

9. CYPRUS

Economic activity in Cyprus contracted sharply in 2020, due to the COVID-19 crisis, albeit less than the EU average. The tourism sector has been severely affected, while the impact on domestic demand and the labour market has been cushioned by temporary income support measures. A gradual recovery in economic activity is forecast for 2021 and 2022, driven mainly by domestic demand. Public finances worsened significantly in 2020 due to the crisis but are set to improve in 2021 and 2022.

A severe economic recession in 2020

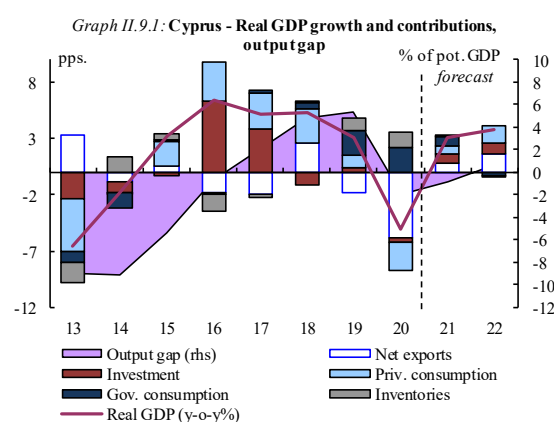
Economic activity declined sizeably by 5.1% in 2020 as a result of the COVID-19 crisis and accompanying lockdown measures. The impact on domestic demand has been only partially mitigated by the temporary income support measures as private consumption fell by 3.9% in 2020 and investment by 2%. Exports of goods and services dropped by 12.4%, the latter reflecting the impact of travel restrictions on tourism.

Gradual recovery in 2021 and 2022

A moderate recovery is forecast in 2021, with real GDP growth expected at 3.1%. Lockdown measures in Cyprus during the first half of 2021, as well as ongoing restrictive measures in the rest of the EU affecting tourism flows, imply that a durable recovery is expected to take place in the second half of 2021. Domestic demand is expected to be the main driver of the recovery notably private consumption as a result of pent up demand. Investment in construction is also expected to rebound as large-scale infrastructure projects continue and new lending for housing has picked up since the third quarter of 2020. By contrast, demand for high-end residences is set to slow down, following the abolition of the investor citizenship scheme. The forecast for public investment in 2021 takes into account Cyprus' Recovery and Resilience Plan (RRP), which will start to have a gradual impact this year. Public consumption is expected to also have a positive contribution, due to some of the support measures, which were extended into 2021 and the planned increases in compensation of employees. External demand in particular for tourism is forecast to recover moderately, as Member States are still tackling the pandemic and facing further restrictive measures, which negatively affected the demand for tourism for the Easter holidays and is likely to adversely impact also the summer tourist season.

In 2022, real GDP is forecast to grow by 3.8% and exceed the output level of 2019. This will be

mainly due to rising domestic demand, including the positive contribution of the RRP, as well as a small positive contribution from net exports.



Support measures cushioned the impact on labour market

The unemployment rate increased only mildly to 7.6% in 2020 from 7.1% in 2019. The broad utilisation of the temporary income support schemes – up to 65% of eligible employees – has helped to keep unemployment at low levels so far. Targeted measures to sectors mostly affected by lockdown measures, especially the hospitality industry continue. In 2021 the unemployment rate is forecast to decrease only marginally to 7.5% and further down to 7.2% in 2022.

Uncertainty and downside risks to the growth outlook remain significant. The sizeable pre-existing private and public sector debt levels exacerbate the downside risks. On the positive side, the swifter-than-expected vaccination campaigns in the EU could be a significant benefit for the tourism sector in Cyprus.

Inflation turns positive

Headline inflation is forecast to return to positive territory in 2021, at 1.7%, up from -1.1% in 2019. This is expected to be mainly driven by higher

energy prices as well as higher prices of services and non-energy industrial goods. Inflation is expected to moderate to 1.1% in 2022.

Public finances set to improve in 2021-22

The general government deficit is expected to narrow to 5.1% of GDP in 2021, down from 5.7% in 2020. Additional support measures undertaken to mitigate the effects of the pandemic, supporting employment and businesses, should amount to 3.4% of GDP in 2021. The deficit is assumed to narrow further to 2% of GDP in 2022 on the back of the continuing recovery of the economy and the withdrawal of COVID-19 support measures, which are projected to reach 0.2% of GDP. From a peak at 118.2% of GDP in 2020, government debt is forecast to decrease to 112.2% in 2021, reflecting the drawing down of substantial cash buffers accumulated since the beginning of the pandemic. In 2022, the debt ratio is expected to decrease further to 106.6% of GDP.

Government expenditure is expected to increase by 7.2% in 2021 compared to the previous year and reach 47.4% of GDP, before dropping by 2.8% in 2022. This increase results mainly from the prolongation of COVID-19 related support measures and the rollout of the second phase of the

National Health Insurance System (NHIS) reform. Measures included in Cyprus' Recovery and Resilience Plan are also included in the projections. In 2021, the total budgetary impact of reforms and investments entailed in the Plan amounts to 0.3% of GDP.

Government revenue is expected to grow by 9.1% in 2021, bringing its level to 42.3% of GDP. This increase is mainly driven by the economic recovery, higher expected tax collection, and increased social contributions explained by higher contribution rates to the NHIS. Government revenue in 2022 is forecast to increase by a milder 3.8% y-o-y.

Contingent liabilities related to the state's exposure to the financial sector and the NHS are the main risks to public finances. Bankruptcies and higher NPLs could lead to the realisation of explicit contingent liabilities. The financial autonomisation of the State Health Service Organisation (SHSO) has been impaired due to the pandemic, increasing the risk that the state may have to cover the losses of public healthcare providers.

Table II.9.1:

Main features of country forecast - CYPRUS

	2019			Annual percentage change						
	mio EUR	Curr. prices	% GDP	01-16	2017	2018	2019	2020	2021	2022
GDP	22287.1		100.0	1.9	5.2	5.2	3.1	-5.1	3.1	3.8
Private Consumption	14398.9		64.6	2.5	4.9	4.7	1.8	-3.9	1.1	2.3
Public Consumption	3721.7		16.7	1.9	2.1	3.5	15.1	13.1	4.0	-1.6
Gross fixed capital formation	4326.1		19.4	1.4	21.3	-5.2	2.0	-2.0	3.8	4.8
of which: equipment	1077.5		4.8	2.9	20.6	-34.6	-14.9	15.6	7.9	10.0
Exports (goods and services)	16018.6		71.9	2.5	9.9	8.0	-0.4	-12.4	5.3	7.6
Imports (goods and services)	16256.4		72.9	2.7	12.9	4.5	2.0	-4.2	3.7	4.8
GNI (GDP deflator)	21391.6		96.0	2.3	5.9	4.6	2.9	-5.4	3.3	4.1
Contribution to GDP growth:										
Domestic demand				2.3	7.4	2.5	3.8	-0.7	2.3	2.1
Inventories				-0.1	-0.3	0.2	1.0	1.4	0.0	0.0
Net exports				-0.2	-1.9	2.6	-1.7	-5.8	0.8	1.7
Employment				1.3	5.4	5.3	3.1	-0.6	0.6	1.0
Unemployment rate (a)				7.8	11.1	8.4	7.1	7.6	7.5	7.2
Compensation of employees / head				2.0	1.7	1.3	1.9	-3.2	1.6	1.8
Unit labour costs whole economy				1.4	1.9	1.4	1.9	1.5	-0.9	-1.0
Real unit labour cost				-0.3	0.8	0.1	1.0	3.0	-2.3	-2.2
Saving rate of households (b)				3.4	3.0	3.1	3.1	3.8	3.3	2.1
GDP deflator				1.7	1.1	1.2	0.9	-1.5	1.4	1.2
Harmonised index of consumer prices				1.7	0.7	0.8	0.5	-1.1	1.7	1.1
Terms of trade goods				0.8	-1.6	-2.4	-0.9	2.4	0.0	0.0
Trade balance (goods) (c)				-22.9	-24.6	-21.2	-20.8	-20.0	-20.8	-21.3
Current-account balance (c)				-8.3	-5.3	-3.9	-6.3	-11.8	-11.0	-8.9
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				-8.0	-4.9	-3.3	-6.2	-11.6	-10.9	-8.8
General government balance (c)				-3.2	1.9	-3.5	1.5	-5.7	-5.1	-2.0
Cyclically-adjusted budget balance (d)				-3.1	0.9	-5.9	-1.2	-4.7	-4.6	-2.4
Structural budget balance (d)				2.6	0.9	2.0	0.0	-4.7	-4.7	-2.4
General government gross debt (c)				71.8	93.5	99.2	94.0	118.2	112.2	106.6

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