

9. CYPRUS

Economic activity recovered strongly in the first half of 2021. Domestic demand, helped by fiscal stimulus, has been the main driver of growth so far. After a historic fall, the tourism sector is bouncing back, although it is still significantly below the pre-pandemic level. The economy is expected to continue showing a robust growth performance over the forecast horizon. Public finances, negatively affected by the crisis in 2021, are set to improve significantly in the following years.

Strong GDP rebound in 2021

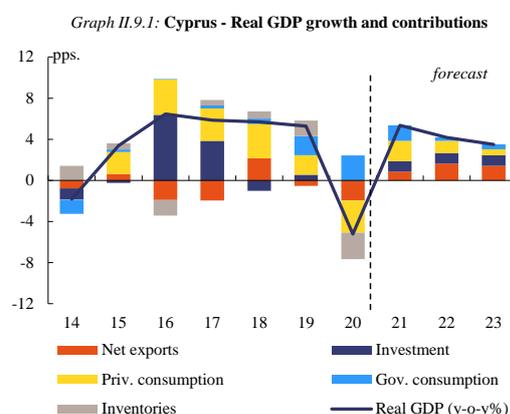
Following a severe recession of 5.2% in 2020, real GDP increased by 5.1% in the first half of 2021 compared to the same period in 2020, with domestic demand as the main driver. Private consumption increased by 2% in the first half of the year, on the back of increased employment. Government consumption increased significantly, by 15.1%, as a result of the support measures aimed at alleviating the crisis. Investment also rebounded, underpinned by buoyant construction activity in housing and infrastructure projects in the tourism, energy and education sectors. External demand for goods and services increased by 3.1%, while external demand for services increased by 8.2%. With respect to the latter, the successful vaccination campaign in Cyprus and the rest of the EU prompted a relaxation of travel restrictions at the beginning of the summer. This in turn led to a relatively good performance of the tourism sector. Revenues from tourism more than doubled in January-July 2021 compared to the same period of 2020, but remain at around 35% of the 2019-levels. For 2021 as a whole, GDP growth is forecast to reach 5.4%, as economic sentiment has improved considerably and prospects for the tourism sector are positive. Real GDP is set to reach its pre-pandemic level in the fourth quarter of 2021.

Growth is set to continue

In 2022 and 2023, private consumption is set to continue expanding due to pent-up demand and the positive employment prospects. At the same time, government consumption is expected to decelerate significantly, as the support measures are being phased out. In 2022, real investment is expected to exceed the 2019-level, boosted by the Recovery and Resilience Plan (RRP). The forecast also incorporates expenditures financed by RRF grants, which are set to gradually increase from 0.2% of GDP in 2021 to 0.8% of GDP in 2023. External demand for tourism is forecast to recover gradually and to reach its 2019-level by the end of 2023.

Overall, real GDP is projected to increase by 4.2% in 2022 and 3.5% in 2023.

Uncertainty and downside risks to the growth outlook remain, mainly related to the pandemic, which makes the tourism sector particularly vulnerable.



Positive prospects for the labour market

The unemployment rate increased to 8.5% in the first half of 2021 from 7.1% on average in 2019. The broad utilisation of the employment support measures has helped to contain further increase in unemployment. After the reopening of the economy, only targeted support measures for the tourism sector and for SMEs that have recorded significant losses in activity remain in place. Going forward, employment is expected to increase on the back of the economic expansion and the implementation of the RRP, which is also expected to facilitate reallocation of the labour force through re- and upskilling. In 2021, the unemployment rate is forecast to decrease to 7.5% and even further in 2022 and 2023, to 7.1% and 6.6% respectively.

Inflation turns positive

Headline inflation is forecast to increase in 2021 to 1.9%, up from -1.1% in 2019, driven by higher prices for energy, services and non-energy

industrial goods. Inflation is expected to slightly decelerate in 2022 to 1.7% and to subside to 1.2% in 2023 mainly due to the expected normalisation of energy prices.

Government deficit and public debt to decline

The general government deficit is expected to decrease to 4.9% in 2021. Government expenditure is forecast to grow by 7.4% in 2021. This is mainly driven by the increased social payments related to the roll-out of the second phase of the National Health System (NHS) reform. In addition, three supplementary budgets have been approved in the second half of the year, which include among others the extension of COVID-19 measures, such as support schemes related to the health sector, wage subsidisation and liquidity support to businesses. These effects are projected to be more than offset by a revenue growth of 9.6% in 2021, mainly on the back of higher revenue from taxes driven by the economic recovery, and increased

social contributions resulting from higher contribution rates in the context of NHS. The deficit is forecast to decline to 1.4% of GDP in 2022 and 0.9% in 2023, helped by the continuing economic expansion and the withdrawal of COVID-19 measures. In particular, government revenue is expected to continue to increase by 4.5% in 2022 and 3.7% in 2023.

The realisation of contingent liabilities, the fiscal sustainability of the NHS, as well as the fiscal impact of the envisaged expansion of KEDIPES, the state-owned asset management company, represent the main risks to the fiscal outlook.

After reaching a peak of 115.3% of GDP in 2020, public debt is set to decrease to 104.1% of GDP this year on the back of high nominal GDP growth and of the use of cash reserves accumulated in the previous year. The debt-to-GDP ratio is projected to decline further to 97.6% and 93.4% in 2022 and 2023, respectively.

Table II.9.1:

Main features of country forecast - CYPRUS

	2020			Annual percentage change						
	mio EUR	Curr. prices		% GDP	02-17	2018	2019	2020	2021	2022
GDP	21548.4		100.0	2.1	5.7	5.3	-5.2	5.4	4.2	3.5
Private Consumption	13725.1		63.7	2.4	5.1	3.0	-5.0	3.1	1.9	1.0
Public Consumption	4303.8		20.0	1.6	3.6	12.7	15.0	7.6	1.6	2.4
Gross fixed capital formation	4308.3		20.0	2.6	-4.9	2.9	0.0	5.2	4.9	4.8
of which: equipment	1204.8		5.6	4.6	-37.1	-15.4	15.4	4.6	6.3	7.0
Exports (goods and services)	16382.2		76.0	3.0	7.3	7.5	-5.1	6.2	7.4	6.8
Imports (goods and services)	16927.8		78.6	3.5	4.3	8.3	-2.5	4.9	5.1	4.9
GNI (GDP deflator)	20267.1		94.1	2.3	5.0	4.1	-6.5	6.4	4.7	3.7
Contribution to GDP growth:										
Domestic demand				2.5	2.9	4.3	-0.7	4.5	2.6	2.1
Inventories				0.1	0.7	1.5	-2.6	0.0	0.0	0.0
Net exports				-0.4	2.2	-0.5	-1.9	0.8	1.6	1.4
Employment				1.5	5.3	3.8	-0.6	1.2	2.2	2.3
Unemployment rate (a)				8.3	8.4	7.1	7.6	7.5	7.1	6.6
Compensation of employees / head				1.9	1.5	4.4	-3.1	2.5	2.7	2.4
Unit labour costs whole economy				1.3	1.1	2.9	1.6	-1.6	0.8	1.2
Real unit labour cost				-0.2	0.1	1.8	2.9	-3.9	-0.8	0.2
Saving rate of households (b)				3.5	3.3	5.7	8.0	7.1	6.8	8.1
GDP deflator				1.6	1.0	1.1	-1.2	2.4	1.6	1.0
Harmonised index of consumer prices				1.7	0.8	0.5	-1.1	1.9	1.7	1.2
Terms of trade goods				0.6	-1.4	-0.3	-0.8	0.0	0.0	0.0
Trade balance (goods) (c)				-22.9	-21.0	-20.1	-19.3	-20.9	-22.4	-24.0
Current-account balance (c)				-8.5	-3.9	-5.7	-10.1	-9.1	-7.3	-5.7
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				-8.1	-3.3	-5.6	-10.0	-9.1	-7.2	-5.6
General government balance (c)				-3.0	-3.5	1.3	-5.7	-4.9	-1.4	-0.9
Cyclically-adjusted budget balance (d)				-2.8	-5.3	-1.6	-4.4	-4.7	-1.8	-1.5
Structural budget balance (d)				2.5	2.5	-0.3	-4.4	-4.8	-1.8	-1.5
General government gross debt (c)				74.0	98.4	91.1	115.3	104.1	97.6	93.4

(a) Eurostat definition. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.