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CYPRUS: MACRO FISCAL ASSESSMENT

AN ANALYSIS OF THE APRIL 2010 UPDATE OF THE STABILITY PROGRAMME

The Stability and Growth Pact requires each EU Member State to present an annual update of its medium-term fiscal programme, called 'stability programme' for countries that have adopted the euro as their currency and 'convergence programme' for those that have not. The most recent update of Cyprus' stability programme was submitted on 1 April 2010.

The attached technical analysis of the programme prepared by the staff and under the responsibility of the Directorate-General for Economic and Financial Affairs (DG ECFIN) of the European Commission, was finalised on 12 May 2010. Comments should be sent to Polyvios Eliofotou (Polyvios.Eliofotou@ec.europa.eu). The main aim of the analysis is to assess the realism of the budgetary strategy presented in the programme as well as its compliance with the requirements of the Stability and Growth Pact. However, the analysis also looks at the overall macro-economic performance of the country and highlights relevant policy challenges.

The analysis takes into account (i) the Commission services' spring 2010 forecast, (ii) the code of conduct ("Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes", endorsed by the ECOFIN Council of 10 November 2009) and (iii) the commonly agreed methodology for the estimation of potential output and cyclically-adjusted balances.

Based on this analysis, the European Commission adopted a recommendation for a Council opinion on the programme on 12 May 2010. The ECOFIN Council is expected to adopt its opinion on the programme on 8 June 2010.

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All these documents, as well as the provisions of the Stability and Growth Pact, can be found on the following website:

http://ec.europa.eu/economy_finance/sgp/index_en.htm

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1. INTRODUCTION

This document assesses the April 2010 update of Cyprus' stability programme. It takes into account all currently available information, notably the Commission services' spring 2010 Forecast and the short-term fiscal stimulus measures adopted by the Cypriot authorities in response to the economic downturn. The programme, which was submitted on 1 April 2010[1], covers the period 2009-2013 and builds on the 2010 budget proposal. It was approved by the government and consequently presented to the political parties.

This assessment is structured as follows. Section 2 discusses the key challenges for public finances in Cyprus. Section 3 assesses the plausibility of the macroeconomic scenario underpinning the public finance projections of the stability programme against the background of the Commission services' economic forecasts[2]. Section 4 analyses budgetary implementation in the year 2009, the budgetary plans for 2010 and the medium-term budgetary strategy. It also assesses risks attached to the budgetary targets. Section 0 reviews recent debt developments and medium-term prospects, as well as the long-term sustainability of public finances. Section 6 discusses institutional features of public finances. Finally, section 7 concludes with an overall assessment of the programme. The annex provides a detailed assessment of compliance with the code of conduct, including an overview of the summary tables from the programme.

[1] The Programme submitted was in English.

[2] This assessment uses the Commission services' 2010 spring forecast, published on 5 May 2010, as a benchmark. However, more recent information that has become available has also been taken into account to assess the risks to the programme scenarios.

Table 1. Comparison of key macroeconomic and budgetary projections

		2008	2009	2010	2011	2012	2013
Real GDP (% change)	**SP Apr 2010**	**3.6**	**-1.7**	**0.5**	**1.5**	**3.0**	**3.2**
	COM May 2010	3.6	-1.7	-0.4	1.3	n.a.	n.a.
	CP Feb 2009	*3.8*	*2.1*	*2.4*	*3.0*	*3.2*	*n.a.*
HICP inflation (%)	**SP Apr 2010**	**4.4**	**0.2**	**2.7**	**2.0**	**2.0**	**2.0**
	COM May 2010	4.4	0.2	2.7	2.5	n.a.	n.a.
	CP Feb 2009	*4.4*	*2.0*	*2.5*	*2.5*	*2.5*	*n.a.*
Output gap[1] (% of potential GDP)	**SP Apr 2010**	**2.9**	**-1.3**	**-2.4**	**-2.5**	**-1.6**	**-0.5**
	COM May 20102	3.4	-0.7	-2.1	-1.6	n.a.	n.a.
	CP Feb 2009	*0.8*	*-0.1*	*-0.6*	*-0.5*	*-0.2*	*n.a.*
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	**SP Apr 2010**	**-17.7**	**-8.5**	**-11.5**	**-12.2**	**-12.6**	**-12.9**
	COM May 2010	-17.6	-8.2	-6.8	-6.7	n.a.	n.a.
	CP Feb 2009	*-12.4*	*-12.1*	*-11.5*	*-10.9*	*-10.2*	*n.a.*
General government revenue (% of GDP)	**SP Apr 2010**	**43.5**	**40.3**	**41.6**	**42.8**	**43.6**	**44.2**
	COM May 2010	43.5	40.3	41.2	41.3	n.a.	n.a.
	CP Feb 2009	*45.3*	*43.8*	*44.0*	*44.4*	*44.8*	*n.a.*
General government expenditure (% of GDP)	**SP Apr 2010**	**42.6**	**46.4**	**47.6**	**47.2**	**47.0**	**46.7**
	COM May 2010	42.6	46.4	48.3	49.0	n.a.	n.a.
	CP Feb 2009	*44.3*	*44.6*	*45.5*	*46.3*	*47.1*	*n.a.*
General government balance (% of GDP)	**SP Apr 2010**	**0.9**	**-6.1**	**-6.0**	**-4.5**	**-3.4**	**-2.5**
	COM May 2010	0.9	-6.1	-7.1	-7.7	n.a.	n.a.
	CP Feb 2009	*1.0*	*-0.8*	*-1.4*	*-1.9*	*-2.2*	*n.a.*
Primary balance (% of GDP)	**SP Apr 2010**	**3.7**	**-3.6**	**-3.7**	**-2.1**	**-1.0**	**0.1**
	COM May 2010	3.7	-3.6	-4.4	-4.8	n.a.	n.a.
	CP Feb 2009	*3.9*	*1.5*	*0.8*	*0.2*	*-0.2*	*n.a.*
Cyclically-adjusted balance[1] (% of GDP)	**SP Apr 2010**	**-0.2**	**-5.6**	**-5.1**	**-3.5**	**-2.8**	**-2.3**
	COM May 2010	-0.4	-5.8	-6.3	-7.1	n.a.	n.a.
	CP Feb 2009	*0.7*	*-0.8*	*-1.2*	*-1.7*	*-2.1*	*n.a.*
Structural balance[3] (% of GDP)	**SP Apr 2010**	**-0.2**	**-5.6**	**-5.2**	**-3.6**	**-2.9**	**-2.3**
	COM May 2010	-0.4	-5.8	-6.3	-7.1	n.a.	n.a.
	CP Feb 2009	*0.7*	*-0.8*	*-1.2*	*-1.7*	*-2.1*	*n.a.*
Government gross debt (% of GDP)	**SP Apr 2010**	**48.4**	**56.2**	**61.0**	**63.2**	**63.1**	**62.3**
	COM May 2010	48.4	56.2	62.3	67.6	n.a.	n.a.
	CP Feb 2009	*49.3*	*46.8*	*45.4*	*44.2*	*44.2*	*n.a.*

Notes:

[1]Output gaps and cyclically-adjusted balances from the programmes as recalculated by Commission services on the basis of the information in the programmes.

[2]Based on estimated potential growth of 2.0%, 2.8%, 2.8%, 2.8% and 2.8% respectively in the period 2009-2013.

[3]Cyclically-adjusted balance excluding one-off and other temporary measures. One-off and other temporary measures are 0.1% in years 2010, 2011 and 2012 (all deficit reducing) according to the most recent programme. There are no one-off and other temporary measures in the Commission services' spring 2010 forecast.

Source :

Stability programme (SP); Commission services' spring 2010 forecasts (COM); Commission services' calculations.

2. KEY CHALLENGES IN THE ECONOMIC DOWNTURN AND THE POLICY RESPONSE

This section describes recent economic and budgetary developments for Cyprus, which form the background against which the current programme assessment should be viewed, and outlines the key challenges to be addressed by future economic policies.

More than a decade of sustained and strong economic expansion in Cyprus came to an end in 2009. For the first time in 35 years, economic activity in Cyprus fell by 1¾%. According to Commission services' calculations, the output gap passed into negative territory and widens. Weak domestic demand and an adverse external environment weighed strongly on growth. In particular, high household indebtedness together with tighter lending conditions, a worsening labour market outlook and negative confidence effects led to a decline in private consumption. In parallel, investment recorded a strong correction, amidst a fall in foreign demand for housing, low capacity utilisation and the restructuring of corporate balance sheets. Government consumption was the only demand component supporting economic activity. Adverse external conditions and weak economic activity in Cyprus' main trading partners had a negative effect on exports of both goods and services. Due to the contraction of private consumption and investment, imports also declined. Overall, the growth contribution of external sector was negative while there was a significant, yet partial, correction of the external deficit, which nevertheless remained high, at 8.5% of GDP in 2009. The weak economic outlook weighed on the labour market, particularly in labour-intensive sectors such as construction and tourism. Accordingly, employment declined while the unemployment rate rose to about 5¼% in 2009. The deterioration of labour market conditions remained limited. High contractual salary increases coupled with the application of the backward-looking automatic wage indexation system (cost of living allowance, COLA) led to strong wage growth in 2009. As productivity declined, in line with a contracting GDP, unit labour costs grew at high levels, above the euro area average, thus eroding the country's competitiveness.

The downturn took also a heavy toll on public finances. The government deficit outturn was higher than expected and reached 6.1% of GDP in 2009, reflecting both reduced revenues from the fading away out of the asset boom and higher expenditures. The debt ratio reversed its declining trend and rose to 56¼% of GDP. The quickly changing outlook for the Cypriot economy seriously hampers the fiscal prospects mainly to the extent that important tax bases will suffer further from the demand retrenchment as suggested already by the developments observed since 2008.

Cyprus has adopted a number of measures to stimulate economic activity since the second half of 2008. These measures aimed at mitigating the impact of the crisis on the most exposed economic sectors, particularly the construction and tourism sectors. The government has also adopted targeted measures to enhance social cohesion, providing support to low income families, as well as a series of structural measures, which are part of the longer-term policy reform agenda, but help to address the current challenges posed by the downturn. These measures are related to the medium-term reform agenda and aim at augmenting the growth potential, strengthening competitiveness and enhancing the physical and human capital.

The crisis has highlighted the accumulation of a high external imbalance, which reflects not only the low private sector net savings but also a deterioration of the net position of general government and competitiveness losses, and a particularly oversized housing sector. These factors set the stage for the structural adjustment of the economy. The external imbalance is likely to weigh on economic growth over the medium-term. High public sector dissavings would need to be financed by foreign debt or domestic private savings. Thus, the adjustment of the current account imbalance would require either higher cost of debt-financing or higher savings from the private sector. The latter would imply lower output growth through lower private consumption or investment (crowding-out effect). Therefore, in the light of the high external imbalance, maintaining prudent policies and strengthening fiscal sustainability should be a major priority. Consequently, controlling current expenditure while supporting revenues through structural measures, represents a major challenge for the fiscal policy in Cyprus in order to safeguard a sound long-term budgetary position. In addition, fostering the quality of public finances is important also with a view to underpinning a smooth adjustment of the economy in the light of the imbalances it is faced with.

Moreover, although much of the observed decline in actual GDP in the context of the crisis is cyclical, the level of potential output has also been negatively affected. The crisis is expected to also affect potential growth in the medium-term through lower investment, constraints in credit availability and increasing structural unemployment. The impact of the economic crisis also compounds the negative effects of demographic ageing on potential output and the sustainability of public finances. Against this background it will be essential to accelerate the pace of structural reforms with the aim of supporting potential growth. For Cyprus, it is also important to undertake reforms in the area of the labour market, especially to strengthen lifelong learning opportunities, in particular, with regard to the low-skilled, older workers and unemployed people as well as to ensure the timely and effective implementation of the planned reforms in technical and vocational education. Moreover, there is a need to better align wage growth with productivity, employment growth and competitiveness.

3. MACROECONOMIC OUTLOOK

Against the background of the current macroeconomic situation and the main policy challenges set out in the previous section, this section makes an assessment of the plausibility of the macroeconomic scenario underpinning the public finance projections of the programme.

The macroeconomic scenario underlying the programme envisages that real GDP growth will rise from -1.7% in 2009 to 0.5% in 2010, thus economic activity would return to a recovering trend as of the current year. Thereafter, GDP would grow at around 2.6% per year, above potential (as estimated by the Commission Services for the spring 2010 forecasts) until the end of the programme period. The recovery in 2010 would be mainly triggered by a positive adjustment of the inventory cycle, following the significant destocking observed in 2009. On the other hand, weak domestic demand and a negative contribution from net exports are set to weigh on growth.

The programme foresees domestic demand to continue being the main driver of growth, on the back of a recuperating private consumption, although at more sustainable rates than the exuberant rates of the recent past. Investment is projected to continue exhibiting a significant correction in 2010 and to a lesser extent in 2011, owing mainly to slackening construction, on account of a subdued external demand for secondary residences in coastal areas. Despite a boost of public investment in infrastructure projects, the overall growth of construction investment is set to contract. Investment in machinery and equipment is also projected to decline in 2010 but to recover thereafter. On the external side, the Programme projects also a negative contribution to growth throughout the programme period. The growth of total exports is set to remain subdued in 2010, mainly dragged by the expected bleak outlook for tourism and transportation services in the backdrop of a frail economic recovery of the main trade partners, and then to recover gradually. However, exports of services other than tourism, such as financial and other business services, are foreseen to continue on more robust growth rates over the period. As imports are forecast to rebound in 2010 from the large drop of last year, and recuperate growth moderately thereafter, the contribution of the external sector to growth is projected to remain negative during the programme period. Accordingly, the current account deficit is expected to stay at relatively high levels over the medium term and resume its increasing trend, reaching almost 13% of GDP by 2013. This would imply an overall deterioration in the savings-investment balance, as according to the update, the decline in the domestic saving ratio will be larger than the fall in the investment rate.

The programme projects that unemployment will increase and reach a peak at 6.5% in 2011 as a result of below-potential growth. Thereafter, unemployment is projected to decline in line with the recovering economic activity. Employment growth is projected to remain positive, although in sectors more directly exposed to the external slowdown such as hotels, restaurants and construction, some decreases in employment will be observed. The gainfully employed population is forecast to continue increasing moderately, though at significantly slower pace compared to recent past trends. In this context, productivity is also expected to grow mildly, at about 1% per year, below past rates. Inflationary pressures are projected to return to the historical trend around 2½% over the medium-term, although subject to risks associated with developments in the oil and commodity prices.

Table 2: Comparison of macroeconomic developments and forecasts

	2009		2010		2011		2012	2013
	COM	SP	COM	SP	COM	SP	SP	SP
Real GDP (% change)	-1.7	-1.7	-0.4	0.5	1.3	1.5	3.0	3.2
Private consumption (% change)	-3.0	-3.0	-1.1	0.5	2.1	3.5	4.5	4.6
Gross fixed capital formation (% change)	-12.0	-12.0	-12.9	-9.0	-3.8	-3.3	3.5	4.2
Exports of goods and services (% change)	-11.8	-11.8	0.6	1.2	3.3	3.9	4.3	4.8
Imports of goods and services (% change)	-19.8	-19.8	-1.3	5.0	2.4	4.6	5.6	6.0
Contributions to real GDP growth:								
- Final domestic demand	-3.9	-3.4	-3.2	-1.2	1.1	1.9	3.7	3.9
- Change in inventories	-4.1	-4.5	1.8	3.6	0.0	0.2	0.3	0.4
- Net exports	5.8	6.2	0.9	-1.9	0.3	-0.7	-1.0	-1.1
Output gap[1]	-0.7	-1.3	-2.1	-2.4	-1.6	-2.5	-1.6	-0.5
Employment (% change)	-0.7	-0.7	-0.7	0.0	-0.2	0.5	1.5	1.5
Unemployment rate (%)	5.3	5.3	6.7	6.5	7.0	6.5	6.0	5.5
Labour productivity (% change)	-1.1	-1.1	0.3	0.5	1.5	0.9	1.5	1.7
HICP inflation (%)	0.2	0.2	2.7	2.7	2.5	2.0	2.0	2.0
GDP deflator (% change)	0.0	0.0	2.1	1.7	2.4	2.0	2.1	2.1
Comp. of employees (per head, % change)	5.4	5.6	3.2	4.3	3.6	3.5	3.1	3.3
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	-8.2	-8.5	-6.8	-11.5	-6.7	-12.2	-12.6	-12.9

Note:

[1]In percent of potential GDP, with potential GDP growth according to the programme as recalculated by Commission services.

Source :

Commission services' spring 2010 forecasts (COM); Stability programme (SP).

The economic outlook described in the programme's central scenario is more favourable than the Commission services' spring 2010 forecast. The Commission services' forecast expects a deeper and more protracted economic downturn, with real GDP contracting also in 2010. Accordingly, in the Commission projections, labour market developments are less favourable and the recovery outlook more moderate. Furthermore, the Commission services also project a more severe correction in investment and a more gradual recovery of trade.

4. General government balance

This section consists of four parts. The first three parts discuss the budgetary implementation in the year 2009, the budgetary plans for 2010 and the medium-term budgetary strategy in the programme. The final part analyses the risks attached to the budgetary targets.

4.1. Budgetary implementation in 2009

In 2009, economic activity contracted by 1.7% after 35 years of positive growth. The magnitude of the economic slowdown was significantly larger than anticipated. As a result, the general government balance deteriorated considerably, reaching a deficit of 6.1% of GDP from a surplus of 0.9% of GDP in 2008, on account of both lower-than-expected revenue and higher-than-planned expenditure. The structural balance (i.e. the cyclically adjusted balance net of one-off and other temporary measures as recalculated by Commission services on the basis of the information in the programme update) fell from -½% of GDP in 2008 to -5½%. Overall, fiscal policy was expansionary in line with the European Economic Recovery Plan (EERP).

Table 3: Budgetary implementation in 2009

	2008		2009	
	Planned **SP Feb 2009**	**Outcome** **SP Apr 2010**	**Planned** **SP Feb 2009**	**Outcome** **SP Apr 2010**
Government balance (% of GDP)	1.0	0.9	-0.8	-6.1
Difference compared to target [1]	-0.1		-5.3	
Difference excluding denominator effect [1,2]			**-5.4**	
Of which : due to a different starting position end 2008			0.0	
due to different revenue / expenditure growth in 2009			-5.0	
p.m. Residual [3]			-0.4	
p.m. Nominal GDP growth (planned and outcome)			*4.8*	*-1.7*
Revenue (% of GDP)	45.3	43.5	43.8	40.3
Revenue surprise compared to target [1]	-1.8		-3.5	
Revenue surprise excluding denominator effect [1,2]			**-6.2**	
Of which : due to a different starting position end 2008			-1.7	
due to different revenue growth in 2009			-4.3	
p.m. Residual [3]			-0.2	
p.m. Revenue growth rate (planned and outcome)			*1.3*	*-8.9*
Expenditure (% of GDP)	44.3	42.6	44.6	46.4
Expenditure surprise compared to target [1]	1.7		-1.8	
Expenditure surprise excluding denominator effect [1,2]			**0.9**	
Of which : due to different starting position end 2008			1.7	
due to different expenditure growth rate in 2009			-0.6	
p.m. Residual [3]			-0.2	
p.m. Expenditure growth rate (planned and outcome)			5.5	7.1

Notes:

[1] A positive number implies that the outcome was better (in terms of government balance) than planned.

[2] The denominator effect captures the mechanical effect that, if GDP turns out higher than planned, the ratio of revenue or expenditure to GDP will fall because of a higher denominator. Although the denominator effect can be very significant for revenue and expenditure separately, on the balance they usually largely cancel against each other.

[3] The decomposition leaves a small residual that cannot be assigned to the previous components. The residual is generally small, except in some cases where planned and actual growth rates of revenue, expenditure and GDP differ significantly.

Source : *Commission services*

Table 3 compares the projected outcome for the general government balance, revenue and expenditure (as a percentage of GDP) in 2009 as presented in the new stability programme with the targets from the previous update of the programme. Differences between outcome and targets (excluding the impact of an unanticipated GDP developments which may have affected the ratio, referred to as the ‘denominator effect’) are decomposed in the impact of a different starting position (i.e. the outcome of 2008 may also have been different from what was anticipated in the previous programme update) and the impact of differences in the revenue / expenditure growth rate from the planned growth rates[3].

[3] Mathematically, the difference in the revenue ratio in Table 3 can be expressed as:

$$\rho^o - \rho^p = \underbrace{\frac{1+r^p}{1+g^p}\Delta\rho_{-1}}_{\text{Base effect}} + \underbrace{\frac{\rho^o_{-1}}{(1+g^o)(1+g^p)}\Delta r}_{\text{Revenue growth effect}} - \underbrace{\frac{\rho^o_{-1}}{(1+g^o)(1+g^p)}\Delta g}_{\text{Denominator effect}} + \underbrace{\frac{\rho^o_{-1}\left(r^o g^p - r^p g^o\right)}{(1+g^o)(1+g^p)}}_{\text{Residual}}$$

The worse-than-expected budgetary deterioration in 2009 largely reflects the crisis that affected the country with a lag compared with the rest of the EU. It also reflects the stimulus measures amounting to 1½% of GDP which the government adopted in line with the EERP. On the one hand, the slowdown of activity coupled with the fading impact of the asset boom, with reduced corporate profitability, growth composition effects due to the significant decline of tax-rich private consumption, imports and lower commodity prices, weighed heavily on tax receipts. These were aggravated further by the temporary application of the reduced VAT rate (from 8% to 5%) on hotel accommodation, which was introduced as part of the fiscal stimulus package in order to address the negative repercussions of the crisis on the tourism sector. As a result, direct taxes declined by 3½ pp of GDP while indirect taxes fell by 1¾ pp. Only social contributions and other revenue posted positive growth rising by 1½ and ½ pp of GDP respectively, with the former benefiting from the rise of contribution rates adopted in the first half of the year as part of the pension reform. On the other hand, current expenditure continued to rise, despite the fall in interest paid. In particular, expenditure growth was driven by an increase in the public wage bill and social transfers by 1½ and 1¾ pp of GDP respectively. Social cohesion measures and the anticipated increase in the number of new retirees, following the gradual extension of the retirement age from 60 to 63 years of age introduced in mid-2005, contributed to an acceleration of social outlays. Public investment also increased considerably, due to the stimulus package. Despite the positive base effect from 2008, when expenditure outturn was 1¾% of GDP lower than planned, an acceleration of expenditure in 2009 by about 7% rather than 5½% as planned in the 2009 Stability Programme, more than offset the positive starting point, leading to an overrun of 1¾ pp of GDP.

The 2009 deficit is significantly higher than the target of 0.8% of GDP deficit set in the 2008 stability programme, as a result of the economic downturn and an expansionary fiscal stance due to the adoption of significant stimulus measures in line with the EERP.

4.2. The programme's budgetary strategy for 2010

The update projects a budget deficit of 6% of GDP in 2010. This represents a downward revision by 1½ percentage points of GDP vis-à-vis the 2010 budget law (approved by the Parliament on 24 December 2009), which targeted a deficit of 4.5% of GDP on the basis of an estimated outturn for the deficit in 2009 of about 3% of GDP. Given that the final outturn for 2009 was a deficit of 6% of GDP, the budget law would imply an even higher deficit. However, the programme aims to stabilise the 2010 deficit at the 2009 levels.

According to the update, the growth of total revenue is projected to accelerate consistently with the programme's projected moderate recovery of economic activity. Revenues are forecast to rise by 5.5%, above nominal GDP growth, and to reach 41.6% of GDP in 2010 compared with 40.3% the year before. Direct and indirect taxes are projected to rise by ½ percentage points of GDP each. Social contributions are also set to increase by ¼ percentage points of GDP, benefiting from the full-year impact of the rise of contribution rates adopted in 2009, as part of the adopted pension reform. The accelerated rate of growth is mainly attributed to the assumed application of a number of fiscal consolidation measures such as the adoption of legislative measures combating tax evasion and avoidance (0.1% of GDP), a town planning amnesty (0.1% of GDP; one-off), the harmonisation of the minimum excise duties on petroleum products (0.2% of

where r is the growth rate of revenue and g is the growth rate of GDP. The subscript -1 refers to the previous year's value. Superscripts o and p refer to the outcome and the planned value respectively. Similar for the expenditure ratio.

GDP), and a receipt of dividend income from various semi-governmental organisations (0.5% of GDP). The update also expects revenues to be supported by a reversal of the negative trend of revenues associated with real estate and construction activity. In particular, land and survey fees and capital gains taxes are forecast to exhibit growth of some 4%, following a cumulative loss amounting to 77 percent since 2008.

Public expenditure is also planned to increase in 2010 (1¼% of GDP) on the back of rising primary current expenditure. In particular, social transfers, subsidies and in the public wage bill are planned to increase by 0.6, 0.3 and 0.2 percentage points of GDP, respectively. According to the update, interest payments are set to continue their declining trend, falling by a ¼ percentage point of GDP, despite the rising stock of debt. Public investment is planned to remain at 2009 levels.

Overall, the fiscal policy stance, as measured by the structural balance (i.e. in cyclically-adjusted terms net of one-off and other temporary measures), implied by the Programme will be tightening in 2010 of an order of ½% of GDP.

Table 4. Main budgetary measures for 2010

Revenue measures[1]	Expenditure measures[2]
• Application of the reduced VAT rate on hotel accommodation of 5% instead of 8% (-0.1% of GDP) • Temporary suspension of overnight stay fees levied by local authorities on hoteliers (-0.05% of GDP) • Reduction of airport taxes levied on airline companies (-0.1% of GDP) • Application of the minimum excise duty, prescribed by the acquis, on heating oil (-0.1% of GDP) • Full year impact from the application of parametric reforms to the Social Security Funds (+0.1% of GDP)	• Introduction of a means-tested scheme targeted towards low income households with at least one pensioner aiming at raising their level of income vis-à-vis relative poverty. Eligible households of two must have an annual income less than €15.597 (+0.3% of GDP) • Introduction of an island-wide public transportation scheme (+0.2% of GDP) • Introduction of a means tested scheme for tertiary education students' care (+0.1% of GDP) • Suspension of the creation of permanent posts in the civil service and the employment of temporary personnel for the next eighteen months (-0.05% of GDP)

Notes:

[1] Estimated impact on general government revenue
[2] Estimated impact on general government expenditure

Source: Commission services and Stability Programme 2009-2013.

4.3. The programme's medium-term budgetary strategy

The Programme foresees the headline deficit to improve gradually from a target of 6% of GDP in 2009 to 2.5% in 2013. By sub-sector, the budgetary improvement takes place in the central government balance. The surplus of the Social Security Fund is projected to decline by 1 percentage point of GDP due to worsening demographics and an unchanged social security contribution rate over the period. The local government remains in balance. The primary balance will improve in tandem and from a deficit of 3.6% of GDP in 2009 is projected to reach a balanced position by the end of the period. The structural balance (i.e. in cyclically-adjusted terms net of one-off and other temporary measures) points to an improvement of the deficit from 5½% of GDP in 2009 to about 2¼% of GDP in 2013. The annual fiscal effort would average about ¾ percentage points of GDP per year over the period 2010-2013. The adjustment appears front-loaded, although measures taken in 2010 will have their full effect only in 2011. Moreover, measures taken within the context of the EERP will only be phased out by the end of 2010. On the basis of the commonly agreed methodology, the structural balance deviates from the MTO, which is reaffirmed as a balanced budget in structural terms, throughout the period. Overall, although the programme foresees an improvement in the structural balance, the MTO does not seem to be reached within the programme period. The significant deviation from the MTO is problematic in the light of the large external imbalance of the Cypriot economy.

Box 1: The medium-term objective (MTO) for Cyrus

As noted in the Code of Conduct[4], the MTO aims to (a) provide a safety margin with respect to the 3% of GDP deficit limit; (b) ensure rapid progress towards fiscal sustainability; and (c) allow room for budgetary manoeuvre, in particular taking into account the needs for public investment. The MTO is defined in cyclically adjusted terms, net of one-off and other temporary measures. On 7 July 2009, the ECOFIN Council took note of a new methodology for setting MTOs, ensuring that implicit liabilities (costs related to ageing populations, in particular projected healthcare and pension expenditure) are also accounted for.

Specifically, the country-specific MTOs should take into account three components: (i) the debt-stabilising balance for a debt ratio equal to the (60% of GDP) reference value (dependent on long-term potential growth), implying room for budgetary manoeuvre for Member States with relatively low debt; (ii) a supplementary debt-reduction effort for Member States with a debt ratio in excess of the (60% of GDP) reference value, implying rapid progress towards it; and (iii) a fraction of the adjustment needed to cover the present value of the future increase in age-related government expenditure. This implies a partial frontloading of the budgetary cost of ageing irrespective of the current level of debt. In addition to these criteria, MTOs should provide a safety margin with respect to the 3% of GDP deficit reference value and, for euro area and ERM II Member States, in any case not exceed a deficit of 1% of GDP.

As communicated by the authorities, the MTO of Cyprus is a balanced budget in structural terms In view of the new methodology and given the most recent projections and debt level, the MTO more than adequately reflects the objectives of the Pact.

Consolidation is planned to be achieved from the revenue side of the budget, which is projected to increase by almost 4 percentage points of GDP between 2009 and 2013, while expenditure retrenchment would contribute only ¼ percentage point of GDP. In particular, the bulk of the revenue increase is expected to come from an increase in direct and indirect taxes, by 1½ and 1¼ percentage points of GDP respectively, while social contributions are set to rise by ½ percentage point. Revenue supporting measures include the fight against tax evasion, a town planning amnesty during 2010-2012, harmonisation of the minimum excise duties on petroleum products and application of the reduced VAT on foodstuff and pharmaceutical products as well as dividend income from semi-governmental organisations.

On the other hand, expenditure is projected to increase by ¼ pp of GDP between 2009 and 2013, mainly due to current primary expenditure. In particular, social payments are projected to rise by about 1 percentage point of GDP and subsidies by another ¼ percentage point, partially offset by savings in intermediate consumption and other expenditure. Interest payments are foreseen to decline only marginally during the

[4] "Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes", endorsed by the ECOFIN Council on 10 November 2009, available at: http://ec.europa.eu/economy_finance/sgp/legal_texts/index_en.htm

programme period, in line with a declining debt, as a rise in 2010 is set to fade away in the following years. It has to be noted though that after an initial increase in 2010, expenditure is set on a declining trend. Specifically, between 2010 and 2013 expenditure is projected to decline by almost 1 percentage point of GDP on the back of a reduction in primary expenditure due to savings in intermediate consumption and other expenditure. The programme lists the targeting of social transfers and the containment of size and the rate of growth of public wage bill as expenditure categories for consolidation when consensus would be reached among social partners.

Table 5: Composition of the budgetary adjustment

(% of GDP)	2008	2009		2010		2011		2012	2013	Change: 2009-2013
	COM	COM	SP	COM	SP	COM[1]	SP	SP	SP	SP
Revenue	**43.5**	**40.3**	**40.3**	**41.2**	**41.6**	**41.3**	**42.8**	**43.6**	**44.2**	**3.9**
of which:										
- Taxes on production and imports	18.4	15.0	15.0	15.0	15.5	15.2	16.1	16.6	16.7	1.7
- Current taxes on income, wealth, etc.	12.9	11.2	11.2	11.2	11.6	11.2	12.1	12.4	12.7	1.5
- Social contributions	7.7	9.3	9.3	9.6	9.6	9.6	9.7	9.8	9.9	0.6
- Other (residual)	4.5	4.9	4.8	5.4	4.9	5.4	4.9	4.8	4.9	0.1
Expenditure	**42.6**	**46.4**	**46.4**	**48.3**	**47.6**	**49.0**	**47.2**	**47.0**	**46.7**	**0.3**
of which:										
- Primary expenditure	39.8	43.9	43.9	45.6	45.3	46.1	44.8	44.5	44.1	0.2
of which:										
Compensation of employees	14.1	15.6	15.6	15.9	15.8	16.0	15.9	15.8	15.7	0.1
Intermediate consumption	5.3	5.6	5.6	5.8	5.6	5.8	5.6	5.4	5.2	-0.4
Social payments	12.1	13.8	13.8	15.2	14.4	15.7	14.9	14.9	14.9	1.1
Subsidies	0.4	0.1	0.1	0.4	0.4	0.4	0.4	0.4	0.4	0.3
Gross fixed capital formation	3.0	4.1	4.1	4.1	4.1	4.1	4.1	4.0	4.0	-0.1
Other (residual)	5.0	4.7	4.7	4.2	5.0	4.1	4.1	4.1	4.0	-0.7
- Interest expenditure	2.8	2.5	2.5	2.7	2.3	2.9	2.4	2.5	2.6	0.1
General government balance (GGB)	**0.9**	**-6.1**	**-6.1**	**-7.1**	**-6.0**	**-7.7**	**-4.5**	**-3.4**	**-2.5**	**3.6**
Primary balance	**3.7**	**-3.6**	**-3.6**	**-4.4**	**-3.7**	**-4.8**	**-2.1**	**-1.0**	**0.1**	**3.7**
One-off and other temporary measures	0.0	0.0	0.0	0.0	0.1	0.0	0.1	0.1	0.0	0.0
GGB excl. one-offs	**0.9**	**-6.1**	**-6.1**	**-7.1**	**-6.1**	**-7.7**	**-4.6**	**-3.5**	**-2.5**	**3.6**
Output gap[2]	3.4	-0.7	-1.3	-2.1	-2.4	-1.6	-2.5	-1.6	-0.5	0.8
Cyclically-adjusted balance[2]	-0.4	-5.8	-5.6	-6.3	-5.1	-7.1	-3.5	-2.8	-2.3	3.3
Structural balance[3]	**-0.4**	**-5.8**	**-5.6**	**-6.3**	**-5.2**	**-7.1**	**-3.6**	**-2.9**	**-2.3**	**3.3**
Change in structural balance		*-5.4*	*-5.2*	*-0.5*	*0.4*	*-0.8*	*1.5*	*0.7*	*0.6*	
Structural primary balance[3]	2.4	-3.3	-3.1	-3.6	-2.9	-4.2	-1.2	-0.4	0.3	3.4
Change in structural primary balance		*-5.7*	*-5.5*	*-0.3*	*0.2*	*-0.6*	*1.6*	*0.8*	*0.7*	

Notes*:*

[1]On a no-policy-change basis.

[2]Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission services on the basis of the information in the programme.

[3]Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

Source :

Stability programme (SP); Commission services' spring 2010 forecasts (COM); Commission services' calculations

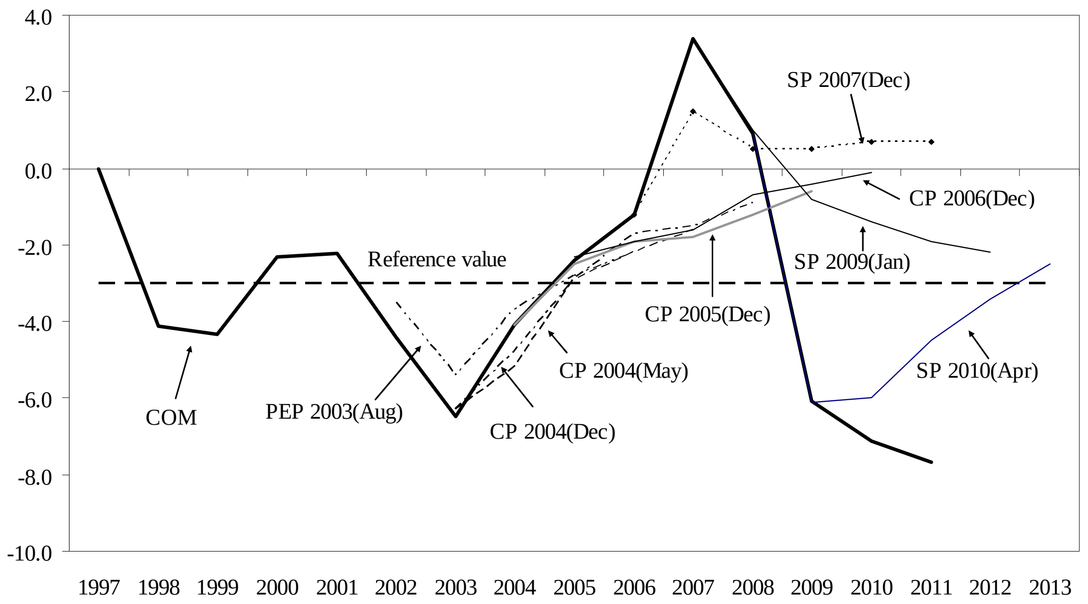
4.4. Risk assessment

This section discusses the plausibility of the programme's budgetary projections by analysing various risk factors. For the period until 2011, Table 5 compares the detailed revenue and expenditure projections in the Commission services' autumn 2009 forecast, which are derived under a no-policy change scenario, with those in the updated programme. However, although the assessment uses the Commission services' forecast as a benchmark, it also takes explicitly into account all available information about more recent developments.

The budgetary outcomes are subject to downside risks. In particular, the macroeconomic scenario projected in the update appears to be based on favourable growth assumptions throughout the programme period. Consequently, budgetary projections are subject to downside risks associated with a more severe or protracted slowdown of the Cypriot economy.

On the one hand, there are downside risks regarding the revenue projections associated with a sharper contraction and rebalancing of economic growth towards a less tax rich composition of growth. Total revenue in 2010 is projected to rise by 1.3 percentage points of GDP. However, under the light of the bleak external outlook and the severe slowdown in Cyprus' main trading partners, particularly in the UK and Russia, growth prospects may be even more dismal due to its small size and openness as well as its strong specialisation in tourism. In the context of the unfolding developments, growth prospects for Cyprus may prove to closer to the "more sluggish external recovery" scenario included in the sensitivity analysis of the programme. On the other hand, revenue surprises in recent years led to better-than-expected budgetary outturns, but these took place in an environment of high GDP growth, which is no longer available.

Figure 1: Government balance projections in successive programmes (% of GDP)



Source: Commission services' autumn 2009 forecast (COM) and successive stability programmes

Moreover, in view of the continuation of frail economic conditions, the risk of potential expenditure overruns is also non negligible, based on the experience with the previous slowdown (2002-2003). A negative risk to expenditure also stems from the practise of adopting supplementary budgets during the course of the year, which has hitherto contributed to increase extra-budgetary current primary expenditure.

Overall, the balance of risks regarding the budgetary outcomes remains tilted to the downside.

5. GOVERNMENT DEBT AND LONG-TERM SUSTAINABILITY

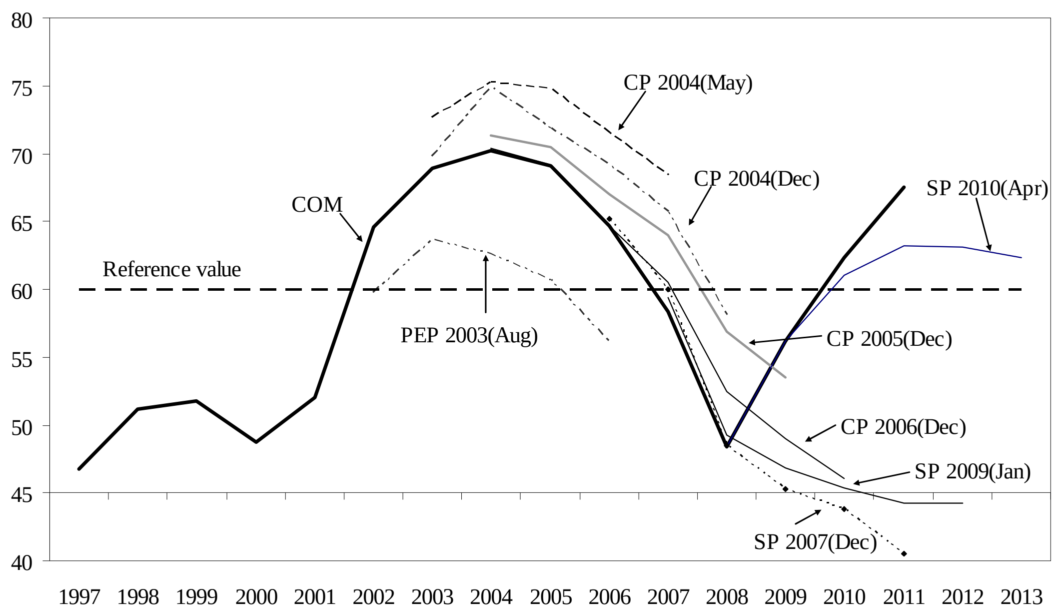
This section is in two parts. A first part describes recent debt developments and medium-term prospects, including risks to the outlook presented in the programme. A second part takes a longer-

5.1. Recent debt developments and medium-term prospects

5.1.1. Debt projections in the programme

The April 2010 update projects a progressive increase of the debt-to-GDP ratio until 2011 before reverting to a declining trend for the remaining years of the programme. In particular, debt is foreseen to reach 63¼% of GDP by 2011, from 48½% in 2008, and 56¼% in 2009, adversely affected from primary deficits and "snowball effects", resulting from interest expenditure and low nominal growth. The 2010 and 2011 projections are broadly in line with the Commission services' spring 2010 forecast. The update's targets are significantly higher than the targets of the Stability Programme 2008-2012, (45¼% and 44¼% of GDP for 2010 and 2011 respectively). The deviations are attributed to larger primary deficits projected in the April 2010 Programme following the marked deterioration of public finances in 2009 and its carry over effects, coupled with a downward revised set of projections for GDP growth in the April 2010 update.

Figure 2: Debt projections in successive programmes (% of GDP)



<u>Source</u>: *Commission services' autumn 2009 forecast (COM) and successive stability programmes*

Stock-flow adjustments (SFA) in Cyprus are associated with the accumulation or decumulation of financial assets. In 2007, the accumulation of government assets was equivalent to 3% of GDP. This was followed in 2008 by a depletion of government assets, equivalent to almost 4¾% of GDP, reflecting the planned reduction of deposits with the central bank (sinking funds) and other accumulated financial assets to repay maturing debt. The SFA in 2008 also includes privatisation proceeds from the sale of the Cyprus Development Bank amounting to ¼ of a percentage point of GDP. The SFA in

2009 reflects the accumulation of government assets, equivalent to 0.9% of GDP, reflecting an over financing at the end of the year in order to meet debt maturity obligations arising early in January of 2010, as well as, differences between cash and accruals. SFAs are foreseen by the programme to be almost negligible until 2012.

The update's sensitivity analysis points out the high importance of growth assumptions for the envisaged consolidation path. The moderate impact from interest rates differentials is due to the fact that the bulk of the debt stock is at fixed interest rates and relatively long maturities. Floating rate issuances consist mainly of bilateral loans between the Republic of Cyprus and supranational institutions such as the EIB. According to the programme, the share of short-term debt during 2009 increased to 9.7% of net total debt compared to 5.7% the previous year. This coupled with low interest rates kept borrowing costs at relatively low levels in 2009. The level of short term debt, however, is forecast to hover around 9% over the programming period.

Overall, the balance of risks is for the debt ratio to be higher due to risks associated with the growth prospects and the budgetary outcomes.

Table 6: Debt dynamics

(% of GDP)	average 2003-07	2008	2009		2010		2011		2012	2013
			COM	SP	COM	SP	COM	SP	SP	SP
Gross debt ratio[1]	**66.2**	**48.4**	**56.2**	**56.2**	**62.3**	**61.0**	**67.6**	**63.2**	**63.1**	**62.3**
Change in the ratio	-1.3	-9.9	7.8	7.8	6.1	4.8	5.2	2.2	-0.1	-0.8
Contributions[2] *:*										
1. Primary balance	**-1.1**	**-3.7**	**3.6**	**3.6**	**4.4**	**3.7**	**4.8**	**2.1**	**1.0**	**-0.1**
2. "Snow-ball" effect	**-1.4**	**-1.7**	**3.3**	**3.3**	**1.8**	**1.1**	**0.7**	**0.4**	**-0.6**	**-0.6**
Of which:										
Interest expenditure	3.3	2.8	2.5	2.5	2.7	2.3	2.9	2.4	2.4	2.6
Growth effect	-2.4	-1.9	0.9	0.8	0.2	-0.3	-0.8	-0.9	-1.8	-1.9
Inflation effect	-2.3	-2.6	0.0	0.0	-1.2	-0.9	-1.4	-1.2	-1.2	-1.3
3. Stock-flow adjustment	**1.4**	**-4.4**	**0.9**	**0.9**	**-0.1**	**0.0**	**-0.2**	**-0.2**	**-0.4**	**-0.1**
Of which:										
Cash/accruals diff.	0.2	0.1		0.2		0.0		0.0	0.0	0.0
Acc. financial assets	1.0	-4.5		0.7		0.0		-0.1	-0.5	-0.1
Privatisation	0.0	n.a.		n.a.		n.a.		n.a.	n.a.	n.a.
Val. effect & residual	0.1	0.1		0.0		0.0		0.0	0.0	0.0

Notes:

[1]End of period.

[2]The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.

Source :

Stability programme (SP); Commission services' spring 2010 forecasts (COM); Commission services' calculations

5.2. Long-term debt projections and the sustainability of public finances

5.2.1. Sustainability indicators and long-term debt projections

This section presents sustainability indicators based on the long-term age-related government spending as projected by the Member States and the Economic Policy Committee (EPC) in 2009 according to an agreed methodology[5].

[5] Economic Policy Committee and the European Commission (2009), '2009 Ageing Report: Economic and budgetary projections for the EU-27 Member States (2008-60)', *European Economy* No. 2/2009.

Table 7 shows that the projected increase in age-related spending is rising by 10.7 percentage points of GDP between 2010 and 2060, which is significantly above the EU average. Sustainability indicators for two scenarios are presented in Table 8. 'The 2009 scenario' is based on a no-policy-change assumption and the 2009 structural primary balance as a starting year, while 'the programme scenario' takes into account the consolidation planned in the programme up to 2013 and is based on the projected 2013 structural primary balance as a starting position. Including the impact of age-related expenditure and assuming that the structural primary balance remained at its 2009 level, the sustainability gap (S2)[6] would amount to 12.5% of GDP; nearly 7 percentage points of GDP wider than in last year's assessment. This is mainly due to a lower estimated structural primary balance in the starting year. In contrast, the rise in age-related expenditure is somewhat lower in the new expenditure projections.

In contrast to the "2009 scenario", the "programme scenario", which is based on the end-of-programme structural primary balance, shows a smaller gap. The budgetary development planned in the programme would somewhat reduce the risks to long-term sustainability of public finances.

Table 7: Long-term age-related expenditure: main projections

(% of GDP)	**2007**	**2010**	**2020**	**2030**	**2040**	**2060**	**Change 2010- 60**
Total age-related spending	**15.4**	**15.5**	**16.8**	**19.1**	**21.0**	**26.2**	**10.7**
- Pensions	6.3	6.9	8.9	10.8	12.8	17.7	10.8
- Healthcare	2.7	2.8	2.9	3.0	3.1	3.3	0.6
- Long-term care	0.0	0.0	0.0	0.0	0.0	0.0	0.0
- Education and unemployment benefits	6.4	5.8	5.0	5.3	5.0	5.2	-0.6
Property income received	0.7	0.6	0.4	0.3	0.2	0.1	-0.5

Source: Economic Policy Committee and Commission services.

Table 8: Sustainability indicators and the required primary balance

	2009 scenario			**Programme scenario**		
	S1	**S2**	**RPB**	**S1**	**S2**	**RPB**
Value	8.7	12.5	8.9	5.1	9.0	8.9
of which:						
Initial budgetary position (IBP)	3.7	4.1	-	0.2	0.6	-
Debt requirement in 2060 (DR)	0.2	-	-	0.0	-	-
Long-term change in the primary balance (LTC)	4.9	8.4	-	4.9	8.4	-

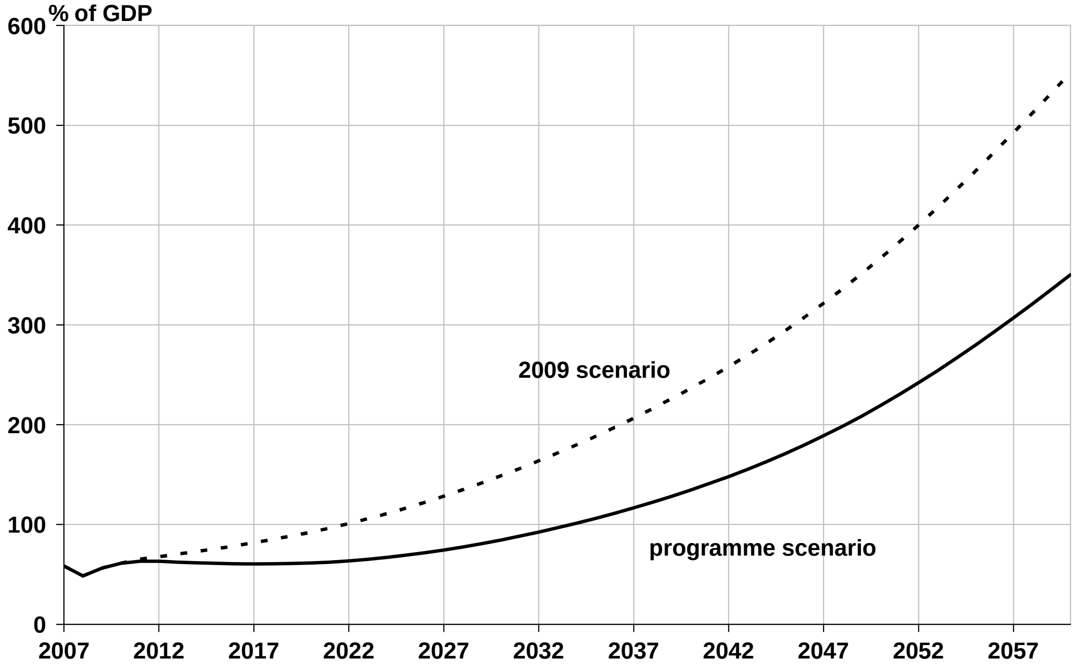
Source: Commission services.

Based on the assumptions used for the calculation of the sustainability indicators, Figure 3 displays the projected debt/GDP ratio over the long-term.

European Commission (2009), 'Sustainability Report 2009, European Economy No. 9/2009. European Commission (2008), 'Public finances in EMU – 2008', *European Economy* No. 4/2008..

6 The S2 indicator is defined as the change in the current level of the structural primary balance required to make sure that the discounted value of future structural primary balances (including the path of property income) covers the current level of debt.

Figure 3: Long-term projections for the government debt ratio



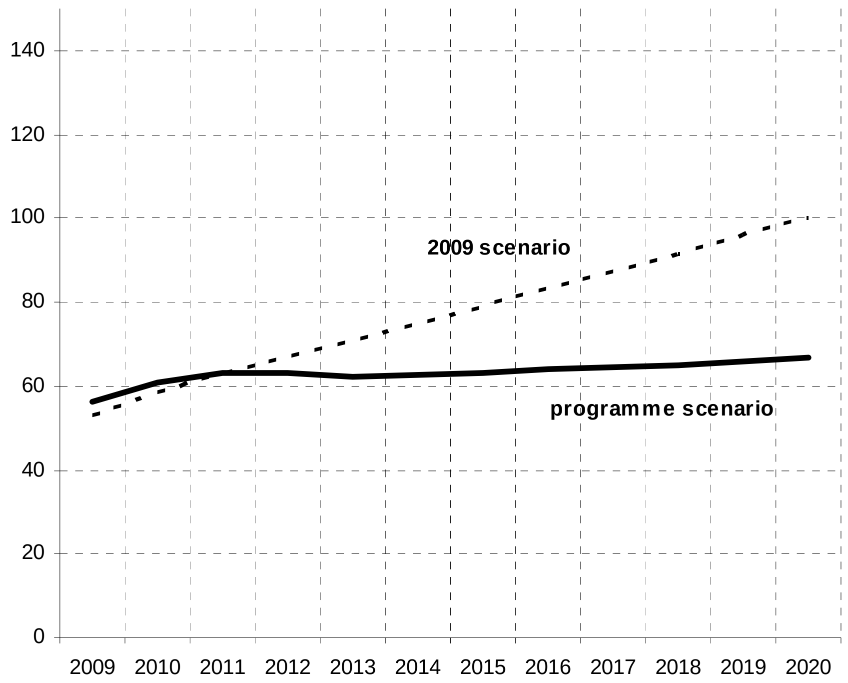
<u>Note</u>: Being a mechanical, partial-equilibrium analysis, the long-term debt projections are bound to show highly accentuated profiles. As a consequence, the projected evolution of debt levels should not be seen as a forecast similar to the Commission services' short-term forecasts, but as an indication of the risks faced by Member States.

<u>Source</u>: Commission services calculations

Based on the assumptions presented in COM autumn 2009 forecast publication[7], Figure 4 shows projected medium-term trajectory of the debt/GDP ratio. In both the baseline (above) and taking into account the most recent economic developments (below) show debt almost stabilising close to 70% of GDP by 2020.

[7] Section 3.5 in European Commission (2009), 'European Economic Forecast – autumn 2009', European Economy No. 10/2009

Figure 4: Medium-term projections for the government debt ratio



Source: Commission services' calculations

5.2.2. Additional factors

For an overall assessment of the sustainability of public finances, other relevant factors are taken into account. These are summarized in Table 9. The decline in the structural primary balance as estimated in the Commission autumn 2009 forecast, would increase the risks to long-term sustainability, while the difference between the S1 and S2 indicators reduces the overall risks to sustainability, as it implies that Cyprus has still time to introduce the necessary measures to curb the significant increases in age related expenditure.

Notably the programme discusses a pension reform that was introduced in April 2009. The reform is mainly aimed at the revenue side and would reduce the rise in pension expenditure only slightly. Given that the social security contribution rates and the overall tax ratio are on a relatively low level, the adopted reforms on the revenue-side, which consist of clearly legislated gradual increases in the contribution rates, would improve the projected balance of the pension system and decrease risks to the long-term sustainability of public finances. Nevertheless, as this kind of revenue improvements are not captured by the sustainability indicators, they are currently only taken into account as an additional factor in the category of alternative projections of the cost of ageing. This would however not change the overall assessment.

Table 9: Additional factors for the assessment of long-term sustainability risks

	Impact on risk
Debt and pension assets	na
Decline in structural balance until 2011 in COM Autumn 2009 forecast	- -
Alternative projection of cost of ageing	+
Strong decline in benefit ratio	na
High tax burden	na
Difference between S1 and S2	+

Note: '-': factor tends to increase the risk to sustainability, '+': factor tends to decrease the risk to sustainability. 'na': not applicable.
Alternative projections are often presented in the programmes, whose assumptions often diverge from the common method. Projections currently discussed in the Economic Policy Committee but not yet published, are for the time being also considered 'unofficial'.
An explanation on these factors can be found in chapter V of: European Commission (2009), Sustainability Report 2009, European Economy No. 9/2009.
Source: Commission services.

5.2.3. Assessment

The long-term budgetary impact of ageing is well above the EU average, mainly as a result of a relatively high increase in pension expenditure as a share of GDP over the coming decades. This is partly due to the fact that the pension scheme is still in a maturing phase. The programme discusses a pension reform introduced in April 2009 that would slightly reduce the increase in pension expenditure and, more significantly, raise the social security contribution rates. The reform would improve the long term balance of the pension system and reduce risks to sustainability, however without having an effect on the overall assessment. Moreover, until the updated projections are not finally validated by the EPC, they can only be considered as "national projections". The budgetary position in 2009 as estimated in the programme compounds the budgetary impact of population ageing on the sustainability gap. Improving the primary balance over the medium term and implementing further measures aimed at curbing the substantial increase in age-related expenditure would contribute to reducing the high risks to the sustainability of public finances.

Medium-term projections that take account of more recent economic developments and projections on the potential growth show that the budgetary development envisaged in the programme, taken at face value, is almost enough to stabilise the debt-to-GDP ratio by 2020.

6. FISCAL FRAMEWORK AND QUALITY OF PUBLIC FINANCES

This section is subdivided into two elements: the fiscal framework and the quality of public finances in a broader sense.

6.1. Fiscal framework

In recent years, Cyprus has over-achieved its budgetary targets, albeit in a context of buoyant economic activity and tax-rich composition of growth. In the recent past, the budgetary framework has been improved by the adoption of the Financial Management Accounting System (FIMAS), the gradual introduction of a three-year Medium-Term Budgetary Framework (MTBF) and of Programme and Performance Budgeting (PPB). However, the practice of adopting supplementary budgets during the course of the year has implied an increase in current expenditure beyond the intended reallocation of funds.

According to the Programme, the new budgeting framework is expected to cease this practice when fully implemented and lead to a more effective and efficient budgeting process, contributing to containing expenditure. At the same time, the new budgeting process would set a sound basis for reallocating expenditure in favour of growth-enhancing activities consistent with the priorities set by the National Reform Programme. However, the new framework is still at an early stage of implementation and is only foreseen to be fully in place in 2012. Therefore, its impact could become effective only in the medium-term. The new framework's timely implementation would be critical for a successful and lasting consolidation of the public finances.

6.2. Quality of public finances

As regards the quality of public finances, the programme acknowledges its importance as a means to support potential growth and to ensure the long-term sustainability of public finances. In particular, the programme notes the impact the MTBF and PPB budgeting will have upon full implementation on the better allocation of resources to high-priority, growth enhancing areas in tandem with better control of non-productive expenditure. On the expenditure side, the programme includes a review of recent projects aimed at enhancing infrastructure, through Private Public Partnerships (PPP), as well as measures to improve education, through the increased use of computers in primary and secondary education and improvements in research and academic institutions. The update also includes the allocation of funds to restructure public hospitals into autonomous units and the adoption of a National Health Scheme, with the aim of improving effectiveness via regulated competition and cost containment. This seems essential as a means to control the anticipated expenditure increases associated to an ageing population. On the revenue side, the programme emphasizes the positive impact the introduction of the MTBF would have on improving the accuracy and sensitivity of revenue forecasts over the medium-term. The authorities note that given the volatility of tax elasticities in recent years due to the asset boom, revenue projections were adapted to take into account the impact of asset prices and the composition of GDP growth. The programme also notes the constant monitoring of the tax-benefit system by the authorities in order to endure that work pays, while ensuring the support to vulnerable social groups.

7. OVERALL ASSESSMENT

Taking into account risks attached to the budgetary targets discussed above, this section assesses the appropriateness of the fiscal strategy in relation to the budgetary objectives of the Stability and Growth Pact, against the background of the current economic situation, the debt and long-term sustainability position of the country, and the institutional features of its public finances.

The overall conclusion is that Cyprus' public finances deteriorated significantly as a result of the economic downturn and an expansionary fiscal stance due to the adoption of significant stimulus measures in line with the EERP. As a result, the budgetary balance turned to a deficit of 6.1% of GDP in 2009 from a surplus of 0.9% of GDP in 2008.

The programme outlines a consolidation path starting in 2010 which aims to bring the headline deficit below the 3% of GDP reference value by 2013. In particular, the update foresees the headline deficit to improve gradually from a target of 6% of GDP in 2009 to 2.5% in 2013. The primary balance will improve in parallel and from a deficit of 3.6% of GDP in 2009, it is projected to reach a balanced position by the end of the period. The structural balance points to an improvement of the deficit from 5½% of GDP in 2009 to about 2¼% of GDP in 2013. The annual fiscal effort would average at ¾ percentage points of GDP per year over the period 2010-2013. The adjustment appears front-loaded, although measures taken in 2010 will have their full effect only in 2011. Moreover, measures taken within the context of the EERP will only be phased out by the end of 2010. On the basis of the commonly agreed methodology, the structural balance deviates from the MTO, which is reaffirmed as a balanced budget in structural terms, throughout the period. Overall, although the programme foresees an improvement in the structural balance, the MTO does not seem to be reached within the programme period. The significant deviation from the MTO is problematic in the light of the large external imbalance of the Cypriot economy.

However, the adjustment is planned to be achieved mainly from the revenue side of the budget while the expenditure-to-GDP ratio remains at historically high levels. Moreover, against the background of a frail global economic recovery, the budgetary strategy is subject to significant downside risks, as the growth assumptions underlying the macroeconomic scenario of the programme are favourable. In the light of the high domestic and external imbalances, maintaining prudent policies and strengthening fiscal sustainability should be a priority. Therefore, controlling current expenditure through the implementation of an effective multi-annual budgetary framework would be an essential instrument to support the achievement of the consolidation plans and budgetary targets. In addition, fostering the quality of public finances is important also with a view to underpinning a smooth adjustment of the economy in the light of the imbalances it is faced with, notably by lifting potential GDP, enhancing competitiveness and further narrowing the external imbalance. Moreover, given that the long-term budgetary impact of ageing is well above the EU average, reform measures to control pension and health care expenditure would be conducive in controlling the projected increase in ageing-related expenditure.

* * *

ANNEX. COMPLIANCE WITH THE FORMAT AND CONTENT REQUIREMENTS FOR STABILITY AND CONVERGENCE PROGRAMMES

This annex provides an assessment of whether the programme respects the requirements of Section II of the code of conduct (guidelines on the format and content), notably as far as (i) the model structure (Annex 1 of the code of conduct); (ii) the formal data provisions (Annex 2 of the code of conduct); and (iii) other information requirements is concerned.

(i) Model structure

The programme adheres to the code of conduct for stability and convergence programmes as far as its table of contents is concerned, notably follows the model structure in Annex 1 of the code of conduct.

(ii) Data requirements

As regards the data requirements specified in the code of conduct for stability and convergence programmes, the programme provides all required and optional data.

The tables on the following pages show the data presented in the February 2009 update of stability programme, following the structure of the tables in Annex 2 of the code of conduct. Compulsory data are in bold, missing data are indicated with grey-shading.

(iii) Other information requirements

The table below provides a summary assessment of the adherence to the other information requirements in the code of conduct.

The SCP…	Yes	No	Comments
a. Involvement of parliament			
… mentions status vis-à-vis national parliament.		X	
… indicates whether Council opinion on previous programme has been presented to national parliament.		X	
b. Economic outlook			
… (for euro area and ERM II Member States) uses “common external assumptions” on main extra-EU variables.	X		
… explains significant divergences with Commission services' forecasts[1].		X	The SP though provides a whole section explaining differences in estimation of potential output vis-à-vis the Commission.
… bears out possible upside/downside risks to economic outlook.	X		
… analyses outlook for sectoral balances and, especially for countries with high external deficit, external balance.	X		
c. Monetary/exchange rate policy			
… (CP only) presents medium-term monetary policy objectives and their relationship to price and exchange rate stability.			N.A.
d. Budgetary strategy			
… presents budgetary targets for general government balance in relation to MTO and projected path for debt ratio.	X		
… (in case new government has taken office) shows continuity with respect to budgetary targets endorsed by Council.			N.A.
… (when applicable) explains reasons for deviations from previous targets and, in case of substantial deviations, whether measures are taken to rectify situation (+ provides information on them).	X		
… backs budgetary targets by indication of broad measures necessary to achieve them and analyses their quantitative effects on	X		

The SCP…	Yes	No	Comments
balance.			
… specifies state of implementation of measures.	X		
e. "Major structural reforms"			
… (if MTO not yet reached or temporary deviation is planned from MTO) includes comprehensive information on economic and budgetary effects of possible 'major structural reforms' over time.	X		
… includes quantitative cost-benefit analysis of short-term costs and long-term benefits of reforms.		X	
f. Sensitivity analysis			
… includes comprehensive sensitivity analyses and/or develops alternative scenarios showing impact on balance and debt of: a) changes in main economic assumptions b) different interest rate assumptions c) (for CP only) different exchange rate assumptions d) if common external assumptions are not used, changes in assumptions for main extra-EU variables.	X		
… (in case of "major structural reforms") analyses how changes in assumptions would affect budget and potential growth.			N.A.
g. Broad economic policy guidelines			
… provides information on consistency with broad economic policy guidelines of budgetary objectives and measures to achieve them.		X	
h. Quality of public finances			
… describes measures to improve quality of public finances, both revenue and expenditure sides.	X		
i. Long-term sustainability			
… outlines strategies to ensure sustainability.	X		
… includes common budgetary projections by the AWG and all necessary additional information (esp. new relevant information).	X		
j. Other information (optional)			
… includes information on implementation of existing national budgetary rules and on other institutional features of public finances.	X		
Notes: SCP = stability/convergence programme; CP = convergence programme [1]To the extent possible, bearing in mind the typically short time period between the publication of the Commission services' autumn forecast and the submission of the programme. *Source:* *Commission services*			

Tables from Annex 2 of the code of conduct

Table 1a. Macroeconomic prospects

	ESA Code	2008 Level	2008 rate of change	2009 rate of change	2010 rate of change	2011 rate of change	2012 rate of change	2013 rate of change
1. Real GDP	B1*g	*15270.0*	3.6	-1.7	0.5	1.5	3.0	3.2
2. Nominal GDP	B1*g	*17249.0*	8.6	-1.7	2.2	3.5	5.1	5.4
Components of real GDP								
3. Private consumption expenditure	P.3	*10794.0*	8.4	-3.0	0.5	3.5	4.5	4.6
4. Government consumption expenditure	P.3	*2775.0*	6.2	5.8	1.0	1.2	1.2	1.2
5. Gross fixed capital formation	P.51	*3529.0*	8.6	-12.0	-9.0	-3.3	3.5	4.2
6. Changes in inventories and net acquisition of valuables (% of GDP)	P.52 + P.53	*117.0*	0.8	-3.3	0.4	0.5	0.5	0.5
7. Exports of goods and services	P.6	*6998.0*	-2.1	-11.8	1.2	3.9	4.3	4.8
8. Imports of goods and services	P.7	*8943.0*	8.0	-19.8	5.0	4.6	5.6	6.0
Contributions to real GDP growth								
9. Final domestic demand		*17098.0*	8.1	-3.4	-1.2	1.9	3.7	3.9
10. Changes in inventories and net acquisition of valuables	P.52 + P.53	*107.0*	1.0	-4.5	3.6	0.2	0.3	0.4
11. External balance of goods and services	B.11	*-1945.0*	-5.5	6.2	-1.9	-0.7	-1.0	-1.1

Table 1b. Price developments

	ESA Code	2008 Level	2008 rate of change	2009 rate of change	2010 rate of change	2011 rate of change	2012 rate of change	2013 rate of change
1. GDP deflator		*113.0*	4.8	0.0	1.7	2.0	2.1	2.1
2. Private consumption deflator		*111.0*	4.8	0.3	3.0	2.3	2.3	2.3
3. HICP[1]		*109.0*	4.4	0.2	2.7	2.0	2.0	2.0
4. Public consumption deflator		*111.4*	5.3	2.9	2.5	2.3	2.3	2.3
5. Investment deflator		*114.0*	5.8	-1.8	-0.1	0.3	0.5	0.5
5a. Gross Fixed Capital Formation Deflator		*114.1*	5.9	-2.2	0.2	0.3	0.5	0.5
6. Export price deflator (goods and services)		*110.3*	3.5	-2.0	1.8	1.8	1.8	1.8
7. Import price deflator (goods and services)		*108.5*	4.4	-1.7	3.5	1.8	1.8	1.8

[1] Optional for stability programmes.

Table 1c. Labour market developments

	ESA Code	2008	2008	2009	2010	2011	2012	2013
		Level	rate of change	rate of change	rate of change	rate of change	rate of change	rate of change
1. Employment, persons[1]		*379.1*	2.8	-0.7	0.0	0.5	1.5	1.5
2. Employment, hours worked[2]		*732.1*	2.4	-1.6	0.0	0.5	1.5	1.5
3. Unemployment rate (%)[3]		*14.5*	3.7	5.3	6.5	6.5	6.0	5.5
4. Labour productivity, persons[4]		*n.a.*	0.8	-1.1	0.5	0.9	1.5	1.7
5. Labour productivity, hours worked[5]		*n.a.*	1.2	-0.1	0.5	0.9	1.5	1.7
6. Compensation of employees	D.1	*7569.1*	9.9	4.9	4.4	4.0	4.6	4.8
7. Compensation per employee		*19966.0*	6.9	5.6	4.3	3.5	3.1	3.3

[1]Occupied population, domestic concept national accounts definition.

[2]National accounts definition.

[3]Harmonised definition, Eurostat; levels.

[4]Real GDP per person employed.

[5]Real GDP per hour worked.

Table 1d. Sectoral balances

% of GDP	ESA Code	2008	2009	2010	2011	2012	2013
1. Net lending/borrowing vis-à-vis the rest of the world	B.9	-17.7	-8.5	-11.5	-12.2	-12.6	-12.9
of which : - Balance on goods and services		-11.7	-6.2	-8.5	-9.0	-9.7	-10.4
- Balance of primary incomes and transfers		-5.9	-2.3	-2.9	-3.1	-2.9	-2.5
- Capital account		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
2. Net lending/borrowing of the private sector	B.9	-18.6	-2.4	-5.5	-7.7	-9.2	-10.4
3. Net lending/borrowing of general government	EDP B.9	0.9	-6.1	-6.0	-4.5	-3.4	-2.5
4. Statistical discrepancy		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Table 2. General government budgetary prospects

	ESA Code	2008	2008	2009	2010	2011	2012	2013
		Level	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
Net lending (EDP B.9) by sub-sector								
1. General government	S.13	*157.6*	0.9	-6.1	-6.0	-4.5	-3.4	-2.5
2. Central government	S.1311	*-447.3*	-2.6	-8.8	-8.6	-6.8	-5.4	-4.2
3. State government	S.1312	*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
4. Local government	S.1313	*-8.6*	0.0	-0.1	0.0	0.0	0.0	0.0
5. Social security funds	S.1314	*613.5*	3.6	2.7	2.7	2.4	2.0	1.7
General government (S13)								
6. Total revenue	TR	*7503.3*	43.5	40.3	41.6	42.8	43.6	44.2
7. Total expenditure	TE[1]	*7345.7*	42.6	46.4	47.6	47.2	47.0	46.7
8. Net lending/borrowing	EDP B.9	*157.6*	0.9	-6.1	-6.0	-4.5	-3.4	-2.5
9. Interest expenditure	EDP D.41	*484.2*	2.8	2.5	2.3	2.4	2.5	2.6
10. Primary balance[2]		*641.8*	3.7	-3.6	-3.7	-2.1	-1.0	0.1
11. One-off and other temporary measures[3]		*0.0*	0.0	0.0	0.1	0.1	0.1	0.0
Selected components of revenue								
12. Total taxes (12=12a+12b+12c)		*5395.8*	31.3	26.2	27.1	28.2	28.9	29.4
12a. Taxes on production and imports	D.2	*3168.9*	18.4	15.0	15.5	16.1	16.6	16.7
12b. Current taxes on income, wealth, etc	D.5	*2220.3*	12.9	11.2	11.6	12.1	12.4	12.7
12c. Capital taxes	D.91	*6.6*	0.0	0.0	0.0	0.0	0.0	0.0
13. Social contributions	D.61	*1332.5*	7.7	9.3	9.6	9.7	9.8	9.9
14. Property income	D.4	*131.0*	0.8	0.9	0.9	0.4	0.4	0.4
15. Other[4]		*644.0*	3.7	3.9	3.9	4.4	4.4	4.5
16=6. Total revenue	TR	*7503.3*	43.5	40.3	41.6	42.8	43.6	44.2
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)[5]		6721.7	39.0	35.4	36.8	37.9	38.8	39.3
Selected components of expenditure								
17. Compensation of employees + intermediate consumption	D.1+P.2	*3336.6*	**19.3**	**21.2**	**21.4**	**21.5**	**21.1**	**20.8**
17a. Compensation of employees	D.1	*2426.9*	14.1	15.6	15.8	15.9	15.8	15.7
17b. Intermediate consumption	P.2	*909.7*	5.3	5.6	5.6	5.6	5.4	5.2
18. Social payments (18=18a+18b)		*2079.3*	12.1	13.8	14.4	14.9	14.9	14.9
18a. Social transfers in kind supplied via market producers	D.6311, D.63121, D.63131	*21.4*	0.1	0.2	0.2	0.2	0.2	0.2
18b. Social transfers other than in kind	D.62	*2057.9*	11.9	13.6	14.2	14.7	14.8	14.7
19=9. Interest expenditure	EDP D.41	*484.2*	2.8	2.5	2.3	2.4	2.5	2.6
20. Subsidies	D.3	*70.0*	0.4	0.1	0.4	0.4	0.4	0.4
21. Gross fixed capital formation	P.51	*508.9*	3.0	4.1	4.1	4.1	4.0	4.0
22. Other[6]		*866.7*	5.0	4.7	5.0	4.1	4.1	4.0
23=7. Total expenditure	TE[1]	*7345.7*	42.6	46.4	47.6	47.2	47.0	46.7
p.m.: Government consumption (nominal)	P.3	*3015.8*	17.5	19.1	19.4	19.4	19.1	18.8

[1]Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9.

[2]The primary balance is calculated as (EDP B.9, item 8) plus (EDP D.41, item 9).

[3]A plus sign means deficit-reducing one-off measures.

[4] P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91).

[5]Including those collected by the EU and including an adjustment for uncollected taxes and social contributions (D.995), if appropriate.

[6] D.29+D4 (other than D.41)+ D.5+D.7+D.9+P.52+P.53+K.2+D.8.

Table 3. General government expenditure by function

% of GDP	COFOG Code	**2007**	**2012**
1. General public services	1	10.1	10.0
2. Defence	2	1.8	1.7
3. Public order and safety	3	2.1	2.1
4. Economic affairs	4	4.2	4.3
5. Environmental protection	5	0.3	0.5
6. Housing and community amenities	6	2.4	3.4
7. Health	7	2.9	3.3
8. Recreation, culture and religion	8	1.3	1.4
9. Education	9	7.3	8.4
10. Social protection	10	9.8	11.9
11. Total expenditure (=item 7=23 in Table 2)	TE[1]	42.2	47.0

[1]Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9.

Table 4. General government debt developments

% of GDP	ESA Code	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
1. Gross debt[1]		48.4	56.2	61.0	63.2	63.1	62.3
2. Change in gross debt ratio		-9.9	7.8	4.7	2.3	-0.2	-0.8
Contributions to changes in gross debt							
3. Primary balance[2]		3.7	-3.6	-3.7	-2.1	-1.0	0.1
4. Interest expenditure[3]	EDP D.41	2.8	2.5	2.3	2.4	2.5	2.6
5. Stock-flow adjustment		-4.4	0.9	0.0	-0.1	-0.5	-0.1
of which:							
- Differences between cash and accruals[4]		0.2	0.2	0.0	0.0	0.0	0.0
- Net accumulation of financial assets[5]		-4.6	0.7	0.0	-0.1	-0.5	-0.1
of which:		-	-	-	-	-	-
- privatisation proceeds		0.3	n.a.	n.a.	n.a.	n.a.	n.a.
- Valuation effects and other[6]		0.0	0.0	0.0	0.0	0.0	0.0
p.m.: Implicit interest rate on debt[7]		5.2	5.1	4.2	4.0	4.1	4.4
Other relevant variables							
6. Liquid financial assets[8]		2.2	2.9	2.8	2.7	2.2	2.1
7. Net financial debt (7=1-6)		46.2	53.3	58.1	60.6	60.9	60.2

[1]As defined in Regulation 3605/93 (not an ESA concept).

[2]Cf. item 10 in Table 2.

[3]Cf. item 9 in Table 2.

[4]The differences concerning interest expenditure, other expenditure and revenue could be distinguished when relevant.

[5]Liquid assets, assets on third countries, government controlled enterprises and the difference between quoted and non-quoted assets could be distinguished when relevant.

[6]Changes due to exchange rate movements, and operation in secondary market could be distinguished when relevant.

[7]Proxied by interest expenditure divided by the debt level of the previous year.

[8]AF1, AF2, AF3 (consolidated at market value), AF5 (if quoted in stock exchange; including mutual fund shares).

Table 5. Cyclical developments

% of GDP	ESA Code	2008	2009	2010	2011	2012	2013
1. Real GDP growth (%)		3.6	-1.7	0.5	1.5	3.0	3.2
2. Net lending of general government	EDP B.9	0.9	-6.1	-6.0	-4.5	-3.4	-2.5
3. Interest expenditure	EDP D.41	2.8	2.5	2.3	2.4	2.5	2.6
4. One-off and other temporary measures[1]		0.0	0.0	0.1	0.1	0.1	0.0
5. Potential GDP growth (%)		3.70	2.00	2.75	2.75	2.75	2.75
contributions:							
- labour		2.0	0.7	0.7	0.8	0.8	0.8
- capital		1.0	0.6	1.5	1.5	1.5	1.5
- total factor productivity		0.7	0.7	0.7	0.7	0.7	0.7
6. Output gap		-0.1	-5.3	-6.7	-7.8	-7.5	-7.0
7. Cyclical budgetary component		0.0	-2.1	-2.6	-3.0	-2.9	-2.7
8. Cyclically-adjusted balance (2 - 7)		0.9	-4.0	-3.4	-1.5	-0.5	0.2
9. Cyclically-adjusted primary balance (8 + 3)		3.7	-1.5	-1.1	0.9	2.0	2.8
10. Structural balance (8 - 4)		0.9	-4.0	-3.5	-1.5	-0.6	0.2

[1]A plus sign means deficit-reducing one-off measures.

Table 6. Divergence from previous update

	ESA Code	2008	2009	2010	2011	2012	2013
Real GDP growth (%)							
Previous update		3.8	2.1	2.4	3.0	3.2	n.a.
Current update		3.6	-1.7	0.5	1.5	3.0	3.2
Difference		-0.2	-3.8	-1.9	-1.5	-0.2	n.a.
General government net lending (% of GDP)	EDP B.9						
Previous update		1.0	-0.8	-1.4	-1.9	-2.2	n.a.
Current update		0.9	-6.1	-6.0	-4.5	-3.4	-2.5
Difference		-0.1	-5.3	-4.6	-2.6	-1.2	n.a.
General government gross debt (% of GDP)							
Previous update		46.8	45.4	44.2	44.2	n.a.	46.8
Current update		56.2	61.0	63.2	63.1	62.3	56.2
Difference		9.4	15.6	19.0	18.9	n.a.	9.4

Table 7. Long-term sustainability of public finances

% of GDP	2008[1]	2020	2030	2040	2050	2060
Total expenditure	42.6	47.7	52.6	56.0	61.8	68.1
Of which: age-related expenditures	18.7	19.8	22.1	23.8	26.6	29.1
Pension expenditure	6.6	9.4	11.3	13.0	15.6	17.7
Social security pension	4.6	7.0	8.9	10.6	13.2	15.3
Old-age and early pensions	3.3	5.1	6.6	8.0	10.4	12.2
Other pensions (disability, survivors)	1.3	1.9	2.3	2.6	2.9	3.1
Occupational pensions (if in general government)	2.0	2.4	2.4	2.4	2.4	2.4
Health care[2]	3.0	3.0	3.2	3.3	3.5	3.7
Long-term care *(this was earlier included in the*	0.006	0.006	0.007	0.008	0.010	0.011
Education expenditure	7.8	6.0	6.2	6	5.9	6.2
Other age-related expenditures	1.3	1.4	1.4	1.5	1.5	1.5
Interest expenditure	2.8	3.6	5.3	7.5	10.3	14.5
Total revenue	43.5	44.9	45.9	46.9	46.8	46.8
Of which: property income	1.3	0.7	0.7	0.7	0.7	0.7
Of which : from pensions contributions (or social contributions if appropriate)	5.5	7.7	8.9	10.2	10.1	10.1
Pension reserve fund assets	35.2	45.1	48.4	50.9	42.5	10.1
Of which : consolidated public pension fund assets (assets other than government liabilities)	0.4	n.a.	n.a.	n.a.	n.a.	n.a.
Assumptions						
Labour productivity growth	1.2	2.7	2.0	1.8	1.7	1.7
Real GDP growth	3.6	3.9	2.6	2.3	1.8	1.8
Participation rate males (aged 20-64)	81.4	84.2	83.4	83.0	83.0	82.9
Participation rates females (aged 20-64)	65.8	74.4	75.2	75.1	75.2	75.2
Total participation rates (aged 20-64)	73.5	79.3	79.3	79.1	79.2	79.1
Unemployment rate	3.7	3.4	3.4	3.4	3.4	3.4
Population aged 65+ over total population	12.4	15.0	17.9	20.0	23.2	26.2

[1]Instead of providing data for 2000, 2005, 2010, 2020, 2030 and 2050 according to the Code of Conduct the program provides data for 2008, 2020, 2030, 2040, 2050, 2060.

[2]Ageing working group calculations

Table 8. Basic assumptions

	2008	2009	2010	2011	2012	2013
Short-term interest rate[1] (annual average)	4.5	1.25	1.0	1.5	2.0	2.5
Long-term interest rate (annual average)	n.a.	4.0	4.1	4.4	4.5	4.5
USD/€ exchange rate (annual average) (euro area and ERM II countries)	1.47	1.39	1.48	1.48	1.48	1.48
Nominal effective exchange rate	3.6	0.8	1.0	0.0	0.0	0.0
(for countries not in euro area or ERM II) exchange rate vis-à-vis the € (annual average)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
World excluding EU, GDP growth	3.3	-0.25	4.25	5.0	5.0	5.0
EU GDP growth	0.8	-4.1	0.7	1.6	2.3	2.4
Growth of relevant foreign markets	0.5	-4.8	0.9	1.9	2.9	2.9
World import volumes, excluding EU	4.6	-12.6	4.6	5.0	n.a.	n.a.
Oil prices (Brent, USD/barrel)	98.5	61.3	76.5	80.5	80.5	80.5

[1]If necessary, purely technical assumptions.