypriot banks surged to EUR 1 276 million in 2023, surpassing the previous year's level of EUR 171 million <sup>(8)</sup>. Return on equity rose to 29% after 4.4% in 2022, rendering Cyprus's banking sector one of the best performing in the EU. This outstanding result was the upshot of rising interest rates in the context of the continued reliance of Cypriot banks on interest income. Net interest income jumped to EUR 1 922 million from EUR 976 million a year earlier. Higher policy rates quickly translated into higher interest receipts for the banks as the majority of loans bear variable interest rates. At the same time, banks operated with abundant liquidity, and were therefore under little pressure to increase deposit rates to attract additional deposits. Thanks to the large share of funds held in current accounts and the limited transmission of higher policy rates to term deposits, the cost of funding for banks has remained close to historical lows. As a result, lending margins for new and outstanding loans to households and non-financial corporations (NFCs) remain one of the widest in the EU <sup>(9)</sup>.

**The positive result was further supported by strengthening non-interest income and lower staff expenses.** Improving non-interest income, in particular from dividends, attests to efforts that banks, especially large ones, have made in diversifying their income streams. In 2023, non-interest income represented around 24% of net operating income. On the cost side, staff expenses were reduced as a result of voluntary retirement schemes implemented by the two largest banks in previous years. Meanwhile, impairments ticked up slightly, but did not affect the overall positive result. Consequently, Cypriot banks' average cost-to-income ratio dropped to one of the lowest in the EU in 2023. It is important that banks use the current window of opportunity to build capital buffers and improve the efficiency of their business models.

#### Solvency

**Record earnings enabled the banks to bolster their capital cushions, which exceed regulatory requirements by a comfortable margin.** In 2023, the banking sector's Common Equity Tier 1 (CET1) ratio improved further to one of the highest in the EU, climbing to 20% in December, as capital creation from retained earnings exceeded a slight uptick in risk-weighted assets. The average buffer above Pillar-2 guidance (P2G) stood at 8.1pp, the highest so far for Cypriot banks, thus enhancing their capacity to absorb unexpected losses. The aggregate leverage ratio improved to 7.4% in December 2023 from 6.5% a year earlier, well above the minimum requirement of 3% and the EU average of 5.8% <sup>(10)</sup>.

#### Deposits and liquidity

**Liquidity in the banking sector remains abundant thanks to a stable supply of deposits.** Deposits were nearly unchanged in the year and stood at EUR 52 156 million in December 2023 <sup>(11)</sup>. A

---

<sup>(8)</sup> See Central Bank of Cyprus, December 2023, [Aggregate Cyprus Banking Sector Data](#)

<sup>(9)</sup> See European Central Bank, [MFIs lending margins](#)

<sup>(10)</sup> See European Banking Authority, [Risk Dashboard - Q4 2023](#)

<sup>(11)</sup> See Central Bank of Cyprus, December 2023, [Monetary Financial Statistics](#)

slight drop in deposits from non-financial corporations was compensated for by an increase in household deposits. Deposit rates in Cyprus remain among the lowest in the EU due to a structural liquidity surplus. Despite the limited pass-through to deposit rates, term deposits in December 2023 increased by 7% for households and 64% for NFCs as depositors shifted from current accounts. With regard to the domicile of the depositors, the volume of deposits from domestic clients expanded slightly by 1.4%, while deposits from overseas clients shrank by 6.5%. Cypriot banks have therefore no difficulties in fulfilling their liquidity requirements. Their average liquidity coverage ratio of 374% and average net stable funding ratio of 187% are among the highest in the EU. Given the low loan-to-deposit ratio of 49% in December 2023, Cypriot banks hold a significant share of their assets at the central bank deposit facility (34% compared to the euro-area average of 9%). Only 36% of their assets are loans and advances, against a 63% EU average <sup>(12)</sup>.

## Lending

**In 2023, borrowing costs increased steeply and amid lower demand, the growth in loans stalled.** New lending, excluding renegotiations, to households and NFCs totalled EUR 3 269 million. Of this, EUR 1 921 million was lent to NFCs and EUR 1 348 million to households <sup>(13)</sup>. This level of new lending is on par with that of 2022, which was a year characterised by more favourable conditions for borrowers. Despite the overall stagnation, lending to NFCs increased by 3.5% compared to 2022, reflecting a heightened need for financing to replenish working capital. Additionally, consumer and other loans surged to EUR 332 million, setting a record and indicating a rise in liquidity needs among households confronted with persistently high prices. In contrast, lending for house purchases declined by 14% year-on-year, totalling EUR 1 016 million; this was attributable to the combined impact of rising mortgage rates, reduced real income, and lower consumer confidence in the macroeconomic environment.

## Asset quality

**Banks' asset quality remains robust despite the challenging macroeconomic environment.** The ratio of non-performing loans (NPLs) continued its downward trend, decreasing to 7.9% in December 2023, down from 9.5% a year earlier <sup>(14)</sup> <sup>(15)</sup>; however, it remains above the EU average of 1.8%. The stock of NPLs has dropped to its lowest level since the EU harmonised the NPL definition in 2014, standing at EUR 1 892 million. This reduction is attributed to organic actions such as cures, repayments, and write-offs. Concurrently, the NPL coverage ratio is prudently maintained at 49.5%, which is above the EU average of 42.3%. The amount of non-covered NPLs reached its lowest point so far. Both households and NFCs appear to have withstood well the gradual rise in interest rates. In December 2023, loans amounting to approximately EUR 2 300 million are classified as stage 2 <sup>(16)</sup>, accounting for approximately 10% of all loans and advances, compared with approximately EUR 3 000 million or 12% a year earlier. However, although the amount of loans moving back to stage 1 was greater than those transferred to stage 2, some early signs of distress are becoming apparent in the rate at which loans are migrated from Stage 1 to stage 2 and stage 3, which started increasing in 2023.

---

<sup>(12)</sup> See European Banking Authority, [Risk Dashboard - Q4 2023](#)

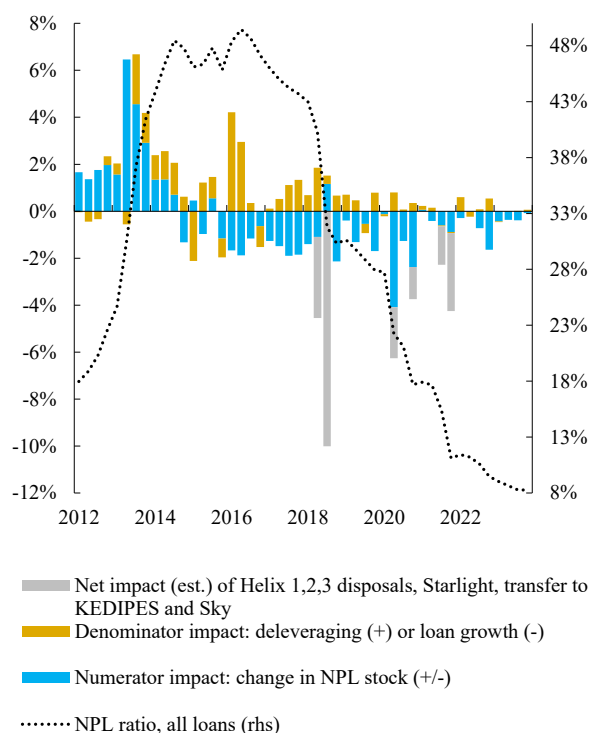
<sup>(13)</sup> See Central Bank of Cyprus, [Monetary Financial Statistics](#)

<sup>(14)</sup> See Central Bank of Cyprus, December 2023, [Aggregate Cyprus Banking Sector Data](#)

<sup>(15)</sup> The NPL ratio here excludes loans and advances to central banks and credit institutions. It is different to the NPL ratio in Cyprus's Country Report, which includes loans and advances to central banks and credit institutions and was 4% compared with the EU average of 1.8%.

<sup>(16)</sup> IFRS 9 staging provides some insights into how the banking sector perceives forward-looking credit risk.

Graph 4.1: NPL ratio and breakdown of changes



Source: Central Bank of Cyprus.

**Approximately a third of all NPLs in the banking system are held by Less Significant Institutions (LSIs).** Despite making some headway in NPL resolution through organic reductions, a few of the smaller banks continue to report NPL ratios significantly above those of systemic banks. Consequently, the Central Bank of Cyprus (CBC) has required them to develop and implement targeted NPL reduction strategies.

**In Cyprus, the proportion of loan renegotiations relative to total loan portfolios significantly surpasses the levels observed in other euro area countries.** In 2023, renegotiated loans increased from the previous year. These renegotiations are often motivated by competitive market dynamics and borrowers' endeavours to secure more favourable contractual terms in line with available pricing methodologies within and across banks. CBC monitors this trend, as renegotiations could reflect a healthy competitive environment but they may also indicate hindered repayment capability of borrowers and thus could signal an underlying vulnerability within the financial system.

### Risks to financial stability and macroprudential oversight

**Banks' asset quality has significantly improved, though some risks remain.** Inflation has subsided but remains higher than normal, and interest rates are still elevated. The still tight financing conditions may impact the ability of some vulnerable individuals and businesses to service their debts and could increase the credit risk for banks and deteriorate asset quality. This economic backdrop particularly challenges those with loans linked to Euribor, which have seen upward adjustments in their loan instalments in recent years. A high employment level coupled with wage growth in Cyprus mitigates the risks.



**Cypriot banks have significant exposure to the commercial real estate (CRE) sector, but risks appear contained by prudent underwriting standards and increasing valuations.**

In Cyprus, the banking sector's exposure to loans collateralised by CRE is relatively high compared to its CET1 capital, standing at 136%<sup>(17)</sup> in December 2023, which poses a potential risk to financial stability. However, this risk is counterbalanced by a number of favourable factors such as the relocation of foreign companies which has supported the office sector, and a steady flow of tourists which has buoyed demand for properties in the hospitality sector. Furthermore, prudent underwriting criteria and declining loan-to-value (LTV) ratios<sup>(18)</sup> ensure that companies have adequate headroom to absorb any future price decreases before reaching negative equity. Additionally, rental yields have remained relatively stable compared to the historical average, ensuring that companies are able to produce adequate income to cover debt service covenants. Despite these safeguards, the risk to financial stability associated with CRE, including the impact from the non-banking financial sector, warrants careful and continuous monitoring.

**Despite the banking sector's high exposure to the residential property market, risks appear contained.**

The observed reduction in mortgage loans has not materially affected demand for real estate. The residential property market has seen more transactions in 2022 and 2023 compared with the years of the pandemic and shows no significant signs of overvaluation. Foreign buyers, who rely less on mortgage lending, represent an important source of demand with a share of 44% of sales contracts in 2023. Furthermore, the number of sales contracts increased by 16% in 2023 compared to the previous year. The total value of transactions was similar in both years, with 2023 transactions amounting to EUR 4 039 million, slightly above the total value in 2022 of EUR 3 854 million<sup>(19)</sup>.

**Narrowing interest margins and potentially higher provisioning needs could make it difficult for Cypriot banks to maintain their current levels of profitability.**

Given Cypriot banks' balance-sheet structure, net interest income will likely remain their main income source in the coming year, but interest margins are likely to narrow. Policy rates are expected to decline and settle at levels that are lower than currently but possibly not as low as before the pandemic. Moreover, even though households and NFCs withstood well the gradual rise in interest rates and higher instalments, sustained higher levels of interest rates could weaken their ability to service their loans in the long term and create the need for additional provisions. In addition, even though private sector debt in Cyprus has been declining steadily in recent years<sup>(20)</sup>, it remains relatively high, suggesting that lending volumes are expected to remain subdued in the future. All these challenges may weigh on the banks' long-term profitability prospects.

**Accelerating climate risks call for clear risk ownership and proactive management.**

At the moment in Cyprus, the government provides implicit insurance coverage for these risks, but this may not be a sustainable way to manage them in the future. Physical and transition risks are drivers of prudential risk and thus it is important for institutions to identify, assess and monitor these risks in their balance sheets. Banks have started off on this path by setting up their environmental, social and governance (ESG) strategies and now they need to deliver on their ESG commitments.

---

<sup>(17)</sup> Commission staff calculation based on data from [Risk dashboard | European Banking Authority \(europa.eu\)](https://www.eba.europa.eu/en/risk-dashboard)

<sup>(18)</sup> In December 2023, the weighted average LTV stood at 55% for outstanding CRE loans, compared to 57% in 2022 and 71% in 2021.

<sup>(19)</sup> Department of Lands and Surveys, [Statistics – transfers of sales](https://www.dls.gov.cy/statistics)

<sup>(20)</sup> European Commission, 2024, [In-depth reviews - European Commission \(europa.eu\)](https://ec.europa.eu/economy_finance/in-depth-reviews)



Table 4.1: Soundness indicators for the banking sector in Cyprus

	2016	2017	2018	2019	2020	2021	2022	2023			
	Dec	Dec	Dec	Dec	Dec	Dec	Dec	Mar	Jun	Sept	Dec
<b>NPLs*, all loans (EUR billions)</b>	23,8	20,6	10,3	9,0	5,1	3,0	2,3	2,2	2,1	2,0	1,9
<b>NPLs*, all loans (% of total)</b>	47,2	43,7	30,3	27,9	17,7	11,0	9,5	9,0	8,7	8,3	7,9
<b>NPLs*, loans to NFCs (% of total)</b>	56,4	50,3	33,2	24,5	14,5	8,1	8,0	7,6	7,3	7,2	7,1
of which, restructured non-performing (%)	25,8	22,8	14,4	10,8	6,4	4,0	3,9	4,0	3,9	4,0	3,7
of which, restructured performing (%)	9,4	8,6	6,8	4,5	3,1	10,7	11,4	9,5	6,5	5,7	4,5
<b>NPLs*, loans to households (% of total)</b>	56,0	53,9	37,6	35,2	23,7	14,7	12,1	11,7	11,2	10,6	10,2
of which, restructured non-performing (%)	20,1	19,7	17,1	15,7	10,4	6,2	4,7	4,5	4,2	3,9	3,7
of which, restructured performing (%)	7,7	8,3	7,1	4,8	4,6	3,7	2,9	2,6	2,5	2,3	2,2
<b>Coverage rate (Impairments / NPLs)*</b>	40,3	45,9	49,6	55,2	46,2	42,7	47,5	48,8	50,4	50,3	49,5
<b>Cost-to-income ratio</b>	52,6	53,6	62,5	72,3	63,7	71,9	69,1	37,0	36,0	35,0	35,0
<b>Lending margin on new loans</b>	2,0	1,9	2,6	2,8	2,8	2,7	3,2	4,7	3,8	3,6	3,4
<b>Common Equity Tier 1 ratio</b>	15,9	14,9	15,1	17,4	17,6	17,6	17,7	17,3	18,9	19,4	20,0
<b>Return on equity (annualised)</b>	1,7	-11,2	6,1	3,5	-3,9	0,4	4,4	30,6	29,9	27,8	29,0

Source: Central Bank of Cyprus, European Central Bank. The figures cover Cyprus operations of all domestic and foreign credit institutions operating in Cyprus on a consolidated basis. Figures exclude exposures to central banks and credit institutions.

**The Cypriot central bank closely monitors macroprudential risks and upholds a rather tight macroprudential stance by employing capital-based and borrower-based measures.** In 2023 it announced an increase of the countercyclical capital buffer (CcyB) from 0.5% to 1.0% with effect from 2 June 2024. In April 2024, it published a revised policy for the designation of other systemically important institutions (O-SIIs) and methodology for the determination of the O-SII buffer, which resulted in increased capital requirements for several O-SIIs<sup>(21)</sup>. In addition, CBC employs borrower-based measures and has set maximum limits for LTV and Debt-Service-To-Income (DSTI) metrics, which depend on the type of property and/or the currency of the loan, respectively.

## 4.2. OTHER FINANCIAL SECTOR TOPICS

### Foreclosures framework and other policy developments

**The foreclosure framework has been safeguarded against multiple attempts to dilute its effectiveness.** In December 2023, following lengthy discussions, the Cypriot Parliament agreed on a package of amending laws that promote out-of-court resolution through the Financial Ombudsman and improve transparency during the NPL work-outs without altering the timeline of the foreclosure process. Unresolved disputes falling within the perimeter of eligible borrowers will be dealt with as priorities for a judicial resolution. The incentives of borrowers and creditors for an out-of-court resolution should now become more aligned, reducing reliance solely on the judicial system and potentially resulting in faster proceedings. Around the same time, the long-awaited mortgage-to-rent scheme<sup>(22)</sup> was launched, aiming at safeguarding vulnerable non-performing borrowers and facilitating the resolution of their NPLs. These developments offer an additional safety net to eligible borrowers in default and are expected to support the stability of the foreclosure framework. It is now crucial to allow it to operate without interference and effectively, to maintain payment discipline and

<sup>(21)</sup> Central Bank of Cyprus – [O-SII capital buffer for Other Systemically Important Institutions – Credit institutions](#)

<sup>(22)</sup> KEDIPES, [Mortgage to Rent campaign leaflet](#)

provide lenders with leverage over uncooperative borrowers. An effective foreclosure framework will also benefit the prevention of new NPLs.

**Also in December 2023, Cyprus amended the law on the sale of properties to address legacy inefficiencies in the system of transferring title deeds.** In the past, property rights were not properly defined, leading to the phenomenon of "trapped buyers" <sup>(23)</sup>. This often disincentivised buyers from continuing to service their loans and also hindered the liquidation of collateral. A new requirement in the amending law requires the seller to attach a recent search certificate from the Department of Land Registry and Surveys to the sales and purchase agreement. This adds a layer of security for all prospective buyers, allowing them to be fully informed of encumbrances or prohibitions registered against a property before finalising the transaction. Moreover, the amendments establish a resolution mechanism to address the existence of a prior mortgage from the seller's obligations to banks. The reform is expected to result in a swifter transfer of property rights from lenders to buyers as soon as the contractual obligations of a transaction are fulfilled and prevent further creation of "trapped buyers".

#### **Cyprus Asset Management Company (KEDIPEs)**

**The performance of KEDIPEs was satisfactory in 2023, despite challenges.** Since its inception in 2018, KEDIPEs has made cash repayments of EUR 1 160 million of State aid, of which EUR 280 million was paid in 2023. For 2023, cash inflows amounted to EUR 440 million, registering the highest since its inception in 2018. Until the end of 2023, KEDIPEs outperformed its business plan as regards cash inflows from loan management, property sales and rentals by 34% but lags significantly behind the projected portfolio sales targets <sup>(24)</sup>.

**KEDIPEs achieved an important milestone by selling a portfolio of performing and restructured loans to the Bank of Cyprus.** This transaction, called Project Ledra, was completed in December 2023 and underscores KEDIPEs's commitment to future portfolio sales. However, the perimeter of the portfolio was significantly smaller than initially envisaged <sup>(25)</sup>. This suggests that transferring reperforming loans back to the banking system could be more challenging than initially anticipated because credit institutions may lack the risk appetite to onboard such loans so soon. KEDIPEs plans to recalibrate its business plan to reflect recent trends in performance and also lessons learnt from the Ledra transaction.

**The mortgage-to-rent scheme was launched and KEDIPEs will manage its implementation.** The scheme is still open for applications, and by March 2024 more than 1 400 applications had been received (out of an initial estimated perimeter of 2 500), of which around 500 belong to KEDIPEs's portfolio. It targets NPLs collateralised by a primary residence with a market value of up to EUR 250 thousand and of up to EUR 350 thousand for the approved/eligible borrowers of ESTIA and OIKIA schemes that were assessed as not viable. It is open for borrowers of banks or credit-acquiring companies and participation is subject to strict eligibility criteria <sup>(22)</sup> .

---

<sup>(23)</sup> These are buyers who although they have fulfilled their contractual obligations to the seller, did not acquire a title deed for reasons that do not fall within their responsibility.

<sup>(24)</sup> KEDIPEs's business plan targets the full repayment of the state aid granted amounting to EUR 3 500 million.

<sup>(25)</sup> The final transaction concerned a portfolio of performing loans of value of EUR 58 million, which was smaller than the portfolio that was originally announced for sale, in Q4 2021, of around EUR 476 million.

## Capital market

**Cyprus's capital market remains comparatively small and plays a limited role in financing domestic enterprises.** Cyprus's market funding ratio stands at a mere 22.8%, significantly lower than the EU average of 50.8%, although it has been steadily increasing in recent years. The country ranks low in the NFC bond and equity issuance measured as a share of total NFC financing, and it has one of the lowest indicators measuring the value of venture capital investments relative to GDP in the EU-27 <sup>(26)</sup>. Broader efforts could be undertaken to promote and incentivise market financing through the capital markets, thereby enhancing the competitiveness of Cypriot SMEs and start-ups. A positive development is the recent establishment of a Cypriot Equity Fund enhancing alternative sources of finance for businesses. A developed capital market could also offer alternative investment opportunities to households with growing disposable income.

## Department of Insolvency

The recruitment process to fill in the vacancies within the organisational structure of the Department of Insolvency (DoI) was completed and the positions were filled in February 2024. The implementation of the Action Plan of the Customer Service and Communication departments of the DoI is progressing. A communication strategy for the DoI was adopted by the Council of Ministers in December 2023, thus initiating its implementation phase and aiming to promote the DoI and insolvency proceedings to the public. An operational DoI should guarantee the effective and efficient application of insolvency procedures and preventive restructuring frameworks. The backlog of insolvency cases still remains and the DoI is exploring solutions to clear pending cases such as outsourcing the backlog to professionals to complete the insolvency or liquidation procedures. The digitalisation of insolvency in Cyprus is ongoing and is expected to be implemented in 2025.

---

<sup>(26)</sup> Association for Financial Markets [KPIs report - 6th edition](#).

## 5. SOVEREIGN FINANCING AND CAPACITY TO REPAY

**The general government debt-to-GDP ratio has been decreasing at a fast pace over recent years and is projected to continue its downward path in 2024 and in the following years.** At the end of 2023, the debt-to-GDP ratio stood at approximately 77.3% of GDP, recording a cumulative decline of more than 37.6 percentage points since 2020. This significant reduction was attributed to the utilisation of a significant amount of cash reserves, which covered part of gross financing needs, the high nominal GDP growth and significant primary surpluses. For 2024 and 2025, Cyprus's general government debt ratio is forecast to continue declining, to 70.6% and 65.4% of GDP respectively, as the fiscal position and nominal GDP growth are expected to remain strong. The debt ratio is projected to continue decreasing beyond 2025 (see the Commission's debt sustainability analysis (DSA) annex).

**In 2024, the total gross financing needs (GFN) amount to EUR 1.8 billion (5.4%) of GDP.** They comprise of refinancing demands, which mostly relate to EUR 2.12 billion for medium to long-term debt obligations. The planned main sources of financing are bonds from the Euro Medium Term Notes (EMTN) market, and to a lesser extent loans from the European Investment Bank and the Council of Europe Development Bank. According to the authorities, for 2025 and 2026, GFN are estimated at EUR 1.2 billion (3.6% of GDP) and EUR 1.8 billion (around 5% of GDP) respectively.

**Cyprus maintains a robust cash position.** Its cash reserves represented approximately EUR 3.5 billion (11% of GDP) at the end of February 2024 and cover two times the gross financing needs for the rest of the year and 2.2 times the gross financing needs for the next 12 months.

**The public debt maturity profile is relatively long, limiting short-term risks.** The average maturity of debt is 7 years in 2023. In respect to debt distribution, Cyprus links 30.5% of its debt to a floating interest rate, which is to a large extent made up of ESM loans<sup>(27)</sup>. With Cypriot current and new stock of debt being issued in euro, there are no foreign exchange risks.

**The rise in interest rates in the last year increased the cost of issuing new long-term debt.** At the end of April 2024, the yield of the Cyprus 10-year bond stood at around 3.5% and the spread on the 10-year German Bund stood at around 0.9%, continuing a decreasing trend. At the same time, the higher borrowing costs on the primary markets have so far only had minimal effects on the weighted average cost of debt, increasing it to 1.62% in 2023 from 1.58% in 2022, keeping it on consistently low levels since its peak in 2012.

**Credit-rating upgrades over 2023 brought the country back to investment grade by all major credit-rating agencies.** The investment grade upgrade was driven by positive credit trends, particularly in respect to economic and fiscal strengths, as well as by progress made in clearing up non-performing loans (NPLs) in the banking system. The S&P and Fitch credit ratings for Cyprus currently stand at BBB, with the next scheduled rating reviews taking place in early and mid of June 2024, respectively, while Moody's (next scheduled rating review in May 2024) and DBRS's ratings stand at Baa2 and BBB(high) respectively. In March 2024, DBRS confirmed the credit rating of Cyprus at BBB(high) with a stable outlook. All major credit-rating agencies rank Cyprus at least two notches up from the highest non-investment grade. The Cyprus credit outlook has further improved with Fitch correcting it from stable to positive in December 2023. Thus, Fitch and S&P have a positive credit outlook, while DBRS and Moody's hold a stable credit outlook for Cyprus.

**Cyprus is scheduled to repay its debt to the European Stability Mechanism (ESM) over the period 2025-2031.** The country's total outstanding debt to the ESM is EUR 6.3 billion, representing around 21% of Cyprus's GDP and constituting approximately 27% of the nation's total public debt in

<sup>(27)</sup> The ESM interest payments on the floating-rate debt rely on a blended interest rate, calculated based on the funding and operational costs of the ESM.

2023. The repayment process will start in 2025 with an initial instalment of EUR 0.35 billion, followed by annual repayments averaging EUR 0.99 billion until the debt is fully settled by 2031.

**Cyprus maintains the capability to service its debt.** According to the DSA, Cyprus faces low fiscal sustainability risks in both the short and long term, while in the medium term, risks appear to be medium. Cyprus benefits from substantial cash reserves and growing primary surpluses, which serve to alleviate possible considerations arising from increased borrowing and refinancing costs.

## ANNEX 1

### Main macroeconomic indicators

Table A1.1:

	2019	2020	2021	2022	2023	2024	2025
<i>Real economy</i>							
	<i>(percent change)</i>						
Real GDP	5,5	-3,4	9,9	5,1	2,5	2,8	2,9
Domestic demand incl. inventories	6,1	-2,3	5,0	8,9	8,7	2,8	2,5
Private consumption expenditure	3,9	-6,4	5,6	8,6	4,2	2,2	1,9
Government consumption expenditure	12,4	11,0	7,5	2,7	1,6	2,5	1,4
Gross fixed capital formation	6,9	5,7	0,0	8,3	19,5	3,6	5,1
Exports of goods and services	8,7	1,6	21,6	13,6	-1,5	3,2	3,3
Imports of goods and services	9,5	3,2	15,4	18,3	5,1	3,2	2,9
	<i>(percentage points)</i>						
Domestic demand (excl. inventories)	5,6	-1,2	4,9	7,1	6,8	2,6	2,5
Foreign trade	-0,5	-1,2	4,9	-3,4	-6,3	0,0	0,3
Changes in inventories	0,4	-1,0	0,2	1,4	1,9	0,2	0,0
<i>Inflation</i>							
	<i>(percent change)</i>						
GDP deflator	1,3	-1,3	2,7	6,1	4,7	3,7	2,4
HICP	0,5	-1,1	2,3	8,1	3,9	2,4	2,1
<i>Labour market</i>							
	<i>(percent change, unless otherwise stated)</i>						
Unemployment rate (% of labour force)	7,1	7,6	7,5	6,8	6,1	5,6	5,4
Employment	3,8	-1,2	3,2	3,0	1,5	1,4	1,4
Compensation per employee	4,4	-0,5	4,3	1,1	5,6	3,9	1,5
Labour productivity	1,7	-2,3	6,5	2,0	1,0	1,4	1,4
Unit labour costs	2,7	1,9	-2,1	-0,9	4,6	2,5	0,1
<i>Public finance</i>							
	<i>(percent of GDP)</i>						
General government balance	0,9	-5,7	-1,8	2,7	3,1	2,9	2,9
Total revenue	39,4	38,6	40,1	41,5	43,3	43,3	43,2
Total expenditure	38,5	44,2	41,9	38,8	40,2	40,4	40,3
General government primary balance	3,1	-3,6	-0,1	4,2	4,5	4,3	4,2
Gross debt	93,0	114,9	99,3	85,6	77,3	70,6	65,4
<i>Balance of payments</i>							
	<i>(percent of GDP)</i>						
Current external balance	-5,5	-10,0	-6,1	-7,9	-12,1	-11,2	-10,8
Ext. bal. of goods and services	1,0	-1,4	4,0	0,3	-0,9	-0,7	0,0
Exports goods and services	76,5	80,7	89,4	95,0	89,4	88,5	89,1
Imports goods and services	75,5	82,0	85,5	94,7	90,3	89,1	89,1
<i>Memorandum item</i>							
	<i>(EUR bn)</i>						
Nominal GDP	23,2	22,1	24,9	27,8	29,8	31,8	33,5

Source: European Commission, European Economic Forecast Spring 2024.

## ANNEX 2

### Debt Sustainability Analysis

**This annex assesses fiscal sustainability risks for Cyprus over the short, medium and long term.** It follows the multi-dimensional approach of the European Commission's 2023 Debt Sustainability Monitor, updated based on the Commission's 2024 spring forecast.

**1 – Short-term risks to fiscal sustainability are low.** The Commission's early-detection indicator (SO) does not point to major short-term fiscal risks (Table A2.2) <sup>(28)</sup>. Government gross financing needs are expected to decrease to around 6% of GDP on average over 2024-2025 (Table A2.1, Table 1) <sup>(29)</sup>. Financial markets' perceptions of Cyprus are favourable as its debt rating continued to be upgraded in 2023. The main four credit-rating agencies now rate Cyprus' sovereign debt at investment grade (two notches within the investment-grade area with a positive or stable outlook).

**2 – Medium-term fiscal sustainability risks are medium.**

**The DSA baseline shows that the government debt ratio is expected to decline substantially to reach around 38% of GDP in 2034** (Graph 1, Table 1) <sup>(30)</sup>. The debt reduction is supported by the assumed sizeable structural primary surplus (excluding changes in the cost of ageing) of 3.5% of GDP as of 2024. This appears ambitious compared with past performance, suggesting limited fiscal room of manoeuvre <sup>(31)</sup>. The debt decline also benefits from a still favourable but declining snowball effect of around 1 pp. of GDP annually on average over 2025-2034, which is also supported by the expected impact on potential growth of Next Generation EU (NGEU).

**The baseline projections are stress-tested against four alternative deterministic scenarios to assess the impact of changes in key assumptions relative to the baseline** (Graph 1). Under the *historical structural primary balance (SPB) scenario* (i.e. the SPB returns to its historical 15-year average of 1.5% of GDP) the debt ratio would be about 15 pps. of GDP higher than under the baseline in 2034. Under the *adverse interest-growth rate differential scenario* (i.e. the interest-growth rate deteriorates by 1 pp. compared with the baseline), the debt ratio would be higher than under the baseline by 4 pps. of GDP in 2034. Under the *financial stress scenario* (i.e. interest rates temporarily increase by 1 pp. compared with the baseline) government debt ratio would be almost unchanged compared with the baseline. Finally, under the *lower structural primary balance scenario* (i.e. the projected cumulative improvement in the SPB over 2023-2024 is halved) the debt ratio would be higher than under the baseline by about 1 pp. in 2034.

---

<sup>(28)</sup> The SO is a composite indicator of short-term risk of fiscal stress. It is based on a wide range of fiscal and financial-competitiveness indicators that have proven to be a good predictor of emerging fiscal stress in the past.

<sup>(29)</sup> Gross financing needs are determined in line with the methodology described in the European Commission's 2023 Debt Sustainability Monitor, updated based on the Commission 2024 spring forecast.

<sup>(30)</sup> The assumptions underlying the Commission's 'no-fiscal policy change' baseline include in particular: (i) a structural primary surplus, before ageing costs, of 3.5% of GDP from 2024 onwards; (ii) inflation converging linearly towards the 10-year forward inflation-linked swap rate 10 years ahead (which refers to the 10-year inflation expectations 10 years ahead); (iii) the nominal short- and long-term interest rates on new and rolled over debt converging linearly from current values to market-based forward nominal rates by T+10; (iv) real GDP growth rates from the Commission 2024 spring forecast, followed by the EPC/OGWG 'T+10 methodology projections between T+3 and T+10 (average of 1.9%); (v) ageing costs in line with the 2024 Ageing Report (European Commission, Institutional Paper 279, April 2024). For information on the methodology, see the 2023 Debt Sustainability Monitor (European Commission, Institutional Paper 271, March 2024).

<sup>(31)</sup> This assessment is based on the consolidation space indicator, which measures the frequency with which a tighter fiscal position than assumed in a given scenario has been observed in the past. Technically, this consists of looking at the percentile rank of the projected SPB within the distribution of SPBs observed in the past in the country, taking into account all available data from 1980 to 2022.

**The stochastic projections indicate medium risk, pointing to the moderate sensitivity of these projections to plausible unforeseen events** <sup>(32)</sup>. These stochastic simulations indicate a 9% probability that the debt ratio will be higher in 2028 than in 2023, implying limited risks. At the same time, the uncertainty surrounding the baseline debt projections is high: the difference between the 10<sup>th</sup> and 90<sup>th</sup> debt distribution percentiles points) is high, as there is an 80% probability that the debt ratio will lie in a large range of 45 pps. of GDP in five years' time (Graph 2).

**3 – Long-term fiscal sustainability risks appear overall low.** This assessment is based on the combination of two fiscal gap indicators, capturing the required fiscal effort to stabilise debt (S2 indicator) and bring to 60% of GDP (S1 indicator) over the long-term <sup>(33)</sup>. This assessment is driven by the very favourable initial budgetary position, which is, however, (partly) offset by the projected increase in ageing costs. These results are conditional on the country maintaining a high structural primary surplus over the long term.

**The S2 indicator points to low fiscal sustainability risks.** The indicator shows that relative to the baseline, the SPB would only need to improve by 0.7 pp. of GDP in 2025 to ensure debt sustainability over the long term. This result is underpinned by significant ageing costs (contribution of 3.7 pps. of GDP), which are partly offset by a very favourable initial budgetary position (-3 pps. of GDP). Ageing costs are primarily driven by the projected increase in public pension expenditure (3.3 pps. of GDP) (Table A2.1, Table 2).

**The S1 indicator also points to low fiscal sustainability risks.** The S1 indicator signals that no consolidation effort is needed to bring debt to 60% of GDP by 2070. This result is driven by the very favourable initial budgetary position (contribution of -3.5 pps. of GDP), which is only partly offset by ageing costs (2.8 pps. of GDP) and the debt requirement (0.2 pp. of GDP) (Table A2.1, Table 2).

**4 – Finally, several additional risk factors need to be considered in the assessment.** On the one hand, risk-increasing factors are related to heightened borrowing costs and increased exposure to interest rate fluctuations in light of the high interest rate environment, Cyprus' negative net international investment position and risks to the budget balance due to higher public wage and social spending as well as a number of government-sponsored housing schemes, including the mortgage-to-rent scheme offered through KEDIPEs. On the other hand, risk-mitigating factors include the lengthening of debt maturities in recent years, substantial cash reserves, credit rating upgrades, relatively stable financing sources (with a diversified investor base), the currency denomination of debt, the low share of short-term public debt and the phasing out of energy-related support measures.

---

<sup>(32)</sup> The stochastic projections show the joint impact on debt of 10000 different shocks affecting the government's budgetary position, economic growth, interest rates and exchange rates. This covers 80% of all the simulated debt paths and therefore excludes tail events.

<sup>(33)</sup> The S2 fiscal sustainability indicator measures the permanent SPB adjustment in 2024 that would be required to stabilise public debt in the long term. It is complemented by the S1 indicator, which measures the permanent SPB adjustment in 2024 to bring the debt ratio to 60% by 2070. For both the S1 and S2 indicators, the risk assessment depends on the amount of fiscal consolidation needed: 'high risk' if the required effort exceeds 6 % of GDP, 'medium risk' if it is between 2% and 6% of GDP, and 'low risk' if the effort is negative or below 2% of GDP. The overall long-term risk classification combines the risk categories derived from S1 and S2. S1 may notch up the risk category derived from S2 if it signals a higher risk than S2. See the 2023 Debt Sustainability Monitor for further details.



Table A2.1: Debt sustainability analysis - Cyprus

Table 1. Baseline debt projections	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
Gross debt ratio (% of GDP)	99,3	85,6	77,3	70,6	65,8	60,9	57,1	53,6	50,1	47,0	44,2	41,7	39,6	37,6
Changes in the ratio	-15,7	-13,7	-8,3	-6,7	-4,8	-4,9	-3,9	-3,5	-3,5	-3,1	-2,8	-2,5	-2,2	-2,0
of which														
Primary deficit	0,1	-4,2	-4,5	-4,3	-3,7	-3,2	-2,8	-2,5	-2,7	-2,4	-2,2	-2,0	-1,7	-1,6
Snowball effect	-11,4	-8,7	-4,4	-3,4	-2,4	-1,6	-1,0	-0,9	-0,9	-0,7	-0,6	-0,5	-0,5	-0,4
Stock-flow adjustments	-4,4	-0,7	0,6	1,0	1,3	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
Gross financing needs (% of GDP)	6,0	4,5	2,7	5,2	6,8	6,8	6,5	6,6	5,8	4,9	4,9	2,3	2,2	2,1

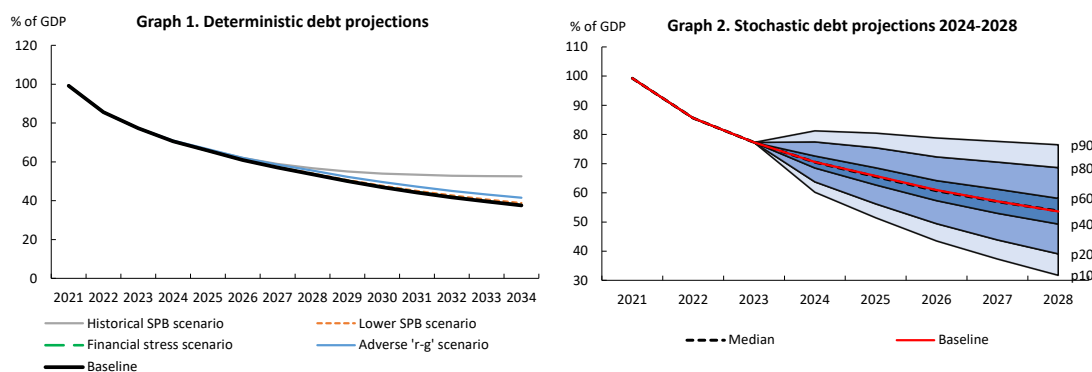


Table 2. Breakdown of the S1 and S2 sustainability gap indicators

	S1	S2
Overall index (pps. of GDP)	-0,5	0,7
of which		
Initial budgetary position	-3,5	-3,0
Debt requirement	0,2	
Ageing costs	2,8	3,7
of which		
Pensions	2,6	3,3
Health care	0,5	0,7
Long-term care	0,1	0,1
Education	-0,3	-0,4

Source: Commission services.

Table A2.2: Heat map of fiscal sustainability risks - Cyprus

Short term	Medium term - Debt sustainability analysis (DSA)							Long term			
	Overall (S0)	Overall	Deterministic scenarios					Stochastic projections	S2	S1	Overall (S1 + S2)
			Baseline	Historical SPB	Lower SPB	Adverse 'r-g'	Financial stress				
LOW	MEDIUM	Overall	LOW	LOW	LOW	LOW	LOW	MEDIUM	LOW	LOW	LOW
		Debt level (2034), % GDP	37,6	52,6	38,7	41,5	37,7				
		Debt peak year	2024	2024	2024	2024	2024				
		Fiscal consolidation space	20%	31%	20%	20%	20%				
		Probability of debt ratio exceeding in 2028 its 2023 level						9%			
							44,7				

(1) Debt level in 2034. Green: below 60% of GDP. Yellow: between 60% and 90%. Red: above 90%. (2) The debt peak year indicates whether debt is projected to increase overall over the next decade. Green: debt peaks early. Yellow: peak towards the middle of the projection period. Red: late peak. (3) Fiscal consolidation space measures the share of past fiscal positions in the country that were stringent than the one assumed in the baseline. Green: high value, i.e. the assumed fiscal position is plausible by historical standards and leaves room for corrective measures if needed. Yellow: intermediate. Red: low. (4) Probability of debt ratio exceeding in 2028 its 2023 level. Green: low probability. Yellow: intermediate. Red: high (also reflecting the initial debt level). (5) The difference between the 90th and 10th percentiles measures uncertainty, based on the debt distribution under 10000 different shocks. Green, yellow and red cells indicate increasing uncertainty. (For further details on the Commission's multidimensional approach, see the 2023 Debt Sustainability Monitor)

Source: European Commission (for further details on the Commission's multidimensional approach, see the 2023 Debt Sustainability Monitor)

Source: Commission services.



## **EUROPEAN ECONOMY INSTITUTIONAL PAPERS SERIES**

European Economy Institutional Papers series can be accessed and downloaded free of charge from the following address: [Publications \(europa.eu\)](http://ec.europa.eu/economy_finance/publications/european_economy/index_en.htm).

Titles published before July 2015 can be accessed and downloaded free of charge from:

- [http://ec.europa.eu/economy\\_finance/publications/european\\_economy/index\\_en.htm](http://ec.europa.eu/economy_finance/publications/european_economy/index_en.htm)  
(the main reports, e.g. Economic Forecasts)
- [http://ec.europa.eu/economy\\_finance/publications/occasional\\_paper/index\\_en.htm](http://ec.europa.eu/economy_finance/publications/occasional_paper/index_en.htm)  
(the Occasional Papers)
- [http://ec.europa.eu/economy\\_finance/publications/qr\\_euro\\_area/index\\_en.htm](http://ec.europa.eu/economy_finance/publications/qr_euro_area/index_en.htm)  
(the Quarterly Reports on the Euro Area)



## **GETTING IN TOUCH WITH THE EU**

### **In person**

All over the European Union there are hundreds of Europe Direct Information Centres. You can find the address of the centre nearest you at: <http://europa.eu/contact>.

### **On the phone or by e-mail**

Europe Direct is a service that answers your questions about the European Union. You can contact this service:

- by freephone: 00 800 6 7 8 9 10 11 (certain operators may charge for these calls),
- at the following standard number: +32 22999696 or
- by electronic mail via: <http://europa.eu/contact>.

## **FINDING INFORMATION ABOUT THE EU**

### **Online**

Information about the European Union in all the official languages of the EU is available on the Europa website at: <http://europa.eu>.

### **EU Publications**

You can download or order free and priced EU publications from EU Bookshop at: <http://publications.europa.eu/bookshop>. Multiple copies of free publications may be obtained by contacting Europe Direct or your local information centre (see <http://europa.eu/contact>).

### **EU law and related documents**

For access to legal information from the EU, including all EU law since 1951 in all the official language versions, go to EUR-Lex at: <http://eur-lex.europa.eu>.

### **Open data from the EU**

The EU Open Data Portal (<http://data.europa.eu/euodp/en/data>) provides access to datasets from the EU. Data can be downloaded and reused for free, both for commercial and non-commercial purposes.

